

# LEGAL INSTRUMENTS OF POLITICAL AND ECONOMIC COMPETITION: TPP T&A AND AUTOMOTIVE ROOs

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**Abstract** *Rules of origin (ROOs) are not merely neutral, value-free formulas to determine entitlement to duty-free, quota free (DFQF) treatment under a free trade agreement (FTA). They are the outcome of tortuous bargaining over competing political and economic interests in and within exporting and importing countries seeking to establish an FTA. Preferential ROOs in the Trans Pacific Partnership (TPP) illustrate this point. In the textile and apparel (T&A) and automotive sectors, negotiators from the TPP Parties battled to gain comparative advantages, or prevent erosions of these advantages. They did so not only with respect to each other, but also with an eye to competition from China. How successful they were in advancing or preserving their domestic sectoral interests, and anticipating challenges from China, remains to be seen.*

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## I. IMPORTANCE OF TPP AND ROOs

The *Trans Pacific Strategic Economic Partnership*, or *TPP*, is a 21<sup>st</sup> century vehicle for trade liberalization through expanded market access for goods and services, enhanced intellectual property (IP) protection, and increased FDI, for the United States and countries in the Asia-Pacific region. This vehicle takes the form of the largest free trade agreement (FTA) in human history. *TPP* spans 12 countries – Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam – accounting for 800 million people and 40% of world Gross Domestic Product (GDP), 30% of global exports, and 25% of global imports.<sup>1</sup>

The United States has long had FTAs with 6 *TPP* Parties: Canada and Mexico (via the 1 January 1994 *North American Free Trade Agreement* (*NAFTA*)); Australia (effective 1 January 2005); Chile (1 January 2004); Peru (1 February 2009); and Singapore (1 January 2004). It helped negotiate the terms of accession to the WTO of Vietnam (effective 1 January 2007), which along with the other Parties are WTO Members. Thus, American producer-exporters and importers already enjoy considerably liberalized trade in goods and services via the preferential access under pre-*TPP* FTAs and MFN treatment memorialized in WTO Schedules of Concessions for goods and services. Moreover, under these regional and multilateral frameworks, American direct foreign investors benefit from credible, reliable dispute settlement mechanisms. And, of course, all other 11 *TPP* Parties count as American geopolitical and military allies.

No FTA can operate without Rules of Origin (ROOs). It is those ROOs that determine eligibility for preferential trade treatment under the FTA. Typically, the preference takes the form of Duty Free, Quota Free (DFQF) treatment. Merchandise wholly grown or manufactured in a single country that is Party to the FTA, or in multiple Parties to the FTA, qualifies for such treatment. It has no content from outside the FTA zone, so there is no reason to doubt its origination. But, what about merchandise that is not

<sup>1</sup> See Daniel Twining, Opinion, *Obama's Late Lamented Trade Deal*, FINANCIAL TIMES, 15 October 2015, at 11.

entirely raised or made within the zone? Only a ROO can answer the question of eligibility for a DFQF treatment. There are many categories of preferential ROOs, such as Substantial Transformation, Value Added, Specified Process.<sup>2</sup> The rules may be Product Specific, that is, a Product Specific Rule of Origin (PSRO), or may be generic to a group of merchandise. They can be straightforward, or nightmarishly complex.

This article highlights the importance of *TPP* preferential ROOs in the textile and apparel (T&A) and automotive sectors. These sectors, along with agriculture, raised some of the most controversial issues in *TPP* negotiations. In specific, *this article argues TPP preferential ROOs are not merely neutral, value-free mechanical formulas, but rather the outcomes of hard bargaining over competing political and economic interests*. Those interests are in competition with each other in 3 contexts: among *TPP* Parties; within a single Party; and with a view to China. First, those interests compete across different Parties whenever they pit 1 Party against another or others. Second, those interests compete within certain Parties. That is because ROOs sometimes pose trade-offs among different domestic constituencies. Third, all Parties affected by a particular ROO are concerned about the effect of that ROO with respect to the most important non-Party in the world, China. In brief, *preferential ROOs are legal manifestations of broad, deep political and economic competition*.

## II. YARN FORWARD AND SHORT SUPPLY

The United States is the 3<sup>rd</sup> largest exporter of T&A merchandise in the world (as of November 2013).<sup>3</sup> America's T&A industry has suffered considerable downsizing in the late 20<sup>th</sup> and early 21<sup>st</sup> centuries in the face of competition from developing and least developed countries. Yet, its vaunted status, especially in high-value added activities and high technology fabrics (*e.g.*, medical textiles made in Kansas City, Missouri), sometimes is forgotten. Both facts – decline yet continued prominence – help explain why America pressed for restrictive, sometimes protectionist, *TPP* T&A importation rules.<sup>4</sup>

<sup>2</sup> For a treatment of preferential ROOs, see Raj Bhala, *International Trade Law: An Interdisciplinary, Non-Western Textbook*, Volume Two, Chapter 84 (Durham, North Carolina: Carolina Academic Press – LexisNexis, 2015).

<sup>3</sup> See Stephanie Cohen, *Vietnam Sector to Benefit from Eventual TPP Agreement*, 30 International Trader Reporter (BNA) 1817 (21 November 2013).

<sup>4</sup> *TPP* negotiations were concluded on 5 October 2015 in Atlanta, Georgia. The formal text was published in 5 November 2015, and the formal, corrected text, was signed on 4 February 2016, in Auckland, New Zealand.

Overall, the United States Trade Representative (USTR) described its objectives in its September 2015 *Detailed Summary* as:

- Eliminate tariffs on textile and apparel exports to *TPP* countries.
- Secure a “yarn forward” rule of origin, which requires that textile and apparel products be made using U.S. or other *TPP* country yarns and fabrics to qualify for the benefits of the *Agreement*.
- Establish a carefully crafted “short supply” list, which would allow fabrics, yarns, and fibers that are not commercially available in *TPP* countries to be sourced from non-*TPP* countries and used in the production of apparel in the *TPP* region without losing duty preference.
- Secure strict enforcement provisions and customs cooperation commitments that will provide for verification of claims of origin or preferential treatment, and denial of preferential treatment or entry for suspect goods if claims cannot be verified.
- Establish a textile specific safeguard mechanism that will allow the United States and other *TPP* countries to re-impose tariffs on certain goods if a surge in imports causes or threatens to cause serious damage to domestic producers.<sup>5</sup>

The last 2 bullet points were insistences on remedies and enforcement. No matter what T&A liberalization ultimately was agreed, the United States wanted to the ability to escape from portions of it via a special safeguard.<sup>6</sup> If a surge of T&A imports occurred, or was threatened, from another *TPP* Party, then America wanted the ability to put back tariffs to pre-*TPP* levels, and/or impose other blocking remedies.

Another instance concerned phasing out of tariffs, referenced in the 1<sup>st</sup> bullet point. The United States – as of December 2013 – proposed to cut T&A duties by 35% from their Most Favored Nation (MFN) levels.<sup>7</sup> (Whether the base was bound or applied was not clear.) Duties would stay at that lower level for 10 years, and drop to zero in the 11<sup>th</sup> year. Simply put, duty-free treatment would not come to the T&A sector for a decade. But, there was no

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<sup>5</sup> United States Trade Representative, *The Trans Pacific Partnership: Detailed Summary of U.S. Negotiating Objectives* 8-9 (September 2015), <https://ustr.gov/sites/default/files/TPP-Detailed-Summary-of-US-Objectives.pdf>.

<sup>6</sup> See Bryce Baschuk, *High-Level Interventions Required to Resolve TPP Disagreements on Market Access Issues*, 32 *International Trade Reporter* 708 (BNA) (16 April 2015).

<sup>7</sup> See Michael Standaert, *Vietnam, Other Countries Set to Benefit By Straddling Two Major Trade Agreements*, 30 *International Trade Reporter* (BNA) 1899 (5 December 2013).

agreement (as of April 2014) on phase in periods for T&A tariff reductions.<sup>8</sup> Under the final *TPP* accord, those periods are long: for example, Japan does not abolish its T&A tariffs (as well as those on leather goods) for 16 years.<sup>9</sup>

Still another instance, noted in the 2<sup>nd</sup> bullet point, concerned T&A ROOs. The United States championed a tight Yarn Forward preferential ROO. (The only more restrictive rule than Yarn Forward is Fiber Forward, whereby the fiber, such as cotton, must be grown in the FTA area.) So, too, did Mexico: both opposed the more lax ROO sought by Vietnam (explained below).<sup>10</sup> That would mean a T&A article would have to be made from yarns, fabrics, sewing threads, and other inputs that originate within a *TPP* Party (or countries) to qualify for preferential tariff treatment.<sup>11</sup> In effect, for duty-free treatment for the finished article, all materials used in a T&A article, such as a garment, would need to originate within the *TPP* zone.

As per the 3<sup>rd</sup> bullet point, the United States also called for an exception to the Yarn Forward Rule for inputs in short supply.<sup>12</sup> A Short Supply List identifies exceptions to the ROO for material not available in a commercially meaningful quantity from within the pertinent FTA area.<sup>13</sup> If material is in short supply, then it can be sourced from outside that area, incorporated into the T&A article, and that article still can receive duty-free treatment. The Yarn Forward proposal reflected long-standing American practice in its FTAs, and also was logical in that the majority of the value of a finished T&A product comes from its components, not from final assembly. Likewise, the existence of a Short Supply List was familiar in American trade rules.

Notably, whenever there is opposition in trade negotiations to a Yarn Forward ROO, a Short Supply List can be a device for compromise. For example, acceptance of the tough Yarn Forward Rule may be gained in

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<sup>8</sup> See Len Bracken, *Froman Presses Japanese on Autos in TPP; Rep. Camp Sees Moving Ahead Without Japan*, 31 International Trade Reporter (BNA) 690 (10 April 2014).

<sup>9</sup> See Toshio Aritake, *TPP Officials in Japan for Legal Framework Meeting*, 32 International Trade Reporter (BNA) 1840 (22 October 2015). Chemicals are another exception: Japan agreed to abolish its tariffs on them only after 16 years.

<sup>10</sup> See Emily Pickrell, *Mexico Aims for Strict Auto Content Rules*, 32 International Trade Reporter (BNA) 1426 (13 August 2015). A “Yarn Forward” ROO sometimes is called a “Thread Forward” ROO, because “yarn” and “thread” may be used interchangeably.

<sup>11</sup> See Len Bracken, *Lawmaker Stresses TPP Yarn-Forward Rule; Coalition Notes Short-Supply List on Agenda*, 30 International Trade Reporter (BNA) 1367 (5 September 2013); *Groups Address Yarn-Forward Provisions in TPP in Competing Letters to USTR Kirk*, 29 International Trade Reporter (BNA) 1588 (4 October 2012).

<sup>12</sup> See Len Bracken, *Froman Presses Japanese on Autos in TPP; Rep. Camp Sees Moving Ahead Without Japan*, 31 International Trade Reporter (BNA) 690 (10 April 2014).

<sup>13</sup> See Len Bracken, *Lawmaker Stresses TPP Yarn-Forward Rule; Coalition Notes Short-Supply List on Agenda*, 30 International Trade Reporter (BNA) 1367 (5 September 2013).

exchange for a generous List. Opposition can come not only from T&A exporters in other countries, but also domestic constituencies in an importing country, such as T&A retailers that source inputs or merchandise from overseas.

In the *TPP* context, the American Yarn Forward ROO did indeed face opposition. The Hosiery Association of the United States called for a “knit-to-shape, assembly only” preferential ROO.<sup>14</sup> This ROO would cover legwear, like socks and hosiery, which fall under the 4-digit Harmonized Tariff System (HTS) heading 6115. So, *TPP* origin would be conferred simply by converting a yarn from any source (including outside the *TPP*) into legwear components that are knitted or crocheted from that yarn directly to a specific shape. (However, the Yarn Forward ROO would apply to hosiery made of cotton yarns, or from blended cotton-polyester fabrics.) The Hosiery Association feared that if a Yarn Forward Rule applied to HTS heading 6115, then any hosiery article knit in the United States from an American yarn would be ineligible for preferential treatment under the *TPP* if it contained more than 7% of its yarn from outside the *TPP*.

The Hosiery Association agreed the Yarn Forward ROO was a consistent baseline rule in American FTAs, but said the United States did not apply it consistently. It cited so-called “gimped yarns,” which are (as defined by United States Customs and Border Protection (CBP)) as a yarn around which another yarn (or filament or strip) is wrapped, where the core yarn does not twist with the cover yarn wrapped around it.<sup>15</sup> The Association explained all of America’s FTAs exclude gimped yarns from the Yarn Forward Rule. That is because certain core and cover yarns are not made in the United States. Consequently, American legwear manufacturers can source gimped yarn from 3<sup>rd</sup> countries, and still obtain a preference under an FTA. But, if under the *TPP* gimped yarns were included in the Yarn Forward Rule, then these producers would be harmed, because their products would be excluded from *TPP* preferences.

The Association said its more relaxed ROO proposal would not lead to American hosiery and sock production facilities relocating outside the United States. After all, it had made major capital investments in American production facilities, and benefited from the efficient, inexpensive supply of electricity available in the United States. Buttressing the argument of

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<sup>14</sup> See *Groups Address Yarn-Forward Provisions in TPP in Competing Letters to USTR Kirk*, 29 International Trade Law (BNA) 1588 (4 October 2012).

<sup>15</sup> See *Groups Address Yarn-Forward Provisions in TPP in Competing Letters to USTR Kirk*, 29 International Trade Law (BNA) 1588 (4 October 2012).

the Association was another fact, pointed out by Bob Kirke, the Executive Director of the Canadian Apparel Federation.

Mr. Kirke urged the correct ROO for a *TPP* should be Fabric Forward.<sup>16</sup> Though the *NAFTA* contains the Yarn Forward Rule, Fabric Forward was the rule of the 1989 *Canada – United States FTA* that preceded *NAFTA*. Under the more relaxed Fabric Forward rule, American chain apparel stores like Forever 21 and Hollingers benefit. They produce and export quick turnaround garments. Precisely because they do not have to make every aspect of the garment in the United States under a Fabric Forward rule, their garments are quick turnaround items. Indeed, Mr. Kirke observed, thanks to chain apparel stores and their expansion into Canada, the fastest growing T&A exporter to Canada was the United States (as of October 2012).

But, the American Fiber Manufacturing Association, American Manufacturing Trade Coalition, and National Council of Textile Organizations all fought the Hosiery Association *TPP* proposal.<sup>17</sup> They claimed it would allow producers to source their yarns for (1) man-made fiber hosiery and socks, or (2) cotton-polyester hosiery and socks (*i.e.*, made of a blend of cotton, polyester, and/or nylon), from outside the *TPP* Parties. Only for an article containing 100% cotton or polyester would the sourcing have to be from within the *TPP* zone. Consequently, American manufacturers of acrylic, nylon, and other man-made fiber yarns would be hurt. From where would they source?

China. Thus, China would collaborate with countries like Malaysia and Vietnam, which seek to increase their T&A exports to the United States, to the detriment of the American manufacturers of these man-made fibers. Worse yet, some of the Chinese inputs were subsidized, produced by Chinese State Owned Enterprises (SOEs), and some of the Vietnamese manufacturers were SOEs. Both China and Vietnam preferred to see a departure in the *TPP* agreement from the traditional American Yarn Forward Rule in favor of greater flexibility, or at least a generous short supply list. For them, T&A were sectors of keen export interest.<sup>18</sup>

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<sup>16</sup> See Amy Tsui, *Textile Groups Spar Over Vietnam's Inclusion in TPP Ahead of Auckland Negotiating Round*, 29 International Trade Reporter (BNA) 1691 (25 October 2012).

<sup>17</sup> See *Groups Address Yarn-Forward Provisions in TPP in Competing Letters to USTR Kirk*, 29 International Trade Law (BNA) 1588 (4 October 2012).

<sup>18</sup> See David Pilling & Shawn Donnan, *Ocean's Twelve*, FINANCIAL TIMES, 23 September 2013, at 9.

Moreover, Vietnam imports nearly all of its fabric, most of it from China.<sup>19</sup> That includes cotton: most cotton fabric Vietnamese garment producers consume comes from China.<sup>20</sup> Obviously, the United States hoped their source would shift to America thanks to *TPP*. A Yarn Forward ROO would damage the Sino-Vietnamese T&A supply chain – and that was the point, from the American perspective.

That was because, from the Vietnamese perspective, a Yarn Forward ROO essentially would impose a double substantial transformation test. Vietnamese T&A producers, if they continued to supply yarn from China, would have to transform the Chinese yarn substantially in Vietnam for it to qualify as “Vietnamese” yarn, and then use that transformed yarn to make fabric, which they would cut and sew in Vietnam as well (the 2<sup>nd</sup> substantial transformation). To preserve their Chinese yarn networks upward in their supply chains, the Vietnamese firms sought a single substantial transformation rule: they could source yarn, and even fabric, from outside a *TPP* jurisdiction, and be required to cut and sew in Vietnam – in other words, a “Cut and Sew Forward” ROO.<sup>21</sup>

Notably, in October 2012 the Congressional Research Service (CRS) issued a report stating Asian manufacturers would be the principal beneficiaries of anticipated T&A provisions in *TPP*.<sup>22</sup> That is because duties the United States applied on T&A articles were as high as 32%, and overall – as reported in November 2013 by the equity research firm China International Capital Corporation (CICC) – *TPP* Party tariffs on T&A range from 17.3% to 32%.<sup>23</sup> They would enjoy duty free treatment under a *TPP*.

Vietnam, in particular, would benefit. Vietnam is 2<sup>nd</sup> only to China as the largest exporter of garments to the United States – and that is without a duty preference. The United States imposes a 17% tariff, or more, on Vietnamese T&A exports (depending on the precise category of merchandise).<sup>24</sup> These

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<sup>19</sup> See Lien Hoang, *Vietnam Official Pushes U.S. to Drop “Yarn-Forward” Rule from TPP Negotiations*, 31 *International Trade Reporter* (BNA) 719 (17 April 2014); Stephanie Cohen, *Vietnam Sector to Benefit from Eventual TPP Agreement*, 30 *International Trade Reporter* (BNA) 1817 (21 November 2013).

<sup>20</sup> See David Pilling, *It Won’t Be Easy to Build an “Anyone But China” Club*, *FINANCIAL TIMES*, 23 May 2013, at 11.

<sup>21</sup> See Bryce Baschuk, *High-Level Interventions Required to Resolve TPP Disagreements on Market Access Issues*, 32 *International Trade Reporter* 708 (BNA) (16 April 2015).

<sup>22</sup> See Amy Tsui, *CRS Report Says TPP May Benefit Asian Apparel, Textile Manufacturers*, 29 *International Trade Reporter* (BNA) (11 October 2012).

<sup>23</sup> See Stephanie Cohen, *Vietnam Sector to Benefit from Eventual TPP Agreement*, 30 *International Trade Reporter* (BNA) 1817 (21 November 2013).

<sup>24</sup> See Lien Hoang, *Vietnam Official Pushes U.S. to Drop “Yarn-Forward” Rule from TPP Negotiations*, 31 *International Trade Reporter* (BNA) 719 (17 April 2014).

exports from Vietnam to America surged by 15,000% between 2000 and 2012.<sup>25</sup> In 2011, Vietnam accounted for 7.1% of all T&A exports to the United States; the next year, the figure was 7.6%.<sup>26</sup> China accounted for 40.2%. Of all tariffs the United States collects from Vietnam, 73% are on apparel items, and 17% from footwear.<sup>27</sup> So, *TPP* duty free treatment would only enhance the status of Vietnamese T&A merchandise in the United States, and in April 2014, Vietnam called on America to drop its insistence on the Yarn Forward Rule.<sup>28</sup>

Still, officially the USTR stuck to its position that a Yarn Forward Rule would be appropriate for a *TPP*, and would limit access of Asian exporters like Vietnam to the American market.<sup>29</sup> Congress was split on this ROO.<sup>30</sup> In May 2013, 76 Members of the House of Representatives wrote to the USTR calling for a strong Yarn Forward Rule. They wanted to ensure T&A merchandise qualified for *TPP* preferential treatment only if it is made from yarns, fabrics, sewing threads, and other inputs originating in *TPP* parties. They were joined in a separate letter from 5 Senators: inputs from non-*TPP* suppliers, such as China, should disqualify a T&A article from a duty preference, so no list of products exempt from the Yarn Forward ROO should be agreed.<sup>31</sup> In August 2013 came another letter to the USTR, this from North

<sup>25</sup> Amy Tsui, *Competing Views on Textile Provisions in TPP Talks Emerge from House, Senate*, 29 International Trade Reporter (BNA) 756 (19 May 2012).

<sup>26</sup> See Stephanie Cohen, *Vietnam Sector to Benefit from Eventual TPP Agreement*, 30 International Trade Reporter (BNA) 1817 (21 November 2013).

<sup>27</sup> See Len Bracken, *Apparel Makers Call for Flexibility in Trans-Pacific Partnership*, 30 International Trade Reporter (BNA) 728 (16 May 2013).

<sup>28</sup> See Lien Hoang, *Vietnam Official Pushes U.S. to Drop "Yarn-Forward" Rule from TPP Negotiations*, 31 International Trade Reporter (BNA) 719 (17 April 2014).

<sup>29</sup> See Amy Tsui, *Textile Groups Spar Over Vietnam's Inclusion in TPP Ahead of Auckland Negotiating Round*, 29 International Trade Reporter (BNA) 1691 (25 October 2012).

<sup>30</sup> See Len Bracken, *Marantis Meets Vietnamese President, Others on Key Issues Concerning TPP Talks*, 30 International Trade Reporter (BNA) 650 (2 May 2013).

The competing letters essentially were repeats of missives from May 2012, sent to President Barack H. Obama, in which 76 House Members advocated strong Yarn Forward Rules. They also called for extended phase out periods on American tariffs for Vietnamese products, which would be justified by Vietnam being a non-market economy (NME), and electronic tracking of yarn and fabric used by Vietnamese producers, to catch fraud, namely, the use of inputs from China. See Amy Tsui, *Competing Views on Textile Provisions in TPP Talks Emerge from House, Senate*, 29 International Trade Reporter (BNA) 756 (19 May 2012). In contrast, 15 Senators criticized an across-the-board Yarn Forward Rule, with no short supply exception, "overly broad." *Id.* Interestingly, the United States had financial leverage on its *TPP* negotiating partners: in 2010, 68% of all American tariffs (totaling nearly \$1.2 billion) collected from *TPP* Parties were in clothing and home linens. See *id.*

<sup>31</sup> See Len Bracken, *Democratic Senators Oppose Supply List for Textiles in Trans-Pacific Partnership*, 30 International Trade Reporter (BNA) 689 (9 May 2013).

Carolina Republican Representative Patrick McHenry.<sup>32</sup> He, with 167 signers from both parties, demanded a strong Yarn Forward Rule.

In contrast, 15 Senators also wrote the USTR in May 2013, calling for it to reconsider this ROO, and take a more flexible approach. The more flexible approach on sourcing of supplies also was backed by the American Apparel & Footwear Association (AAFA).<sup>33</sup> Global supply changes make a Yarn Forward Rule unworkable. To get duty-free treatment, that rule requires all materials used to make a garment to originate and be assembled in a TPP Parties, but those chains engage in production activities in multiple countries. Moreover, because of onerous documentation requirements for compliance with the rule, many companies never bother to source yarns and fabrics from a Party. Even a Short Supply List is not sufficient flexibility, because it is limited to items on the list.

The AAFA used Vietnam as an example. It is part of the global supply chain of AAFA companies. Only 2% (as of May 2013) of Vietnamese yarn and fabric needs were satisfied by other TPP Parties, excluding Japan, or 12%, including Japan.<sup>34</sup> In other words, AAFA members with facilities in Vietnam had to look outside TPP for about 88% of their yarn and fabric inputs for garments made in those facilities. Of course, lobbying groups like the National Cotton Council opposed any flexibility that might allow Vietnam to source T&A inputs or merchandise from China, and then export it through Vietnam and obtain a TPP preference.

As intimated, a possible compromise was an exception in the form of a Short Supply provision, which exists in some American FTAs: if merchandise in a specific product category in the Harmonized Tariff Schedule of the United States (HTSUS) were unavailable in a commercially meaningful quantity from TPP Parties, then the Yarn Forward Rule would not apply to it.<sup>35</sup> Rather, the Cut and Sew Forward ROO would apply, meaning the merchandise at issue would qualify for TPP treatment as long as it is cut and sewn in 1 or more Parties. This rule is more flexible than Yarn Forward, because cutting and sewing is a more advanced stage in T&A manufacturing than spinning yarn. The yarn to make the T&A merchandise could

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<sup>32</sup> See Len Bracken, *Lawmaker Stresses TPP Yarn-Forward Rule; Coalition Notes Short-Supply List on Agenda*, 30 International Trade Reporter (BNA) 1367 (5 September 2013).

<sup>33</sup> See Len Bracken, *Apparel Makers Call for Flexibility in Trans-Pacific Partnership*, 30 International Trade Reporter (BNA) 728 (16 May 2013).

<sup>34</sup> See Len Bracken, *Apparel Makers Call for Flexibility in Trans-Pacific Partnership*, 30 International Trade Reporter (BNA) 728 (16 May 2013).

<sup>35</sup> See Len Bracken, *Marantis Meets Vietnamese President, Others on Key Issues Concerning TPP Talks*, 30 International Trade Reporter (BNA) 650 (2 May 2013).

come from outside the *TPP* region. The United States tabled a Short Supply proposal as early as the 17<sup>th</sup> round of negotiations in May 2013 in Lima.<sup>36</sup> Vietnam responded saying it needed time to study that proposal.

A more dramatic potential compromise was to eschew a Yarn Forward ROO, and use a Change in Tariff Heading (CTH) rule, a Regional Value Content (RVC) rule, or a hybrid involving both.<sup>37</sup> Under a CTH rule, any product in an apparel chapter of the HTS – *i.e.*, Chapter 61 or 62 – would have to be transformed within the *TPP* region from an article from any heading other than in Chapter 61 or 62. An RVC rule would mean the total value of the processes (including inputs created) within the *TPP* region would have to sum to a minimum percentage, such as 35%, of the total value of the garment. Notably, the Trans-Pacific Partnership Apparel Coalition, which included the AAFA, recommended a CTH or RVC rule.

Also calling for flexibilities beyond the T&A ROO beyond a Short Supply List was the Retail Industry Leaders Association (RILA).<sup>38</sup> In a December 2013 press release, it pointed out the fastest growing markets for American yarn and fabric exporters are not subject to the Yarn Forward Rule. The implication was it was hypocritical of the United States to insist on an inflexible one.

In respect of flexibilities, RILA offered a number of options:

- (1) a Fabric Forward ROO (whereby the origin of yarn used to make a fabric does not matter);
- (2) a Cut and Sew Forward ROO (whereby an article may be manufactured from fabric of any origin, and the origin of the yarn used to make the fabric, as well as the origin of sewing thread, narrowing elastics, and pocketing fabric, does not matter, hence duty-free treatment is accorded as long as all components are cut or knit, and sewn, within the *TPP* region);
- (3) cumulation (allowing for component materials from multiple *TPP* Parties), RVC, (whereby preferential treatment is accorded based on a numerical threshold for value added within the *TPP* region); and

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<sup>36</sup> See Lucien O. Chauvin, *Progress Made as Latest Round Ends; Questions Remain on Japan's Upcoming Role*, 30 International Trade Reporter (BNA) 773-774 (30 May 2013).

<sup>37</sup> See Len Bracken, *Apparel Makers Call for Flexibility in Trans-Pacific Partnership*, 30 International Trade Reporter (BNA) 728 (16 May 2013).

<sup>38</sup> See Len Bracken, *Retail Leaders Back Senate, House Letters Seeking Flexible Rules for Apparel in TPP*, 30 International Trade Reporter (BNA) 1941 (12 December 2013).

- (4) export matching.<sup>39</sup>

Indeed, RILA pointed out there are precedents for all such options: they exist in various FTAs to which the United States is a party.

### III. INDUSTRIAL POLICY

In the end, the *TPP* Parties agreed on 3 basic points with respect to the T&A Chapter:

- (1) The baseline ROO would be Yarn Forward, hence fabric (because it is produced from yarn) in a garment would have to originate from within the *TPP* region for that garment to qualify for preferential treatment.
- (2) There would be a Short Supply List. This List would have breathable, waterproof fabric (which is used in high-technology outer garments), cotton flannel, and stretch wool (with at least 2%-5% elastomeric).<sup>40</sup>
- (3) Cumulation would be permitted so as to promote regional value added chains and SMEs.

In January 2016 testimony to the ITC, the Peruvian Ambassador to the United States gave an illustration of the 3<sup>rd</sup> point. Peruvian T&A firms could purchase cotton from the United States, and buttons from Malaysia, using *TPP* preferences for imports of both of these inputs. Then, those firms could make yarn and a shirt, and export that shirt to the United States, again under *TPP* preference.<sup>41</sup>

The problem with this illustration was not that it was false, but that it was not the whole truth. Indeed, much of the debate about *TPP* T&A ROOs was incomplete. Underlying it was fear of further job loss in the T&A sector of developed country Parties, particularly the United States. Left unaddressed were the questions of whether (1) developing countries that receive preferences actually benefit from them, and (2) if so, their benefit is to the detriment of developed countries (in the sense of a zero-sum game). That is, are preferential ROOs that determine entitlement for DFQF treatment for T&A merchandise the key causal factor in also determining whether preference

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<sup>39</sup> See Len Bracken, *Retail Leaders Back Senate, House Letters Seeking Flexible Rules for Apparel in TPP*, 30 *International Trade Reporter* (BNA) 1941 (12 December 2013).

<sup>40</sup> See Len Bracken, *Froman Defends Market Protection for Biologics*, 32 *International Trade Reporter* (BNA) 1843 (22 October 2015).

<sup>41</sup> See Rossella Brevetti, *Rep. Levin Calls for Broad TPP Analysis*, 33 *International Trade Reporter* (BNA) 104 (21 January 2016).

receiving countries grow and develop into the upper echelons of the T&A value added chain? If so, then should preference-granting countries insist on restrictive ROOs needed to protect jobs and wages? The analysis of at least 1 practitioner suggests a negative answer, at least as to the initial question.<sup>42</sup>

Ms. Colette van der Ven argues industrial policy not only complements preferential ROOs, but also is essential if a poor country seeks to escape the lower echelons of that sector. Her analysis begins with questions *TPP* negotiators, supporters, and critics did not ask:

“How can preference-receiving countries benefit from increased market opportunities yet prevent preference – and market – dependency?” “What are the reasons that most factories in Cambodia are foreign owned while Sri Lanka’s apparel ... industry is mainly locally owned?” or “Why has Bangladesh been able to set up a textile base, while other countries still import nearly all garment inputs?”<sup>43</sup>

These questions matter for a clear understanding of whether *TPP* Chapter 4 on T&A, and Annex 4-A concerning T&A ROOs, help the T&A sector in poorer Parties without inflicting significant adjustment costs on that sector in richer ones:

Answering these questions warrants an approach that looks beyond the confines of the international trade preferences framework and analyzes the extent to which preference-receiving *domestic* policy measures have enabled or constrained sustainable economic growth. Such policy interventions that alter a society’s industrial structure are known by the unpopular term “industrial policy.” Yet, the meaning of “industrial policy” continues to evolve and is no longer just associated with traditional market failure and protectionist concepts.<sup>44</sup>

Accordingly, van der Ven thinks of “industrial policy” as “governmental interventions that maximize sustainable economic growth,” including “measures aimed at diversifying production within the apparel sector, incentivizing linkages between ... FDI and local businesses, and creating

<sup>42</sup> See Colette van der Ven, *Where Trade and Industrial Policy Converge: How Developing Countries Can Utilize Trade Preferences to Generate Sustainable, Local Growth in the Garment Sector*, 49 THE INTERNATIONAL LAWYER number 1, 49-92 (summer 2015).

<sup>43</sup> Colette van der Ven, *Where Trade and Industrial Policy Converge: How Developing Countries Can Utilize Trade Preferences to Generate Sustainable, Local Growth in the Garment Sector*, 49 THE INTERNATIONAL LAWYER number 1, 49, 51 (summer 2015).

<sup>44</sup> Colette van der Ven, *Where Trade and Industrial Policy Converge: How Developing Countries Can Utilize Trade Preferences to Generate Sustainable, Local Growth in the Garment Sector*, 49 THE INTERNATIONAL LAWYER number 1, 49, 51 (summer 2015) (emphasis original).

specifically targeted training programs.”<sup>45</sup> In other words, industrial policy is state-directed or guided efforts to identify strategic priorities (e.g., the T&A sector), create networks (e.g., backwards and forwards integration of supply and distribution chains), build institutions (e.g., education and infrastructure), and enhance factors of production (e.g., human capital).

Further, van der Ven delineates 4 Stages of T&A production in a “Global Value Chain” (GCV) that stitches together suppliers in multiple developing countries and/or LDCs with buyers in developed countries:

- (1) the supply of raw material (natural and synthetic) to textile companies;
- (2) the production and finishing of yarn by textile companies;
- (3) apparel production in garment factories [involving sewing, cutting, and finishing, sometimes called “CMT,” for “Cut-Make-Trim”]; and
- (4) distribution and sales channels at the wholesale and retail level.<sup>46</sup>

The T&A sector in most poor countries typically starts in Stage 3, because it is relatively more labour-intensive than the other Stages and they have a competitive advantage in cheap labour. Yet, activities in Stage 3 also contribute less value to an overall finished product than any other Stage.

So, those countries seek (or ought to seek) to ascend to Stage 4, earn revenues from higher-value added activities, and invest their marginal revenues in pro-growth, pro-development activities. Successful developing countries and LDC do so by enhancing their processes and products:

“Process upgrading” refers to companies or countries improving their position in the value chain by creating new production efficiencies, through improved technologies or organizational forms. “Product upgrading” occurs when a country begins to produce more complex goods that require more value-added, for example, when a country moves from manufacturing to textile production. Upgrading within and across the value chains can also happen. For example, individual producers can change their function in the value chain by moving to higher value-added activities like branding and marketing, or entirely new value chains.<sup>47</sup>

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<sup>45</sup> Colette van der Ven, *Where Trade and Industrial Policy Converge: How Developing Countries Can Utilize Trade Preferences to Generate Sustainable, Local Growth in the Garment Sector*, 49 THE INTERNATIONAL LAWYER number 1, 49, 51 (summer 2015).

<sup>46</sup> Colette van der Ven, *Where Trade and Industrial Policy Converge: How Developing Countries Can Utilize Trade Preferences to Generate Sustainable, Local Growth in the Garment Sector*, 49 THE INTERNATIONAL LAWYER number 1, 49, 60 (summer 2015).

<sup>47</sup> Colette van der Ven, *Where Trade and Industrial Policy Converge: How Developing Countries Can Utilize Trade Preferences to Generate Sustainable, Local Growth in the Garment Sector*, 49 THE INTERNATIONAL LAWYER number 1, 49, 62 (summer 2015).

To appraise the relative importance of preferential ROOs and industrial policy in ascending (or not) the GVC, van der Ven studied 6 countries: Bangladesh; Cambodia; Lesotho; Kenya; Madagascar; and Sri Lanka. T&A exports from all 6 countries rose thanks to trade preferences. Prudent industrial policy distinguished the 3 successful ones, Bangladesh, Madagascar, and Sri Lanka, which experienced “sustained” industrialization. In contrast, the T&A sectors in Kenya, Madagascar, and Sri Lanka enjoyed only “ephemeral” growth.

Why the difference? Industrial policy measures:

... Developing country governments that have adopted industrial policies that are solely export-oriented – *e.g.*, through establishing export processing zones (EPZs), but not extending certain EPZ-specific benefits to local producers – have generally failed to generate sustainable growth in the apparel sector, whereas governments that adopted a balanced industrial policy aiming both to attract foreign investors to build up an export-oriented industry while providing incentives for domestic firms to engage in the apparel industry – *e.g.*, through policies that encourage and require foreign investors to partner with local businesses – have generally experienced more sustainable growth.

... [There are] policy options for governments interested in adopting a more balanced approach to growing their apparel industry. At a national level, governments can encourage local production by lowering entry barriers for entrepreneurs, providing special skills training, equalizing incentives for domestic and foreign enterprises, and promoting joint ventures and other collaboration between foreign and national businesses through tools such as tax benefits and limits on the percentage of foreign ownership. A balanced industrial policy should also encourage the creation of backward linkages, either locally or regionally. This can be done through input subsidies such as local-sourcing initiatives, or, where relevant, regional coordinating industry bodies. Additionally, governments can help the industry move up the value chain by stimulating product upgrading and the development of niche products. Skill training for integrated/upward development, product promotion organizations and branding, and investment all contribute to this goal. [Also of] ... critical importance ... is strengthening regional market integration. One way to do so would be through lowering import [quotas] and tariffs on apparel and textile at the regional level, *e.g.*, the Southern African Development Community (SADC) and the Southern African Customs Union (SACU), or to have more flexible ROOs.<sup>48</sup>

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<sup>48</sup> Colette van der Ven, *Where Trade and Industrial Policy Converge: How Developing Countries Can Utilize Trade Preferences to Generate Sustainable, Local Growth in*

The key lesson from her research is that it is vital for preference-receiving countries to behave “strategically with an eye to long-lasting, sustainable growth.”<sup>49</sup>

To be sure, the van der Ven study focuses on preferential ROOs under the Generalized System of Preferences (GSP) (including that of the United States and the European Union Everything But Arms (EBA) program), plus the United States *African Growth and Opportunity Act (AGOA)* and the European Union’s *Cotonou Agreement*. Her analysis excludes preferences under FTAs. Nevertheless, might it hold a lesson for the FTA context? It certainly seems to. It refers explicitly to SACU and ROOs. The distinction between an FTA and customs union (CU), namely, that only the latter has a Common External Tariff (CET), ought not to matter in terms of the relevance of the analysis.

So, should *TPP* Parties pay heed to the possibility that ROOs are not the key determinant of successful use of T&A preferences? Surely, Vietnam and the United States would have a better appreciation for the effects of *TPP* T&A provisions if they eschewed exaggerating the importance of Annex 4-A ROOs. Vietnam needs to implement prudent industrial policy measures to proceed upward through the 4 T&A production stages. Its doing so casts doubt on the specter of America facing endless wage-eroding, job-destroying competition from cheap Vietnamese workers.

#### IV. MULTINATIONAL CORPORATE AUTOMOTIVE SUPPLY CHAINS

T&A products were not the only instances in which market access disputes in traditional sectors impeded final agreement on *TPP*. Industrial products mattered, too. American exporters of electric vehicles, specifically, golf carts from Augusta, Georgia, were eager to see the 50% Malaysian tariff on the carts drop to zero.<sup>50</sup> Understandably, they eyed the golf-crazed Asian mar-

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*the Garment Sector*, 49 *THE INTERNATIONAL LAWYER* number 1, 49, 52-53 (summer 2015). Note that input subsidies could violate the *WTO Agreement on Subsidies and Countervailing Measures* (e.g., if they were *de jure* or *de facto* specific to the T&A industry) and local-sourcing initiatives could breach GATT Article III (as impermissible import substitution measures).

<sup>49</sup> Colette van der Ven, *Where Trade and Industrial Policy Converge: How Developing Countries Can Utilize Trade Preferences to Generate Sustainable, Local Growth in the Garment Sector*, 49 *THE INTERNATIONAL LAWYER* number 1, 49, 53 (summer 2015).

<sup>50</sup> See Trevor Williams, *Behind Closed Doors: Outcome of Atlanta TPP Talks to Have Global, Local Impact*, *GLOBAL ATLANTA*, 29 September 2015, <http://globalatlanta.com/behind-closed-doors-outcome-of-atlanta-tpp-talks-to-have-global-local-impact/>. Nearly 40% of exports of goods and services from Georgia are to the *TPP* region, including

ket with anticipation of sales revenue to come. Similarly, Canadian exporters of aerospace goods, *e.g.*, aircraft parts to Australia and aircraft seats to New Zealand, were delighted by removal of tariffs of 5%, as were Canadian exporters of medical, surgical, and laboratory equipment.<sup>51</sup>

In other words, undeniably *TPP* would redound to the benefit of many agricultural and industrial producer-exporters, in keeping with orthodox free trade theory. *TPP* proponents eagerly touted the story of these “winners” from the implementation of Ricardo’s Law of Comparative Advantage. As Ricardo himself understood, there would be “losers,” and their voices were heard especially if their sectors were of great commercial significance. In terms of the controversy they generated, autos and auto parts were the industrial analog to sugar and dairy. Among the supporting evidence for that analogy was the deal struck on phasing out America’s 2.5% tariff on cars: there would be no change for the 1<sup>st</sup> 15 years in which *TPP* was in effect; that duty would drop to zero in stages from year 15 to 25. Taking ¼ century to abolish a *de minimis* tariff was nothing if not micro-managed trade.<sup>52</sup>

In the run up to the July 2015 Maui negotiations, the United States thought it had reached an agreement with Japan about the amount of content of a vehicle that needs to come from within the *TPP* region to qualify – RVC – for *TPP* DFQF treatment. Reportedly, the side deal was between 30% (which Japan sought) and 55% (which America wanted), namely, 30% for auto parts and 45% for light duty vehicles.<sup>53</sup>

But, the Americans failed to inform Mexico or Canada of that deal. They also failed to tell their Japanese counterparts that they had not kept Mexico or Canada apprised of the accord. (Subsequently, the Americans told Mexico, which then told Canada.) Not surprisingly, when the Mexican, Canadian, and Japanese teams reached Maui, they were surprised, even angry: if the

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Georgia-based service providers, such as Delta Airlines and UPS. Conversely, over 500 companies from *TPP* Parties (particularly Canada and Japan) have invested in Georgia, creating 461,600 jobs (as of 2011). *See id.*

<sup>51</sup> See Steven Chase, *Canada, Mexico Seek Concessions on Auto Rules at TPP Talks*, THE GLOBE AND MAIL, 1 October 2015, <http://www.theglobeandmail.com/news/politics/trade-minister-ed-fast-at-atlanta-meetings-pushing-for-trans-pacific-partnership-deal/article26597742/>.

<sup>52</sup> See Toshio Aritake, *TPP Officials in Japan for Legal Framework Meeting*, 32 International Trade Reporter (BNA) 1840 (22 October 2015).

<sup>53</sup> See Emily Pickrell, *North American Auto Parts Industry Raises Minimum Bar for TPP Talks*, International Trade Daily (BNA) (1 September 2015); Stephen Chase, *Canada, Mexico Drawn into Deal-breaking Auto Talks in Trans-Pacific Negotiations*, THE GLOBE AND MAIL, 5 August 2015, <http://www.theglobeandmail.com/news/politics/us-excludes-canada-mexico-from-tpp-auto-negotiations/article25842330/>.

USTR had thought it could reach a bilateral deal with Japan on autos and auto parts, and its *NAFTA* partners would accept it unquestioningly, then American thought wrong.

Via a lax ROO, the Japanese were trying to allow their auto parts supplies from Asian countries not in the *TPP* to qualify, and thereby preserve their non-*TPP*, Asian-based supply chain to qualify for *TPP* treatment. Japan sought lax ROOs favoring its car companies.<sup>54</sup> Those companies had long-standing supply chains involving Thailand, so Japan wanted *TPP* ROOs that would allow auto parts that Honda, Toyota, Renault-Nissan, and other Japanese firms source from Thailand (and other non-*TPP* participants) to qualify for *TPP* preferential treatment.<sup>55</sup> Might it be possible for these firms to include 55% of the value of a car, such as an engine, from China, and still have that car get DFQF treatment throughout the 12-member *TPP*?

A “yes” answer (which, in the end as discussed below, was the answer) would erode the position of Mexican and Canadian auto parts suppliers. They would have to compete with like parts that, from their perspective, were non-originating and, therefore, should be subject to an import duty. They have long-standing *NAFTA* supply chains, and whereas Thailand was not a party to *TPP*, all 3 *NAFTA* Parties were. A pro-Japanese ROO would allow Japanese auto and auto parts to compete on a level playing field in the *TPP* area with ones made in Mexico and Canada. As the Mexican Secretary of the Economy, Ildefonso Guajardo Villarreal, put it unapologetically: “What you can accuse me of is putting myself to the front to really push the interests of my country.”<sup>56</sup>

It was a battle between cross-border corporate supply chains in the context of technical ROOs. Would aspects of the Japanese Asian non-*TPP* supply chain be allowed into *TPP*? Or, would the North American integrated supply chain be preserved within *TPP*? The Executive President of Mexico’s National Auto Parts Industry, Oscar Albin, explained in an interview:

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<sup>54</sup> See Ami Miyazaki & Krista Hughes, *Pacific Rim Trade Talks Fall Short of Deal*, REUTERS, 1 August 2015, <http://mobile.reuters.com/article/topNews/idUSKCN0Q-52FL20150801?irpc=932>; *Australia Walks Away from Trans-Pacific Partnership Trade Deal Talks*, THE GUARDIAN, 31 July 2015, <http://www.theguardian.com/business/2015/aug/01/australia-walks-away-from-trans-pacific-partnership-trade-deal-talks>.

<sup>55</sup> See Len Bracken & Rossella Brevetti, *Hatch Urges USTR Not To Rush TPP Deal*, 32 International Trade Reporter (BNA) 1684 (1 October 2015) (noting Nissan sources parts from Thailand and Japan sought to accommodate Nissan at the September-October Atlanta negotiations with a low percentage RVC ROO).

<sup>56</sup> Quoted in Carter Dougherty, *Pacific Trade Deal Elusive in Hawaii; Amari Sees More Talks*, 32 International Trade Reporter (BNA) 1375 (6 August 2015).

Japan's proposal could reduce Mexico's current auto parts annual revenue of \$85 billion to \$62 billion by 2025, Albin said. Under Mexico's proposal, it is estimated to reach \$115 billion by 2025. If no TPP agreement were to take place, Mexico's auto parts industry is estimated to grow to about \$100 billion annually....

...

At stake in these figures is the risk that a low-content requirement *could encourage car companies with manufacturing plants in North America to move their facilities to Vietnam or Malaysia, taking advantage of both lower labour costs and cheaper sourcing from non-TPP countries*, Albin said.

"These Asian countries are going to get their raw materials from China or India or Thailand," .... "Not only Mexico, but the U.S. and Canada, would then lose the complete supply chain to the China supply chain. It would be very attractive for those countries to deliver the raw materials, if the low local requirements opened that door."<sup>57</sup>

Market share data backed Mr. Albin's concerns, and given their supply chains, Japanese car companies were the key target of those concerns.

Mexico is the world's 7<sup>th</sup> largest auto producer and 4<sup>th</sup> largest auto exporter.<sup>58</sup> By 2020, it is projected to overtake Korea as the 6<sup>th</sup> largest producer.<sup>59</sup> A remarkable benefit for Mexico of 20 years of integration wrought by NAFTA was realized in 2014, when "Mexico overtook Japan to become the second-largest exporter of vehicles to the U.S., behind Canada."<sup>60</sup> Further, in 2014, "[o]ne out of almost five vehicles built in North America ... was made in Mexico, double the proportion in 2005. ... [That figure is projected] to rise to one in four by 2020, as companies including Volkswagen, Ford and Nissan add capacity in the country."<sup>61</sup> And, between 2009-2015, car

<sup>57</sup> Quoted in Emily Pickrell, *North American Auto Parts Industry Raises Minimum Bar for TPP Talks*, International Trade Daily (BNA) (1 September 2015).

<sup>58</sup> See Emily Pickrell, *Mexico Aims for Strict Auto Content Rules*, 32 International Trade Reporter (BNA) 1426 (13 August 2015).

<sup>59</sup> See Krista Hughes & Ana Isabel Martinez, *Exclusive: TPP Would Include Auto Market Opening for Japan – Source*, REUTERS, 2 October 2015, <http://mobile.reuters.com/article/idUSKCN0RW2JV20151002>.

<sup>60</sup> See Carter Dougherty, *Mexico Throws a Wrench into Trade Talks*, 32 International Trade Reporter (BNA) 1572 (10 September 2015). By the end of 2015, Mexico shipped more vehicles to America than either Japan or Canada. See Sander Levin, *What's Still Wrong with the TPP*, Politico, 1 October 2015, <http://www.politico.com/agenda/story/2015/10/whats-still-wrong-with-the-tp-000262>.

<sup>61</sup> See Carter Dougherty, *Mexico Throws a Wrench into Trade Talks*, 32 International Trade Reporter (BNA) 1572 (10 September 2015).

companies announced 7 new auto production plants to be located in North America – all of them in Mexico.<sup>62</sup>

As for Canada, it is the world's 8<sup>th</sup> largest auto exporter. Canada is the 9<sup>th</sup> largest vehicle maker in the world, and its auto and auto parts sector is its largest industrial sector, supporting 550,000 jobs.<sup>63</sup> Thus, not surprisingly, both said “no” to the United States. Mexico was particularly tenacious: because it had leapfrogged other aspirants in the world auto and auto parts market, it understood the competitive threat posed by Japan, as well as other *TPP* auto exporter aspirants, namely, Malaysia and Vietnam. These countries could do to Mexico what Mexico had done, thus unwinding via *TPP* ROOs the benefits of *NAFTA*.

All this was an unnecessary, self-inflicted blow by the USTR, borne out of haste, disrespect, or outright arrogance. Not consulting *NAFTA* partners before purporting to finalize an auto RVC rule with Japan ought to have been unthinkable. Yet, the USTR compounded the error: in August, Japan said it was not aware that America was holding talks with Canada and Mexico over auto ROOs, and thus was worried it would be presented *fait accompli* with an outcome from those talks.<sup>64</sup>

## V. TIGHT VERSUS LOOSE RVC ROOs

Understandably, amidst the Maui negotiations, Mexico and Canada turned to each other, collaborating to achieve tight auto and auto parts ROOs to ensure those items from non-*TPP* countries would not gain access to *TPP* countries. During the July 2015 Maui negotiations, Mexico said that to qualify for DFQF treatment under *TPP*, autos should have at least 62.5%, and possibly 65%, of their parts from within the *TPP* region.<sup>65</sup> The latter figure would be an even higher threshold than the 62.5% *NAFTA* RVC ROO, but

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<sup>62</sup> See Krista Hughes & Ana Isabel Martinez, *Exclusive: TPP Would Include Auto Market Opening for Japan – Source*, REUTERS, 2 October 2015, <http://mobile.reuters.com/article/idUSKCN0RW2JV20151002>.

<sup>63</sup> See Stephen Chase, *Canada, Mexico Drawn into Deal-breaking Auto Talks in Trans-Pacific Negotiations*, THE GLOBE AND MAIL, 5 August 2015, <http://www.theglobeandmail.com/news/politics/us-excludes-canada-mexico-from-tpp-auto-negotiations/article25842330/>.

<sup>64</sup> See Toshio Aritake, *Japan Unaware of NAFTA Auto Talks, Official Says*, 32 International Trade Reporter (BNA) 1505 (27 August 2015).

<sup>65</sup> See Doug Palmer, *Ministers Fail to Cinch Major Trade Pact*, POLITICO, 1 August 2015, <http://www.politico.com/story/2015/07/pharmaceuticals-trans-pacific-partnership-trade-pact-120877.html> (reporting 62.5%); Jonathan Weisman, *Talks for Pacific Trade Deal Stumble*, NEW YORK TIMES, 31 July 2015, [http://mobile.nytimes.com/2015/08/01/business/tpp-trade-talks-us-pacific-nations.html?referrer=&\\_r=0](http://mobile.nytimes.com/2015/08/01/business/tpp-trade-talks-us-pacific-nations.html?referrer=&_r=0) (reporting 65%).

both would force Japanese companies to alter their Thai-, Indonesian-, or Chinese-oriented chains, and source instead from parts suppliers within the *TPP* Region (e.g., in Ohio, Ontario, or Tamaulipas) hence the Japanese aim to get a sub-*NAFTA* rule. By the end of the Maui talks, there was no deal.

But, Mexico and Canada had another ally: the United Auto Workers (UAW). It sought a 75% ROO.<sup>66</sup> The UAW and other labour advocacy groups knew well that the lower the value of the ROO, the greater the out-sourcing of auto parts, and thus jobs in the auto parts sector, from the *NAFTA* region to relatively lower wage countries both within and outside *TPP*. From their perspective, it was a cruel, decades-long game. Two decades earlier, they endured rationalization of the automobile industry thanks to *NAFTA*, with jobs shifting from Canada and the United States to Mexico. Now, all *NAFTA* Parties felt pressure to do so again, not on the logic of efficiency gains (i.e., the standard Smith-Ricardo specialization of production and enhancement of consumption opportunities) within a new North America community, but a frightfully larger East Asian one. Put differently, *TPP* was a back-door renegotiation of *NAFTA*.<sup>67</sup>

There was little room for maneuver. Flavio Volpe, President of the Automotive Parts Manufacturers' Association, explained the Canadian position:

As Canadian, U.S. and Mexican negotiators met in Washington Aug. 20 to discuss the demands that caught Canada and Mexico by surprise at the recent *TPP* talks in Hawaii, a spokesman for Canada's auto parts sector said that Canada can only agree to a small reduction from the 62.5 percent domestic content requirement negotiated in ... *NAFTA*.

The Mexican government apparently has told its negotiators to go no lower than 50 percent, and Canada can't afford to give any ground beyond that, Flavio Volpe ... [noted].

The *NAFTA* domestic content requirement shifted a significant portion of low-value-added manufacturing to Mexico, while allowing Canada to retain significant levels of high-value-added production, but the proposal by the U.S. and Japan to reduce the level to as little as 30 percent is unacceptable, Volpe said.

"If 70 percent of a vehicle's content can come from outside the country, what's the point?" ....

<sup>66</sup> See Emily Pickrell, *Mexico Aims for Strict Auto Content Rules*, 32 International Trade Reporter (BNA) 1426 (13 August 2015).

<sup>67</sup> See Jim Stanford, *Trans-Pacific Partnership: Renegotiating NAFTA by the Back Door* (23 September 2015), <http://www.bilaterals.org/?trans-pacific-partnership-28598>.

The Canadian government understands that dynamic, but is only one of 12 countries at the *TPP* table, he said. And while trade deals by definition involve giving ground in some areas to gain in others, the highly integrated North American auto sector makes further domestic content concessions a tricky proposition, he said.

“At what point does it exceed what you get?” Volpe said. “Auto is just one slice of the *TPP* negotiations, but it’s the largest single industrial sector of the Canadian economy.”<sup>68</sup>

By September, the USTR re-grouped with its Mexican and Canadian counterparts. They agreed to push for a minimum RVC ROO of 50%.<sup>69</sup> That did not please the Ohio Senators, Sherrod Brown (Democrat) and Rob Portman (Republican), or Michigan Senator Debbie Stabenow (Democrat): they called on the USTR to stick to the *NAFTA* 62.5% RVC ROO.<sup>70</sup>

When the *NAFTA* representatives met with Japan in mid-September, no agreement was reached. Thereafter, Japan ventured that America appeared willing to eliminate duties on 80% of Japanese auto part exports, which if true, conjured up the possibility of access into the United States that might threaten Canadian and Mexican parts suppliers.<sup>71</sup> Japan exports about 100 types of auto parts to America, and brakes, exhaust gas filters, and seat belts would be among the 80%, with the United States retaining its tariffs on gearboxes, transmissions, and the other 20% for perhaps 10 years (the outer limit of the phase out period Japan could accept).

On the eve of the September-October 2015 Atlanta negotiations, Japan appeared minimally flexible. It might accept a 32.5% ROO for auto parts, up just 2.5 percentage points from its initial position, or possibly one as high as 40%, up 10 percentage points from that position.<sup>72</sup> Canada tried to shore up support for a *TPP* ROO that might be a lower threshold than the *NAFTA* RVC requirement, such as 45-50%.<sup>73</sup> It trumpeted a statement

<sup>68</sup> Quoted in Peter Menyas, *Little Room for Canada to Negotiate on Autos*, 32 International Trade Reporter (BNA) 1512 (27 August 2015).

<sup>69</sup> See Emily Pickrell, *North American Auto Parts Industry Raises Minimum Bar for TPP Talks*, International Trade Daily (BNA) (1 September 2015).

<sup>70</sup> See Rossella Brevetti, *TPP Auto Talks Among Japan, NAFTA Countries End Without Agreement*, International Trade Daily (BNA) (15 September 2015).

<sup>71</sup> See Ryohei Yasoshima, *U.S. Seen Waiving Tariff on 80% of Japanese Autoparts*, NIKKEI ASIAN REVIEW, 30 September 2015, <http://asia.nikkei.com/Features/Trans-Pacific-Partnership/US-seen-waiving-tariff-on-80-of-Japanese-autoparts>.

<sup>72</sup> See Len Bracken & Rossella Brevetti, *Hatch Urges USTR Not To Rush TPP Deal*, 32 International Trade Reporter (BNA) 1684 (1 October 2015) (reporting Japan agreed to 40% in the July 2015 Maul negotiations).

<sup>73</sup> At least one report said Canada would accept no less than 50%. See Steven Chase, *Canada, Mexico Seek Concessions on Auto Rules at TPP Talks*, THE GLOBE AND MAIL, 1 October 2015, <http://www.theglobeandmail.com/news/politics/trade->

by its multinational auto parts companies, Linamar Corp., and Martinrea International Inc. (the 2<sup>nd</sup> and 3<sup>rd</sup> largest Canadian auto parts manufacturers by revenue), which said *TPP* would benefit them by opening up new foreign markets for exports of their parts from Canada, possibly boosting employment at their Toronto headquarters.<sup>74</sup> What they did not say is a lower-than *NAFTA* RVC ROO in *TPP* would give them more flexibility in their supply chains to source parts from outside of the *NAFTA* region – at the cost of up to 26,000 Canadian jobs, according to Unifor (a union representing auto workers).<sup>75</sup> In effect, they were in a similar position as Japanese companies, and Canada successfully divided its own auto parts industry by distinguishing these giants from the SMEs that account for about half of the 80,000-strong employment in its auto parts industry.

Amidst the Atlanta negotiations, reports circulated a 4-way deal had been agreed: Japan, the United States, Canada, and Mexico would accept a general 45% RVC ROO for autos, along with a 35% ROO for simple parts, and a 40% or 45% ROO for complex parts.<sup>76</sup> Canada and Mexico initially denied any resolution was agreed, but the reports proved largely correct. Canada said the 35% ROO affected parts it did not produce or export.<sup>77</sup> Bumpers, chassis components, engines, suspensions, and transmissions were in the 40% or 45% category. They did matter to Canadian industry.

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minister-ed-fast-at-atlanta-meetings-pushing-for-trans-pacific-partnership-deal/article26597742/.

<sup>74</sup> Steven Chase & Greg Keenan, *Conservatives Line Up Support from Auto Parts Makers for TPP Deal*, 28 September 2015, <http://www.theglobeandmail.com/news/politics/conservatives-line-up-auto-support-for-tpp-deal/article26597770/>.

<sup>75</sup> See *Trans-Pacific Partnership Deal Could be Near After Auto Compromise*, TORONTO STAR, 2 October 2015, <http://www.thestar.com/news/canada/2015/10/02/trans-pacific-partnership-deal-could-be-near-after-auto-compromise.html>.

<sup>76</sup> See Steven Chase, *TPP Trade Talks Extended an Extra Day as Progress Seen on Auto Imports*, THE GLOBE AND MAIL, 2 October 2015, <http://www.theglobeandmail.com/news/politics/tpp-trade-talks-extended-an-extra-day-as-progress-seen-on-auto-imports/article26631467/>; *Four-way Auto Deal Advances TPP talks*, THE JAPAN TIMES, 2 October 2015, <http://www.japantimes.co.jp/news/2015/10/02/business/tpp-talks-extended-ministers-struggle-strike-trade-deal/> - .Vg7qp9YaD-J.

Under the peculiar separate calculation methods used by Japanese authorities, the 45% ROO was a 55% RVC rule. See Krista Hughes & Ana Isabel Martinez, *Exclusive: TPP Would Include Auto Market Opening for Japan – Source*, REUTERS, 2 October 2015, <http://mobile.reuters.com/article/idUSKCN0RW2JV20151002>.

Note that in the wake of the Atlanta negotiations, some reports put the minimum RVC ROO for auto parts at 40%. See, e.g., Emily Pickrell, *Mexican Groups OK with Regional Content Level*, 32 International Trade Reporter (BNA) 1776 (15 October 2015).

<sup>77</sup> See Steven Chase, *Auto-Sector Protection under TPP Deal Less than Ottawa Touted*, THE GLOBE AND MAIL, 8 October 2015, <http://www.theglobeandmail.com/news/politics/feds-omit-key-detail-of-tpp-deal-affecting-auto-sector/article26725640/>.

The general 45% rule would answer the question “how much value added to a vehicle must come from within the *TPP* region for that vehicle to qualify for DFQF treatment within the region?” The 3 rules for auto parts (35%, 40%, or 45%) were needed, because of the reality these parts (*i.e.*, components) consist of many sub-parts (*i.e.*, sub-components). In other words, what constitutes a locally made part? ROOs were needed to define whether a part originated within the *TPP* region, where that part was made up of sub-parts, some of which were from outside the region. If so, then that part could be counted toward the overall 45% RVC of a car; if not, then the part would be excluded from materials qualifying as originating and thus not contribute to that RVC.

The auto and parts ROOs reflected another reality. Mexico was less concerned about its ability to sustain its post-*NAFTA* car manufacturing boom on account of a threat of low-value added, cheap auto parts.<sup>78</sup> Mexico cared that high-margin parts be sourced from its existing supply chains, and not threatened by Japan’s non-*TPP*, Asia based networks. Possibly, that is why the compromise *TPP* rule excluded a *NAFTA*-like traceability (or tracking) requirement.<sup>79</sup> There would be no need to trace back the origin of sub-components, as there was in *NAFTA*.

The USTR defended the lack of a tracing requirement in *TPP* on a different ground: the *TPP* ROOs “are more accurate, more easily verifiable, and more enforceable than those of *NAFTA*, which used tracing, diminishing the value of the strict ROOs, and diluting the incentive to source from the U.S. and *NAFTA* partners.”<sup>80</sup> But, it appeared the *TPP* RVC ROO on auto parts was akin to the pre-*NAFTA* “Roll Up” ROO, under the Canada-United States FTA. If so, then the *TPP* ROO was less strict than that of *NAFTA*, and did the opposite: it diluted the incentive to source from within North America. That was because non-North American parts would be “rolled up” (*i.e.*, counted as qualifying) with *TPP* origin parts.

Critics in upstream industries charged the auto and auto parts ROOs were too weak to protect American jobs. For example, American steel producers said the percentage RVC thresholds allowed for too much non-*TPP* foreign

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<sup>78</sup> See Krista Hughes & Ana Isabel Martinez, *Exclusive: TPP Would Include Auto Market Opening for Japan – Source*, REUTERS, 2 October 2015, <http://mobile.reuters.com/article/idUSKCN0RW2JV20151002>.

<sup>79</sup> See Peter Clark, *TPP All Done But For the Shouting*, IPOLITICS, 3 October 2015, <https://ipolitics.ca/2015/10/03/tpp-all-over-but-the-shouting/>.

<sup>80</sup> USTR, *Fact Sheet: The Trans-Pacific Partnership, Getting the Best Deal for the U.S. Auto Industry* (issued following 5 October 2015, undated), <https://ustr.gov/sites/default/files/TPP-Getting-the-Best-Deal-for-the-US-Auto-Industry-Fact-Sheet.pdf>.

steel, at the expense of their own output, to be included in auto and auto parts.<sup>81</sup> Moreover, nothing in *TPP* nor prior FTAs addressed the problem of world over-capacity in the steel industry (thanks in large part to Chinese and Korean production). But, the potentially the most ominous criticism implicated national security: would China benefit from the ROOs? Following the 4 February 2016 signing ceremony in Auckland, American legislators from both political parties “want[ed] to know whether China could be a non-signatory beneficiary of *TPP* as a limited percentage of Chinese auto parts and components could be used on cars assembled in *TPP* countries and thus benefit from *TPP* tariff terms.”<sup>82</sup>

For Michigan Congressman Sander Levin, the answer was evident. He declared his opposition to *TPP*.<sup>83</sup> Three of 4 his justifications (discussed below) were insufficient labour rights protections (such as in Malaysia and Vietnam, and in Mexico, where he said a lack of unionization meant wages were artificially depressed, *e.g.*, as low as \$40 per week in the auto industry), the lack of binding, enforceable provisions on currency manipulation under the November 2015 *Joint Declaration*, and concern the ISDS mechanism might be used to weaken environmental regulations. *TPP* ROOs were his 4<sup>th</sup> rationale: those *TPP* ROOs were weaker than those in *NAFTA*. More non-*TPP* content could enter autos and auto parts made in the United States under *TPP* than non-*NAFTA* content could enter such goods under *NAFTA*. That would mean a continued, perhaps accelerated, decline in the Big 3 and its domestic suppliers. As he put it: “... *U.S. consumers could find themselves driving TPP cars or trucks with over half of their parts by value made in China or elsewhere and the vehicle itself assembled in Mexico. This model comes with job loss as standard equipment.*”<sup>84</sup>

## VI. LESSONS

This article argues ROOs are far more than neutral, value-free formulas to determine entitlement to DFQF treatment under an FTA. They are the

<sup>81</sup> See Rossella Brevetti, *Levin Calls for ITC Analysis on Trade Deals' Wage Impact*, International Trade Daily (BNA) (18 November 2015) (reporting the views of Kevin M. Dempsey, Senior Vice President of Public Policy and General Counsel, American Iron and Steel Institute).

<sup>82</sup> Len Bracken, *TPP's Path on Hill Emerges, but Timing Still Uncertain*, 33 International Trade Reporter (BNA) 203 (11 February 2016).

<sup>83</sup> See Sander Levin, *Why I Oppose TPP*, 18 February 2016, <https://medium.com/@rep-sandylevin/why-i-oppose-tpp-1810dec2a79d-.2ikf66o9r>; Len Bracken, *Key Democrat Opposes TPP Trade Agreement*, 33 International Trade Reporter (BNA) 277 (25 February 2016).

<sup>84</sup> Sander Levin, *Why I Oppose TPP*, 18 February 2016, <https://medium.com/@rep-sandylevin/why-i-oppose-tpp-1810dec2a79d-.2ikf66o9r> (emphasis original).

outcome of tortuous bargaining over competing political and economic interests in and within exporting and importing countries seeking to establish an FTA. Preferential ROOs in *TPP* exemplify this contention. In the T&A and automotive sectors, negotiators from the *TPP* Parties battled to gain comparative advantages, or prevent erosions of these advantages. They did so not only with respect to each other, and in response to competing domestic constituencies within them, but also with an eye to competition from China. Succinctly put, preferential ROOs are legal manifestations of broad, deep political and economic competition.

Were the Parties successful in advancing or preserving their domestic sectoral interests, and anticipating challenges from China? That question needs time for an answer. *TPP* must be approved and implemented, and only years thereafter will a partial picture emerge of the effects of its preferential ROOs on workers, firms, and communities in the T&A and automotive sectors across the *TPP* zone.

