

Intelligence MEMOS



From: Dennis DesRosiers
To: Canadian Trade Policy Makers
Date: January 26, 2017
Re: **TRUMP, TRADE AND THE AUTOMOTIVE INDUSTRY, PART II**

In order to understand the impact of a Trump policy and the broad policy direction discussed in Part I of my memo series, one has to understand that the North American automotive sector is highly integrated at all levels. This started in 1965 with the Canada-U.S. Automotive Products Trade Agreement (The AutoPact), was enhanced in 1989 with The Canada-U.S. Free Trade Agreement (The FTA) and was further enhanced with NAFTA starting in 1994. A typical vehicle is made up of thousands of components that can cross these borders 6 to 8 times before a finished vehicle is shipped from a factory in any of the three countries. It would be impossible to unbundle this integration. Get rid of NAFTA and there would be chaos in the sector. Remember that NAFTA provides not only duty free treatment for automotive products but relatively paper work free treatment. These trade agreements have provided one of the most efficient industries in the world and are one of the reasons why vehicle prices adjusted for content have witnessed little to no inflation for the last two decades.

Trump says he would renegotiate NAFTA and replace it with terms more favourable to the U.S. From a pure automotive perspective, I'm not sure what would be more favourable terms. High U.S. content rules? Maybe, but it would take years for component companies to build the capacity to add U.S. content and why would Canada or Mexico agree to this?

It is possible from a Canadian perspective that we would just revert back to the FTA. It was effective while it lasted and there was little if any negative for both the U.S. and Canada when it replaced the Autopact. There would still be negatives for Mexico that would also affect Canada but at least there would be an agreement covering Canada and US automotive trade.

If Trump also got rid of The FTA (which he has not threatened to do) as well as NAFTA then Canada would have a real serious problem but so would the U.S. The inefficiencies that would emerge from eliminating the integration of the sector would significantly increase the price of vehicles, especially small entry level vehicles, and will almost certainly push the North American automotive sector into a serious cyclical downturn. This would be similar to what occurred during the 2008/2009 financial crisis, when thousands of automotive jobs were lost across North America.

Economists in the U.S. are already publishing studies on the degree of job losses in the automotive sector under this scenario and they are in the tens of thousands. In Part III of this memo series, I will discuss possible scenarios involving protectionist measures directed specifically against Mexico, but also a plausible, more positive scenario that could limit the damage.

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