# The TPP & the Border Economy

## Final TPP Text Reveals that TPP "Preference Erosion" Would Undercut the Benefits Mexico Enjoys Under NAFTA, Threatening Jobs in El Paso

The Trans-Pacific Partnership (TPP) poses a significant threat to the U.S.-Mexico border economy by creating new incentives to shift production of goods now made in Mexico to low cost competitors in the Asia-Pacific region.

Since before the TPP text's release, the Texas Fair Trade Coalition and others have warned that the TPP could pose unique threats to U.S. border communities' economies and jobs. Now that the final TPP text has been made public, some key previously-unknowable variables can be analyzed. Most importantly, this includes the TPP's final "rules of origin" for apparel products, electronics, automobiles and other goods that are important to Mexico's manufacturing economy. As described below with detail by manufacturing sector, the unfortunate reality is that the final TPP rules of origin are weak. Indeed, Democratic presidential frontrunner Hilary Clinton has named the TPP's lax rules of origin as an important basis for her opposition to the pact.

Rules of origin determine the level of content or the in-country value that goods must meet in order to obtain duty-free or other preferential access under a trade pact. Until the final TPP rules of origin were published, it was unclear the degree of displacement Mexican imports into the United States could face from the new duty-free U.S. market access that the TPP would grant to Asian countries that manufacture many of the same goods as Mexico. Because production of apparel in Vietnam, electronics in Malaysia and autos in Japan rely on significant shares of Chinese and other non-TPP-nation inputs, whether large volumes of these competing goods could *qualify* to obtain new duty-free access into the United States under TPP was unknowable.

The final TPP text makes clear that the TPP's lax rules of origin would greatly amplify the erosion of the preferences Mexican-made goods now enjoy under the North American Free Trade Agreement (NAFTA) with respect to duty-free entry into the U.S. market. Given the high level of integration between U.S. border communities' economies and that of Mexico, this could result in significant economic losses for U.S. border communities.

## NAFTA, U.S.-Mexico Economic Integration, and Border Communities' Economies

Many border cities, such as El Paso, suffered serious job loss after NAFTA took effect. According to the Trade Adjustment Assistance (TAA) program administered by the Department of Labor, more than 178,000 specific Texas jobs have been certified as lost to offshoring or imports since NAFTA. In Texas' 16th district, which includes the city of El Paso, more than 29,500 jobs have been certified as lost. And these TAA job loss numbers significantly undercount trade-related job loss given the limited scope of job categories the program covers and the fact that workers or firms had to be informed of the program and take the initiative to apply in order to even be considered.[1]

The El Paso area was especially hard hit. A trickle of apparel jobs relocating to Mexico before NAFTA turned into a gusher of offshoring once NAFTA guaranteed duty-free access into the U.S. market for

clothing made in Mexico at wages significantly lower than those paid to the many thousands of El Pasoans employed in apparel jobs.

Twenty years into NAFTA, U.S. and Mexican production has become deeply integrated, especially in sectors such as autos and apparel. As well, after NAFTA a significant share of U.S. production in the electronics sector shifted to Mexico. American retailers rely on just-in-time production in Mexico linked to distribution and transport hubs on the U.S. side of the border. This has occurred because NAFTA's terms ensured that firms shifting production to Mexico would enjoy lower-costs and permanent duty-free access to the U.S. market, as long as the goods they produced met NAFTA's rules of origin.

After many hard years, the economy of southern Texas transitioned from significant employment in manufacturing (for instance, El Paso renown as the "Blue Jeans Capitol of the USA") to the creation of new businesses and jobs that provide U.S.-Mexico supply chain support. These "NAFTA-support" business and jobs include customs, logistics, distribution, transportation, accounting and more.

**However, these Texas border-community "NAFTA-support" jobs would now face special peril if the TPP were to enter into force.** The combination of the TPP's provision of new duty-free access and weak rules of origin to qualify for such treatment would result in significant *preference erosion* that would undermine the impact of the benefits now provided to Mexico by NAFTA.

## TPP Would Erode Preferential U.S. Market Access Mexico Now Has with NAFTA

TPP countries, including Vietnam, Malaysia and Japan manufacture many of the same goods as Mexico. But currently, these Asian nations, none of which have free trade agreements (FTA) with the United States, face tariffs when selling their goods in the United States. These tariffs make their products less competitive relative to the same product coming from Mexico duty free under NAFTA.

While apparel from Mexico is duty free when sold in the United States and textile inputs made in Mexico sent to Central America to made into apparel are duty free under the Central America Free Trade Agreement (CAFTA), the same products coming from countries that do not have a U.S. FTA face tariffs set under the WTO's terms. In the case of apparel products, some significant U.S. tariffs remain. Mexico sends autos and light trucks to the United States duty free under NAFTA, while vehicles from non-FTA countries also face U.S. tariffs. Avoiding the U.S. tariff and using Mexico as an "export platform" to enjoy NAFTA duty-free U.S. access has been the incentive for Japanese and Korean automakers to build production capacity in Mexico. **By eliminating these existing tariffs, the TPP would create significant new incentives to shift production of goods intended for sale in the U.S. market away from Mexico and to TPP nations whose products would newly have duty-free access to the United States.**

Even before the final TPP rules of origin were published, economists had noted that preference erosion under the TPP could wreak havoc on the current U.S.-Mexico border economy.

> ... [T]he TPP is likely to … result in the loss of more than a million jobs in Mexico and the Caribbean … This is because under NAFTA and CAFTA [Central American Free Trade Agreement] textile producers in the Caribbean and Mexico who use U.S.-made fiber and yarn receive duty free access to the American market. The only manufacturing industries in the Caribbean are based on this deal, as is much of Mexico's manufacturing industry … A

> TPP will remove the tariffs on textile imports from much of Asia and take large chunks of the U.S. market away from Caribbean and Mexican producers and give it to Vietnamese producers that are heavily controlled and backed by their government, according to studies by the Mary O'Rourke Partners Group of economic analysts. (Clyde Prestowitz, *Foreign Policy,* February 13, 2013.)[2]

**The U.S. border businesses involved in the customs brokering, handling, distribution and delivery of Mexican-made goods would face losses if Mexico's share of the U.S. market is reduced by competing TPP imports from Asia that would newly obtain duty-free entry under the TPP.** Alternatively, Mexico could try to compete with the incredibly low wages and labor standards in Vietnam by lowering its domestic wages or labor standards. However, even if feasible, this would be a bad outcome for Mexican workers and would result in pressure for U.S. border firms also to cut costs, such as wages. This scenario could increase the profits of large retailers and multinational producers, but this would be to the detriment of the small and medium-sized firms operating NAFTA-support services on the U.S. side of the border and/or undermine Mexican and U.S. workers' wages.

Under either scenario — a declining share of U.S. trade or wage and cost-cutting to try to compete with the newly duty-free Asian competitors — the TPP could have significant adverse effects on the Mexican economy, worsening the economic and social challenges Mexico already faces. This threatens U.S. border communities that have staked their post-NAFTA employment on support of U.S.-Mexico trade.

Mexico already suffered a form of preference erosion and lost hundreds of thousands of jobs when China entered the World Trade Organization (WTO) in 2001. This allowed investors' certainty about duty-free access into the United States from China, incentivizing them to move production from Mexico to profit from China's lower wages. As well, retailers without their own production capacity gained more certainty about sourcing from China. Even though apparel, electronics and other goods from China faced higher tariffs than like Mexican goods when entering the U.S. market (because NAFTA provides duty-free access while good entering under WTO rules still face some tariffs according to the U.S. Most Favored Nation tariff schedule), production costs in China for many goods still were lower. This is due to both China's currency devaluations and the reality that wages in China are considerably lower. **In the last decade, as China's manufacturing wages have risen, Mexico's share of manufactured products imported into the United States has started to rise again.[3] But the TPP would jeopardize this recovery.**

## Rules of Origin

Mexico's preferential NAFTA access into the United States is conditioned on meeting NAFTA's rules of origin, which require that final products only obtain duty free access if they meet rules about the sourcing of inputs or the share of a final good's value that comes from Mexico or another NAFTA country. The *degree* to which goods that Mexican firms now sell here would be displaced by cheaper products from TPP countries relied on the TPP's rules of origin.

This is the case because production in nations such as Vietnam and Malaysia relies heavily on inputs from China and other non-TPP nations, including Thailand, Bangladesh and others. (Indeed, a significant share of Vietnam's textile and apparel industry is owned by Chinese firms.) That is to say that while the TPP, if it entered into force, would newly provide duty-free access into the United States from Vietnam and Malaysia, whether Mexico's share of U.S. imports would be decreased significantly

depends on whether the TPP's rules of origin are lax enough to allow U.S. entry of significant amounts of goods made in the Asian nations that have established supply chains with non-TPP nations.

As described below with detail by manufacturing sector, the unfortunate reality is that the final TPP rules of origin are weak. Theoretically, Mexico could try to complete by also increasing its share of low-cost inputs from non-TPP nations. (The TPP's terms will replace the NAFTA rules of origin for Mexican-made goods entering the United States to obtain duty-free status.) But as a practical matter, the economics and logistics do not work in Mexico's favor: Vietnam, Malaysia and Japan have better access to non-TPP inputs than Mexico has, given proximity (e.g. it's much cheaper and speedier for Japan to import auto parts from Thailand and for Vietnam to import fabric from China and Bangladesh than it is for Mexico to do so). As well, the Asian TPP countries already have established supply chain linkages. For instance, Vietnam's apparel industry already sources fabric from China, giving them a leg up over Mexico, which does not substantially source from China. Indeed, meeting NAFTA and CAFTA's stronger rules of origin was a significant incentive for development of textile production in Mexico.

As well, with respect to the auto sector, Japanese automakers producing *in Japan* already source parts from their established lost-cost production sites in Southeast Asia. But the Japanese automakers' significant assembly operations in Mexico were required to meet the NAFTA rules of origin in order for finished vehicles to enter the United States duty free. Were the TPP to go into effect, the NAFTA standard requiring 62.5 percent of a vehicle's value be sourced in a NAFTA nation would be replaced with the TPP's 45 percent rule of origin, which, as explained below, in practice is even weaker. Thus, even if the Japanese automakers decided to retain current production levels in their Mexican assembly plants for U.S.-destined vehicles, they could newly import cheaper inputs from Southeast Asia. The result would be damage to the massive auto parts sector in Mexico that was developed over the past twenty years in order to satisfy the NAFTA rule of origin. Currently, Mexico's auto parts production is the fifth largest in the world. The last available government data, for December 2012, showed that the sector employed 583,706 Mexican workers.

The Mexican government raised concerns with the United States about preference erosion in the TPP negotiations, siding with Canada in fierce battled against Japan with respect to the TPP's auto sector rules of origin. However, the dynamic in multi-country talks meant that the U.S. Trade Representative's (USTR) zeal to get Vietnam to agree to concessions that U.S. pharmaceutical, financial sector and other interests seek had to be "paid for" with concessions on Vietnam's "offensive" interest list — such as loosening the rules of origin for apparel. The tradeoff for the United States to get Japan to agree on agricultural tariff cuts was weaker rules of origin for vehicles. And for Mexico, the endgame choice was to accept the terms that the United States negotiated with the other TPP nations, or to decide to withdraw Mexico from the pact altogether — an option with unknowable repercussions economically and for Mexico's foreign policy.

If the TPP is not approved during the Obama administration, and the rules of origin are renegotiated as Secretary Clinton has suggested she would do, then Mexico would have a new choice: A TPP that does not threaten the manufacturing sectors that the nation developed under NAFTA. This would also be the best outcome for U.S. border communities. Whether or not one supported NAFTA, it is now in place and various industries have adjusted to it. There is no upside to Mexico or the U.S. border states if jobs in Mexico are lost because of competition with apparel or electronics products made with 65-cents-an-hour Vietnamese production assembling Chinese inputs or Japanese autos made in Japan having Thai and Chinese parts in addition to already enjoying the subsidy of a devalued yen.

**Textiles and Apparel:** The TPP would eliminate much of the advantage now enjoyed by Western Hemisphere apparel producers in the U.S. market. In addition to the loss of apparel production in Mexico, both the TPP's looser rules of origin and the loss of more U.S. apparel market share to the Asian TPP nations would cut the demand for textiles made in Mexico.

Mexican and Central American textile and apparel industry officials have expressed significant concerns about this TPP threat. "We are very worried, this country [Vietnam] is an evident risk to our country and enjoys big government subsidies," said Juan Alfonso Ayub, president of Canaintex, the main textiles trade lobby in Mexico in a May article *Mexican Textiles Industry Fears TPP Losses*. "Fifteen years ago, we were the number one or two supplier to the United States. Now we are the fifth or sixth."[4] In a recent article "Central America Tense over TPP-empowered Vietnam," Karin de Leon, executive director of the Central America — Dominican Republic Apparel and Textile Council noted: "Vietnam's government has a very aggressive strategy to grow their industry, build more plants, and duplicate production capacity in 5 to 10 years… more sourcing and investments are going to move there [Vietnam]."[5]

Currently, Mexico and the CAFTA countries can export apparel to the United States duty-free if the clothes are made with inputs from the United States, Canada, Mexico or the CAFTA countries. The basic rule of origin for NAFTA and CAFTA is called a "yarn forward" rule — everything from yarn onward has to be "in country" among the listed FTA partners to qualify for duty-free entry into the United States. In contrast, the apparel and footwear imports to the United States from Asian countries such as Vietnam and China — a current and a prospective TPP partner — face the WTO MFN tariffs coming into the United States, and some of the tariffs are substantial.

**EXHIBIT 1: Top Sourcing Countries in 2013 ranked by Production Cost Index**

| RANK | COUNTRIES 2013 | PCI 2013 USA |
|---|---|---|
| 1 | Bangladesh | 14 |
| 2 | Vietnam | 18 |
| 3 | Sri Lanka | 19 |
| 4 | Thailand | 21 |
| 5 | Pakistan | 21 |
| 6 | El Salvador | 24 |
| 7 | Philippines | 24 |
| 8 | Indonesia | 25 |
| 9 | Cambodia | 26 |
| 10 | India | 27 |
| 11 | Guatemala | 30 |
| 12 | Egypt | 30 |
| 13 | Nicaragua | 31 |
| 14 | Jordan | 32 |
| 15 | Honduras | 32 |
| 16 | Central & Southwest China | 37 |
| 17 | Northeast China | 44 |
| 18 | North China | 45 |
| 19 | Dominican Republic | 46 |
| 20 | South China | 49 |
| 21 | Mexico | 57 |
| 22 | Brazil | 60 |
| 23 | Peru | 61 |

To no small degree, those tariffs are why U.S. brands source in Mexico and the CAFTA nations even though it is more expensive to produce in Mexico and the CAFTA countries than Vietnam. Not only is Vietnam the second cheapest apparel production venue while Mexico is the 21st, Guatemala is the 11th, and Dominican Republic is the 19th, the TPP would actually lower Vietnam's production cost.

A quantitative analysis conducted by Dr. Sheng Lu, a professor at the University of Rhode Island's Department of Textiles, Fashion Merchandising and Design, shows that TPP would "considerably improve" Vietnam's price competitiveness in apparel production by removing tariff rates on textile imports from Japan that average 9.7 percent. Moreover, Japan's production of textiles matches very well with the textiles Vietnam needs for its apparel exports to the United States. Dr. Lu concludes that even a strict ROO for textiles and apparel might still lead to less U.S. market share for NAFTA and CAFTA countries.[6]

Already, even with the tariffs in place, Vietnam's apparel imports into the United States are growing significantly. The TPP would eliminate Mexico's and the CAFTA countries' tariff

"preferences" (i.e. duty-free entry). Without the duties, the "landed price" (total costs of a good, tariffs and shipping) of even more categories of apparel made in Vietnam would become cheaper than Mexican or CAFTA nation production, even if it must be shipped further. And Thailand, the Philippines and Indonesia (the fourth, seventh and eighth cheapest apparel production venues respectively) are among the nations lined up to "dock" onto the TPP.

A significant reason why the Asian nations' apparel is so cheap is because the producers located there import fabric from China, which has invested in high tech automated looms and development of artificial fiber materials, as well as manufacturing of finishings, such as zippers and the like. A significant share of Vietnamese production could not meet the NAFTA rules of origin and would thus be denied duty-free access.

However, the TPP's rules of origin are more lax than NAFTA's. Despite strenuous objections from Vietnam, the TPP does include the "yarn forward" rule. However, there are three major exceptions to the yarn forward standard that were negotiated between the United States and Vietnam. This is problematic for Mexico, because the exceptions were explicitly designed to maximize protection for current U.S. manufacturers and maximize U.S. market access for Vietnam. That means that the exceptions do not protect the categories of textile and apparel goods that may well have been made in the United States before NAFTA, but for which production has since shifted to Mexico.

The first exception that is important for Mexico and the CAFTA countries excludes certain products such, as bras, synthetic baby garments, and textile bags, from the yarn forward standard altogether. These goods obtain duty free access into the United States if they meet what is call a "cut and sew" rule, which allows TPP countries to use yarn or fabric from countries like China and Bangladesh as long as the product is cut and sewn within a TPP country.

The second exception, which also has significant implications for Mexico and the CAFTA countries, is the inclusion in the TPP of an extensive "Short Supply List." This is a list of 194 fibers, fabrics and other inputs that *the United States* does not now produce in significant quantity, but other TPP nations such as Mexico may. Apparel made from inputs on the short supply list would enter the United States duty-free even if the inputs come from China or some other countries outside of the TPP or NAFTA and CAFTA countries. This is especially problematic for Mexico because of Vietnam's proximity to China and the reality that much of Vietnam's apparel sector is Chinese owed and Vietnamese assembly it integrated with Chinese firms' input production in China. The U.S. short supply list reflects U.S. priorities, not those of other TPP's nations' producers. Finally the TPP includes a de minimis exception that allows textiles and apparel to enter the U.S. market duty-free as long as the total weight of all non-TPP-nation-originating materials is not more than 10 percent of the total weight of the good.

The TPP's exceptions to the "Yarn Forward" rule will allow Vietnam to take a bigger market share than it would otherwise, displacing Mexican and Central American goods in the U.S. market. Perhaps the most relevant signal that the TPP would result in major shift of apparel and textile production from Mexico and Central America to the Asia-Pacific region is the concern being expressed by the Mexican and Central American trade associations.

**Autos:** Before NAFTA, there were only a handful of carmakers producing in Mexico. Now nearly a dozen major automakers employ tens of thousands of Mexican workers in assembly plants. Japanese carmakers, Mazda, Honda, Nissan and Toyota, all have production facilities in Mexico. They comprise about one-third of Mexican auto production. Approximately 40 percent of autos sold in Mexico are

produced by these plants, which export to the United States duty-free. The Japanese automakers built their Mexican assembly plants to create a duty-free export platform into the United States under NAFTA. This allows them to avoid the 2.5 percent U.S. tariff on automobiles and most auto parts and tariffs of 25 percent on light trucks. (The 2.5 percent tariff may seem small, but according to the United Automobile Workers, for small to medium sized vehicles it averages to $625, which is essentially the entire profit margin for such a car.)

In addition, the Mexican auto parts industry is the fifth largest in the world, surpassing South Korea and just behind China, Japan, Germany and the United States. Last year, Mexico's auto parts production reached a historical high at $75 billion after experiencing growth of 88 percent just since 2009. The development of this massive Mexican auto supply sector, which includes more than 1,000 auto parts makers employing hundreds of thousands of additional Mexican workers, is also a direct result of NAFTA's rules of origin that the TPP would replace with more lax standards allowing duty-free access into the United States for cars containing a larger share of non-TPP country inputs.

Mexico produces a total of three million cars annually — placing it eighth among the world's car-making nations. It is fourth in car exports, behind Germany, South Korea and Japan. Two-thirds of Mexico's auto exports currently go to the U.S. market.

"The transformation of the auto industry in Mexico, as a result of NAFTA, was nothing short of dramatic. It was, in fact, the biggest transformation of any industry in all three of our countries," noted Gary Hufbauer of the Institute for International Economics in a National Public Radio interview at the time of NAFTA's 20th anniversary. The auto-sector investment boom in Mexico occurred because for global automakers seeking to sell cars in North America, NAFTA provided a duty-free export platform into the United States in a venue where manufacturing wages were per day per worker than many American auto workers made per hour.

**If the TPP were to go into effect, the elimination of tariffs on Japanese auto imports into the United States along with Japan's depreciated yen value would significantly increase the incentive for Japanese automakers to supply the U.S. market with autos made in Japan rather than in U.S. or Mexican plants.** The TPP would reduce the incentive for Japanese automakers to produce vehicles in Mexico -- *and especially in the United States* -- where costs are higher than Mexican production. (This would not be an immediate effect for passenger vehicle production, given the phase out of the U.S. passenger vehicle tariff is on the longest TPP phase-out schedule of 25 years. Rather, in the short term it would affect decision about investing in upgrades at existing facilities or new plants.)

**But an immediate shift in auto parts sourcing away from Mexican production would occur if the TPP went into effect because given the TPP's auto sector rules of origin, which would go into effect immediately, are much more lax than those of NAFTA.** Thus, if Japanese producers decide to stay in Mexico, the TPP's looser rules of origin would allow them to replace inputs now made in Mexico with parts sourced in ultra-low wage venues such as China, Thailand or Vietnam (using the same supply chains established for plants assembling cars in Japan) and newly obtain duty-free access to the United States.

In September 2015, Mexico's National Automotive Parts Association, and America's Motor & Equipment Manufacturers Association and the Canada's Automotive Parts Manufacturers' Association wrote a joint letter demanding that TPP content requirements be at least 50 percent for finished vehicles or the agreement might devastate the three million jobs in the motor vehicle component

industry.[7] Eduardo Solis, the president of Mexico's automakers association, AMIA, also stated that TPP needed to mandate that all automobiles, engines, and transmissions have at least 50 percent regional content: "A lower rule would allow more input from outside the region to be brought in.[8]"

While the NAFTA rules of origin required that 62.5 percent of a vehicle's value originate in one of the three NAFTA countries, the TPP lowers the rule of origin for automobiles to 45 percent under the Net Cost Method. Stunningly, the rule of origin for some auto parts is only 35 percent. And the standard for measuring inputs is so weak that a simple transformation from one tariff line to another satisfies the requirements for many auto parts. And, thanks to the TPP's inclusion of a "deemed originating" rule for some parts, if 35 percent of the value of a part comes from a TPP country, then in calculating the total value of an assembled vehicle the full cost of the part is counted as if 100 percent of it were made in a TPP country. As noted in the U.S. Labor Advisory Committee official TPP report: "The majority of the parts in an auto, by value, could come from a non-TPP country such as China and be eligible for preferred status under the TPP."

If this weakening of the rule of origin were not sufficient, unlike NAFTA, the TPP also provides a second method of calculating the regional content requirement called the "Build Down Method." This is a methodology used by Japan and Korea in their free trade agreements. Under the Build Down Method, the content requirement is based on the transaction value of the good rather than the net cost. Since the transactional value is always higher than the net cost of a good, this method requires the content of a product to be between 45 to 55 percent to meet the rules of origin. Although one cannot predict which method - Net Cost or Build Down - auto manufactures would opt to use, Japan led the effort to include the alternative valuation method, which in Japan's view would give their automakers additional flexibility in souring non-TPP materials for their finished products.

The TPP also does not include "tracing," which is found in NAFTA. According to Customs and Border Protection, tracing is useful in ensuring that content requirements are calculated honestly.

> "Tracing ensures greater accuracy in calculating the regional value content by tracking the value of major automotive components and subassemblies imported into the NAFTA region, so that the non-originating value of these components and subassemblies is reflected in the regional value-content calculation of the motor vehicle or in auto parts destined for original equipment use. This significantly limits the phenomenon known as "roll-up" and "roll-down," whereby the full value of goods is counted as originating or non-originating content even though they may contain a mix of originating and non-originating materials."[9]

With these weak rules of origin, Japanese plants in Mexico — as well as U.S. automakers operating there - could also begin to source such lower-cost inputs. While the considerations noted above with respect to proximity and established supply chains would be a factor, Mexico's wages would still be significantly cheaper than Japan's and shipping costs would be less and that could provide incentives to maintain assembly jobs in Mexico. (We could not find any studies that compared the cost benefits of closer proximity to the U.S. market for shipping finished autos from Mexico relative to the higher costs of shipping inputs to Mexican facilities from Asian parts suppliers.) However, even assuming that reconfiguring supply chains made sense, it could spell the doom of Mexico's burgeoning auto parts sector.

The TPP's auto sector terms are also relevant to the future of the San Antonio Toyota plant and other Japanese "transplant" production facilities in the United States. Some Texas members of Congress hope that somehow the TPP would benefit this plant. However, in fact the TPP would create incentives

for lower volumes of production there. Japanese automakers located production facilities in the United States and Mexico, in part, to avoid U.S. tariffs. But the TPP will eventually eliminate the U.S. tariffs, although with a long phase out. Arguably, the plants could operate more cheaply under the TPP rules of origin, as lower-cost Chinese, Thai and other Asian-made inputs could be used. Whether this would create incentives to continue investment in U.S. assembly plants by Japanese automakers is unclear. But such a shift would spell significant losses for the large Mexican auto parts sector.

Finally, the controversial issue of currency devaluation is highly relevant to the TPP's implications for where auto and auto part production will be located. The Japanese yen has depreciated against the dollar by 50 percent since 2012. This represents a 50 percent discount for goods exported from Japan to the United States and a 50 percent penalty for goods exported from the United States to Japan. This is why the Obama administration faced considerable pressure from Congress and various U.S. industries to include enforceable provisions in the TPP to discipline currency manipulation.

Despite this, the TPP does not include such provisions. A "Declaration" on currency announced at the time of the TPP text release simply restates the existing International Monetary Fund (and for some G-20) obligations not to devalue currencies for trade competition reasons that they already have and regularly ignore. The Declaration is not enforceable. It is not connected to the TPP. It's only new feature is that, with respect to non G-20 nations, such as Vietnam and Malaysia, governments are supposed to more regularly release data on currency interventions and other relevant information.

As Ziad Ojakli, VP of government and community relations for Ford, noted: "This summer, U.S. lawmakers took unprecedented action to set a clear negotiating objective for addressing currency manipulation in all future trade deals. The TPP fails to meet that test."[10]

**In sum, the final TPP text has negative implications for Mexico's auto sector on two levels: new competition in the U.S. market for cars produced in Japan and low-cost competition for the large auto parts/supplier industry that has grown in Mexico since NAFTA. As well the TPP would create incentives to shift production away from Japanese firms' "transplant" assembly in the United States.**

**Electronics:** Similar shifts in production away from Mexico would occur with respect to Malaysian competition with Mexico's electronics production sector. Mexico's second most important goods export to the United States after automotive products is computer and electronic products. Malaysia is a leading global exporter of a number of products in that category. For example, Malaysia accounts for 7.2 percent of the world's exports of integrated circuits and electronic components, while Mexico accounts for just 0.5 percent, according to the WTO.

Mexico currently is by far the leading exporter of electrical machinery and equipment to the U.S. market among the TPP countries. Electrical machinery produced in Mexico currently reaches the U.S. duty-free under NAFTA. For the same goods produced in countries like Malaysia, the United States charges an applied tariff rate as high as 15 percent.

In 2015, Vietnam and Malaysia had major increases in their exports of these products to the United States. Given this was a spike in U.S. imports from these nations, rather than continuation of a trend, one explanation is that U.S. firms have begun shifting their supply chains in anticipation of new duty free access from these nations to the U.S. market once the TPP enters force.

Moreover, the USTR asserts that the TPP "includes more detailed provisions than any previous U.S. FTA Trade Agreement (FTA) for importers to make claims for preferential tariff treatment." This starts with the flexible rules of origin that multinational corporations now have at their disposal. Under the TPP, firms would be able to employ a variety of different rules to calculate the necessary regional value content requirement including the focused value method, build-down method, or the build-up method. The regional content requirement for many consumer products including electrical machinery and equipment can be as low as 30 percent under the build-up method which is based on the value of originating materials. This means that only a third of a product must be originating to enter the United States duty free.[11]

We have not done a line-by-line tariff analysis comparing WTO MFN tariff rates charged for Malaysian electronics goods versus the current NAFTA duty-free status for such goods originating from Mexico. However, to the extent that there are products produced in Mexico for U.S. sale that compete with Malaysian products now charged tariffs at the WTO MFN level, granting duty-free treatment to computer/electronic products from such a major exporter of those products would threaten Mexican production. It is also worth noting that Malaysia has been cited for using forced labor in its electronics production sector.[12]

## ENDNOTES

[1] TPP job loss numbers significantly undercount trade-related job loss as TAA only covers a subset of jobs lost to trade. See http://www.citizen.org/taadatabase for more information on the scope of the TAA program, which has changed over time. For instance, until 2011 the program did not cover *any* service-sector, agricultural or fisheries jobs. Prior to 2002, only actual manufacturing jobs were counted in the tally of industrial jobs loss. Thus, for instance, if an auto assembly factory employing 4,000 workers was closed and production of the vehicle was moved to Mexico, TAA did not list 4,000 job losses. Those who did office and accounting, engineering, maintenance and retooling, shipping and distribution and custodial jobs at the closed facility were not counted. Further, to even be considered for the program, workers or a union or a company had to take the initiative to apply.

[2] Clyde Prestowitz, "Obama administration at odds with itself on trade policy," Foreign Policy, Feb. 13, 2013 Available at http://foreignpolicy.com/2013/02/13/obama-administration-at-odds-with-itself-on-trade-policy/.

[3] See e.g. Herman Kamil and Jeremy Zook, *"The Comeback", Finance & Development,* International Monetary Fund, Mar. 2013. Available at www.imf.org/external/pubs/ft/fandd/2013/03/pdf/kamil.pdf.

[4] Magic Online, "Mexican Textiles Industry Fears TPP Losses," May 3, 2016. Available at: http://www.magiconline.com/news/mexican-textiles-industry-fears-tpp-losses.

[5] Just-Style, "Central America Tense over TPP-empowered Vietnam," May 3, 2016. Available at: http://www.just-style.com/analysis/central-america-tense-over-tpp-empowered-vietnam_id127211.aspx.

[6] Sheng Lu, "Impact of the Trans-Pacific Partnership on China's Textiles and Apparel Exports: A Quantitative Analysis," June 3. Available at http://www.tandfonline.com/doi/abs/10.1080/08853908.2014.933686.

[7] APMA, Letter to Ambassador Froman, May 3, 2016. Available at: http://www.mema.org/Document-Vault/MEMA-Industry-News/NAFTA-TPP-ltr-090915.pdf.

[8] "Mexico carmakers seek 50 percent regional content in trade deal," Reuters, Aug. 17, 2015. Available at htttp://www.reuters.com/article/trade-tpp-mexico-idUSL1N10Q03L20150817

[9] U.S. Customs and Border Protection, "Automotive Products," May 3, 2016. Available at: http://www.cbp.gov/trade/nafta/guide-customs-procedures/provisions-specific-sectors/automotive-products.

[10] Todd Spangler, "Ford, others say trade deal lacks currency protections," Detroit Free Press. Oct. *5, 2015.* Available at http://www.freep.com/story/news/2015/10/05/ford-others-say-trade-deal-lacks-currency-protections/73372996/

[11] Under NAFTA, many electronic products had to have a regional value content of 50 percent under the net cost method. There is not a perfect way to compare the net cost method to the build-up method, but the TPP provides multinational corporations an unprecedented variety of ways to achieve content requirements under the TPP.

[12] See e.g. Verité, "Forced Labor in the Production of Electronic Goods in Malaysia: A Comprehensive Study of Scope and Characteristics", Sept. 2014. Available at http://www.verite.org/sites/default/files/images/VeriteForcedLaborMalaysianElectronics_2014_0.pdf