## 1. BACKGROUND

During the past decade, the Mexican automotive industry has undergone a major transformation, driven by an integration with the American market. The new competitive needs of the American market originated the creation of new plants on Mexican territory with an organizational and technological design linked to such conditions. Thus, since the early 80's, a new exporting specialization emerged in the local car assembly plants and in a great number of auto parts firms. Manufacturing and complex assembly plants coexist now in this new exporting system.

From 1962 to 1977, the Mexican government advocated a policy of import substitution. The 1962 decree mandated to prohibit the import of engines in order to encourage local manufacture of mechanical components and auto assembly operations. It also sought to increase value added in motor vehicles to 60%. The 1972 decree mandated that 40% of foreign exchange earning should be used to buy Mexican auto parts, goods and services. After 1977, the policy focus gradually shifted towards rationalizing the industry and encouraging export-led growth. The 1977 decree imposed trade balancing requirements and strict restrictions on foreign investment not designed to promote exports. These measures brough about investments in engine manufacturing plants, primarily for export, by the large car manufacturers.

In response to this regulatory framework, the strategies of Mexico's automotive firms were traditionally in conflict with governmental policies. The companies operated trying to obtain maximum benefits from the protected market and thereby hindering import substitution policies. On the other hand, the government had to protect the local market, it being the axis of the country's industrial growth and employment, but at the same time encouraging exports.

The conflict between the companies and the authorities' guidelines was mostly to be seen when, between the late 70's and early 80's, the oil boom generated a great demand which exceeded the possibilities of the existing short-range production structure, giving way to rising imports. This led to a dangerous situation in 1981 and 1982, when the automobile sector accounted for 43% and 53% respectively of the country's trade deficit. Between 1978 and 1981, imports of auto parts jumped from $516 million (1) to $2.4 billion, and in this process, the import substitution strategy was buried with the lack of a clear exporting orientation. In time, a liberal model was implemented and the relationship between the agents in the industry underwent a significant modification. In the 80's there was an inflection point, and in the 90's, a significant autonomy for the companies is expected.

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1. Note: All values in this report, unless otherwise stated ($ Mexican pesos, Cdn $, etc.), are quoted in United States dollar equivalents.