Automotive Sector

Trade

Future Perspectives
Introduction

This article is one of a series that provides Mayer Brown’s perspective on legal issues that might be faced by the automotive sector in the future, particularly in relation to the development of electric and autonomous vehicles. Each article addresses a single legal subject, such as trade, health and safety, antitrust, or IP. The articles assume some familiarity with the automotive sector, and identify business issues that follow from the legal developments.
Future challenge

Electric and autonomous vehicles have the common element of containing large amounts of innovative technology. Battery technology, sensing devices and increasingly powerful onboard computers are some examples. To date, the technology and related elements are specific to a particular vehicle, without regard to other vehicles. As the “internet of things” begins to apply to vehicles it will increasingly become preferable and, perhaps in time, necessary that vehicles communicate with each other. The extent to which such developments will have an impact on and be affected by trade policy and law is important because of the size of the industry and the trade aspects of the industry. Two poles of vehicle manufacturing, the European Union (EU) and the United States demonstrate the point. The EU/US trade in automotive vehicles represents 10% of all trade between the two regions. The automotive sector directly employs 2.2 million people in the EU. In 2012 a total of 9,541 patents were filed with the European Patent Office by the automotive sector, more than any other sector.

This article addresses the potential for issues arising from the innovation developments and identifies possible ways forward.
“Good old” tariffs

Tariffs are not irrelevant in the context of electric and autonomous vehicles. For example, in the EU and U.S. relationship, the standard tariff for importing cars to the United States is 2.5 percent of their value. For pickup trucks and commercial vans, the tariff is 25 percent. Currently, electric cars are noticeably more expensive than their combustion engine equivalents, at least for cars in the main commercial market, so even though tariff levels on cars are relatively low, the existence of any tariff means the price difference is further increased. Inevitably this has a dampening effect on trade relating to electric vehicles.

NTBs, TBTs and new technologies

Although trade is to an extent impeded due to customs duties between the EU and the United States, what is estimated to cause significant impediment to trade is the regulatory difference. It is estimated these non-tariff barriers to trade (NTBs) are equivalent to an ad valorem tariff of 26 percent. It is further estimated that the elimination of the existing tariffs and elimination of just one quarter of existing EU and U.S. NTBs would increase EU exports of vehicles and parts to the United States by 149 percent, while U.S. to EU exports would increase by 347 percent.

Most of the NTBs that are impeding trade between those regions and between the rest of the world’s vehicle producing nations are regulations concerning the vehicle, referred to as technical barriers to trade (TBTs). For example, there are separate regulations concerning child restraint systems. A vehicle satisfying a U.S. regulation does not necessarily satisfy the EU equivalent, and vice versa. The result is that manufacturers spend significant time and money seeking to produce cars that meet all the regulations. The Ford Fusion/Mondeo was intended to be a world car suitable for all geographic markets, but even with this deliberate goal the Fusion’s global parts commonality is only 80 percent (although this is notably higher than the industry norm). This is why in practice OEMs produce different versions of models for different markets.

The trade problems created by these TBTs have endured for many years. The 1958 U.N. Agreement concerning the Adoption of Uniform Technical Prescriptions and Reciprocal Recognition has helped to create a set of regulations intended to be globally recognised. The United States is not a contracting party, which is a material detraction from realizing the benefits of that multilateral agreement.
Trade restrictions

A few of the issues that will give rise to trade restrictions or already do are listed below by way of illustration.

(i) Autonomous vehicles

A fundamental issue has arisen in relation to autonomous vehicles because Article 8 of the Vienna Convention on Road Traffic 1968, to which 72 countries are party, provides that every vehicle “shall have a driver” and “every driver shall at all times be able to control his vehicle.” The United States is not a party to that Convention but is party to the Geneva Convention on Road Traffic 1946 that has very similar provisions. A concern has been raised that pursuant to these treaties autonomous vehicles are not allowed on our roads. Without entering into the debate of whether or not this concern is valid, it is a commonly expressed concern and the existence of the concern will itself impede trade. After all, no producer will seek to export cars to a country that does not allow the exporter’s vehicles to be used on the roads by consumers. By the same commercial reasoning, no intermediate customer (importer) will demand a product from an OEM for which end consumer demand would be zero due to domestic regulatory issues.

(ii) Lithium batteries for electric vehicles

The United Nations Recommendations on the Transport of Dangerous Goods, ICAO’s Technical Instructions, IATA’s Dangerous Goods Regulations and the IMO’s International Maritime Dangerous Goods Code designate batteries, and in particular lithium batteries, as dangerous goods. Accordingly, they must be handled, packaged, labelled and transported as provided for in these provisions which add costs and might impede trade. Addressing these legal requirements has to date been a niche subject in the automotive sector, but if electric vehicles become as common in the marketplace as many predict (for example, one estimate identifies 100 million electric vehicles on the roads of the EU by 2030) then the physical transportation and so trade in batteries will face significant cost and related issues.
(iii) Recycling

Another trade issue concerns recycling. The value of the component products available for recycling in electric and autonomous vehicles, such as the rare earth metals within the electronic components, is likely to be higher than for combustion engine cars. This is particularly the case in relation to batteries given the concern over rare earth metals. A material quantity of rare earth metals is required to build the batteries (several kilos of these rare earth metals are in each battery), such as neodymium or lanthanum (lanthanum in the United States). These metals are not particularly rare, but in many countries their extraction is very costly and, as a result, there are few sources currently active. This issue drives the need for a generalization and improvement of recycling not only for environmental reasons but also for economic ones. This situation is even more challenging since, for most of these metals, the majority of the world’s known reserves are in China (for lanthanum for example, China is the only country able to achieve economies of scale in its extraction), and China has restricted the exportation of its rare earth metals. Trade issues have arisen as a result, with a WTO procedure against China being pursued by the United States, the EU and Japan.

Trade in waste might be expected to be subject to the usual policy and laws for the trade in goods. As an EU example shows this might not always be the case. Under its key legislative instrument on the subject the EU should be self-sufficient in waste disposal (Article 5 of Directive 2006/12). This is reinforced by the requirement in related legislation that consent to import or export a particular shipment of waste may be objected to if “the planned shipment or disposal would not be in accordance with measures taken to implement the principles of proximity, priority for recovery and self-sufficiency at Community and national levels.”

Recycling of cars has already raised trade issues, notably and when Russia introduced a recycling fee on 1 September 2012, levied on cars, trucks, buses and other motor vehicles. A WTO procedure against Russia has been pursued by the EU and Japan.
The best way forward is international harmonization before disputes arise. Thus, for example, within the framework of the WTO, there is an initiative recently announced (24 January 2014) between the EU, United States and a dozen other countries to eliminate tariffs on “green” goods. This follows an earlier initiative by a group of Asian-Pacific countries, identifying a list of “green” goods to be treated favorably in terms of tariffs. Electric vehicles are not on the list but there is a form of catalytic converter. Perhaps electric vehicles will be a candidate for the list.

International dispute resolution under the auspices of the WTO may contribute to setting the framework and contribute to harmonization and the dismantling of restrictions. Dispute resolution under Bilateral Investment Agreements may also provide an avenue. One example of a relevant WTO dispute settlement is that in relation to China’s restriction on the exportation of its rare earth metals, as mentioned, WTO litigation has arisen. On March 26, 2014, a WTO panel held that China’s export duties and quotas on rare earths, tungsten and molybdenum are incompatible with China’s WTO obligations. China had argued that the export restrictions are necessary for the conservation of its natural resources and to reduce pollution caused by mining. While the WTO rules include exceptions that allow Members to establish trade-restrictive measures for a legitimate purpose (e.g., the protection of human, animal or plant life or health), such measures must be applied in a non-discriminatory manner and be the “least trade-restrictive” measure available to achieve the measure’s stated goal. In its report, the WTO panel rejected China’s argument that these measures are justified under any of the recognized exceptions to the WTO rules. The panel noted that China’s WTO Accession Protocol requires China to eliminate all export duties. Additionally, the panel observed that, rather than working to reduce extraction, China’s export quotas encourage domestic extraction of these raw materials and secure preferential use of these resources by Chinese manufacturers. Finally, the panel found that China failed to explain how its restrictions on the right of enterprises to export these materials are justified under any exception to China’s Accession Protocol.

This Panel decision has already been appealed. The time that it will take for the appeal and possible negotiations afterwards, as well as the fact that the manufacturing of the mined material into a consumable product is also largely based in China means that, for the foreseeable future, customers around the world will largely be dependent on China for rare earths.

The Russian recycling fee identified above is also in the early stages of WTO dispute settlement. According to the EU, the Russian Federation imposes a discriminatory recycling fee that applies to end-of-life vehicles imported into the EU but not on the end-of-life Russian vehicles, while the scheme of a recycling fee for new vehicles is argued to impose higher cost burdens on imported vehicles vis-à-vis Russian vehicles (vehicles imported from Belarus and Kazakhstan are exempted from the fee). The EU and then Japan in July 2013 requested within the WTO procedures formal consultation with Russia. On 1 January 2014 Russia enacted an amendment to the relevant law and it is now for the EU and Japan to reassess whether to continue or reformulate claims vis-à-vis the Russian recycling fee scheme.
FTAs and TTIP

The EU/South Korea Free Trade Agreement, which entered into force in July 2011, addressed the TBTs problem, with South Korea largely agreeing to harmonize with or adopt the regulations promulgated under the 1958 Agreement. Under that FTA, South Korea and the EU will accept products incorporating new technologies on its market unless they are proven to create a significant risk to health, safety or the environment (Annex 2-C, Article 6). We suggest this provision might not be sufficient to prevent concerns being expressed and therefore, potentially, trade being impeded in relation to the new technologies of electric and autonomous vehicles. Too much revenue and strategic positioning may be at stake. Moreover, other policy priorities and law will be relevant and might constrain the openness expressed in this provision. For example, under the EU Treaty, “Environmental protection requirements must be integrated into the definition and implementation of the Union policies and activities” (Article 11), and “The Commission, in its proposals concerning health, safety, environmental protection and consumer protection, will take as a base a high level of protection” (Article 114). These provisions suggest, for example, that in light of the EU’s precautionary principle, before the EU could accept autonomous vehicles on its roads (from whatever country of origin) the technology would have to be proven to be safe. That burden of proof is arguably opposite to the burden of proof indicated in the EU/South Korea FTA. Therefore, the EU cannot comply simultaneously with its obligations under the EU Treaty and the EU/South Korea FTA, raising a conflict of norms question under international law. Without suggesting in which direction such conflict would be resolved, resolution would likely be necessary through the appropriate procedures under the EU/South Korea FTA and if not thus resolved then ultimately the WTO procedure would be pursued.

The issues caused by TBTs are also being addressed elsewhere. In the context of the EU/U.S. Transatlantic Trade and Investment Partnership (TTIP), the commonly advocated position is to work in the context of the existing structures of a UN body, in particular the World Forum for Harmonization of Vehicle Regulations, which is a specific and long standing working party of the UN, commonly referred to as WP 29. The regulations promulgated under the 1958 Agreement are part of WP 29’s mandate, and the intention is for those regulations to be continuously adapted to the evolution of scientific knowledge and technological progress.

While existing regulations will have some relevance, we suggest that mostly the new technologies will be candidates for new regulations. In terms of developments on this issue, the TTIP proposal is significant. Among other objectives, the TTIP seeks to reduce or eliminate NTBs between the two regions. For the automotive sector, the commonly advocated objective in relation to TBTs relating to new regulations is to implement a joint US-EU auto regulatory harmonization process that promotes and facilitates the development and adoption of common future new regulations. As the EU/U.S. automotive industries together represent just over one third of world production and sales, if the TTIP produces a result relevant to the new technologies of electric and autonomous vehicles, this is likely to have a significant influence on this subject for the automotive sector in the rest of the world. As two leading trade bodies state in a presentation to the U.S. government on TTIP, “This approach will strengthen the U.S. and EU roles as worldwide auto standards setters, providing momentum for global auto regulatory convergence.”
Many of the elements raised in this article seem to come together with the trade issue of rules of origin. For example, for the EU/South Korea FTA identified above, in order to benefit from the preferential treatment under the FTA (that is, duty-free), a car will be originating in South Korea if at least 55% of value added is achieved in South Korea.\footnote{The increasing technological component of cars, which are high value added items (the car battery is a leading example), might have an effect on origination, or at least the result of applying current origination rules. For example, many OEMs will not have the relevant technology in-house and so for the most sophisticated technology the OEMs will need to acquire the relevant products from third parties. This seems to disadvantage OEMs from emerging countries such as India. It might also through serendipity benefit those OEMs located in the countries that are leading the innovation. For example, Google’s work on autonomous vehicles might result in relevant technology being manufactured in the United States, thus boosting U.S. origination for U.S. produced cars.}

If the innovative, technology-heavy components of vehicles in the future do affect the ability of exporters to satisfy the rule of origin that exists in hard-fought FTAs, then countries might use TBTs to rebalance the trade situation, even though that would be against the trend of closer harmonization on regulatory matters. Tariffs might be used, but while these might over time encourage local production, by raising the price of an input this would make satisfying the rule of origin more difficult.
Summary

Technical innovation in the automotive sector is an important aspect of its future development. Trade policy and law (in particular TBTs) will be influenced by and have an influence on this development. However, the quantum of the effect will likely be difficult to measure because determination is complicated by bilateral deals that are entered into with give and take in different areas. For example, a member of the U.S. Congress House Ways and Means Committee, which has jurisdiction in the United States over trade policies, when speaking in July 2013 about the challenges and opportunities of international trade, stated, “the elimination of the US tariff should be tied to the opening of the Japanese auto market, not to whatever the tariff phase-out schedule may be for rice in Japan or shrimp in Brunei. We should eliminate the tariff sooner if Japan opens; we should eliminate the tariff later if Japan remains closed. Some have suggested this is “managed trade”—it is not; it is an antidote to address generations of managed trade.” This is a suggestion for a change from the old ways of dealing with trade. A suggestion also, perhaps, that those international trade agreements are lagging behind the ever-increasing globalization of the automotive sector. The traditional rules of origin might be outdated in light of the innovation in this sector. Whether TTIP can address this concern remains to be seen. With new entities such as Google active in the automotive sector, perhaps new ways of thinking are required to meet the new ways of doing business.
References


2. The United States is a contracting party to the 1998 Agreement on UN Global Technical Regulations, which is related to the 1958 Agreement.


5. For the joint statement by the countries see: http://trade.ec.europa.eu/doclib/docs/2014/january/tradoc_152095.pdf


7. For list see: http://www.apec.org/Meeting-Papers/Leaders-Declarations/2012/2012_aelm/2012_aelm_annexC.aspx

8. The Treaty on the Functioning of the European Union, commonly referred to as the Lisbon Treaty.

9. See, for example, the joint approach adopted by the American Automotive Policy Council (AAPC) and the European Automobile Manufacturer’s Association (ACEA) at: https://www.uschamber.com/sites/default/files/legacy/grc/AAPC-ACEA%20Joint%20Presentation%20at%20Regulatory%20Cooperation%20Forum%20April%202013%20FINAL%20PDF.pdf

10. Ibid.

11. The rule of origin for cars is “manufacture in which the value of all the non-originating materials used does not exceed 45% of the ex-works price of the car.” This means that if you deduct the value of non-originating parts from the ex-works price, at least 55% value added must be left; this 55% does not only contain the value of the originating parts used but also the cost of manufacturing, overheads and even profit. Thus the 55% value added may be easier to reach than might at first appear to be the case. Moreover, the EU made a unique concession in the EU/South Korea FTA in terms of allowing the use of Chinese origin components in South Korea for which no customs duties need to be paid in order for the Korean cars meeting the origin rules to be allowed preferential tariff treatment at importation in the EU.

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