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**CANADA-UNITED STATES TRADE INITIATIVE:
RESEARCH PAPERS**

**THE AUTOMOTIVE AGREEMENT IN
A CANADA-UNITED STATES
COMPREHENSIVE TRADE
ARRANGEMENT**

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THE AUTOMOTIVE AGREEMENT IN A CANADA-UNITED STATES COMPREHENSIVE TRADE ARRANGEMENT

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EXECUTIVE SUMMARY

The Government of Canada has decided to enter into discussions with the United States regarding the possibility of establishing a comprehensive bilateral trade arrangement. The question has arisen as to whether the Automotive Agreement should be folded into a comprehensive arrangement with the United States or whether a separate regime for automobiles should be maintained. This paper examines the options relative to the future of the Automotive Agreement, likely United States attitudes and international implications as well as current international trade and industrial developments in the automobile industry.

Our analysis and conclusions were developed following discussions in the United States with senior officials of the Office of the United States Trade Representative, the Department of Commerce, the International Trade Commission, the Motor Vehicle Manufacturers Association, the motor vehicle companies, the union (UAW) and the National Planning Association (USA).

In Canada discussions were held with the major motor vehicle companies, the Motor Vehicle Manufacturers Association, the Automotive Parts Manufacturers Association, the union (UAW) as well as other knowledgeable persons.

The world automotive scene has changed dramatically since the signing of the Canada-United States Automotive Products Trade Agreement (Automotive Agreement) in 1965. Then the world market was dominated by the North American industry. In the 1970's it became a much more competitively balanced world

industry. In the 1980's Japan has gained a significant competitive advantage among world producers particularly over the North American industry. As the tariffs and other trade barriers governing trade in automobiles and automotive products were liberalized in the 1970's it meant easier access to the major automotive consumer markets, rapidly increasing international automotive trade resulting in a major shift in the equilibrium of world automotive production.

The greatest threat to the viability of the North American automotive industry, as we know it, is the efficiency and competitiveness of its Japanese counterpart. By 1990 Japanese assembly capacity either in Canada or the United States plus imports are expected to be in excess of forty per cent of North American market demand for automobiles. Only moderately increased demand is forecast during this period. If these trends continue and the projections are realized the North American automotive industry will have considerable excess capacity and an urgent need to rationalize existing production facilities. There will be a net decline in production and employment in Canada and in the United States. Where the jobs go or stay is the paramount issue for governments and workers.

Our conclusions are as follows:

1. The issues relating to the Automotive Agreement in the context of a comprehensive trade arrangement with the United States must be measured against concerns about the viability of the automobile industry in Canada and in the United States.

2. The automobile industries on both sides of the border are preoccupied in meeting the competitive challenge of the Japanese industry in the North American market. Substantial structural changes in the production techniques employed by the North American automobile companies will occur as they adjust to new competition which will determine production, location of vehicle assembly and parts plants and employment levels.
3. The North American automobile companies will experience a declining share of the automobile market in both countries which will bring further pressure on decisions relating to the shared production objectives of the Automotive Agreement.
4. The United States, at least publicly, views the initial agenda for any comprehensive trade discussions as Canada's to put forward. If the Automotive Agreement is not included in the agenda this will be a Canadian decision. United States officials say they are unlikely to raise the Agreement unless there are political or industry pressures to do so. That such pressures may arise cannot and should not be dismissed.
5. The key questions which must be assessed relate to the potential costs, benefits and risks posed by adopting one position or another with respect to automotive trade.

6. What is to be gained by including it, if this meant re-opening the terms?
The U.S. has long felt that the safeguards have outlived the transitional period and should be eliminated. It is clear that the Canadian automotive industry and the union favour excluding the Automotive Agreement from any comprehensive trade discussions because of the prospect of withdrawal of the safeguards which they consider essential to the maintenance of production and employment in Canada.

7. The risk of trying to keep the Automotive Agreement outside of any comprehensive discussions is the continuing prospect of a shift in United States commercial policy, the possibility of unexpected trade barriers against cross-border shipments, the re-emergence of U.S. concerns about the safeguards and the trade imbalance due to automotive trade or abrogation on one year's notice.

8. What is to be gained from rolling the Automotive Agreement into the bilateral agreement? Will it really safeguard our access to the U.S. market any better than the status quo? Past experience with United States attitudes should warn us that there are real risks that United States interests will try to eliminate the safeguards if the issue is re-opened. The wisdom and prudence of inviting such demands should be weighed very carefully.

9. Is it necessary to include auto trade to meet the trade coverage envisaged in GATT Article XXIV:5? It is not clear that this is necessary. Must the trade between Canada and the United States be free on a statutory or de facto basis? Surely we could argue that de facto free trade over a period of twenty years is free trade. This issue should be analyzed very carefully. We have not attempted to do it in this paper.

10. If Canada included the automotive sector in a comprehensive bilateral agreement we would almost certainly have to reduce our tariffs on a preferential basis for the United States. If we did not meet the criteria of GATT Article XXV, Canada would have to seek a waiver under GATT Article XXIV to extend these preferences. Our present system does not require a waiver. The United States has had a GATT waiver since 1965. A GATT waiver requires approval by two-thirds of the Contracting Parties. It is considered highly unlikely that Canada would obtain approval of a waiver.

11. Even if Article XXIV criteria were met, other Contracting Parties might consider that moving from a remission based system to preferential duty free access would have the effect of raising a duty inconsistently with Article II (even though the remissions are not bound) they might then pursue their perceived right to seek concessions to restore the balance under Articles XXIV and XXVIII, and possibly XXIII.

12. Also for consideration is whether the U.S. would be prepared to condone the various remission orders now in place for a number of third country producers who may obtain duty-free entry of automobiles in return for purchasing Canadian made automotive parts. United States officials consider that these arrangements are little more than subsidies to Canadian automotive parts producers. These programs which have been important to the parts industry could get caught up in "levelling the playing field."

13. Unless there is some real possibility, significantly to improve on the status quo, and there does not appear to be, the bilateral and multilateral risks of re-opening the Automotive Agreement in a bilateral context, would appear to outweigh the potential benefits by a wide margin.

THE DEVELOPMENT OF THE INDUSTRY

The 1950s and 1960s were periods of continued growth in world-wide demand for automobiles. Rising real incomes and the emergence of substantial consumer demand in Europe and later in Japan contributed to the growth of the automobile industry in these countries. Because of higher gasoline prices and lower per capita income, demand in Europe and Japan was met by more fuel efficient and lower-cost automobiles than those produced in North America. America was not much taken with these small cars, despite the popularity of the VW "Beetle" and their love affair with big cars became stronger than ever, urged on by cheap energy and rising incomes. The automobile industry in each of these major market areas operated almost entirely within their respective boundaries for assembly. The sourcing of components was largely restricted as well. Indeed the North American economies grew less by innovation during these years than by expanding basis scales of production to reduce unit costs. There were relatively few breakthroughs in new products or processes and very little real competition. But the market in North America was generally very bouyant. This was particularly true in automobile production and demand which permitted the North American industry to preserve its position as the world's leading automobile producer. It was against this positive market trend that the Automotive Agreement was negotiated.

Although Canadian demand for automobiles grew throughout the period leading up to the Automotive Agreement, automotive production in Canada was

declining. This was due in large part to the situation created by demand for a proliferation of models, the resultant short runs and higher unit production costs, a rising tide of imports, reduced economic growth, all in a period of rising unemployment. Faced with this proliferation of problems, the Federal Government, in August 1960, appointed Dean Bladen as a one-man Royal Commission to undertake an intensive study of Canada's troubled automotive industry.

In his report¹ Dean Bladen found that the Canadian industry's basic problems resulted from low volume production of a substantial number of different models at a time when the economies of scale were steadily increasing for most major automotive components. The technology of the industry at that time called for a greater degree of specialization which required expensive, dedicated equipment. Dean Bladen concluded that if the Canadian automotive industry was to become more competitive it had to have access to larger markets to take advantage of optimum scales of production. This could only be achieved if there was some form of integration between the Canadian and the United States automotive industries which could lead to a rationalization of the industry with considerable benefit to Canadian production and employment as well as to consumers. His report proposed a plan to enable automobile manufacturers to import any vehicle

1 Report of the Royal Commission on the Automotive Industry, April 1961.

and all parts they required free of duty if they met certain Canadian content provisions calculated as a proportion of the total cost of sales by the manufacturer of vehicles sold in Canada whether there were produced in Canada or imported.

In 1962 and 1963 the government introduced remission programs designed to create an incentive for Canadian motor vehicle manufacturers to export components as a means of increasing output and employment and of providing an opportunity for Canadian producers to gain access to larger markets which in turn would enable them to lower their production costs. The success of the second plan in increasing exports of parts to the United States resulted in a petition under United States trade laws claiming that Canadian exports were benefitting from a "bounty or grant" and that a countervailing duty should be imposed. The subsequent investigation was never concluded as both the Canadian and United States governments were concerned about the possibility that an adverse ruling might seriously damage bilateral trade relations. The desire on both sides to resolve this trade dispute provided the incentive to develop a mutually agreeable arrangement covering automotive trade between the two countries.

During the period of rapid growth in world demand, barriers to automotive trade among the major producing countries were progressively dismantled. By 1973 when the "OPEC Shock" brought the trade spiral to a halt the U.S. automotive tariff had been reduced to 3 per cent, the EC external tariff to 10.9 per cent and the Canadian tariff to 15 per cent. In the Tokyo Round further reductions were

negotiated in the U.S. automobile tariff to 2.5 per cent by 1987. And the Canadian automotive tariff will be 9.2 per cent in 1987. The tariff reduction process was not viewed as threatening to any national automotive industry because the types of vehicles demanded in North America, Japan and in Europe varied markedly. Although international trade in automobiles had been substantial and was growing, most imports were in marginal market segments where domestic producers chose not to compete. Industry leaders generally considered that competition within the major automotive producing countries was reasonably balanced and that more open trade would not lead to a dramatic relocation of automotive production.

During the 1970s, the post-war economic growth slowed markedly. Worldwide automobile demand levelled off in response to broader economic problems, many of them related to energy supplies and pricing. This new situation, a worldwide slowdown of economic activity, raised additional problems for the automotive industry and for prospects for employment from automotive production. Over one million workers were employed in the United States and approximately 125,000 in Canada at the peak of automotive production in North America in 1978. By 1981 the number of directly employed autoworkers had declined to 788,000 in the United States and to 107,000 in Canada. These figures do not include the tens of thousands of workers in related industries whose employment was no doubt affected by the downturn in demand.

TABLE NO. 1
EMPLOYMENT IN THE AUTOMOTIVE INDUSTRY
1978 - 1984

<u>Year</u>	<u>Assemblers</u>	<u>Automotive Parts Manufacturers*</u>
1978	65,900	59,000
1979	67,400	56,400
1980	56,800	47,300
1981	55,500	51,900
1982	51,400	47,500
1983	55,900	59,700
1984	62,000	61,800

*Includes Accessories

Source - Statistics Canada

Since 1982 production and employment in the automotive industry has improved. In the United States employment in 1984 was 896,000 some 11 per cent below the 1978 peak employment year while in Canada employment was 123,800 workers some 1000 workers below the 1978 level. The consensus among industry analysts is that employment may peak in 1985 as the North American producers attempt to regain their competitiveness and the growing impact of the Japanese and other offshore suppliers. Employment reductions are expected to continue as the new automated flexible manufacturing systems now being introduced in the automotive industry start to impact on productivity. Initiatives by Japanese automobile manufacturers to establish production facilities in North America

could also accelerate employment reductions at existing plants, particularly if their operations are simply assembly of largely imported components which more than replace their direct imports. This is a major concern, particularly to the parts industry, but no less serious to workers in assembly plants that may be closed.

To improve their competitiveness, many world automobile producers are purchasing imported components for use in the final assembly of automobiles. This procedure is used most extensively by North American automobile manufacturers. Import sourcing is being used to reduce production costs, increase quality, reduce lead times for major components and to ensure more reliable service. The U.S. International Trade Commission estimated that in 1983 the major North American automobile producers together imported over 2 million engines and 1.5 million transmissions and transaxles as well as substantial quantities of components such as wiring-harnesses, radios and stampings which only five years ago were produced in North America.² According to the Department of Regional Industrial Expansion the percentage on a value basis of foreign content sourced by the major North American producers for incorporation in automobile assembly will increase from 6 per cent in 1985 to 16 per cent by 1990.

² The Internationalization of the Automobile Industry and Its Effects on the U.S. Automobile Industry, USITC Publication 1712, June 1985, p. 5.

The North American automobile producers, by making structural changes to their assembly operations and sourcing more components offshore, have lowered their breakeven points and are once again in a strong profit position. In both 1983 and 1984 the companies earned record profits. The 1984 industry profit was around \$10 billion, 40 per cent more than the \$6.2 billion earned in 1983. The U.S. Department of Commerce believes that current cash flows should enable the industry to finance capital expenditures, debt repayments and dividends without substantial borrowing.³

³ U.S. Department of Commerce unpublished paper.

INTERNATIONALIZATION OF PRODUCT

Perceptions of the automobile industry have changed dramatically. During the 1970's it was commonly held that energy conservation and environmental concerns would make the small or light automobile the standard-size automobile in all world markets. This downsizing and standardization was to evolve what has been called the "world car". It was assumed that competition would be based on price and that high manufacturing volume would be the key to low cost. This would result in a reduction in the number of automobile companies in the Western World as highly competitive producers raced to keep ahead in economies of scale. Further many observers predicted that manufacturing would shift to developing countries from the developed countries to take advantage of lower wages to reduce manufacturing costs.

Probably the most significant factor influencing future world automotive production concepts is the new automated and robotized production machinery. Already it is lowering the minimum efficient annual production scale for individual product lines in the industry. Increased use of flexible, automated equipment in the assembly of automobiles will permit a wide range of products to be assembled on the same line. This will mean that a plant can be highly efficient if a cumulative volume of approximately 250,000 units annually is spread over several models. Previously this volume was considered to be near optimum for the production of one model. Because of the high capital cost of product design and production, equipment volumes of a half million units per

year may have to be maintained for certain power-train components such as engines and transmissions. Producers are likely to enter into joint ventures for the production of these components in order to spread costs. A range of less capital-intensive parts will be economically produced in a single plant using flexible techniques.

No longer do North American industry executives insist that production costs will only be reduced by increasing optimum scales of production through adoption of more automated equipment. Today there is broad industry consensus that production scale requirements are no longer the driving force for industry concentration that they were in the past.

The new or evolving role for the automobile assemblers is forecast to be as coordinators of the production system. There is a trend towards outside purchasing of more of the major components and sub-assemblies, reducing the extent of vertical integration. At the same time, automobile companies are working more closely with component suppliers to ensure that problems of financing, design, quality and cost are resolved cooperatively. This new approach derives many of its features from the Japanese model. There will be smaller number of suppliers for each final assembler, specific parts will be obtained from single sources, longer-term association with suppliers will be developed and efforts to bring much of the production operation as close as possible to the point of final assembly to reduce inventory and other supply problems will accelerate.

An emerging trend is to have dedicated suppliers, linked to the final assemblers although not necessarily integrated with the final assembler, supplying minor and finished parts at the point of final assembly. Senior industry executives interviewed in connection with this study predict that the development of this process is likely to take place in the medium term. Some consider that the industry may merge the system described above with the traditional North American production system because some companies may be reluctant or unwilling to abandon the more efficient manufacturing plants within the existing production system.

While no apparent locational pattern is evident as yet some recent decisions may provide an indication of the future direction of the North American industry. In addition to developing external sources for internationally competitive components, subcompact automobiles and advanced small automobile technology, the three major U.S. automakers have announced internal programs for the production of new subcompact models. These manufacturing projects are designed to revise product development practices, change component materials used and improve assembly and manufacturing procedures. General Motors has announced that its Saturn Project will be located in Tennessee. This is relatively close to the new Nissan assembly plant. Both assemblers will be able to source from parts producers locating in the area. The Chrysler Corporation's Liberty Project will use component systems or a number of component modules similar to the assembly line practice used in Japan. Ford's Alpha Project is designed to study all facets of the company's production system to create a cost competitive small automobile probably using a number of imported components.

Another factor influencing future production concepts is that the automobile markets in Europe, Japan and North America are continuing to demand a very different automobile mix. The effect of the energy shocks have been largely overcome through more fuel efficient automobiles. Consumer interest in new product concepts is strong. These factors raise questions about the level of automotive production that may be maintained in Canada in the longer term. Only the GM Oshawa complex with its two automobile plants and one truck assembly plant and in-house and independent locally positioned parts suppliers appears to have the core features of the new flexible production system being developed. Neither Ford or Chrysler have as established or positioned production facilities in Canada. According to industry analysts each company has facilities in Canada which could be integrated into a flexible production system should such production centers be located in the United States within a distance that meets the delivery requirements of this assembly technique.

COMPETITION IN THE NORTH AMERICAN MARKET

Since 1979 the types of automobiles demanded in the major world markets have converged dramatically. This is particularly true in North America where the market had so long been dominated by the large automobile. Now most manufacturers in the world are a potential threat to every other manufacturer in what is rapidly becoming a largely integrated world market. Intensifying this competitive environment and accelerating change has been a softening of demand and surplus capacity in many markets. The Japanese automobile industry has been the least affected. It has been able to produce high quality automobiles at substantially lower cost than its competitors and has experienced a dramatic export surge particularly to the North American market.

There have also been major changes in automobile buying habits in the United States and Canada. Japan has become a major automobile producing country competing directly with the North American industry. Consumers are purchasing imports from Japan in record numbers. In many cases, the Japanese cars have a perceived quality advantage over North American vehicles. In 1984 almost 2 million automobiles of Japanese origin were sold in the United States and approximately 172,000 in Canada.

The key competitive strength of the North American industry is and will continue to be the very large class of automobiles that are uniquely North American. There are indications that the Japanese will move up their challenge

into the medium size class in part as a result of the voluntary export restraints which have limited Japan's access to the United States and Canada.

A series of voluntary export restraint arrangements (VERS) since 1981 have offered a degree of protection to the North American Automotive Industry. These restraints provided a period of time to the North American industry for retooling and restructuring production to bring out smaller and more fuel efficient automobiles which were more competitive with Japanese automobiles. Since 1979 the North American automobile industry has invested more than \$30 billion in new plant and equipment. This investment and the restrictions against import Japanese cars enabled the industry to generate record profits which has made it possible for the automobile companies to undertake the present investment program.

This new and more efficient production capability is not likely to overcome the intense competition which the North American automobile producers are going to face in the small and mid-size segments of the market in North America for the remainder of this decade. The Japanese are now positioned in the market to offer strong competition in the mid-size automobile market as well as having captured almost all of the small automobile market. The North American producers appear to have recognized their vulnerability in the small automobile market. Most of their recent investment has been directed to the production of mid-size automobiles.

There are also much more rigorous restrictions on Japan's auto trade with Europe. While these are not the subject of this paper they do create a spill-over effect on the relatively much more open North American markets because the Europeans are not taking their fair share. Rodney Grey has argued that the Japanese export controls to Europe discriminate against North America and are inconsistent with Japan's MFN obligations under GATT. It is our view that the unequal treatment of North America and Europe by Japan in automotive export policies exacerbates the problems of North American producers.

The North American automobile market is probably the most mature and volatile in the world. It is the easiest market for foreign producers to enter because of the organization of the retail distribution system. In Europe and Japan retailers are either owned by the automobile manufacturers or have exclusive agreements which require that a dealer may only sell a particular manufacturer's automobiles or lose its franchise. In the United States the validity of exclusive franchise arrangements have been struck down by the courts. In Canada, automobile dealerships appear to operate in a similar manner. Foreign producers can and do find well established dealers who wish to expand their business beyond their existing lines. Off-shore manufacturers therefore enjoy a cost advantage in becoming established in Canada and the United States, often through distribution systems that have been developed by local producers.

There are also differences between North American and Japanese production organization, systems, in supplier relations, financial resources and labour

relations. All of these differences pose particular problems for North American producers because long lead time is required to adjust their large organizations. Very extensive adjustments designed to improve production organizations are underway in Canada and the United States. According to the industry, a full reworking of the production system will take at least ten years. In the meantime, for quite different political and economic reasons, the Japanese are establishing production facilities in the United States and to a much lesser extent in Canada.

Among analysts there is the view that the recovery of the North American industry over the past three years may have peaked and that current levels of production and employment may never again be achieved. The industry's profile is changing rapidly with an ever increasing foreign presence. New production is flowing out of Honda in Ohio which will reach 300,000 units annually by 1988; Nissan in Tennessee with annual production capacity of 115,000 automobiles and a similar number of trucks; Mazda in Michigan with planned annual automobile production by 1988 of 240,000 units; Mitsubishi in a joint venture with Chrysler planned for somewhere in the midwest with annual automobile capacity of 200,000 units; and Toyota in joint venture with General Motors at Fremont, California to produce a subcompact automobile with 250,000 annual unit volume by 1988. In addition Toyota recently announced that it will start building mid-size automobiles in the United States by 1988 in annual volumes of 200,000 units at a location to be announced. In the meantime it will have 50,000 Toyota automobiles built in the Fremont plant to be marketed in North America under

the Toyota name. Toyota has also announced that it will begin assembling automobiles in Canada at an annual volume of 50,000 units. Thus by 1988 Japanese companies will be producing some 1.5 million units in North America either in joint ventures or in their own plants. Hyundai has announced that it will establish a plant in Canada to assemble 100,000 automobiles annually.

Also of significance to the activity of off-shore producers in North America are the investments by United States vehicle manufacturers in foreign firms. Nearly all United States manufacturers own a substantial share of one or more automobile companies in Pacific Rim Countries. General Motors has a strong interest in Isuzu and Susuki as well as the joint California venture with Toyota. In addition, General Motors owns a fifty per cent interest in Daewoo Motors in South Korea. Ford owns a twenty-five per cent interest in Mazda Japan and has a considerable interest in Hyundai in South Korea. Ford owns seventy per cent of Ford Lio Ho Motor Company Limited of Taiwan. Mazda announced recently that it will design a small car for Kia Motors of Korea and Ford (U.S.) would take charge of marketing particularly to the United States.⁴ Chrysler will have a 24 per cent interest in Mitsubishi by 1986. As further evidence of the internationalization of the industry American Motors Corporation is 46 per cent owned by Régie Nationale des Usines Renault of France. All four United States companies, as well, have interests in automobile or truck producing companies in other parts of the world.

⁴ Business Korea, August 1985, Vol. 3 No.2, p.55

NORTH AMERICAN-JAPANESE PRODUCTION COSTS

The international competitiveness of North American producers vis-a-vis their Japanese counterparts and other off-shore suppliers remains the most critical issue. Unless North American producers overcome the present cost disadvantage they will suffer further erosion of their market share and manufacturing base. But assessing comparative costs is a complex task made more difficult by problems of product comparability, degrees of capacity utilization, exchange rate fluctuations and the lack of adequate detailed information. According to many automobile analysts, the Japanese enjoy a landed cost advantage of approximately \$1,500 to \$2,000 per automobile when compared to a North American built automobiles.

Despite major gains in productivity, large fixed cost reductions and more efficient controls over variable costs in recent years North American automobile producers will continue to face a substantial Japanese cost advantage of the above magnitude in the production of small cars. This will limit the ability of North American producers to generate increased small car sales through major price reductions. A recent study⁵ suggests that the differential may have widened rather than narrowed as the Japanese have also been improving their production efficiency. The Japanese production cost advantage has been an

⁵ Joint United States - Japan Automobile Study. University of Michigan, Ann Arbor, Michigan, February 1984 p. 151-52.

important factor in causing North American producers to obtain significant numbers of small cars from off-shore sources while they attempt to develop new approaches to lowering the cost of producing small cars in North America. This situation may be further aggravated by the entry of newly industrialized countries such as Korea and Taiwan in automobile production.

Both the automobile producers and the UAW consider that an important factor favouring the Japanese is improperly aligned currencies (the yen is too weak and the dollar is too strong). While the yen has strengthened in recent weeks, it is not clear how far the realignment may go or how much it may help. Industry representatives consider that the basic structure of the North American industry is a more important factor in creating cost differences.

The "voluntary" restraint arrangements which limit imports of Japanese automobiles and pressures in the Congress to limit trade with Japan have been viewed by Japanese producers as risks, making their access to the North American market less than certain. The establishment of the Japanese assembly plants in North America is a response to restraints on exports and according to analysts will not substantially alter Japan's cost advantage. Initially over 50 per cent of the value added components will be imported from Japan. In recent remarks in Toronto⁷ Ambassador Kiyooki Kikuchi of Japan is reported to have

⁷ Toyota's Auto Pact Role Questioned, The Globe and Mail October 29, 1985 Section B.

said that neither Toyota or Honda would be able to obtain enough parts in Canada to meet the minimum content requirements of the Automotive Agreement. "Toyota and Honda won't be part of the auto pact. They would like to be but they can't". The Japanese Ambassador also indicated that Canada might see more automotive investment but not because of any restrictions on imports from Japan. Japanese automobile assemblers "are investing in all foreign markets because there is no room to expand in the mature Japanese market". There also would be little incentive for Japanese companies to meet the conditions of the Automotive Agreement because to export automobiles to the United States market will mean overcoming a U.S. tariff of only 2.5 per cent by 1987. These moves into the Canadian and United States market should be viewed as the next step in increasing the Japanese industry's earnings and will in turn increase Canada and United States automotive trade deficits with Japan.

Japanese producers have obtained concessions from the UAW which will add to their cost advantage. Also because the Japanese in North America have recruited production workers in their early twenties they will delay for many years payment of pensions to retired workers. According to industry executives and analysts, current pension payments by the established North American producers to retired workers adds about seven hundred dollars to the average cost of an automobile.

PRODUCTION AND TRADE

In 1984 over 30 million automobiles were produced in the world, a one per cent increase over the 29.7 million produced in 1983. Truck and bus production in 1984 was almost 11.5 million units up 15 per cent from the approximately 10 million units produced in 1983. Production of automobiles in Canada and the United States in 1984 was nearly 8.8 million units the highest since 1979 and a 13 per cent increase over the 1983 output. Passenger automobiles assembled in the United States accounted for 88 per cent of the total production in North America and in Canada automaking surpassed the one million mark for the first time since 1978.

There was also sizeable growth in truck and bus production on both sides of the border. In the United States 3.1 million trucks and buses were made in 1984 for a 27 per cent gain over 1983 and the best production year since 1978. Truck and bus production in Canada was up with 262,192 more units manufactured than in 1983 for a total of over 800,000 units — the best year ever. Combining all motor vehicle production — automobiles, trucks and buses — showed that the United States and Canada built nearly 12.7 million vehicles during 1984 up 18 per cent over 1983. This was a dramatic turn around from the recession year 1982 when 8.2 million units were produced.

In 1984 the combined Canada/United States percentage share of world production was 30.5 per cent up from 27 per cent in 1983. Japan's percentage

share of world production in 1984 was 27.5 per cent down from 27.9 per cent in 1983. Japan, though hampered by voluntary restraints on exports of its automobiles to Canada, the United States and other countries remained the world's leading exporter of motor vehicles during 1983. The Japanese exported 3.8 million cars and nearly 1.9 million trucks for a total of 5.7 million vehicles, more than twice its nearest export competitor. In 1984 United States imports of Japanese automobiles represented 2.7 million units or 18.3 per cent of market demand while Japanese exports of automobiles into Canada were 138,677 units or 17.6 per cent of Canadian demand in that year. Projections are that 1985 market demand in both countries will increase modestly while Japanese imports will capture 22 per cent of the United States market and 18 per cent of the Canadian market. Automobile demand in the North American market is expected to grow at less than 2 per cent annually over the next five years.

PROSPECTS FOR THE NORTH AMERICAN INDUSTRY

Producers in all producing countries face many challenges in the years ahead. None more than the North American industry. While progress is being made and North American producers have succeeded in lower their breakeven points, lead times to adopt more competitive production systems and redirecting production workers and management are considerable. New designs and manufacturing techniques are being developed to reduce the minimum economic scale and the manpower requirements of automobile production. Although the automobile industry will continue to be a dominant factor in manufacturing in North America it may have peaked as a producer and employer of labour. The North American industry's future competitive position is jeopardized by the growing presence of the Japanese automobile in the North American market.

The future size and strength of North American automobile producers will be influenced by the total level of North American automobile sales, the competition of North American producers, the degree of import penetration and the extent of participation by Japanese and other off-shore producers in the mid-size and large car markets. There will also be a challenge from the North American subsidiaries of Japanese and other off-shore suppliers whose output is expected to supplement rather than replace imports.

Despite major gains in productivity by North American producers since 1981, Japanese automobile producers appear to have maintained or increased their

previously reported landed cost advantage in the North American market. Although detailed supporting data is not readily available, the Japanese manufacturing cost advantage, lower worker compensation rates, lower capital and material costs, and higher productivity continue to be moving targets. In recent years movements in the dollar/yen exchange rates have aggravated the competitiveness by partially neutralizing the favourable impact of recent efficiency improvements by the North American industry. Based on studies of the U.S. and Japanese automobile industries, the United States Department of Commerce estimates that U.S. firms require at least twenty per cent more hours to produce a small automobile than Japanese companies. Even with a stronger yen, the competitive strength of Japanese producers suggests only a gradual reduction in their manufacturing cost advantage is likely to occur in the next five years. While a higher yen can increase their sticker price it also makes imported raw materials cheaper.

The termination of the "voluntary" restraint arrangement between the United States and Japan on March 31, 1985 raises the question of how the North American industry is likely to fare during the next few years. Although the Japanese have agreed to contain imports to 2.3 million units in the following twelve months the prospects for the North American industry will depend on the growth in sales of Japanese automobiles and the future level of total North American demand for automobiles. Canada and Japan have recently agreed that Japanese shipments of automobiles to Canada in the twelve month period from March 31, 1985 will not exceed 18 per cent of market demand. Japan

Automobile Manufacturers Association of Canada argues that they cannot meet this target because of unhindered Korean competition in the Canadian market.⁸

There are a number of variables that could influence the market outlook to 1988 and there are a number of assumptions that could be made regarding various potential import penetration levels. For the purposes of this analysis forecasts made by Data Resources Inc., the U.S. Department of Commerce and the Department of Regional Industrial Expansion have been utilized. These forecasts exhibit a range of pessimism or optimism which reflects assumptions respecting GNP growth and inflation during the period as well as the extent of the slowdown in economic activity in 1986. These forecasts track closely the 1985/88 sales projections of the Motor Vehicle Manufacturers Association.

⁸ News from JAMA Canada Japan Automobile Manufacturers Association of Canada, October 22, 1985.

TABLE 2
NORTH AMERICAN PASSENGER CAR MARKET
(Millions of Vehicles)

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
<u>Total Sales</u>					
North American	11.383	11.857	11.645	12.007	12.121
U.S.	10.402	10.808	10.641	10.975	11.100
Canadian	0.981	1.049	1.004	1.032	1.021
<u>Total Imports</u>					
North American	2.656	3.010	3.434	3.783	4.101
U.S.	2.409	2.720	3.119	3.443	3.737
Canadian	0.247	0.290	0.315	0.340	0.364
<u>Total Domestic</u>					
North American	8.727	8.841	8.211	8.224	8.020
U.S.	7.993	8.088	7.522	7.532	7.363
Canadian	0.734	0.757	0.689	0.692	0.657
<u>Total Foreign Plants</u>					
North American	.240	.366	.422	.596	.912
U.S.	.230	.357	.412	.586	.902
Canadian	1.000	.900	.900	1.000	1.000
<u>Traditional Domestic</u>					
North American	8.488	8.424	7.779	7.623	7.109
U.S.	7.466	7.434	6.760	6.609	6.053
Canadian	1.022	1.043	1.029	1.014	1.046

Source: Data Resources Inc. (DRI) Department of Regional Industrial Expansion.

This table shows that the total level of import penetration in the North American market is expected to be about 34 per cent compared to 23.3 per cent in 1984. Total off-shore company plant production will increase to 7.5 per cent

of the North American market in 1988 compared to just over 2.0 per cent in 1984. Combined North American production and imports by these off-shore companies will account for approximately 42 per cent of the total North American market in 1988 compared to 25.4 per cent in 1984.

The United States Department of Commerce forecast which is given in Table 3 also predicts growth in Japanese automobile sales, including U.S. assembled models from just over 2 million in 1984 to 3.7 million units (34 per cent) in 1987. This forecast assumes an increase of 500,000 units in total U.S. demand between 1984 and 1987. It should be recognized that the forecast was also based on the assumptions that there will be no major appreciation of the yen against the United States dollar and the manufacturing cost advantage of the Japanese automobile producers will continue to be roughly at its current level throughout this period.

TABLE 3
U.S. AUTOMOBILE MARKET DEMAND 1984-87
(Millions of units)

	<u>1984</u>	<u>%</u>	<u>1985F</u>	<u>%</u>	<u>1986F</u>	<u>%</u>	<u>1987F</u>	<u>%</u>
Total Sales of Japanese Imports	1,906	18.3	2,275	21.3	2,675	25.2	3,025	27.7
Sales of U.S.-Built Japanese Cars	<u>133</u>	<u>1.3</u>	<u>275</u>	<u>2.5</u>	<u>525</u>	<u>5.0</u>	<u>675</u>	<u>6.2</u>
Total Japanese Car Sales	2,039	19.6	2,550	23.8	3,200	30.2	3,700	33.9
Total Sales of European Imports	534	5.1	530	5.0	480	4.5	474	4.4
Total Sales of U.S./Canadian-Built Cars	<u>7,818</u>	<u>75.3</u>	<u>7,620</u>	<u>71.2</u>	<u>6,920</u>	<u>65.3</u>	<u>6,725</u>	<u>61.7</u>
Total U.S. Car Sales	10,391	100.0	10,700	100.0	10,600	100.0	10,900	100.0

Source: U.S. Department of Commerce

The United States automobile producers are expected to experience about a 1.1 million unit drop in sales between 1984 and 1987 despite a 500,000 unit increase in total market volume. This decrease will occur in the small car segment (subcompacts) as a result of imports by U.S. and Japanese automobile companies and sales of U.S. built Japanese vehicles. Increasing Japanese competitive pressure will also be felt in the mid-car segment (compact, intermediate) and could minimize growth opportunities for U.S. automobile manufacturers in that market.

United States imports of Japan automobiles will rise from just under 2.0 million units in 1984 to an estimated 3 million units in 1987 or from 18.3 per cent to 27.7 per cent of the market. Japanese automobiles assembled in the United States and Canada will also become a factor during this period and by 1987 shipments are expected to be 675 thousand units or 6.2 per cent of the North American market. Together Japanese produced automobiles will represent almost 34 per cent of North American demand in 1987 while imports from Europe, Asia (other than Japan) and Mexico will capture 5.4 per cent of demand.

Many North American industry executives and the United States Department of Commerce predict that by 1988 the split between North American producers and Japanese producers of North American automobile demand will be not less than 60/40 while other predictions show a more even split. In testimony before the U.S. Subcommittee on Trade, Productivity and Economic Growth on June 24, 1985, Maryann N. Keller, noted automotive industry analyst, stated that the Department of Commerce study implies "that sales of foreign sourced cars are a function of supply and that U.S. manufacturers' volume is the residual of total sales less foreign brand cars."

PRODUCTION AND EMPLOYMENT

Some industry analysts forecast that shipments from North American companies in Canada and the United States will decline from 76 per cent of total demand in 1984 to approximately 55 per cent of estimated total demand in 1988. All forecasts are that there will be a decline in production and employment among the North American producers.

Based on the preceding market projections there will be considerable excess capacity in automobile production by 1988. Overall shipments from North American automobile producers are also expected to decline which will result in over-capacity and employment losses. Shipments from North American producers are expected to decline by 15 per cent from 8.4 million units in 1984 to 7.1 million units in 1988 resulting in a net excess capacity of about 1.3 million units. Most of the loss in sales by the North American industry is expected to occur in the small car segment which is principally located in the United States.

The United States Department of Commerce estimates (Table 4) that total North American automobile production capacity will approach 11.5 million units by 1990. Of this total Canada would have a production capacity of approximately 1.2 million units.

TABLE 4
NORTH AMERICAN PASSENGER CARS' EXISTING
AND PLANNED PRODUCTION CAPACITY BY 1990

<u>Manufacturers</u>	<u>Small Cars</u>	<u>Mid-Size Cars</u>	<u>Large Cars</u>	<u>Total Cars</u>
General Motors	1,600,000	3,050,000	1,150,000	5,800,000
Ford	930,000	850,000	950,000	2,730,000
Chrysler	375,000	950,000	-	1,325,000
AMC/Renault	250,000	50,000	-	300,000
Volvo Canada	-	50,000	-	50,000
VW-U.S.A.	250,000	-	-	250,000
Sub-Total	3,405,000	4,950,000	2,100,000	10,455,000
U.S. Based Joint				
U.S. - Japanese Production				
Honda	300,000	-	-	300,000
Nissan	100,000	-	-	100,000
GM/Toyota	250,000	-	-	250,000
Mazda	240,000	-	-	240,000
Mitsubishi	150,000	-	-	150,000
Sub-Total	1,040,000	-	-	-
Total Capacity	4,445,000	4,950,000	2,100,000	11,495,000

Source: U.S. Department of Commerce

Approximately 39 per cent of total North American capacity would be in small automobile production, approximately 43 per cent in mid-size automobile production and some 18 per cent in large automobile production. To date all of the existing or planned Japanese capacity will be in small car production although there is evidence that the Japanese are planning to move into the mid-car segment.

The estimates in Table 4 indicate that by 1988 North American automobile producers are expected to lose approximately 1.9 million units of sales to offshore imports and offshore companies production capacity based in North American despite modest growth in the North American market during this period.

TABLE 5
NORTH AMERICAN (CANADA & U.S.) AUTOMOBILE DEMAND
AND PRODUCTION CAPACITY (MILLION UNITS)
BY MARKET SEGMENTS 1988

	<u>Market</u> <u>Size</u> (1)	<u>N.A.</u> <u>Capacity</u> (2)	<u>Imports &</u> <u>F. Capacity</u> (3)	<u>Excess</u> <u>Capacity</u> (4)	<u>Excess Capacity as</u> <u>% of Domestic</u> <u>Capacity</u> (5)
Sub-Compact	3.93	1.80	3.08	.96	53.3
Compact	2.07	1.50	.88	.31	20.7
Sporty	.87	0.65	.35	.13	20.0
Large	<u>5.32</u>	<u>5.05</u>	<u>.79</u>	<u>.52</u>	<u>10.3</u>
Total	12.19	9.00	5.10	1.92	21.3

Source: DRI & DRIE

Note: Excess capacity = Col. 2 + Col. 3 - Col. 1

Depending upon market growth most of the excess capacity will be in the small car segment with more modest excess capacity in mid-size automotive production as a result of increased imports and the sales of United States built Japanese cars. Most of this over-capacity is located in the United States and at least in the next two years the decline in production and employment is likely to

take place to a greater extent in the United States than in Canada because of present mix but it will impact on both sides of the border. The demand for large size cars is expected to remain at approximately present levels as the supply and price of oil is expected to remain relatively stable. Production in Canada is largely geared to mid-size and large automobile production and the downturn in demand for North American automobiles should not impact on production levels to the same extent as in the United States at least in the near term. This is not to suggest that certain plants in Canada are not likely to be vulnerable to the downsizing of capacity due to political and industry pressures in the United States, the utilization and age of the plants. What effect, if any, the safeguard provisions of the Automotive Agreement are likely to have on the downsizing of production facilities forecast for the North American industry and on the adjustment decisions to meet the decline in demand for North American automobiles will vary from company to company.

THE CANADIAN AUTOMOTIVE INDUSTRY UNDER THE AUTOMOTIVE AGREEMENT

To position the Automotive Agreement and the industry in Canada in the context of discussions of a comprehensive trade arrangement with the United States it would seem appropriate to examine briefly the terms of the Agreement and the perceptions of its objectives and provisions.

The Agreement provides essentially for free trade between the two countries in automobiles, trucks, buses and original equipment parts. Excluded from the Agreement is trade in aftermarket parts and accessories, tires and tubes, batteries and used vehicles. No attempt has been made to assess the effect of including these additional items in any comprehensive trade arrangement. Duty free entry of the vehicles and parts covered by the Agreement are subject to a number of conditions, particularly relating to importation into Canada. There are five conditions applying to entry into Canada three are incorporated in the Agreement and two are contained in undertakings by the motor vehicle companies in Letters of Commitment to the Canadian Government.

The Agreement stipulates as a first condition that only a Canadian manufacturer of automobiles, trucks or buses may import products duty free provided the manufacturer in the year of importation maintained a production to sales ratio equal to that achieved in the base year and Canadian value added equal to that obtained in the base year. Canada implemented the Automotive Agreement on a

Most-Favoured-Nation basis which allows only motor vehicle manufacturers to import complete vehicles and original equipment parts duty free from MFN sources provided the production share conditions are met. The United States obtained a waiver under the GATT and restricts duty free entry of motor vehicles from Canada provided the motor vehicles have fifty per cent North American content.

The second provision was designed to maintain the proportion of vehicles assembled in Canada in relation to vehicles in each class sold in Canada. The third condition was designed to establish a floor under the amount of Canadian value added in absolute terms (1964 model year) achieved by each vehicle producer and has been largely eroded as inflation has diluted these fixed amounts.

In the letters of commitment the motor vehicle manufacturers undertook two additional commitments. They undertook to ensure that in each model year the value added in Canada would amount to at least 60 per cent in the value of automobiles sold in Canada and 50 per cent of the growth in the value of commercial vehicles sold in Canada. Further the Canadian vehicle manufacturers collectively agreed to increase the amount of CVA being produced in Canada by the 1968 model year by a further \$260 million annually. The Canadian industry executives are unanimous in their view that the production to sales ratio and the CVA provisions in the Automotive Agreement and the undertakings in the Letters of Commitment continue to influence

production location decisions by their companies and have contributed to the present high level of production and employment in Canada.

There are several other features of the Automotive Agreement that are relevant to our study which may arise in discussions of its future in any context or form. The Agreement is unlimited in duration but Article VII stipulates that it can be terminated on a year's notice by either country. It also stipulated that by January 1, 1968, the two governments would undertake a comprehensive review of the progress being made toward the achievement of the objectives of the Agreement in order to consider what further steps should be taken in pursuit of these goals.

From the time of its signing there have arisen differing perceptions of the Agreements objectives and provisions and differing views of actual results. Of particular importance is the ambiguity of the objectives which reflect the different emphasis and perceptions of the two governments. During the negotiations there was acknowledgement by the United States of the perceived need of Canada for assurance that there would be a minimum Canadian value added level and provision for growth in production to assist the automotive industry in Canada to adjust to competition from the United States industry. From the beginning the United States contended that these production assurances or safeguards should be for a limited time only or "transitional". At the end of the transitional period in the United States view "market forces" should determine patterns of investment, production and trade.

Canada's concern was reflected in the second objective which called for the liberalization of trade to enable the industries in both countries "to participate on a fair and equitable basis" in an expanding North American market. This preoccupation reflected a concern for the oligopolistic North American industry, dominated through ownership and control by three large United States corporations. In the Canadian view, ownership and control were "institutional barriers" which could impair the prospect of "market forces" operating in a "fair and equitable manner" to the benefit of the automotive industry in Canada. It was therefore necessary to have safeguards to ensure a minimum level of automotive production in Canada and to maintain the prospect of investment in Canada.

The 1968 review of the Agreement was completed with no resolution of the various issues. On the Canadian side the review consultations were announced as being "successfully completed". In a special report to Congress President Johnson indicated that no decision had been reached with regard to changes in the Agreement including liberalization of conditions on duty free entry into Canada as possible means of progressing toward full achievement of the Agreement's objectives.

During the early 1970s the trade balance under the Automotive Agreement swung in the United States favour (\$401 million in 1973 against a deficit of \$45 million in 1972). This tended to ease some of the pressure from the United States for the removal of the safeguards. However the safeguards continued to

be an issue. Between 1968 and the end of the 1970s the United States Administration, the Senate and various Congressional committees demanded that the safeguards maintained by Canada in the Automotive Agreement be terminated. In the recently released Eighteenth Annual Report of the President to Congress on the operation of the Automotive Agreement, Mr. Reagan in referring to certain Letters of Undertaking to increase Canadian value added noted that "Although the letters were exchanged between the companies and the Canadian Government they were signed with the tacit approval of the United States Government. This approval was withdrawn in 1970 after the passing of the July 31, 1968 deadline."

President Reagan's reference to "the passing of the 1968 "deadline" had to do with the removal of the safeguards from the Automotive Agreement. The President's statement is consistent with the United States position since the inception of the Agreement that it is fundamentally a free trade arrangement that contained transitional production safeguards for Canada in the 1965 -1968 period. These safeguards were not a permanent feature of the Agreement and the apparent unwillingness of Canada to contemplate their removal has remained an irritant. What has contributed to this variance of view is the different perception of the Agreement which has existed since it was negotiated and the fact that it is vague on the subject of the life of the safeguards.

A widely held view in the automotive industry in Canada is that the safeguards are important to ensure a "fair share" of production and investment in Canada

and are necessary as long as ownership and control of the major elements of the industry rest in the United States. Others believe that the existing safeguards do not adequately provide for participation in the North American automotive market. The Automotive Parts Manufacturers' Association (APMA) and the Ontario Government have contended that the measure of success or failure of the Agreement should be judged by whether or not Canada achieves production equal to consumption in Canada. The United States administration rejects this production sharing concept as an objective of the Automotive Agreement. In a report to the United States Senate Committee on Finance, the United States Administration re-asserted its basic position:

"The United States has rejected the "fair share" concept on the grounds that the Auto Pact is a limited free trade arrangement, not a market sharing agreement, or a mechanism to manage an industrial strategy for the auto industry".⁹

The United States administration in any subsequent discussions on the Automotive Agreement is not likely to change its traditional posture of viewing the Agreement as essentially a free trade arrangement. The United States administration will continue to argue against the existence of the production safeguards and may be expected to take a more aggressive position against Canadian initiatives either to increase the safeguards as proposed in the 1983

⁹ Report on the North American Trade Agreements Office of the United States Trade Representative, (Washington, D.C.: US Trade Representatives Office 1981) p. 54.

Report of the Federal Task Force on the Canadian Motor Vehicle, and Automotive Parts Industries¹⁰ or any other measures to extend benefits to increase automotive production in Canada.

There is a view within the automotive industry on both sides of the border that the Automotive Agreement has been an important factor in the development of the industry on a North American basis. Mr. Roger B. Smith, Chairman, General Motors Corporation, in a speech in Toronto said:

"This agreement has been called --- "the largest and most comprehensive trade agreement between any two countries in the world." It is assuredly the most successful trade policy in the history of our industry. And despite some shortcomings, it remains - in my mind at least - an excellent example of a rational and responsible way to resolve thorny trade issues between nations.¹¹

This general acceptance may contribute in part to the apparent absence of industry pressure for change on the U.S. administration at this time.

Are the safeguards economically important to the maintenance of production and investment in Canada? Are they likely to be in the future? The Automotive Agreement in its present form has been central to the development of the automotive industry in Canada. It has reinforced the nature and structure of the Canadian automotive industry, as an adjunct of the United States industry. In the early years of the Agreement rationalization of production took place and there were substantial increases in output, employment, investment and improvement in productivity in the automotive industry in Canada. Today the motor vehicle producers assemble substantially more automobiles than are

¹⁰ An Automotive Strategy for Canada Report of the Federal Task Force on the Canadian Motor Vehicle and Automotive Parts Industries, May 1983 p. xvii.

¹¹ Automotive Products Trade Agreement, Roger G. Smith, 20th Anniversary Dinner, January 16, 1985, Toronto.

consumed in Canada. Original equipment parts production is at a record high. The level of overall value added in vehicle assembly and original equipment parts production substantially exceeds the minimum levels established by the safeguards in the Agreement. According to the Department of Regional Industrial Expansion total Canadian value added as a percentage of cost of sales was 83 per cent in 1984.

On the assumption that the total Canadian value added as a percentage of cost of sales committed to by all qualified producers was estimated to be 60 per cent, the same as in 1983, the total achieved Canadian value added in 1984 was substantially greater than the minimum required under the Automotive Agreement. Since 1982 high levels of Canadian value added has been achieved in each model year in relation to cost of sales in Canada which may be attributed to the increasing North American demand for medium and larger automobiles that are being assembled in Canada and other factors such as labour productivity, wage rate advantage and the exchange differential. The economic importance of the safeguards in maintaining production and employment in the present buoyant market situation is less of a factor as other considerations tend to have a more important bearing on the level of production in Canada.

The increasing presence of Japanese and other off-shore automobiles in the North American market and the projected decline in demand for North American type automobiles may increase the economic relevance of the safeguards in the future. The projected decline in demand is expected to begin in 1986 but is not

likely to affect Canadian production levels at least initially because of the product mix of automobiles assembled and the influence of other factors mentioned earlier. As the contraction in demand for North American type automobiles deepens automobile producers and their parts suppliers will be consolidating production facilities and adopting new production techniques which will impact on the level of production on both sides of the border. The safeguards may serve to impede disinvestment in Canada although their effectiveness may be influenced by other variables.

Declining demand for North American automobiles in the Canadian market will reduce the number of automobiles required to be assembled in Canada to meet the ratio to sales requirement and the absolute dollar amount of Canadian value added will also be reduced as the total cost of North American type automobiles sold in Canada declines. This will lessen the pressure on the companies to maintain production and employment in Canada and reduce the effectiveness of the safeguards as an impediment to disinvestment. Other factors may also influence the effectiveness of the safeguards. Canada's labour cost advantage is likely to be reduced over time and the exchange differential will fluctuate and the gap narrow as the United States takes measures to cause the dollar to fall in value in relation to other currencies.

The level of the Canadian tariff on motor vehicles and original equipment parts could influence decisions by companies on the importance of meeting the safeguards. In 1965 the Canadian tariff on motor vehicles was 17.5 per cent

under the MFN and in 1987 the rate will be 9.2 per cent. This reduction in rate has placed continuing pressure on the industry to improve its efficiency and has had a salutary affect on the price of automobiles to the consumer. This reduction in the tariff has affected the vehicle producers differently. Initially Ford and Chrysler experienced the most cost benefit under the Automotive Agreement through rationalization of production on a North American basis. These companies, however, continue to experience relative cost penalties in meeting their production requirements in Canada. The incentives to maintain production may be increasingly marginal against the level of the tariff as the companies experience downturns in automobile demand and find it more difficult to justify meeting the production safeguards. The balance of advantage will vary from company to company. In a declining market environment any further reduction in the tariff could reduce the incentive to maintain production in Canada.

There are potential costs and risks and no discernible benefits from rolling the Automotive Agreement into a more comprehensive trade arrangement. There is the risk that if the Agreement should become an element in the discussions of a comprehensive trade arrangement that the United States would seek removal of the safeguards. The United States is certain to be unwilling to consider any proposal to improve Canada's access to the United States automotive market. The United States has taken the decision to remove any impediments to entry into its automobile market and would not look favourably on any attempt by Canada to gain more favourable access to the United States market or to take

any action that is likely to direct production away from the United States. Canada could be under pressure to abandon the status quo. Past experience would suggest that there is a real risk that United States interests would try to eliminate the safeguards if the Agreement is included on the agenda of more comprehensive trade discussions. The wisdom and prudence of inviting such demands should be weighed very carefully.

There is the prospect that if the Automotive Agreement is raised the United States will seize the opportunity to draw attention to the current favourable Canadian trade balance in the automotive sector and to the need to redress the automotive trade balance given Congressional concerns about the growing overall unfavourable United States trade balance. In 1984 Canada had a favourable trade balance of almost \$6 billion in automotive trade with the United States the highest annual surplus recorded by either country under the Automotive Agreement. Motor vehicle trade was in surplus by \$10.8 billion in that year and automotive parts in deficit by \$5.1 billion. Canada's automotive trade with the United States has been in surplus since 1982 although with the exception of a three-year period in the early 1970s the United States has had an annual favourable trade balance in automotive products with Canada. The United States continues to experience a small overall trade balance in this sector. The balance in automotive trade has been the most visible and ready symbol of relative economic activity in the automotive industry. Movement of the balance in favour of either Canada or the United States had tended to raise the interest and intensity of concern of the side experiencing the deficit.

Also for consideration is whether the United States would be prepared to condone the various remission orders now in place for a number of third country producers who obtain duty-free entry of autos in return for purchasing Canadian made auto parts. United States officials consider that these arrangements are little more than subsidies to Canadian auto parts producers. These programs which have been important to the parts industry could get caught up in "levelling the playing field."

There is a view that the Automotive Agreement was an agreed basis for meeting a growing trade dispute, is unique to the automotive industry, and is working to the benefit of both countries. Trade under the Automotive Agreement represents 35 per cent of total merchandise trade between the two countries and, as a minimum, in any comprehensive trade discussions there would be need to reach an understanding on the positioning of the Agreement in relation to the broader trade arrangement.

NEED FOR A CONSULTATIVE MECHANISM?

There is no structured procedure under the Automotive Agreement for assessing whether the full objectives are being achieved. The only provision for review covered the period to January 1, 1968, when the two Governments were to have jointly undertaken "a comprehensive review of the progress made towards achieving the objectives" (Article IV (c)). This review was approached by each side differently with respect to measuring progress towards "achieving the objectives" and no clear assessment was possible and no agreement on its progress was reached.

There is provision for consultation. Article IV (a) provides that the two Governments shall "consult with respect to any problems relating to the Agreement." This subparagraph would appear to relate to the working of the Agreement. More specifically subparagraph (b) provides for consultation "with respect to any problem which may arise concerning automotive producers in the United States which did not have facilities in Canada ..." in the base year designated in the Agreement or new entrants which established facilities in Canada after the Agreement came into effect. There is no clear evidence that subsequent discussions between the two sides were held under the provisions of Article IV. These discussions did not appear to have appeased one side or the other and this may have contributed to the apparent reluctance of either side in recent years to seek further discussions on outstanding issues. If the Agreement had a dispute settlement mechanism there may have been less acrimony on

either side but the lack of such a mechanism may have been of benefit to Canada given that in the twenty years of the Agreement its provisions remain intact.

In this respect the Automotive Agreement has not lived up to its earlier expectations of contributing a strong and positive influence on Canada-United States relations in this sector or on our economic relationship more generally. The Agreement has been of substantial economic benefit to both countries and to the industry on both sides of the border. But throughout its history the Automotive Agreement has been accompanied by continuing complaints in the United States and Canada. On occasion, these disputes have threatened its existence. The Agreement is vague on how its success or failure should be measured. As a result the flow of trade between Canada and the United States has been one of the principal measurements adopted by governments and the media to measure the health of the industry and its competitiveness. The extent to which the trade in automotive products moves away from being roughly in balance in either direction has in the past determined the dissatisfaction - or satisfaction with the Agreement although this may have very little bearing on the actual condition of the industry on either side of the border.

Today the Automotive Agreement remains virtually as originally drafted although there have been important changes in the industry which could be accommodated by modification to the Agreement. In the 1968 review one of the areas that was considered as a possible means of progressing towards the full achievement of the objectives of the Agreement was through amendment to

encompass additional products. Nothing was accomplished as the United States administration was not prepared to reopen the Agreement with Congress unless Canada agreed to the withdrawal of the safeguards. If there be fault it is that the Agreement has not provided a flexible framework within which important issues could be considered or resolved.

Important provisions of any comprehensive trade arrangement between Canada and the United States will relate to review, consultation and dispute settlement procedures and there may be merit in extending this institutional framework to encompass the functioning of the Automobile Agreement. This would provide a more stable and secure basis for the Agreement. It would bring a large segment of trade between the two countries under the same joint management as would apply to the trade covered by the new comprehensive arrangement. This would ensure that any issues relating to the Automotive Agreement would be viewed in the context of overall Canada-United States trade relations. It would be seen as managing trade issues in the automotive sector and should reduce the political and public attention that has tended to inflate issues arising from the working of the Agreement. There would be advantage in having an established consultative procedure to examine the impact of change now that the North American industry is facing the prospect of declining demand for its automotive products and the resultant downsizing of production capacity on both sides of the border. It could be viewed as a positive attempt to provide a consultative mechanism to discuss the future prospects for the industry and possibly what collective steps might be taken to ensure its future as a viable industry in North America.

It may be difficult to confine consultation or other related procedural provisions to matters relating to the vagaries of the market without reference to the structure of the Agreement particularly if it was an impediment to the ability of the automobile producers to meet reduced demand by restructuring or rationalizing their production facilities in Canada and the United States. There is likely to be strong political and industry pressure on the United States administration to negotiate changes that would enable the maximum prospect for production being concentrated in the United States. That this situation may arise whether or not the Automotive Agreement is included in the broader consultative procedure is distinctly possible. There may be prospect of managing these discussions more effectively under formally established procedures in a comprehensive trade arrangement but it is difficult to envisage how this might be achieved without opening up the prospect of the economic provisions of the Agreement being included.

CANADIAN INDUSTRY VIEWS

Parts Producers

The Automotive Parts Manufacturing Association (APMA) has claimed over the years that the parts sector has not fared well under the Automotive Agreement. The APMA has argued that the "fair share" commitments under the Agreement have not worked equally to the benefit of all segments of the industry. As evidence the APMA has claimed that Canada's trade balance with the United States in original equipment parts has risen every year. In 1984 the parts imbalance under the Arrangement was \$5.1 billion although Canada had an almost \$6 billion favourable balance in automotive trade with the United States. Simon Reisman in his Inquiry into the Automotive Industry¹² concluded that "the figures indicate clearly that the growth in Canadian value added from the production of parts for incorporation in Canadian-made vehicles and for export has far exceeded the increase in CVA contributed by vehicle assembly". A very substantial portion of original equipment parts imported into Canada are assembled into vehicles which are shipped to the United States. Reisman concluded "in no sense can these components be said to have been consumed in Canada."

¹² The Canadian Automotive Industry Performance and Proposals for Progress, Commission on the Automotive Industry SS Reisman October 1978, p. 83.

In more recent times the APMA have urged the government to expand the Agreement or to put in place arrangements that would require all vehicle manufacturers selling vehicles in Canada to achieve a certain amount of Canadian value added preferably through the purchase of Canadian produced parts. The Association has also suggested that the Canadian valued added requirements should be increased for all manufacturers selling in the Canadian market. The APMA in its presentation to the Special Joint Committee on Canada's International Relations on August 18, 1985, stated that:

"Rapidly rising Japanese imports in the United States as a result of the ending of quotas last March are likely to cause a fall-off in U.S. vehicle production by the end of the year, precipitating more unemployment among autoworkers. This is not the environment in which to raise the prospect of ending the Canadian safeguards in the Auto Pact and we can no longer count on the UAW in the United States to support continuing employment for their former colleagues in the United States.

To date, the government has not dealt with these issues. . . .We have urged the government to leave the Auto Pact out of any trade discussions with the United States. To do otherwise poses a very serious threat to the stability to the largest area of trade between the two countries."

AUTOMOBILE PRODUCERS

The Canadian automobile companies have identified increasing participation in the market by Japanese producers as the most immediate threat to the automobile industry in North America. The companies also consider that the safeguards play an important role in sourcing of production in Canada. They

point to the relative buoyancy of the Canadian industry during the 1981-82 downturn in the market as compared to the industry in the United States in support of their claim.

The Motor Vehicle Manufacturers' Association in its statement to The Special Joint Committee on Canada's Trade Relations on August 18, 1985 stated that "Canada's best, indeed only, automotive export market is the U.S. and vice-versa. Hence the importance of the principles of the A.P.T.A. — and the reason for its continuation as the keystone of Canadian automotive policy."

The Canadian automobile producers are also concerned that if the Automotive Agreement was rolled into any comprehensive free trade arrangement that this would enable Japanese automobile manufacturers with production facilities in the United States to ship automobiles duty free into the Canadian market. This would give these automobiles a further competitive advantage in the Canadian market at the expense of production and employment in Canada.

The potential shrinkage in demand for North American industry produced vehicles in the Canadian and United States market and the 1987 level of the Canadian tariff may create a situation that will cause the automobile producers to bring more into question whether there is a balance of advantage to continuing production in Canada.

THE UNITED STATES ATTITUDE

Officials in the United States do not appear inclined to suggest that the Automotive Agreement should form part of any such discussion. Should they change their position, we should expect they will propose that as a condition of acceptance of a more comprehensive package that the various safeguards in the Automotive Agreement be withdrawn. Indeed, if the Automotive Agreement is not put on the agenda by Canada because there is no disposition to discuss the removal of the safeguards our interviews suggest that this would be unlikely to cause surprise to the United States.

The U.S. Commerce Department and the Motor Vehicle Manufacturers Association (U.S.) consider that as there are no apparent serious issues on either side there would be advantage to leave the Automotive Agreement out of any comprehensive trade discussions but possibly to use it to illustrate the gains that can be achieved through freer access and rationalization on a Northern American basis. The Automotive Parts and Accessories Association (U.S.) has taken the position that U.S. aftermarket producers want no part of any arrangement that would extend free trade to aftermarket parts (Appendix A).

The United States approach to removal of the safeguards is likely to be guided in large measure by the position taken by the United States industry should the issue be raised. There has been no apparent approach by United States officials to the industry on issues arising from the operation of the Agreement in the

context of preparations for discussions on a possible comprehensive trade arrangement. Nor does there appear to have been any industry view expressed about the desirability of including the Automotive Agreement on the agenda in the public hearings convened by the US ITC or by USTR. Our discussions suggest that it is unlikely that the United States side will press for the inclusion of the Automotive Agreement in a comprehensive trade arrangement.

During our discussions in Washington other concerns were expressed which, while not directly bearing on the United States attitude, provide an insight into matters which may influence the subsequent benefits for Canada under the Automotive Agreement. The recent split in the United Auto Workers Union (UAW) and the creation of an independent Canadian UAW adds a new dimension to the labour scene which could have far-reaching consequences for the Canadian industry. This view is shared by the motor vehicle industry and the UAW (U.S.). Prior to the 1982 round of union negotiation there was a fairly uniform approach by the UAW to each of the motor vehicle companies on both sides of the border. This created a fair degree of certainty as to the longer term labour environment for the industry. It was not a compelling factor in locating production. Recent changes in production techniques and the emergence of larger more sophisticated parts suppliers and the single sourcing of certain components has made the motor vehicle companies more conscious of the need for labour predictability and a continuous supply of parts to maintain the most cost effective production process.

The recent successfully completed round of negotiations between Chrysler and the unions on both sides of the border is viewed as a positive indication that the two unions have not chartered a separate course in reaching settlements with Chrysler. Although details of these settlements are not available it is understood that the benefits obtained maintain equivalent wage and benefit provisions of the previous agreements. This should help to overcome some of the apprehension in the industry over having a separate union on each side of the border particularly as the settlement in Canada was concluded first with minimum disruption to production. The Chrysler settlements may also influence the pattern of contract negotiations in the automobile industry in the future.

This labour scene should be viewed against projected demand for North American type vehicles by 1990 and the resultant overcapacity of assembly and parts production facilities. An increasing share of total North American demand will be met by imports from Japan or other off-shore sources or from production in North American facilities of the Japanese automobile companies. It is likely in this market situation that the UAW in the United States will have less allegiance to the Canadian union than in the past and will no doubt bring pressure on the U.S. administration and the motor vehicle companies to maintain maximum production facilities in the United States.

The Motor Vehicle Manufacturers' Association (U.S.) point to the apparent growing disparity between the approach to equal pay for equal work provisions between the United States and Canada and cite recent proposed legislation by

Ontario. The Association is undertaking a review of the effect of the recent Canadian budget and the proposed changes in the United States tax system to determine the effect on the industry doing business in both countries. The Association tends to view these disparities as potential impediments to investment in Canada.

GATT IMPLICATIONS

Is it necessary to include auto trade to meet the trade coverage envisaged in GATT Article XXIV:5? It is not clear that this is necessary. Must the trade between Canada and the U.S.A. be free on a statutory or de facto basis? Surely we could argue that de facto free trade over a period of twenty years is free trade. Very careful analysis should be given to this issue, which we have not attempted to do in this paper.

If Canada included autos in a comprehensive bilateral agreement we would almost certainly have to reduce our tariffs on a preferential basis for the United States. If we did not meet the criteria of GATT Article XXIV, Canada would not seek a waiver under GATT Article XXV to extend these preferences. Our present system does not require a waiver. The U.S. has had a GATT waiver since 1965. A GATT waiver requires approval by two-thirds of the Contracting Parties. It is considered highly unlikely that Canada would obtain approval of a waiver.

Even if Article XXIV criteria were met, other Contracting Parties might consider that moving from remissions to preferential duty free access had the effect of raising a duty inconsistently with Article II (even though the remissions are not bound) they might then pursue their perceived right to seek concessions to restore the balance, under Articles XXIV and XXVIII, and possibly XXIII. Experts we have consulted suggest they would not have a substantive case.

CONCLUSIONS

The automotive industry on both sides of the border is preoccupied with attempting to meet the competitive challenge of the Japanese intrusion into the North American market. It is difficult to predict whether the North American industry will remain viable. There will need to be substantial structural changes in the North American industry if it is successfully to adjust to the new competitive environment.

The North American market demand for automobiles is forecast to grow moderately over the next five years while the market share held by the domestic manufacturers will decline sharply. This will result in plant closures and substantially lower production and employment levels. Sales of Japanese automobiles in North America will increase rapidly in this period with demand being met by imports and from North American situated assembly facilities. These assembly operations will use a high percentage of imported components and the employment effect will be a net loss in Canada and the United States.

The Automotive Agreement has been of benefit to both countries and there is no pressure on either side to have it included in any comprehensive trade discussions. If Canada does not propose that the Automotive Agreement be included on the agenda it is unlikely to be raised as an issue by the United States. If it was included in the decision there is the risk that the United States would be seeking the removal of the safeguards which could adversely affect the level of

production and employment in Canada. If the safeguards and the tariff are removed Japanese automobiles assembled in the United States would have more favourable access to the Canadian market. If the Automotive Agreement is raised it should be to determine how it might be positioned in relation to any comprehensive arrangement.

The danger of retaining the Automotive Agreement outside any comprehensive trade arrangement with the United States is the risk, which has always existed, of a substantial shift in United States commercial policy. This is a disincentive to the automobile companies investing in Canada as they must always hedge against the possibilities of unexpected tariff or non-tariff barriers against cross-border shipments. A change in United States laws or rulings could affect the profitability of the Canadian operations. The possibility of abrogation of the Agreement on one year's notice is an important consideration to future investment and production planning in the automotive industry.

There could be some advantage to Canada in this period of structural adjustment and down-sizing of the industry if the Agreement had a greater perceived degree of permanence and there was an established monitoring organization to oversee actions under the Agreement. This must be weighed against the international and bilateral risks in re-opening the agreement and/or including it in a comprehensive agreement.

Unless there is some real possibility, significantly to improve on the status quo, and there does not appear to be, the bilateral and multilateral risks of re-opening the Automotive Agreement in a bilateral context, would appear to outweigh the potential benefits by a wide margin.

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September 30, 1985

Honorable Malcolm Baldrige, Secretary
U.S. Department of Commerce
Washington, D.C. 20230

Dear Mr. Baldrige:

Now that Canada's Prime Minister Mulroney has formally asked President Reagan to explore Congressional interest in negotiating a bilateral free trade agreement, the Automotive Parts & Accessories Association (APAA) would like to link our knowledge of the U.S. automotive aftermarket industry's needs to the skills of our negotiating team to ensure that our industry is not imperiled by any new pact.

Not only is the free trade proposal the centerpiece of the Macdonald Commission Report on Canada's economic future, but the concept also has many backers in the Administration and Congress who wish to eliminate tariff barriers between principal trading partners. We believe that the proposal warrants serious study, and we recognize that there are sure to be some industry sectors in both nations where a free trade agreement would prove mutually beneficial.

We do not believe this would be the case for the automotive aftermarket industry. We contend this because Canada has introduced a new twist into our bilateral automotive trade -- the lure of Japanese suppliers to use Canada as a springboard to launch duty free original equipment exports into both domestic and Japanese car assembly plants in the U.S.

Of course, both Canadian and Japanese parts makers view the U.S. aftermarket as the major prize in world parts trade. The minimal degree of tariff protection now afforded aftermarket products must remain intact to absorb some of the shock of the price advantage that the exchange rate alone guarantees aftermarket exports of Canadian firms and a growing number of Canadian-based Japanese firms.

We note that Canada has a longstanding commitment to a national policy for its automotive industry. Concern for its supplier base spurred the 1975 implementation of a duty remission program for imported vehicles. The objective was to induce foreign-based

auto makers to buy Canadian content, by netting out the value of that content from the dutiable value of the car maker's shipments to Canada. The 11 percent plus Canadian tariff makes this a valuable incentive.

In a 1981 spin-off of this program, Canada offered Volkswagen (VW) duty free importation of cars into Canada in exchange for their manufacture of parts in Canada for export to VW's U.S. assembly plants. That plan was cut short by the auto making depression and the deep plunge in VW's equipment demands.

Finally, Canada's 1983 Private Sector Task Force on the Motor Vehicle and Parts Industries named a domestic content requirement as the cornerstone of its recommendations to the federal government. The task force proposal effectively would broaden the Auto Pact content stipulations to apply to Japanese and other foreign vehicle producers who market cars in Canada.

In the U.S., APAA has worked with the Department of Commerce (DOC) and the Office of U.S. Trade Representative (USTR) to begin development of our own program for the aftermarket. While we have joined Administration ranks in denouncing domestic content as bad economics that would threaten both short-term and long-term industry vitality, we still hope to gain Administration support for the Automotive Products Export Council (APEC)-developed Parts Purchase Incentive Plan, tailored after the Canadian duty remission program.

The linchpin of the U.S. parts program is the industry/government Japan Initiative to crack Japanese car company-controlled markets. Through the exchange of buying and selling missions, already begun at the recent APAA Show, and the creation of a bilateral Trade Facilitation Committee (TFC) to help smooth the rough edges in private contract talks, we have a program to build American supplier opportunities wherever Japan builds and sells cars.

Clearly our policy objectives differ -- Canadian industry support of domestic content versus the U.S. industry/government market opening initiative, preferably assisted by the leverage that our Parts Purchase Incentive Plan would provide. The bottom line is the same, however, as both industries work feverishly to develop new customers -- namely Japanese car makers -- to supplant the sagging parts demand of traditional Big Four customers.

While we have no quarrel with healthy competition, we must object to the playing field being tipped to Canada's advantage. We cite the well-reported Canadian government bounties to lure new Japanese supplier investment to Canada. In fact, it was Canadian government seed money that helped found Pacific Automotive Co-operation, Inc.

(PAC) in 1984, for the purpose of stimulating both the Canadian and Japanese parts industries. Staffed by Japanese auto executives and directed by officials of the Japanese Automobile Manufacturers Association (JAMA) and the Japan Auto Parts Industries Association (JAPIA), PAC is waging an ambitious campaign to entice Japanese suppliers to take some of the sting out of U.S. political frustration with the mounting parts trade deficit, by entering the U.S. through the back door. Perhaps this fits the letter of the Auto Pact, but it clearly does not conform with the spirit. Moreover, it seriously undermines our market opening initiatives.

But, Japan is reacting to political pressure from both countries. Its chief response is to move more of its vehicle production to North America. Reluctant to choose from U.S. suppliers who are capable of supplying the entire gamut of Japanese auto manufacturing needs, Japanese car makers prefer to establish their own supplier families nearby. Faced with U.S. industry resistance to a network of new plants setting up next door to underutilized American plants, Japanese firms are finding PAC's sales pitch most appealing. Not only will Canada welcome their suppliers, but the Japanese can locate close enough to the U.S. assembly plants for just-in-time delivery. All is done duty free and in full compliance with the Auto Pact.

Obviously, Canada offers advantages beyond a receptive climate. The strong U.S. dollar, that has hampered our firms' access to foreign markets, becomes a potent club against us as our chief trading partner offers a built in 25 percent plus discount on every component and car shipped to the U.S.

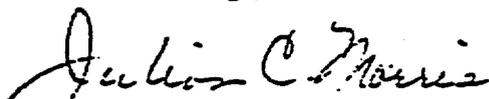
Add to this the lure of government grants and lower operating costs in the key areas of wages, utilities, and materials, and it is easy to see that our parts trade deficit with Canada could mount swiftly as Japanese suppliers exploit the Auto Pact to sidestep U.S. political pressures.

To reiterate, it is imperative that we not aid this onslaught by making our aftermarket industry more vulnerable. Even with the status quo, we know that Japanese suppliers to American OE markets will enter our aftermarket with the same competitive advantages cited above. Moreover, their OE production base will help lower the cost of the extra units produced for the U.S. aftermarket, making their price competitiveness even more formidable.

Honorable Malcolm Baldrige
September 30, 1985
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As a member of ISAC-16, I look forward to discussing this issue with fellow council members. More importantly, APAA wishes to work with trade negotiators from your department and the USTR. Please let me know how and when we can help at each stage of the negotiating process.

Sincerely,



Julian C. Morris
President

JCM/lk/dp

cc: Mr. Bruce Smart, Undersecretary, International Trade, DOC
Mr. Robert Watkins, Deputy Assistant Secretary, Automotive Affairs and Consumer Goods, DOC
Mr. Robert Reck, Division Director, Parts & Suppliers Division, DOC
Mr. Thomas Brewer, Director, Office of Canada, DOC
Mr. William S. Merkin, Deputy Assistant U.S. Trade Representative, Canada and Mexico

TABLE 6

Retail Sales of Motor Vehicles in Canada and the United States
1965 and 1970-84 - (Thousands of Units)

Year	Automobiles			Trucks			Total Vehicles
	North American Type	Overseas Import Type	Total	North American Type	Overseas Import Type	Total	
<u>1. Canada</u>							
1965	634	75	709	120	2	122	831
1970	497	143	640	125	9	134	774
1971	592	188	780	147	13	160	940
1972	654	205	859	190	17	207	1,066
1973	783	188	971	235	20	256	1,227
1974	797	146	943	288	19	307	1,249
1975	836	154	989	310	17	327	1,317
1976	793	153	946	331	14	345	1,291
1977	798	194	991	338	16	354	1,345
1978	816	173	989	364	13	377	1,366
1979	863	140	1,003	381	12	393	1,396
1980	741	191	932	312	22	334	1,266
1981	647	257	904	251	36	287	1,191
1982	489	224	713	167	40	207	920
1983	625	218	843	193	45	238	1,081
1984	725	246	971	274	39	313	1,284

Source: Statistics Canada

**Retail Sales of Motor Vehicles in Canada and the United States
1965 and 1970-84 - (Thousands of Units)**

Year	Automobiles			Trucks			Total Vehicles
	North American Type	Overseas Import Type	Total	North American Type	Overseas Import Type	Total	
1965	8,763	569	9,332	1,539	44	1,583	10,915
1970	7,120	1,285	8,405	1,746	65	1,811	10,216
1971	8,681	1,570	10,251	2,011	85	2,096	12,347
1972	9,327	1,623	10,950	2,486	143	2,632	13,575
1973	9,676	1,763	11,439	2,916	228	3,144	14,583
1974	7,454	1,413	8,867	2,512	171	2,683	11,550
1975	7,053	1,587	8,640	2,249	231	2,480	11,120
1976	8,611	1,498	10,109	2,944	237	3,181	13,290
1977	9,109	2,075	11,184	3,353	323	3,676	14,860
1978	9,312	2,000	11,312	3,776	337	4,113	15,425
1979	8,328	2,300	10,628	3,000	500	3,500	14,128
1980	6,578	2,398	8,976	2,002	484	2,486	11,462
1981	6,206	2,324	8,530	1,852	448	2,300	10,830
1982	5,757	2,222	7,979	2,151	410	2,561	10,540
1983	6,795	2,386	9,181	2,588	464	3,052	12,233
1984	7,951	2,439	10,390	3,484	607	4,091	14,481

Source: Motor Vehicle Manufacturers' Association and Ward's Reports

TABLE 7

**CANADIAN SALES OF NEW PASSENGER CARS BY ORIGIN
1964 - 1984 CALENDAR YEAR (Units)**

Year	Total Sales		Domestic			Total Imported			Japanese		
	Volume		Volume	Per cent		Volume	Per cent	Volume	Per cent		
1964	616	759	550	823	89.3	65	936	10.7	-	-	
1965	708	716	633	641	89.4	75	075	10.6	2	834	0.4
1966	694	820	626	986	90.2	67	834	9.8	2	742	0.4
1967	679	435	605	049	89.1	74	386	10.9	5	617	0.8
1968	741	915	637	393	85.9	104	522	14.1	15	859	2.1
1969	760	803	638	270	83.9	122	533	16.1	39	033	5.1
1970	640	360	497	185	77.7	143	175	22.3	65	569	10.2
1971	780	762	592	319	75.9	188	443	24.1	106	552	13.7
1972	858	959	653	933	76.1	205	026	23.9	116	860	13.6
1973	970	828	782	914	80.6	187	914	19.4	111	467	11.5
1974	942	797	796	840	84.5	145	957	15.5	87	609	9.3
1975	989	280	835	679	84.5	153	601	15.5	95	772	9.7
1976	946	488	793	201	83.8	153	287	16.2	101	558	10.7
1977	991	398	797	752	80.5	193	646	19.5	134	900	13.6
1978	988	890	815	994	82.5	172	896	17.5	113	166	11.4
1979	1,003	008	863	554	86.1	139	454	13.9	79	879	8.0
1980	932	060	740	767	79.5	191	293	20.5	138	107	14.8
1981	904	195	646	942	71.6	257	253	28.4	207	639	23.0
1982	713	481	489	435	68.6	224	046	31.4	178	174	25.0
1983	843	318	625	088	74.1	218	230	25.9	176	525	20.9
1984	971	210	724	932	74.6	246	278	25.4	171	204	17.6

Source: Statistics Canada

TABLE 8

**NORTH AMERICAN PRODUCTION OF MOTOR VEHICLES
(^{'000} UNITS)**

Year	Canada		U.S.A.		North America Total	
	Volume	Per cent	Volume	Per cent	Volume	Per cent
1965	846	7.1	11,114	92.9	11,960	100.0
1966	902	8.0	10,363	92.0	11,265	100.0
1967	947	9.5	8,992	90.5	9,939	100.0
1968	1,180	9.8	10,794	90.2	11,974	100.0
1969	1,353	11.7	10,182	88.3	11,535	100.0
1970	1,193	12.6	8,263	87.4	9,456	100.0
1971	1,373	11.4	10,650	88.6	12,023	100.0
1972	1,474	11.5	11,297	88.5	12,771	100.0
1973	1,575	11.1	12,663	88.9	14,238	100.0
1974	1,564	13.5	9,984	86.5	11,548	100.0
1975	1,442	13.9	8,965	86.1	10,407	100.0
1976	1,647	12.5	11,486	87.5	13,133	100.0
1977	1,775	12.3	12,699	87.7	14,474	100.0
1978	1,818	12.4	12,895	87.6	14,713	100.0
1979	1,632	12.4	11,475	87.6	13,107	100.0
1980	1,374	14.6	8,010	85.4	9,384	100.0
1981	1,280	13.9	7,941	86.1	9,221	100.0
1982	1,236	15.0	6,985	85.0	8,221	100.0
1983	1,502	13.9	9,226	86.1	10,728	100.0
1984	1,830	14.4	10,924	85.6	12,754	100.0

Source: Ward's Automotive Reports

TABLE 9

MOTOR VEHICLE PARTS AND ACCESSORIES PRODUCTION
CANADA AND THE U.S.
(\$ millions Canadian)

Year	Canada	U.S.	Canadian as a percentage of Total North America
1972	2,106.0	27,765.3	7.1
1973	2,533.8	32,919.8	7.1
1974	2,510.0	32,231.8	7.2
1975	2,552.9	34,035.4	7.0
1976	3,417.8	43,271.2	7.3
1977	4,138.8	57,017.0	6.8
1978	5,119.7	68,345.5	7.0
1979	4,897.4	69,833.6	6.6
1980	4,034.2	58,119.3	6.5
1981	4,879.3	66,527.6	6.8
1982	5,538.9	44,642.0	11.0
1983	6,544.4	58,785.0	10.0
1984	10,231.8	74,012.0	12.1

Source: Statistics Canada and the U.S. Department of Commerce

TABLE 10

EMPLOYMENT RELATED TO AUTOMOTIVE MANUFACTURING IN CANADA
1964 - 1984
(Thousands)

Calendar Year	Motor Vehicle Assembly (SIC 323)	Truck Body & Trailers (SIC 324)	Automotive Parts & Acc. (SIC 325)	Automobile Fabric & Acc. (SIC 188)	Total
1964	34.3	4.4	30.5	1.3	70.5
1965	39.8	5.8	35.3	1.9	82.8
1966	40.7	6.3	37.6	2.7	87.3
1967	38.7	6.7	37.7	2.6	85.7
1968	39.6	6.8	37.3	3.1	86.8
1969	42.3	8.2	40.4	4.1	95.0
1970	37.5	8.4	36.4	3.7	86.0
1971	41.0	10.1	41.3	4.3	96.7
1972	41.9	14.2	41.4	5.2	102.7
1973	45.2	14.8	48.8	5.8	114.6
1974	47.1	15.2	45.9	5.7	113.9
1975	43.4	14.4	41.2	4.8	103.8
1976	46.6	14.0	46.2	5.6	112.4
1977	50.6	12.6	48.6	6.5	118.3
1978	52.3	13.6	52.1	6.9	124.9
1979	52.6	14.8	49.8	6.6	123.8
1980	43.9	12.9	41.0	6.3	104.1
1981	43.4	12.1	44.7	7.2	107.4
1982	42.7	8.6	41.1	6.3	98.7
1983	44.4	11.5	55.2	4.5	115.6
1984	49.5	12.5	56.9	4.9	123.8

Source: Statistics Canada

TABLE 11

**CANADA - UNITED STATES TRADE IN AUTOMOTIVE PRODUCTS
1967 - 1984**

	1976	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	
	\$ MILLION																		
United States Imports from Canada*																			
Cars	748	1,204	1,662	1,538	1,943	2,046	2,272	2,540	2,858	3,430	4,032	4,723	4,345	4,452	5,145	7,170	8,973	13,085	
Trucks, etc.	247	399	605	589	593	706	789	868	932	1,344	1,964	2,364	2,218	3,142	3,946	4,437	5,880		
Parts	512	846	1,037	1,127	1,495	1,778	2,172	1,963	2,045	2,942	3,721	4,753	4,489	3,405	4,151	4,902	7,056	10,287	
Tires & tubes	13	9	5	15	8	23	68	64	68	163	144	192	234	231	286	406	419	598	
Total	1,520	2,458	3,309	3,269	4,039	4,553	5,301	5,435	5,903	7,879	9,861	11,993	11,432	10,306	12,724	16,424	20,885	29,850	
Canadian Imports from United States																			
Cars	588	809	792	659	960	1,056	1,439	1,621	2,183	2,317	2,834	3,038	3,747	3,388	3,710	2,875	4,886	6,085	
Trucks etc.	132	189	263	275	361	495	643	896	942	970	1,118	1,322	1,952	1,217	1,347	873	1,129	2,039	
Parts	1,314	1,820	2,307	2,107	2,485	2,907	3,528	3,829	4,425	5,473	6,848	8,092	8,666	7,600	9,230	9,676	11,359	15,446	
Tires & tubes	8	29	37	24	36	50	92	218	174	115	153	130	155	146	165	147	225	345	
Total	2,042	2,847	3,399	3,065	3,842	4,508	5,702	6,564	7,724	8,874	10,953	12,582	14,520	12,351	14,452	13,571	17,599	23,915	
Balances																			
Cars	160	395	870	879	983	990	833	919	675	1,113	1,198	1,685	598	1,064	1,435	4,295	4,087	7,000	
Trucks etc.	115	210	342	314	232	211	146	-28	-10	375	846	1,003	412	1,001	1,795	3,073	3,308	3,841	
Parts	-802	-974	-1,270	-980	-990	-1,129	-1,866	-1,866	-2,380	-2,531	-3,127	-3,339	-4,177	-4,195	-5,079	-4,774	-4,303	-5,159	
Tires & tubes	5	-20	-32	-9	-28	-27	-24	-154	-106	48	-9	62	79	85	121	259	194	253	
Total	-522	-389	-90	204	197	45	-401	-1,129	-1,821	-995	-1,092	-589	-3,087	-2,045	-1,728	2,853	3,286	5,935	

*A more accurate measurement of trade in automotive products is obtained by comparing the import statistics of each country. Accordingly, Canadian exports are derived from the counterpart United States statistics of imports.

TABLE 12

**Relationship Between Canada/U.S. Auto Pact Trade Imbalance
and Canadian Value Added in Automotive Production as
Percentage of Canadian Cost of Sales**

Year	Canadian Value Added as Percentage of Cost of Sales in Canada	Canada Auto Pact Trade Imba- lance as Percentage of Total Canada/U.S. Auto Pact Trade
	(model year)	(calendar year)
1966	69	-24.7
1967	69	-15.8
1968	72	-7.8
1969	81	-1.4
1970	92	4.4
1971	95	3.5
1972	90	1.5
1973	79	-1.5
1974	71	-7.0
1975	66	-11.1
1976	67	-3.0
1977	72	-3.2
1978	74	-1.4
1979	64	-11.0
1980	53	-8.6
1981	62	-6.0
1982	91	9.1
1983	87	6.5
1984	83	n/a

Source: Department of Regional Industrial Expansion

TABLE 13

**Overall Net Production to Net Sales Value Ratios* Achieved by
Auto Pact Companies in Canada 1971-1984**

	MODEL YEARS													
	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
<u>Passenger Vehicles</u>														
(Required ratio: range 95-100)														
Net Sales Value Ratio Achieved (All companies)	149	125	121	122	122	122	125	130	130	106	123	202	196	173
<u>Commercial Vehicles</u>														
(Required ratio: range 75-100+)														
Net Sales Value Ratio Achieved (All companies)	142	122	115	98	101	113	132	155	127	115	140	238	272	231
<u>Buses</u>														
(Required ratio: range 85-100)														
Net Sales Value Ratio Achieved	120	119	97	102	114	98	105	163	183	199	273	213	243	312

* Net production to net sales value ratio is the ratio of the total value of Canadian vehicle production to the total net sales value of vehicle sales for all Auto Pact companies.

Source: Compiled from Company Auto Pact Reports to Department of Regional Industrial Expansion.

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