

NAFTA: Essential for Our Auto Industry

- The auto industry has one of the most highly integrated supply chains in North America: three-quarters of US-made auto parts exports are sent to its NAFTA partners, with one-third going to Mexico.
- The industry is outperforming: NAFTA auto exports have gained global market share and the US auto industry now garners a record slice of overall US manufacturing activity.
- In Canada, auto industry output is advancing nearly four times faster than the overall growth rate of manufacturing as a whole.
- Roughly 75% of the value of all auto parts used in North American-built vehicles is sourced within NAFTA, well above the 62.5% threshold required for finished automobiles to move duty-free between NAFTA countries.
- Auto sector employment has outpaced overall job creation across North America and any disruption of the free flow of vehicles and parts would hurt growth and employment.

NAFTA A WIN-WIN-WIN FOR THE AUTO SECTOR

Although the general consensus is that the Mexican auto industry has been the clear winner since the inception of NAFTA in 1994, the agreement has also played a critical role in the outperformance of the US and Canada auto sectors over the last two decades. Auto production in Mexico has more than tripled since the mid-1990s and exports of vehicles and parts have surged tenfold such that Mexico now accounts for 6.5% of global auto trade. However, both the United States' and Canadian auto industries have also benefitted substantially from the agreement. Below we highlight how the entire North American auto industry has changed and become stronger under NAFTA, enabling it to gain production and market shares both at home and abroad.

NORTH AMERICAN AUTO INDUSTRY OUTPERFORMS WITH NAFTA

NAFTA has enabled the North American auto industry to become one of the most competitive in the world, allowing it to boost productivity and gain global market share. For example, auto industry exports from NAFTA to the rest of the world have advanced by an average of 3.5% per annum over the past decade, more than half a percentage point faster than the average increase in the global auto industry's exports. North America now accounts for roughly 22% of global auto industry exports, up from less than 19% a decade ago (chart 1). While Mexico has led these export gains, the United States is also outpacing the growth in global export volumes. During the past decade, auto industry exports from the United States have increased by an average of 3.1% annually, and now garner 9.5% of the global total, a percentage point higher than their share a decade ago.

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Chart 1

NAFTA Gains Export Market Share

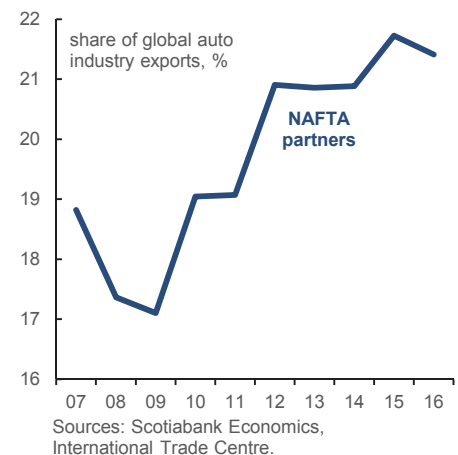
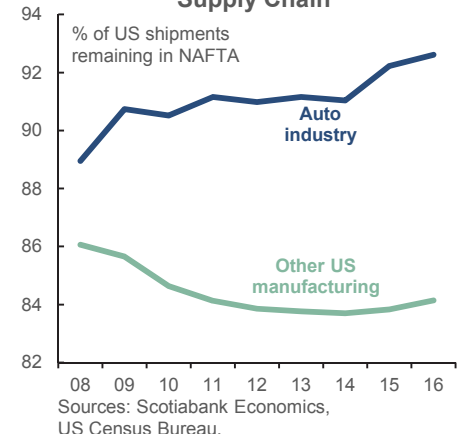


Chart 2

Integrated Auto Industry Supply Chain



US AND CANADIAN AUTO INDUSTRIES POWER AHEAD

The North American auto industry has boosted its competitiveness by increasing its integration across the three NAFTA countries and it is now one of the most highly connected manufacturing sectors in the world. More than 92% of all auto industry shipments from the United States remain in the NAFTA area, with this integration continuing to strengthen (chart 2). This is nearly 10 percentage points higher than other manufacturing sectors. Auto parts and components produced in any one North American country cross NAFTA borders as many as eight times before being installed in a final assembled product.

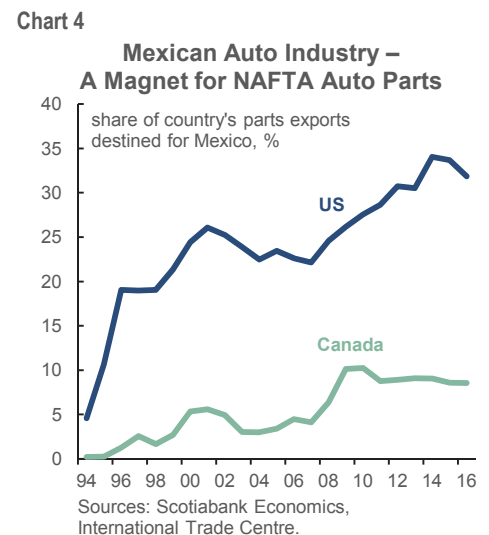
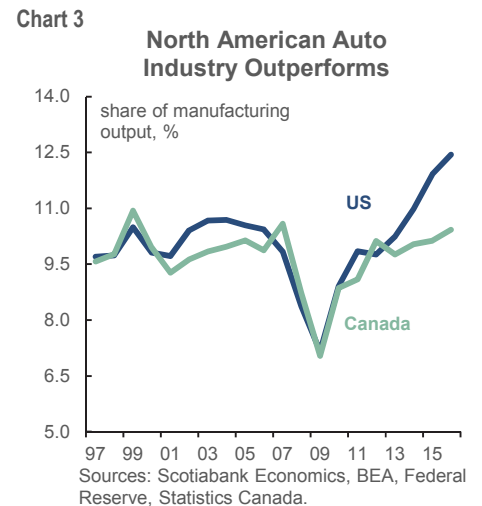
NAFTA has enabled the US auto industry to outperform other industrial sectors, increasing its share of overall US manufacturing activity to record highs. Output gains for the US auto industry have accelerated to an average of nearly 2.5% annually since the introduction of NAFTA, roughly half a percentage point quicker than in the preceding two decades, and almost a full percentage point faster than overall US manufacturing growth. As a result, the auto sector now accounts for a record 12.4% of total US manufacturing activity, up from less than an estimated 10% share prior to the introduction of NAFTA (chart 3).

A similar trend is also evident in Canada, with auto industry output expanding nearly 4% per annum over the past five years, three percentage points faster than overall manufacturing. Motor vehicles and parts now account for 10.5% of total Canadian manufacturing activity, the highest level in a decade and up 50% from the low set during the global economic downturn of 2008–09. This outperformance is being driven by auto parts, whose production has been expanding by an average in excess of 5% per annum during the present economic rebound, the best performance since the start of the millennium (chart 3).

NAFTA SUPPORTS NORTH AMERICAN COMPETITIVENESS

More than 75% of the value of all motor vehicle parts used in the region are sourced within NAFTA—a much higher level than the current NAFTA requirements for duty-free movement throughout the trade area (i.e., 62.5% for vehicles and 60% for parts). In fact, the North American auto industry’s supply chain network has maintained a relatively stable sourcing pattern, despite the emergence of Asia—especially China—as a large global auto parts exporter. For example, Asian auto parts exports destined to North America have increased at an average annual rate of 6% per annum over the past decade, a percentage point lower than the growth rate in auto parts exports from Asia to the rest of the world. Auto parts shipments from Asia have made fewer inroads in North America than into the European Union—a region perceived by many as the leader in engineering innovation and technological efficiency.

There is no need to tighten further NAFTA’s rules of origin for the auto sector. The North American auto industry already meets and exceeds the minimum rules of origin thresholds set for it under the agreement. By some estimates, there is, however, a chance that a reassessment of the typical values attributed to different automobile components in order to reflect the increasing presence of high technology in cars and trucks could lead to a downward revision of the 75% locally-sourced figure cited above. The use of electronics in North American-built vehicles grew by an annual average of about 12% from 2010 to 2016 and over 40% of these products are imported from outside the NAFTA area. Import growth of these products is advancing at an even faster pace, in large part because few local suppliers exist or, where they do, their assembly plants are located overseas. Tightening NAFTA’s rules of origin on automobiles, either by raising the NAFTA-wide threshold or by introducing a US-specific content requirement, wouldn’t bring the production of these components back



onshore. Instead, such actions would likely reduce the competitiveness of North American auto production, push more production to Mexico rather than into the US, and nudge auto producers to conduct some of their intra-North American trade under most-favoured-nation (MFN) tariffs rather than bothering to qualify for duty-free access under NAFTA—thereby raising their costs further.

US SUPPLIES THE MEXICAN AUTO INDUSTRY

The US auto industry is the major supplier of auto parts to both of its NAFTA partners and has been a major beneficiary of the rapid expansion of assembly plants in Mexico. More than three-quarters of all auto parts exported from the United States are sent to either Canada or Mexico. In particular, Mexico is now the destination for more than one-third of overall auto parts exports from the United States, up from less than 5% when NAFTA took effect in 1994 (chart 4). Overall US auto industry shipments to Mexico have increased by 7% per annum during the past 23 years, nearly double the export growth to the rest of the world. Export growth to Mexico has picked up even more quickly from Canada, though Mexico's share of overall Canadian auto parts shipments remains in the single-digits.

Given the rapid growth in US auto parts exports to assembly plants in Mexico, the United States accounts for 60% of all foreign auto parts shipments to assembly plants in Mexico. This means that each vehicle built in Mexico contains more than USD 5,000 of US-made parts, roughly 40% of overall vehicle content. The US-content is much higher in Canadian-built vehicles, averaging nearly USD 9,500 per model.

NAFTA MEANS AUTO JOBS

The highly integrated North American auto supply chain has enabled US auto industry employment to increase by nearly 6% per annum during the current economic expansion, more than five times the growth in overall manufacturing employment and triple the pace of total employment gains in the United States. This means that any disruption to the integrated supply chain that has been achieved under NAFTA could challenge the outperformance of the North American auto industry, including potential job losses for some of the nearly 2 million auto industry positions in the United States, Canada and Mexico.

While the pace of job creation has been somewhat slower in the Canadian auto industry, it has run ahead of Canadian manufacturing employment growth and overall job creation. Job growth in the auto sector has averaged nearly 3% per annum since 2010, and is now approaching the level of employment that prevailed in 2008. This represents a much better performance than Canadian manufacturing employment, which is only now starting to report year-over-year job gains for the first time since 2012, and is 2½ times faster than overall economy-wide job growth.

THE FUTURE OF AUTOS IS IN NAFTA

NAFTA remains critical to the future of auto manufacturing in North America. The sector provides one of the best examples of the various ways in which greater economic integration under NAFTA has allowed the continent's manufacturers, particularly those in the US, to maintain their global competitiveness. Efforts to modernize NAFTA should ensure that the agreement remains flexible enough for the North American auto sector to maintain its outperformance of recent years.

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