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Canada-United States Automotive Trade and Trade Policy Issues

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CANADA-UNITED STATES AUTOMOTIVE TRADE

AND TRADE POLICY ISSUES

Andrew R. Moroz

This paper contains preliminary findings from research still in progress and should not be quoted without prior approval of the author.

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UNIVERSITY OF WESTERN ONTARIO
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THE SECOND ANNUAL WORKSHOP ON U.S.-CANADIAN RELATIONS

"U.S.-Canadian Trade and Investment Frictions: Implications for Ontario and the Global Economy"

November 18-19, 1983

Spencer Hall
University of Western Ontario
London, Ontario

Andrew R. Moroz
Institute for Research on Public Policy

"Canada-United States Automotive Trade and Trade Policy Issues"
CANADA-UNITED STATES AUTOMOTIVE TRADE AND
TRADE POLICY ISSUES

by

Andrew R. Moroz
Institute for Research on Public Policy
Canada-United States Automotive Trade and Trade Policy Issues

"It is now fairly obvious that by 1985 Japan and the United States will have their own "autopact" (based more on the politics than the economics of trade), and that the North American Autopact could become moribund." 1

For all intents and purposes, this prediction has come true, in 1983 if not two years earlier. The export restraint arrangements between Japan and the United States, along with the migration of Japanese automotive investment to the United States, constitute, for the most part, an "autopact", albeit a "voluntary" one. Canada too has attempted to establish an "voluntary autopact" with Japan, negotiating its own export restraints and soliciting, unsuccessfully so far, both Japanese automotive investment and Japanese procurement of Canadian automotive products. While both Canada and the United States, as well as Japan, continue to state their support for liberalized trade, it has been the politics, not the economics, of trade that has determined these arrangements. And as for the North American Autopact, its longevitivy does not reflect its on-going usefulness but rather the inability of the two signatorys to reach a mutually better arrangement.

Automotive trade is the single largest area of economic interaction between Canada and the United States. Consequently, at any point in time, there are a number of automotive issues on the bilateral trade agenda. Since 1965, there have been three key developments that have shaped Canada-United States automotive trade and trade policy issues. The first was the signing of the Canada-United States Automotive Trade Products Agreement of 1965 (APTA). This agreement has established the basic structure of the Canadian automotive sector and the patterns of North American production, trade and investment.

The second was change in the political-economic position of the United States in the world economy. This change has had a profound effect on the U.S. economy and on U.S. foreign policy which in turn has altered permanently the underlying basis of the Canada-United States economic relationship. The third was the dramatic changes in the international automotive market which have invalidated the basic premise upon which the Canada-United States Automotive Products Trade Agreement of 1965 (APTA) was negotiated and signed. As a result of these international changes, bilateral automotive issues are no longer contained within North America nor isolated from outside factors.

The overriding concern in the current policy environment is the adjustment of the automotive sector to the changes in the international automotive market. Within the key question of adjustment, two basic policy problems confront the governments of Canada and the United States. The first is the short-run problem of increased penetration into their respective domestic markets by the Japanese vehicle producers. Whether or not this will continue to be an economic and political-economic problem for both countries depends on the ability and success of the North American automotive companies to adjust their products, production facilities and corporate organization to improve competitiveness and economic performance. This is the second issue, however, it has two dimensions: the economic question of whether the domestic automotive sector can successfully adjust to the international changes in the automotive market, and the political-economic question of how and where this adjustment will take place?
Both Canada and the United States share these basic policy problems. The major bilateral question concerns the managing of the adjustment process within North America. However, the problems of economic adjustment are different because of the differences in the structure of the automotive sector in each country. The major bilateral trade and trade policy issues in the current setting are related to the differences in the automotive sectors and the different approaches to economic problems in the automotive sector by the two governments.

II. Canada-United States Automotive Issues: The Current Setting

In the first half of 1983, two reports, one each in Canada and the United States, were published on the current state of their respective domestic automotive sectors. Both studies, Lavalle-White (1983) in Canada and the U.S. Department of Commerce (1983) in the United States, were commissioned in response to the disruptions in their domestic markets caused by international developments in the automotive market. The two reports documented the major problems experienced by the domestic automotive companies, the high levels of automotive unemployment, the difficult and disruptive tasks of restructuring and adjusting and the vulnerability of the domestic automotive sector to import competition from Japan. Each study, moreover, cast the resulting policy issues in terms of critical national interest, documenting the strategic economic importance of the automotive sector as an employer, a creator and user of high technology, a major purchaser from other industries and a major producer of goods and services.

The two reports departed on the policy recommendations. Lavalle-White (1983) identified the main issue as jobs and the main problems as the truncation of the domestic automotive sector and the lack of Canada's "fair share" of production and investment. The study argued strongly that policies, particularly trade policies, be based on equity in terms of the commitments by all vehicle companies selling in Canada and in terms of a "fair and equitable share" of automotive activity in Canada commensurate to the benefits from selling in Canada. The study highlighted the problems in the Canadian parts industry, particularly the low level research and development, and identified the growing importance of technology and technological development in the automotive sector. The report proposed that the current commitments under the APTA be extended to all automobile companies selling in Canada and, after a period of transition, these commitments be raised. The report further recommended a number of incentives for R&D and capital investment to assist the parts industry, in particular the Canadian independent parts producers, and stressed the need for labour adjustment policies to deal with the critical problems of unemployment and retraining as the industry adjusted. The recommended policy package was not in any way a radical, or even minor, departure from the traditions of Canadian automotive policy making; it simply extended the traditional Canadian approach to the changed environment.

U.S. Department of Commerce (1983), in contrast, defined the basic policy issue as economic adjustment to changes in market conditions. It identified the key problem as constraints to adjustment faced by the U.S. automotive companies; particularly the financial constraints on the U.S. companies from
depressed sales, large operating losses and high interest rates, and the political-economic constraints of excess capacity and foreign protectionism in the global automotive market. The study argued that policies be based on economic efficiency and competitiveness and warned that policy makers have "an obligation to face the realities of the market place". While the report identified numerous changes in safety and emission regulations to reduce the financial costs of compliance and in labour-community adjustment programs to ease the social costs of adjustment, the main policy emphasis was on allowing the market to work, aided by general economic incentives from macroeconomic policy. By opposing both microeconomic policies specifically designed for the automotive sector and further protection from offshore competition, the policy recommendations in the U.S. Department of Commerce report were consistent with the general direction of U.S. automotive policies in the last three decades.

III. The North American Policy Setting

Table I lists the major events which have directly or indirectly affected the Canada-United States automotive trade relations since 1960. Since there has been a unjustifiable preoccupation with current year bilateral automotive trade balances, these trade data are shown on the table. As the increased penetration of offshore imports into the Canadian and U.S. vehicles markets is dominating policy concerns today, the table also shows the market share of offshore imports in Canada and the United States.
<table>
<thead>
<tr>
<th>Year</th>
<th>Key Developments In or Affecting Canada-U.S. Automotive Issues</th>
<th>Bilateral Trade Balance</th>
<th>Market Share of Offshore Imports</th>
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</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Under APTA (millions)</td>
<td>Outside APTA (millions)</td>
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<tr>
<td>1961</td>
<td>- Royal Commission on the Automotive Industry (Bladen) recommends that content requirements for duty remission programs be based on sales in Canada.</td>
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<td>1962</td>
<td>- Canada introduces duty remission program for automatic transmissions.</td>
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<td>1963</td>
<td>- Canada expands duty remission program to vehicles and other automotive parts.</td>
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<td>1964</td>
<td>- Modine Manufacturing Company of Racine, Wisconsin files petition for countervailing duty against Canadian imports because of remission program; Canada and the United States enter into intensive negotiations.</td>
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<td>1965</td>
<td>- Canada and the U.S. sign Canada-United States Automotive Products Trade Agreement (APTA); Congress passes Automotive Products Trade Act but voices displeasure with Letters of Undertaking and with not being consulted during the negotiations.</td>
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<td>1966</td>
<td>- Canada agrees to reduce tariff on automobiles from 17.5% to 13% in Kennedy Round negotiations; U.S. agrees to cut automobile tariff from 6.3% to 3.6%; both agree to tariff cuts on other automotive products.</td>
<td>580.8</td>
<td>118.1</td>
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<td>1967</td>
<td>- Automatic bilateral review of APTA exposes major fundamental disagreements between Canada and the U.S. over interpretation of objectives and retention of safeguard conditions; U.S. seeks removal of Canadian safeguards and opposes Canada's request for additional undertakings from vehicle manufacturers; Canada opposes elimination of safeguard conditions and insists on new Letters of Undertaking, however vague.</td>
<td>401.7</td>
<td>143.4</td>
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<td></td>
<td>- U.S. Senate Finance Committee conducts special hearings on termination of the APTA.</td>
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<td></td>
<td>- Congress secures public agreement from U.S. manufacturers to oppose further Letters of Undertaking by subsidiaries in Canada.</td>
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<td></td>
<td>- In response to increasing global integration and interdependence, both Canada and the U.S. undertake major reviews of foreign policy assumptions, approaches and positions.</td>
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<td>1969</td>
<td>- U.S. President's Report on APTA states &quot;continued existence of the transitional restrictions (Canadian safeguards) is an obstacle to full realization of the Agreement objectives, has some adverse impact on the U.S. trade position, and would influence investment decisions and the trade position in the long term&quot;; U.S. demands removal of safeguards; Canada argues that safeguards essential to maintain a &quot;fair and equitable share&quot; of North American automotive production.</td>
<td>87.7</td>
<td>195.4</td>
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<td>- A Bill to Repeal the Automotive Products Act of 1965 is introduced, but not passed in the Senate.</td>
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<td></td>
<td>- Nominal wage parity reached between Canadian and U.S. automotive workers.</td>
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<td></td>
<td>- U.S. Senate Finance Committee requests President to ensure Canada-U.S. free trade in automotive products by 1973.</td>
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<td></td>
<td>- Automobile imports from Japan start to enter Canada and the U.S. in significant numbers.</td>
<td>(267.5)</td>
<td>156.6</td>
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<tr>
<td></td>
<td>- Canada switches to floating exchange rate and Canadian dollar moves towards parity with U.S. dollar.</td>
<td>(262.7)</td>
<td>146.1</td>
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<td>1971</td>
<td>- Nixon Administration, in reaction to U.S. balance of payments problems, takes the U.S. off gold standard, devalues U.S. dollar, establishes DISC program and imposes surtax on imports (motor vehicles imported Canada are exempted from surtax); Canada seeks, unsuccessfully, exemption from surtax and reduces manufacturing corporate tax rate to offset DISC.</td>
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<td></td>
<td>- As part of U.S. reaction to balance of payments problem, U.S. demands concerning APTA escalate rapidly from removal of safeguards to elimination of Canadian restrictions on duty free importation of automotive products to removal of safeguards as precondition for negotiations on APTA and U.S. links automotive trade with defence trade and other trade issues; Canada refuses to acknowledge linkages and expresses concern about lack of domestic automotive managerial and R&amp;D activity and growing automotive parts trade deficit.</td>
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<td></td>
<td>- Secretary of U.S. Treasury Connally recommends termination of the APTA but recommendation is not followed thru.</td>
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<td></td>
<td>- In late 1971, U.S. informs Canada that surtax will be removed shortly but linkage between automotive and other trade issues is not dropped; Canada continues to resist linkage approach but drops safeguards-in-principle stance and indicates willingness to discuss modifications in safeguards.</td>
<td>(262.7)</td>
<td>146.1</td>
</tr>
<tr>
<td>Year</td>
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<tr>
<td>1972</td>
<td>- Canada and the U.S. hold informal meetings but no modifications in APTA are agreed to; U.S. continues to demand removal of safeguard conditions and Canada continues to demand their retention citing &quot;institutional barriers&quot;. President Nixon addresses House of Commons: &quot;It is time for Canadians and Americans to move beyond the sentimental rhetoric of the past. It is time for us to recognize that we have very separate identities; that we have significant differences; and that nobody's interest are furthered when these realities are obscured.&quot; - House of Commons passes legislation to establish FIRA; U.S. response is relatively mute. - Prompted by U.S. economic measures in 1971, Canada announces Third Option. - U.S. Congress, which has begun to assert itself more strongly in U.S. foreign policy because of internal changes in the U.S. legislative system and growing dissatisfaction with executive secrecy and the Vietnam War, legislates Case Act of 1972 which requires text of all new international agreements to be submitted to Congress for review.</td>
<td>(125.9) 206.7</td>
<td>23.9 14.6</td>
</tr>
<tr>
<td>1973</td>
<td>- Price of oil triples because of OPEC.</td>
<td>158.2 277.5</td>
<td>19.4 15.2</td>
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<td>1974</td>
<td>- U.S. enacts Trade Reform Act of 1974 which requires the President to include five Senators and five Congressmen as advisors on U.S. delegations involved in trade negotiations. - U.S. enacts Trade Act of 1974 which signals switch from trade policy as an instrument of overall U.S. foreign policy to trade policy as an explicit advancement of U.S. economic self-interests. - Canada institutes energy oil price policy to insulate domestic economy from increase in world energy prices; U.S. introduces price controls on domestically produced energy. - President Ford and Prime Minister Trudeau agree to parallel studies &quot;to examine the state of the automotive industry&quot;</td>
<td>782.6 653.6</td>
<td>13.5 15.7</td>
</tr>
<tr>
<td>1975</td>
<td>- Canada introduces duty remission policy to allow non-U.S. importers of automobiles to earn remission of duty on parts exported from Canada except when exported to the U.S. - U.S. Senate Finance Committee requests U.S. International Trade Commission (U.S. ITC) to review whether Canada has complied with terms of APTA and has phased out safeguards. - Shifts of automotive investment, particularly in parts sector, to U.S. sunbelt (and, to a lesser degree, offshore) raises concerns; both Canada (federal and Ontario) and northern U.S. states start to counter with location incentives. - UAW (U.S.) and House of Representatives Committee on Education and Labour, petition for anti-dumping duties against alleged dumping of automobiles by Canadian, European and Japanese producers; U.S. ITC rules &quot;it did not determine there is no indication that an industry in the United States is being or is likely to be injured&quot;; petition moves to U.S. Treasury. - Motor Vehicular Manufacturing Association (U.S.) recommends following modifications to APTA: include after-market parts, tires and tubes, and all buses; allow unrestricted duty free trade in truck cab chassis; allow Canadian content and production requirements by class of vehicle to be combined at manufacturers' option and computed on multi-year running average; and formally incorporate all acceptable content requirements into the APTA. - U.S. enacts The Energy Policy and Conservation Act which stipulates weight average gas mileage for cars sold in the U.S. must reach 18 mpg by 1978 and 27.3 mpg by 1983; Act includes amendment that stipulates captive import of automobiles must meet minimum 75% U.S. content, starting in 1979.</td>
<td>1404.9 347.0</td>
<td>13.5 18.2</td>
</tr>
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<td>1976</td>
<td>- During ministerial discussions on various bilateral issues, Canada and the U.S. agree to examine ways to deal with Canada's growing parts deficit problem without renegotiating APTA and to study emerging problem of off-shore sourcing of both captive and non-captive parts. - U.S. ITC concludes that Canada has not fully complied with terms of APTA and only United States made concessions under the agreement. - U.S. Treasury requires commitments from U.S. vehicle manufacturers to eliminate price differentials on vehicles between Canada and United States and drops dumping investigation on imports from Canada. - Canadian dollar falls from above parity to approximately 92¢ U.S.</td>
<td>460.3 486.8</td>
<td>16.2 14.8</td>
</tr>
<tr>
<td>Year</td>
<td>Bilateral Trade Balance</td>
<td>Market Share of Offshore Imports</td>
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<td></td>
<td>Under APTA (millions)</td>
<td>Outside of APTA</td>
<td>Canada</td>
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<tr>
<td>1977</td>
<td>633.2</td>
<td>563.3</td>
<td>19.5</td>
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<tr>
<td>1978</td>
<td>315.0</td>
<td>291.0</td>
<td>17.5</td>
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<tr>
<td>1979</td>
<td>2650.0</td>
<td>430.0</td>
<td>13.9</td>
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<tr>
<td>1980</td>
<td>1812.6</td>
<td>346.6</td>
<td>20.3</td>
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### Key Developments In or Affecting Canada-U.S. Automotive Issues

1977
- Review of the North American Automotive Industry (Arthur) warns that Canadian industry is vulnerable to structural changes in automotive industry and imports from off-shore producers.
- Canadian federal government under growing political pressure to renegotiate APTA to address problems of low Canadian based R&D and management activity, growing parts trade deficit, low investment in parts sector and high level of unskilled jobs; in response, federal government includes automotive industry in sector task force studies and presses, with limited success, major vehicle manufacturers and multi-national parts producers for additional investment in parts production.
- Canadian factory list prices of automobiles fall below U.S. factory list prices for first time as Canadian dollar continues to depreciate.
- Impact of Environmental, Energy and Safety Regulations and of Emerging Market Factors in the U.S. Sector of the North American Automotive Industry (U.S. Dept. of Commerce) concludes U.S. automobile companies have financial and technical capacity to meet U.S. mandates for safety emission, fuel efficiency and changes in the U.S. market; study does not deal with the Canada-U.S. issues in trade, production and investment.

1978
- Pennsylvania successfully outbids Ohio and provides $115 million incentive package to Volkswagen to establish new assembly plant.
- Canada and Ontario win subsidy bidding war against Ohio with incentive of $73 million to Ford to locate new engine plant in Windsor.
- Report of Canadian Automotive Consultative Sector Task Force (Beil) warns that pricing and cost constraints and tariff reduction may inhibit capital investment in Canadian automotive industry.
- Canadian Senate Standing Committee on Foreign Affairs recommends that federal government pressure vehicle manufacturers to locate parts plants in Canada and APTA be fixed as a permanent treaty.
- Senior Canadian and U.S. federal officials meet to discuss automotive trade issues; U.S. voices its opposition to federal and provincial incentives but indicates its own difficulties in controlling state incentives; differing views of APTA continue to plague bilateral discussions of automotive issues.
- Inquiry into the Automotive Industry (Reisman) notes that annual service payments to U.S. parent companies from Canadian subsidiaries approaching $50 million and Canadian operations are more profitable than the U.S. operations; Inquiry recommends incentives for the parts industry and duty-free entry for non-APTA producers if they meet 60 to 75 per cent Canadian content in Canadian sales.
- Canada enters into duty remission scheme with Volkswagen which includes exports to the U.S. and is, for all practical purposes, a pure export incentive program; U.S. voices opposition.
- Canada's Share of the North American Automotive Industry: An Ontario Perspective, (Ontario Government) expands concept of "fair share" to encompass employment, value-added, investment and R&D as well as production and trade and redefines "fair share" of production as a "level consistent" with Canada's market share.
- Iranian revolution and second oil price jump in months, North American producers go from excess demand for large cars to excess supply as the real price of gas jumps and gas lines form in U.S.

1979
- Canada announces R&D incentives for the parts industry and expresses desire to enter into bilateral negotiations outside the APTA to limit and control investment location incentives; the federal government states that it is neither its policy or intention at this time to renegotiate APTA.
- Canada agrees to cut tariffs on automobiles to 9.2% by 1988 in Tokyo Round tariff negotiations; U.S. agrees to cut tariff, on automobiles to 2.5% by 1987; both countries also agree to tariffs cuts in other automotive products.

1980
- U.S. government provides loan guarantees of $1.5 billion (U.S.) to Chrysler under domestic and U.S. pressure, Canada provides Chrysler Canada with $200 million in loan guarantees; UAW in the U.S. and Canada make substantial wage concessions to Chrysler.
- UAW (U.S.), followed by Ford, petitions for import relief from imports of automobiles; question of whether imports from Canada should be included is raised; U.S. ITC rules that imports are not the substantial cause of injury, that other factors such as shift towards smaller cars and decline in overall demand are more important causes of injury.
- Following 1980 election promises, Canada requests formal consultations under Article IV of APTA; Canada expresses concern about parts trade deficit and desire to increase investment in parts production and R&D in Canada; U.S. responds that "any modifications (unilaterally implemented by Canada) would be considered a change in the terms of the APTA and would require the expressed approval of both the Executive and the Congress".
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<tbody>
<tr>
<td>- Canada introduces the National Energy Program in 1980 budget and proposes changes to FIRA; U.S. voices strong opposition to both and bilateral relations start to rapidly deteriorate.</td>
<td>Under (millions)</td>
<td>Outside of (millions)</td>
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<tr>
<td>- U.S. enters negotiations with third countries, including Japan, to induce off-shore automotive producers to establish facilities in the U.S.</td>
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<td>- Three European companies and one Japanese firm agree to participate in an expanded duty remittance program.</td>
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<td>- Canada enters discussions with Japan to solicit Japanese automotive investment in Canada and to increase use of Canadian parts by Japanese automobile producers.</td>
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<td>- Volkswagen opens second U.S. plant in Michigan.</td>
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<tr>
<td>1981 - The U.S. Automobile Industry, 1980, (U.S. Dept. of Transportation) concludes that major adjustments required in all areas of automotive sector that, companies, labour and government must all take responsibility for solutions to current problems, that future of industry linked directly to overall U.S. national interests and security, and recommends major policy package of Japanese export restraint, tax changes regulatory changes and labour adjustment programs; Canada is only briefly referred to and not included in discussion of adjustment process or policy development.</td>
<td>1996.6</td>
<td>523.4</td>
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<td>- The bilateral dispute over the NEP and FIRA escalates with the switch from quiet diplomacy and problem solving approach to public and high profile political posturing; bilateral consultations on a wide range of issues come to a halt.</td>
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<td>- Congress introduces bill to legislate quotas on automobile imports from Japan; Reagan Administration opposes the bill but negotiates a three-year export restraint arrangement with Japan.</td>
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<td>- Congress introduces a number of trade reciprocity bills; all are strongly opposed by Reagan Administration.</td>
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<tr>
<td>- Canada and Volkswagen conclude broadened duty remission plan based on 85 per cent Canadian content and Volkswagen agrees to establish plants in Ontario; U.S. express strong opposition to expanded duty remission program.</td>
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<tr>
<td>- President Reagan signs Economy Recovery Tax Act of 1981 to cut personal and business tax rates over three years, orders major review of 30 automobile related regulations to find ways and means to reduce the cost burden on U.S. automobile producers, proposes changes to the Anti-Trust legislation to allow joint-ventures in automotive R&amp;D, and proposes changes to existing labour adjustment assistance programs to provide greater coverage for automotive workers.</td>
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<td>- Canada negotiates one-year export restraint arrangement with Japan.</td>
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<td>- European countries introduce or expand restrictions against Japanese automotive imports.</td>
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<td>1982 - The U.S. Automobile Industry 1981, (U.S. Dept. of Transportation) shifts emphasis of policy recommendation to allowing market forces determine adjustment; again Canada only mentioned in passing.</td>
<td>(2554.5)</td>
<td>(136.6)</td>
</tr>
<tr>
<td>- With amendment that Act not supersede APTA, House of Representatives passes &quot;Fair Practices in Automotive Products Act&quot; which would legislate domestic content in automobiles sold in the U.S.; strong opposition to bill from Regan Administration and in Senate and bill dies on Senate order table.</td>
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<td>- Canada changes approach in dealing with U.S. by increasing direct contact of Canadian embassy with Congress and increasing budget for consultants and lobbying on Capitol Hill.</td>
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<td>- Turbulent GATT ministerial meetings result in weak declaration in support of trade liberalization and limiting further growth of protectionism.</td>
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<td>- Congress and Reagan Administration agree to jointly draft a reciprocity bill; proposed legislation, Reciprocal Trade and Investment Act of 1982, introduced in Senate.</td>
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<td>- U.S. makes major changes in 29 safety and emission regulations to reduce cost of compliance to U.S. producers, and changes and introduces labour adjustment programs and other policies to assist adjustment in automotive sector.</td>
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<td>- The number of Canadian and U.S. academic studies on the automotive industry grows rapidly; studies generally oppose protection and detail both the costs differences between North America and Japan and the major adjustments North American industry faces; U.S. studies rarely include Canada.</td>
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<td>- After prolonged and difficult negotiations in which Canada raises issues of Japan's trade barriers on various products and Japanese purchases of Canadian automotive parts, followed by Canadian slowdown of customs processing of automobile imports from Japan, Canada and Japan reach agreement on automobile export restraint for second year.</td>
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<td>- Honda begins production in Marysville, Ohio.</td>
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<td>- UAW (U.S.) provides major wage and non-wage concessions to GM and the Ford; UAW (Canada) initially opposes providing similar concessions but reaches agreements with GM and Ford involving mostly concessions on non-wage benefits.</td>
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<tr>
<td>Year</td>
<td>Bilateral Trade Balance(^1)</td>
<td>Market Share of Offshore Imports(^2)</td>
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<td></td>
<td>Under APTA (millions)</td>
<td>Outside of APTA</td>
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<tr>
<td>1983</td>
<td>(1400)(^3)</td>
<td>25.2(^4)</td>
</tr>
</tbody>
</table>

### Key Developments In or Affecting Canada-U.S. Automotive Issues

- **The U.S. Automobile Industry, 1982**, (U.S. Dept. of Commerce) states that U.S. automotive industry has made remarkable progress in adjusting and role of government is to ensure smooth and orderly adjustment and not to provide protection against changes in automotive industry and market; Canada only mentioned once with regards to labour conditions.
- **An Automotive Strategy for Canada** (Lavalle and White) recommends that all vehicle manufacturers selling to Canada be required to meet Canadian content commitments comparable to those under the APTA and, overtime, to increase level of minimum content commitments; recommendations are endorsed and supported by vehicle producers, UAW and independent parts producers in Canada.
- **House of Representatives passes the Fair Practices in Automotive Products Act;**
- **Reagan Administration continues to oppose bill.**
- **While general state of the bilateral relationship improves generally, numerous bilateral problems and disputes arise, mainly because of differences in basic policy approaches and deregulation in the U.S., particularly in the service sector.**
- **A Review of Canadian Trade Policy and Canadian Trade Policy for the 1980s** (Canada, External Affairs) recommend greater attention to Canada-U.S. trade and exploration of negotiating sectoral free trade agreements with the U.S.;
- Canadian media interpret studies as implicit but official pronouncement of end of Third Option; U.S. response to two studies is favourable in tone but ambiguous in substance.
- **Sales, production, employment and profits of U.S. owned automotive firms in Canada and the U.S. show major improvements as consumer preference shifts back towards intermediate and larger cars.**
- **U.S. negotiations with Japan limit Japanese automobile exports for fourth year** (1984); during negotiations U.S. links automobile trade issues with agriculture trade and other trade issues;
- **Canada and Japan reach agreement on Japanese automobile exports for a third year.**
- **Nissan begins production of light trucks in Smyrna, Tennessee.**
- **G.M. and Toyota announce joint venture to produce sub-compacts in Fremont, California.**

### Source

1. Expressed as net: U.S. exports, brackets indicate net U.S. export deficit; data from White and Lavelle (1983); data are not reconciled with U.S. data.
2. Retail sales of offshore imports as percentage of total retail sales, measured in units.
3. First six months of 1983 data by Under APTA and Outside of APTA not available.
4. First eight months of 1983.
The basic policy differences between Canada and the United States are demonstrated by the differences in the approaches of each government throughout the 1970s. Until 1979, U.S. automotive policy was largely confined to mandating safety, emission and fuel consumption requirements. The key automotive policy assumption was that the U.S. automotive sector had the financial and technological resources to meet these sometimes conflicting technical requirements for emission, safety and fuel economy. While some concerns about foreign import penetration were raised, primarily from labour and particularly about offshore sourcing of parts, the basic U.S. policy stance has been one of non-intervention in the automotive sector, based on the position that the industry and the United States was best served by free markets and liberalize trade.

Canada, on the other hand, has always provided assistance to the domestic automotive industry. At each stage in the evolution of the industry, any threat to Canada’s “fair share” of automotive manufacturing relative to domestic consumption has been countered by domestic policies - whether tariffs, content schemes or manufacturing requirements - that have sought automotive investment, production and employment in Canada. Throughout the 1970s Canada introduced a number of policies to address problems outside the specific domain of the APTA, particularly the on-going problems of low R&D in the Canadian industry, the concentration on low-skilled labour intensive production activities and the lagging competitiveness of the Canadian parts industry. On the trade policy front, Canada vigorously defended the safeguards and commitments of the APTA, and the Canadian government initiated a number of duty remission programs to entice offshore producers to establish parts facilities in Canada. The basic intent of Canadian automotive policy has been to offset the problems of a small domestic automotive market and the domination of the Canadian automotive sector by the foreign owned multinational automotive companies. The various policies introduced in the 1970s have reflected both the structural problems in the domestic automotive sector and the increasing penetration of the Canadian vehicle market by offshore producers.

The different governmental approaches reflect the basic differences in the structure of the automotive sector in each country and the asymmetric nature of the bilateral automotive trade relationship. The United States has a domestically owned and controlled automotive sector comprising of large independent parts companies and the large vehicle assembly companies. The U.S. automotive sector is a fully integrated sector, conducting the full range of activities from corporate planning, financial and management functions to research and development, as well as producing the entire range of components and vehicles. The Canadian automotive sector, on the other hand, is dominated by the U.S. vehicle assembly companies and the parts industry is comprised of U.S. captive and independent parts producers and a large number of diverse, mostly small, Canadian owned independent parts producers. Even before the APTA, the Canadian automotive sector relied heavily on the U.S. automotive sector for management functions, research and development, and products imported from the United States. Where the automotive sector is unique from the other areas of bilateral economic interaction is that the APTA has, to a large degree, institutionalized both the bilateral automotive economic and political-economic relationships.
Figure 1
Structure of North American Automotive Sector:
1976 - 1981

NOTE: Base of arrow shows percentage of output sold to purchaser; tip of arrow shows percentage purchased from source; brackets show percentage of total national automotive production; all percentages plus or minus 2.5; offshore vehicles not included in table.
managerial functions—primarily because it was not designed to address these issues—it broke the normal production links between parts production, assembly and product demand within the domestic market.

The APTA dictates that the Canadian automotive sector is an appendage to the U.S. sector and to U.S. policies. This affects both the performance and ability to adjust of the Canadian automotive sector and constrains the economic policy options open to Canadian governments. As the APTA sets both the structure and performance of the Canadian industry, it is also drawn into virtually every automotive issue, and its politics, that arise in Canada. From here it is but a short jump to the bilateral agenda. What the APTA does is to ensure that the economic problems of the Canadian automotive sector are translated into continuing political and, especially, diplomatic problems for the Canadian government. It also dictates that the Canadian federal government must be seen as managing the conditions and problems in the Canadian automotive sector and the bilateral automotive trade and trade policy relationship.

The APTA has also had three affects on the structure and performance of the Canadian economy. First, the APTA has increased both the linkage and sensitivity of the Canadian macroeconomy to the cyclical conditions in the U.S. automotive market. Second, other Canadian manufacturing sectors are less competitive because of the spread of higher real wages induced by the real wage increase in the automotive sector. Third, a number of important Canadian non-automotive manufacturing sectors such as iron and steel and metal fabricating have become significantly more dependent on the automotive sector under the APTA. Consequently, the APTA has increased the dependence of both the automotive sector and the Canadian economy on the U.S. automotive market. This makes the Canadian automotive sector a major and ongoing domestic and international policy concern for Canada.

The patterns of North American production, trade and investment described in Figure 1 are the direct product of the safeguard conditions in the APTA and the commitments in the Letters of Undertaking which accompanied the APTA. To reach its stated objective of a “fair and equitable share” of North American automotive activity, Canada insisted on the following safeguards in the APTA:

1. Only companies producing in Canada and designated as “bona fide” manufacturers of vehicles can import vehicles and original equipment parts duty free; there are no restrictions on the origin of these vehicles and parts.

2. A company importing into Canada is required in each model year to maintain, at a minimum, a ratio of Canadian production to Canadian sales in each class of vehicle: cars, commercial vehicles, buses—expressed in net sales value, of 75 per cent or the percentage obtained in the 1964 model year, whichever was higher; the required ratio for each company is confidential but as an industry, the specified ratio for cars ranges from .75 to 1.0, for commercial vehicles from .75 to 1.0, and for buses from .85 to 1.0.

3. The amount of Canadian value added be no less in any given model year than that obtained in the 1964 model year.

4. After market parts are not included in the APTA.

The Canadian federal government also sought and obtained letters of undertaking from the major producers. These letters of undertaking are outside
the formal agreement signed by the two governments and, since 1968, have no legal basis for enforcement. With the exception of one year, 1980, the U.S. assembly companies have collectively continued to meet the commitments which require:

(1) The amount of Canadian value added in vehicles to increase by 60 per cent of the cost of sales of vehicles sold in Canada and 50 per cent of the commercial vehicles sold in Canada.

(2) The producers collectively increase Canadian value added by $260 million at the end of the 1968 model year.

The United States signed the APTA on the belief that the safeguard conditions in APTA would only be in place for a limited, transitional period, and that once the Canadian automotive sector had adjusted, the patterns of production, trade and investment would be determined by market forces. The Letters of Undertaking were initially treated by the U.S. Administration as a private arrangement between the Canadian federal government and the U.S. vehicle companies, although members of the U.S. Congress expressed strong disapproval of the commitments. The conditions specified by the United States in the APTA were that only vehicles and OE parts from Canada with at least 50 per cent North American content where eligible for duty free access, and that only bona fide manufacturers of vehicles in the United States could import original equipment (OE) parts duty free from Canada.

Given the relative sizes of the Canadian and U.S. automotive sectors, it is not surprising that the APTA has not affect the structure of U.S. automotive sector. While the APTA has induced a marginal shift of automotive production activity from the United States to Canada, the U.S. automotive sector has gained from higher profits and more efficient production in Canada and a larger production base to spread management, R&D and engineering service costs. The U.S. economy, moreover, has directly benefited from higher non-automotive net exports to Canada due to the increase in Canadian real incomes and the reduction in Canadian competitiveness in non-automotive sectors.

Both the Canadian automotive sector and Canadian economy have benefited greatly from the APTA. However, the effectiveness of the Canadian safeguards and commitments have been eroded over time. Inflation and industry growth have made the third safeguard and the last commitment - the two requirements which establish the absolute base for Canadian Value Added (CVA) - largely redundant. While the ratio requirement is still legally binding, it does not provide Canada with protection against market downturns or against changes in consumer preferences. Moreover, from Canada's point of view, the effectiveness of ratio safeguard and the growth commitment are now in jeopardy. The driving force of the APTA for Canada is Canadian sales of North American Vehicles. As North American vehicles take a smaller share of the Canadian market, the less effective the ratio safeguard and the growth commitment becomes.

The most important safeguard, however, has always been first safeguard designating restricted duty-free access to Canada. It is the incentive to operate under the APTA and remains the only form of ensuring compliance by the companies. In 1965, the interplay of Canada-U.S. price differential allowed by
the Canadian tariff of 17.5 per cent, the elimination of tariffs on OE parts imports and the 30 per cent lower wage in Canada provided an implicit subsidy to the assemblers to finance the conversion of production facilities and cross subsidize any remaining cost inefficiencies in Canada for meeting the CVA requirements or exporting vehicles to the United States.

Since the mid-1970s, this implicit subsidy has been largely eliminated. Compared to the cost efficiencies of large scale production in a modern automotive plant, the Canadian tariff has become ineffective. Moreover, the U.S. Congress has constrained the remaining margin between the prices charged in Canada and the United States. With nominal wage parity established since 1970, the only source of an "implicity" subsidy is the lower Canadian dollar. Consequently, the compliance safeguard is no longer an effective enticement to the U.S. vehicle companies.

The elimination of the implicit subsidy, or for that the reduction in the general effectiveness of the safeguards and commitments, is not an adverse outcome, given the large economic benefits Canada continues to derive from bilateral automotive trade. However, the APTA has not proved to be useful to Canada or the United States in dealing with the bilateral automotive issues outside the specific domain of the APTA, particularly with the problems of the low research and development in the Canadian industry or bilateral competition for automotive investment through locational incentives for both U.S. and offshore producers. Nor has the APTA sheltered Canadian policies from actions by Congress or under U.S. trade law. To the extent it provides some assurances that Canada will not be left out of the U.S. vehicle companies' corporate strategies, it continues to play a useful role for Canada. However, its role as an insurance policy against new "institutional barriers" arising from the internationalization of the automotive market is even more questionable than against the traditional North American "institutional barriers".

While the APTA has been an effective tool to solving the economic problem of low volume production in Canada, it has become a major problem in Canada-United States economic relations. As indicated in Table 1, the negotiating of the APTA was a damage control exercise which the United States entered on the grounds of overall national interest. The United States signed the APTA to divert a border trade war in the middle of the Kennedy Round tariff negotiations and to defuse the growing economic nationalism in Canada. The main feature of U.S. participation was its willingness to separate and isolate the Canada-United States relationship from its broader, multilateral political-economic global interests. An important factor in this damage control excess was that the Administration was willing to sign the APTA without consulting the Congress.

It is quite obvious from Table 1 that the United States would not have signed the APTA after 1968. In that year, Canada and the United States began feuding over the interpretation of the objectives of the APTA and the retention of the safeguards and commitments. By 1970, the APTA was caught-up in the U.S. balance of payments problems. Since 1973, there has been, for all intents and purposes, a Mexican stand-off between Canada and the United States over
the APTA. While both countries would like to renegotiate the APTA, the objectives Canada and the United States would seek in negotiations are explicitly and inherently conflicting. Both the Canadian and U.S. federal governements have continued to publically express their commitment to the APTA because of the fear of the disruption its termination would cause in the North American automotive sector.

Since the late 1960s, there has been a fundamental change in the basic bilateral relationship which has intensified the conflict over the APTA Canadian. As a result of its changed relative position in global economic and political affairs, the United States is no longer willing to isolate the bilateral economic relationships from its multilateral relationship or isolate the bilateral automotive interaction from other areas of bilateral economic interaction. Unlike 1965, the bilateral environment in the 1970s and 1980s has provided little room for Canada and the United States to renegotiate the APTA without the risk of its outright termination.

The change in the U.S. perception of the Canada-United States relationship has superimposed itself onto the entire range of automotive trade issues. Throughout the 1970s there was an increasing dissatisfaction on the part of the United States with the policies implemented by Canada to deal with the structure problems in the Canadian automotive sector. The use by Canada of incentives and duty remission programs have become an increasing concern to the United States and Canadian subsidy programs are increasingly vulnerable to U.S. trade policy actions. At the same time, Congress has become much more involved in trade matters. It has tended to be more protectionistic, reflecting its position in the U.S. legislative system, and has made its displeasure felt since the day the U.S. bill to incorporate the APTA was sent to its halls.

With the both parties preoccupied with maximizing their individual benefits as opposed to maximizing the mutual benefits from the bilateral automotive trade, the policy environment in the mid-1970s switched from silent antagonism to direct competition for automotive investment. The increasing tensions in the asymmetric competition between Canada and the United States is largely due to the developments in the international automotive sector and market, and it has been complicated by the growing number of offshore owned automotive facilities established in North America.

IV. Internationalization, Adjustment and Issues for North America

The negotiating and signing of the APTA was premised on the assumption that the North American automotive market was fundamentally different, and hence separable, from automotive markets outside the continent. This assumption of separability has now been overwhelmed by the global developments in the automotive industry and market.

The most important development has been the dramatic increase in the real price of gasoline since 1973 and especially after 1979. As shown in Table 2, the resulting shift in consumer preferences from large, luxury oriented, fuel
Table 2

Passenger Car Sales by Size: Canada and the United States

<table>
<thead>
<tr>
<th></th>
<th>Imports</th>
<th>Small Domestic (% of Sales)</th>
<th>Intermediate Domestic</th>
<th>Large Domestic</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>Canada</td>
<td>20</td>
<td>22</td>
<td>34</td>
</tr>
<tr>
<td></td>
<td>United States</td>
<td>15</td>
<td>23</td>
<td>21</td>
</tr>
<tr>
<td>1973</td>
<td>Canada</td>
<td>29</td>
<td>25</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>United States</td>
<td>18</td>
<td>28</td>
<td>26</td>
</tr>
<tr>
<td>1975</td>
<td>Canada</td>
<td>20</td>
<td>25</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>United States</td>
<td>18</td>
<td>24</td>
<td>24</td>
</tr>
<tr>
<td>1977</td>
<td>Canada</td>
<td>20</td>
<td>26</td>
<td>23</td>
</tr>
<tr>
<td></td>
<td>United States</td>
<td>19</td>
<td>24</td>
<td>23</td>
</tr>
<tr>
<td>1978</td>
<td>Canada</td>
<td>18</td>
<td>27</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>United States</td>
<td>18</td>
<td>23</td>
<td>23</td>
</tr>
<tr>
<td>1979</td>
<td>Canada</td>
<td>14</td>
<td>25</td>
<td>19</td>
</tr>
<tr>
<td></td>
<td>United States</td>
<td>22</td>
<td>24</td>
<td>20</td>
</tr>
<tr>
<td>1980</td>
<td>Canada</td>
<td>21</td>
<td>25</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>United States</td>
<td>27</td>
<td>24</td>
<td>21</td>
</tr>
<tr>
<td>1981</td>
<td>Canada</td>
<td>23</td>
<td>20</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>United States</td>
<td>27</td>
<td>20</td>
<td>16</td>
</tr>
<tr>
<td>1982</td>
<td>Canada</td>
<td>31</td>
<td>20</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>United States</td>
<td>28</td>
<td>19</td>
<td>19</td>
</tr>
</tbody>
</table>

Source: MVMA Canada.

1. Until 1979, most imports are small vehicles; after 1979 up to 20 per cent may be intermediate vehicles. See U.S. Department of Commerce (1983).

inefficient vehicles to smaller, quality oriented, fuel efficient vehicles effectively eliminated the natural protection provided to the North American producers in their home market. This had dictated major adjustments and large investment expenditures in the North American automotive sector estimated at up to $80-90 billion in the design of products, the types of materials used in automotive production, and the converting of existing production capacity to match consumer preferences.

The convergence of North American consumers preferences to those outside the continent raises three important implications for corporate and government policy planners in North America. First, the U.S. vehicle companies now face direct competition in vehicle models in their home market. At the same time, they are developing products that can be exported into foreign markets. Second, the degree of competition has increased substantially. While the automotive market remains basically oligopolistic in structure, increased cost and quality competition have eroded both the traditional market size and profit margins available to the U.S. vehicle producers. Third, there is considerable excess vehicle production capacity in the world; it estimated that by 1983, even with full market recovery, the global automobile production capacity will exceed demand by up to 15 per cent. Most of this excess capacity is located in North America and involves a considerable degree of obsolete capacity.

It is, however, misleading to solely concentrate on the increase in the price of gasoline as the only cause of the problems for the North American automotive
sector. A major development emerging from the mid-1970s has been the decreasing rate of growth of vehicle demand. The three major vehicle markets—North America, Europe and Japan—have reached, or are approaching, the saturation point. Much of the future demand in these markets will be replacement demand. While the third-world offers a large potential market, there is at least a 10-15 year gap before this potential will even begin to be realized. Moreover, automotive policies in third world countries are likely to limit import access to these markets.

At the same time, global economic integration and new technologies in production, organization and communications have created the potential for corporations to organize, plan, source, produce and distribute on a global basis. Although this development is not unique to the automotive sector, even before 1973, the automotive sector was, albeit slowly, moving to internationalized production in certain products, particularly parts. However, the convergence of consumer preferences and the exposure to direct foreign competition have spurred the trend to globalized planning and internationalized production by the North American vehicle producers.

Within these basic developments, the main driving force for adjustment in the North American automotive sector is direct competition from the Japanese producers in the North American market. As shown in Table 3, Japanese cars are not new to the North American market. Japanese imports have held a significant share of the North American automobile market as early as the late 1960s. The U.S. vehicle companies first largely ignored the small car market

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Sales (units)</th>
<th>Domestic</th>
<th>Japanese</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>781,992</td>
<td>581,562</td>
<td>117,078</td>
<td>83,352</td>
</tr>
<tr>
<td>1972</td>
<td>833,593</td>
<td>594,956</td>
<td>119,703</td>
<td>124,750</td>
</tr>
<tr>
<td>1973</td>
<td>873,124</td>
<td>609,192</td>
<td>119,234</td>
<td>143,698</td>
</tr>
<tr>
<td>1974</td>
<td>899,375</td>
<td>622,018</td>
<td>114,700</td>
<td>152,657</td>
</tr>
<tr>
<td>1975</td>
<td>927,801</td>
<td>635,456</td>
<td>109,705</td>
<td>182,640</td>
</tr>
<tr>
<td>1976</td>
<td>940,594</td>
<td>647,028</td>
<td>106,707</td>
<td>186,859</td>
</tr>
<tr>
<td>1977</td>
<td>954,227</td>
<td>659,692</td>
<td>103,115</td>
<td>187,419</td>
</tr>
<tr>
<td>1978</td>
<td>966,200</td>
<td>672,824</td>
<td>99,703</td>
<td>187,673</td>
</tr>
<tr>
<td>1979</td>
<td>979,481</td>
<td>686,018</td>
<td>96,295</td>
<td>197,168</td>
</tr>
<tr>
<td>1980</td>
<td>993,592</td>
<td>700,212</td>
<td>92,894</td>
<td>200,486</td>
</tr>
</tbody>
</table>

Table 3: Passenger Car Sales in Canada and the United States


Sources
and, after 1973, adjusted their products and capacity to maintain their overall market share as opposed to competing with the Japanese companies head on. In large part, the Japanese penetration into the North American vehicle market during the 1970s was allowed by the U.S. companies under the umbrella of the oligopolistic market in North America.

Since 1979, this competition has become intense in terms of both cost and quality. It is estimated that a Japanese vehicle at the U.S. border, after all freight, landing and tariff costs are paid, has a cost advantage of $1,750 to $2,000 (U.S.) when compared to a comparable North American produced vehicle. Part of this cost advantage is due to the low yen, the substantially lower wage rates in the vehicle and parts industries and government indirect assistance and protection in Japan. Nevertheless, a major part is explained by higher labour productivity, less waste, greater use of automation and new production technologies, effective control of costs, and the stress on quality in production and products. At the same time, North American consumers have learned since 1979 that Japanese cars are high quality cars in terms of fuel efficiency, reliability, maintenance and performance.

The U.S. vehicle firms have responded by major changes in product design and engineering, production facilities, and corporate organization and planning. North American automotive investment in the past five years has been almost exclusively in designing new products, developing new production technologies and converting capacity, and not in expanding capacity. Greater attention to production costs, inventory and quality control, and on-going research and development to enhance products and processes are showing major improvements in cost and product competitiveness. New production technologies - particularly automation and more capital intensive facilities throughout the production process - are allowing companies to maximize production efficiencies, reduce per-unit costs and improve quality control. One critical outcome is that the number or workers per unit of output is falling and the required skill mix in changing quickly.

The adjustments in products, production and management are causing an important restructuring in the relationships between assemblers and independent parts producers and between the automobile companies themselves. There is a marked shift from multi-source procurement to designated main suppliers; with the main supplier taking greater responsibility for component development, quality and delivery. The sub-assembly industry is taking on a greater role in assembling the main sub-systems of vehicles and the actual amount of component assembly and sub-assembly operations are declining in vehicle production facilities.

New components and vehicle designs - coming after the downsizing stage - have made numerous types of parts totally obsolete. The demand for new components, made from different materials, is affecting both the number and types of material suppliers and parts producers. Of the numerous firms supplying materials or producing parts, some will experience major reductions in the demand for their products; others are being asked to undertake large R&D expenditures, financial risks and production responsibilities to develop and supply
new products; and firms previously not selling to the automotive sector will find their products now demanded by parts producers and assembly companies.

The basic corporate strategies used by the major U.S. assembly companies to address the problems of structural adjustment and Japanese competition are varied within and without the firms. While the variations reflect the numerous opportunities and constraints faced by each U.S. company, two trends have developed. The first trend is to concentrate the entire range of automotive production from basic components to sub-assembly to vehicle assembly in one location to produce a "world car". This is essentially the Japanese model but some of the U.S. assembly companies have undertaken this model for producing certain vehicle lines. The alternative trend is to diversify production in a number of regions of the world. This has been the traditional approach of the U.S. assembly firms to gain market access.

The trends appear to be merging because of economic and political-economic factors. The rationale of the "world car concept" is to produce the same basic car at huge volumes to maximize economies of scale and management control. The major obstacles are national or regional differences in consumer preferences, government mandated fuel, emission and safety requirements, and government trade barriers and incentives. The hybrid trend involves assembling in each regional market along with the production of the specialized parts need to meet the specific consumer preferences and government rules, and producing the key components - basic engine, transmissions, suspension system - in centralized locations to maximize large volume production of these components. The objective is to minimize total overall costs through compatibility of components and by reducing the number of component systems. This hybrid approach has been facilitated by the development of technologies which allow cost effective production facilities for medium length runs of numerous product types. While economic and political economic factors are preventing the full realization of the "world car", it is materializing through the standardization of components which can be produced at world scale, with the basic unit being modified as needed to local requirements.

The net outcome for the North American automotive sector of the above developments is twofold: the world automotive market has become internationalized, and the North American automotive sector must adjust to become internationally competitive on price and quality. The impact of the international developments have fallen most heavily on the North American sector. The structural changes in the international automotive sector and market have the following implications for policy makers in Canada and the United States, and for Canada-United States relations.

First, much of the recent problems of low production and employment in the North American automotive sector are due to the recession, high interest rates and higher gas prices. Equally so, the low yen has contributed significantly to competitiveness of Japanese vehicles in the North American market. The North American automotive sector has experienced a major upturn since the dramatic days of 1979 to 1982; to the point that in late-1983 there are supply
shortages of certain larger North American built vehicles. However, a higher yen, economic recovery and lower interest rates real gasoline prices will not solve all the problems or eliminate the need for structural adjustment in the North American automotive sector.

Second, the current set of adjustments required by the North American automotive sector represents, to a large degree, a once and for all response to a dramatic, but permanent, change in market conditions. To a major extent, the U.S. vehicle companies have responded successfully in making this adjustment. However, the need to continually improve cost performance, products, facilities and organization will be a major characteristic of the automotive sector long after this adjustment stage is completed. The international market has become dynamic in terms of competitiveness and to remain competitive, each automotive company will have to be flexible, adaptive and innovative. A major instrument of dynamic competitiveness is technological leadership. Technology and technological research and development is taking a growing share of automotive investment expenditures, and the ability of any automotive firm to remain continually competitive on price and quality will depend on staying abreast of technological changes as well as market conditions.

Third, the question of jobs is the single most important political economy issue governing the current automotive policy dilemma in Canada and the United States. Traditionally, the automotive sector has been viewed and used as a major instrument of job creation, particularly in Canada. All indications are that employment in the North American industry will not, even with a full and successful adjustment by the sector, return to the historical levels which prevailed before 1979. Moreover, policies designed to recover jobs and reestablish the sector as an employment creator are likely to inhibit the ability to adjust and regain competitiveness as well as impose major costs on the domestic economies. Nevertheless, the issue of labour adjustment must be dealt with explicitly in any automotive policy package.

Fourth, excess world vehicle capacity will be a major determinant of automotive trade and trade policies. This problem is being exacerbated by policies in numerous countries to limit imports and promote exports. The automotive sector is seen by many nations as a strategic sector - both as an economic base and a source and user of high technology - and as an instrument of public policy. Many countries require the major multinational automobile corporations to meet production, export and content requirements to obtain access to their markets and, at the same time, offer generous location incentives. As both the European and Japanese automotive markets are effectively closed, the main target is the North American automotive market. The shifting of the excess capacity problem onto North American producers and, simultaneously, the barring of exports from North America will exacerbate both the economic and political-economic problems in both North America and the world trading system.

Fifth, offshore sourcing of parts and vehicles are likely to play key roles in the adjustment and long-term corporate strategies of the major U.S. assembly companies. Economic integration and the globalization of automotive production
allows automotive producers to take advantage of such things as differential wage rates, varying pollution laws, and differing government incentives when sourcing and production location decisions are made. Currently, offshore sourcing of OE parts and captive vehicle imports is relatively small but it is likely to grow. It is projected that the offshore OE parts may fill up to 15 per cent of U.S. assembly needs by 1990. The major U.S. automotive companies have already established major offshore facilities and foreign sources for key basic components to be used in North American assembly plants. As for captive vehicle imports, whether these imports are simply being used to fill the gap until North American capacity has adjusted is an open question. Nevertheless, how and where the North American vehicle companies decide to source their parts and vehicles will have important consequences on automotive output and employment, and the balance of payments of Canada and the United States.

Sixth, the international developments have had a direct impact on the ownership structure of the automotive sector in North America. Since the mid-1970s, there has been an increasing number of offshore owned automotive facilities established in North America. Almost all have located in the United States in response to U.S. policies, or potential policies which would limit the access of offshore producers to the largest vehicle market in the world. Canada has attempted to entice offshore producers within its boundaries, and, as shown in Table 1, the bilateral competition for foreign automotive investment is becoming a major irritant in the bilateral relationship.

Last, the adjustments faced by the North American automotive sector are both broad and deep, involving fundamental and on-going adjustment in products, production facilities, supplier-producer relationships, numbers and skills of workers, and so forth. The North American adjustment problem is clearly one of improving cost and product competitiveness. Policies will not succeed if they are designed to protect against change; too much has changed. Even those policies developed to protect basic levels of automotive activity regardless of economic cost and consequences, must accept that a great deal of restructuring and displacement already has, and will continue, to occur.

The above policy implications set the basic parameters faced by government policy makers in Canada and the United States. They have also created a high degree of uncertainty for the North American automotive companies. Not only must the Canadian and U.S. automotive companies adjust to remain competitive in their own home market but they face major financial constraints and the perplexing problem of identifying what the North American consumer wants.

The process of transformation in the North American automotive sector is a source of conflict between Canada and the United States because of the differences in the structure of the automotive sector in each country and the basic policy approaches to development problems in the automotive sector. The adjustment problem for the U.S. automotive sector is one of organizing its financial, technological and market resources to regain its competitiveness. The policy issues for the United States center on how best to facilitate this
adjustment to minimize the disruption within the United States and the
disruption caused by foreign policies, including those of Canada.

The adjustment problem for Canada is essentially a developmental
question, given the structure of its automotive sector, the dependency of the
automotive sector on the U.S. automotive sector and market, and the
dependency of the Canadian economy and balance of payments on the Canadian
automotive sector. A major developmental concern to Canada is the parts
industry, particularly as parts are at the technological and adjustment edge of
the industrial revolution in the automotive sector. The low R&D base in the
parts sector and the concentration of production on low technology standardized
parts and unskilled labour intensive assembly activities make the Canadian
sector vulnerable to the external developments and the impact of these
developments on corporate strategies and foreign government trade policies,
including those of the United States. Should the market share of North
American vehicles in the Canadian market continue to decline, the APTA will
offer little protection to the Canadian parts industry from either from offshore
competition in the United States and Canada or from non-market forces in the
politics of automotive trade. The twin fear that either the U.S. vehicle
corporations will leave Canada out of their global production strategies or that
the U.S. government will leave Canada out of any other "autopact" it enters are
key concerns to Canadian policy makers.

While Canada and the United States face different adjustments within their
respective automotive sectors, they share the same causes of adjustment and the
same external pressure, namely competition from Japan. While many blame high
wages, oligopolistic tendencies of the U.S. vehicle companies or inappropriate
government regulations, the adjustment problem for the North American sector
is to adapt and restructure the products and production facilities to match the
cost and product competitiveness of the Japan automobile producers.
Macroeconomic forces such as high interest rates, low national demand and high
exchange rates are imposing constraints on the North American automotive
companies. However, the adjustment problem in the automotive sector is
essentially microeconomic, reflecting a change in consumer preferences and the
industrial structure of the automotive sector. It is incorrect to define the
economic adjustment problems of the North American automotive sector as
solely a trade problem; the increase in Japanese imports is due to the changes in
the automotive market, not the other way around.

However, as Japanese imports are the "visible cause" of the disruption in
the North American automotive sector, the policy attention is drawn to the
trade policy arena. The trade policy question is relatively straight forward for
Canada and the United States: should the governments actively intervene and
protect their domestic automotive companies and employees or should they
resist the protectionist demands and let market forces operate? There are two
dimensions in this question. Canada and the United States can choose to join
together and either form a continental barrier, or manage the adjustment
process at the continental level. Alternatively, each country could choose its
own route. However, should both decide to go in opposite directions, this is
likely to impose a major strain on the overall bilateral economic relationships.
The Current Policy Question

It is worth remembering that in 1978 the North American automotive sector was operating near full capacity; indeed, some of the U.S. vehicle companies were seriously considering reconverting their newly installed small car capacity back to larger car capacity. Dealers selling Japanese vehicles, on the other hand, were offering significant discounts as late as the spring of 1979. The second oil price increase in 1979 caused a traumatic disruption in the North American automotive sector. Within a year, production employment had dropped by 16.2 per cent in Canada and 21.6 per cent in the United States. The value of shipments by North American automotive producers in Canada and the United States fell by 9.2 per cent and 16.6 per cent respectively. With the market share of Japanese imports rising, both governments came under increasing political pressure to erect trade barriers against Japanese import competition.

The highly charged political environment was further intensified by the threatened collapse of Chrysler. The United States responded with an unprecedented extensive aid package and Canadian authorities had no choice but to offer a measure of support to Chrysler Canada, as the U.S. authorities made it quite clear that their support for Chrysler depended on Canada making a similar gesture. Moreover, as described in Table 1, the bilateral competition for offshore automotive investment heightened as both Canada and the United States attempted to persuade the Japanese and other offshore producers to install automotive facilities in their respective jurisdictions.

Under increasing political pressure, the United States negotiated a three year automobile export restraint agreement with Japan in 1981. This agreement has been subsequently extended for a fourth year. In the same year, Canada negotiated its own export restraint agreement with Japan; while the original agreement was only for one year, Canada and Japan have rolled-over the restraint agreements in each year since 1981. The U.S. Administration continues to state publicly that the restraints are temporary and only to ensure an orderly adjustment for the U.S. automotive sector. The Canadian federal government has said little publicly about its future intentions regarding bilateral export restraints with Japan. Both actions however have benefited the North American automotive sector. In particular, the Canadian automotive sector has benefited from both the U.S. arrangement with Japan, which protects the U.S. markets for Canadian parts and vehicles, and the Canadian arrangement, which protects the share of North American vehicles sold in the Canadian market and hence increases the effectiveness of the APTA.

While the levels of employment, production and profits have substantially improved in the North American automotive sector since 1980, the demands for protection have continued to grow. The current demands are for protection of the status quo and against the structural adjustment pressures emanating from the international developments in the automotive market. In 1983, the automotive trade policy issue in each country has switched from the question of providing relief from imports during a transition period to the question of installing permanent trade protection against foreign competition.
The current automotive trade policy debate in both Canada and the United States is dominated by the proposal to institute domestic content regulations for companies selling in the domestic market. The proposals in Canada and the United States share the same basic objective that companies selling in the home market should produce in the home market. The current U.S. proposal in the Congress, The Fair Practices in Automotive Products Act, would legislate an increasing percentage of U.S. content required against vehicles sold in the United States by each company as that companies' sales increased over 100,000 units. The maximum content percentage would be 90 per cent U.S. content when a company's sales exceed 900,000 vehicles. This bill is strongly supported by the UAW and it has been just passed by the House of Representatives. The bill is unlikely to pass Senate at this time; the Administration is strongly opposed and the President has threatened to veto the bill. The major U.S. vehicle producers are split on the issue with Ford and Chrysler supporting the bill. GM continues to oppose the bill, partly because of its own strategy to use Japanese imports to fill part of its small car fleet.

Whereas the passage of the U.S. content legislation would be a major departure from traditional U.S. automotive trade policy, the Canadian proposal, as outlined in Lavalle-White (1983), is the classic Canadian approach to the development problems of the Canadian automotive sector. Under the Lavalle-White proposal, the CVA commitments under the APTA would be extended to all vehicle producers selling more than 30,000 vehicles in Canada, and, after a transition period, these commitments would be increased. The major objective of the proposed Canadian content legislation is to protect and expand the Canadian parts industry. The Canadian federal government has yet to take a position on the content proposal but, as expected, it is strongly supported by the UAW and the Canadian independent parts producers. The content proposals plus the tax adjustments, financial incentives and labour adjustment proposals recommended in the Lavalle-White (1983) constitute the traditional demands by the two groups. 19 What is particularly interesting is that all the recommendations are also supported by the U.S. owned independent parts producers and the U.S. vehicle companies. 20

While neither the Canadian or the U.S. proposal names individual companies or countries and details on how the content programs would be administered are scarce, the content proposals are directly aimed at the Japanese vehicle companies. In the United States, the U.S. companies are currently exceeding the proposed maximum 90 per cent domestic content. In the case of Canada, the Canadian proposal itself does not discriminate in favour of the U.S. companies operating in Canada. However, as the U.S. companies are already above the current commitments and have direct parental links to the U.S. market, the proposed commitments would effectively discriminate against the offshore companies. Most European companies do not import quantities significantly above the proposed threshold levels and some have existing North American production facilities to fill any required domestic content. The objective of the content proposals are to limit direct competition from Japan and induce Japanese automotive investment into North America.
As the Canadian and U.S. automotive tariffs are ineffective inducements, both proposals rely on quantitative restraints which would effectively embargo imports above the level of the threshold unless the content requirements were met. The quantitative restraints would act to reduce the direct competition from Japan and would allow the U.S. vehicle companies to regain part of their lost market power. The content requirements, in turn, would restrict the use of offshore produced parts. While the Japanese companies could reduce the import constraint of the content requirements by locating higher valued vehicle and parts production in North America, the content requirements would force the Japanese producers to shift a significant part of their export production to either or both Canada and the United States. This would further reduce the competitive pressures on the U.S. vehicle companies as the Japanese producers would have to accept the higher costs of producing or sourcing in North America. As a package, the current content proposals in both Canada and the United States are outright protection which would directly benefit the North American automotive producers at a direct cost to consumers and the national economies from higher consumer prices, inefficient production and a misallocation of resources.

In the United States, the proposed content bill would, in effect, freeze the current degree of uncompetitiveness of the U.S. automotive sector and provide a degree of monopoly power to the U.S. vehicle companies to purchase offshore vehicles to fill their vehicle fleets. While the U.S. vehicle companies would also face direct competition from Japanese owned facilities in the United States, this competition would be based on U.S. competitive standards and not Japanese competitive standards. While automotive workers would receive job protection, either in Japanese owned or U.S. owned facilities, the gains are likely to be less than expected because of the shift to more technological and capital intensive production facilities. More likely, the content proposals would widen the wage margins available to those workers who are employed. Above all, the content proposals would provide direct protection to the production and employment in the parts industry from outsourcing sourcing from offshore producers and the growth of sourcing from the foreign based parts facilities of U.S. companies.

The situation, however, is not so straightforward for Canada, even should the United States and Canada simultaneously enact their current content proposals. To meet the higher content regulations and continue to operate at above the minimum levels of scale production, companies operating in Canada would have to rely on exports to absorb domestic production in excess of what the Canadian market can absorb. Unlike the APTA, the current Canadian proposal does not offer either access to foreign markets or potential increases in economic efficiency from product rationalization and large scale production. The major gains under the APTA were from the increase in production for exports of both vehicles and parts, and not from serving the small Canadian domestic market. The only similarity between the current situation and the situation when the APTA was negotiated is that the impact of the Canadian content proposed on the Canadian automotive sector would depend significantly on what the United States does.
If the United States does enact its own content requirements, then exports to United States by offshore producers located in Canada would be substantially precluded. At the same time, should the United States not legislate automotive content rules, it is certain that neither the Administration or the Congress would tolerate large volumes of content induced exports by offshore producers located in Canada. The U.S. opposition to both the current commitments for U.S. companies under the APTA and Canadian duty remission programs for non-U.S. companies make this clear. Consequently, the Japanese option of locating in Canada to meet the proposed Canadian content requirements for selling in Canada and exporting surplus production to the United States would be limited and risky, regardless of whether or not the United States implements content regulations.

As the U.S. companies are already in a position to meet both the Canadian and U.S. proposed content requirements, the enactment of the U.S. proposal would substantially benefit the existing Canadian automotive sector. With content regulations in both countries, the benefits of trade protection to the U.S. companies would be extended to the North American market. The content barriers in the United States would provide protection for exports to the United States by the U.S. companies from Canada. At the same time, the Canada content proposal would preserve the Canadian market for the U.S. owned facilities on both sides of the border. Since the current patterns and levels of bilateral automotive trade would provide ample room for filling both the Canadian and U.S. content requirements, the Canadian parts industry would not be adversely affected by the U.S. content proposal. In particular, the Canadian owned independent parts producers would continue to benefit for direct access to U.S. owned vehicle assembly facilities in the United States.

While the current U.S. proposal does not provide a provision for the APTA or exempt Canadian content in automotive goods imported into the United States by the U.S. companies, it is unlikely that the status of the APTA would be directly affected by the legislation of the U.S. content proposal. As long as the U.S. companies are able to meet the conditions of both the APTA - or the higher commitments in the current Canadian content proposal - and the U.S. content proposal, the APTA and a U.S. content bill could co-exist in what would be, in effect, a legislative limbo.

The trade protection benefits to the Canadian automotive sector would be maximized if the United States enacted a content bill which defined Canadian content as U.S. domestic content. However, the enactment of both a U.S. content bill and a Canadian content bill would not solve the structural problems that have plagued the Canadian automotive sector, particularly the parts industry. The content barrier around North America would simply preserve the current structure of the Canadian automotive sector, albeit protected from direct competition from Japan. The bilateral problems over the location of research and development and managerial functions and the persistent Canadian bilateral parts deficit would not be alleviated by content laws in Canada and the United States.
There is also cause for Canadian worry right across the entire range of bilateral manufacture goods trade if the United States passes an automotive content bill. Canada could very well find itself facing similar legislation without a provision for counting Canadian content as "U.S. domestic content" in a wide range of goods, including defence goods now exported under the Canada-United States Production Sharing Agreement. Moreover, content legislation in private sector markets would likely preclude Canadian access to public sector goods markets where Canada hopes to reduce the current U.S. government procurement obstacles.

The age-old bilateral problem of small vs large make the content proposals, similar in intent and operation, two different things for Canada and the United States. The size of the United States market is what has already attracted Japanese parts and vehicle facilities Canada's small domestic market and the political-economic risks of exporting to the United States or the economic costs of exporting elsewhere would not give the Japanese much incentive for major automotive facilities in Canada. What the Canadian content proposal would do is ensure that the U.S. companies continue to dominate the Canadian market thus restricting consumer choice. The Japanese companies would likely establish a few parts facilities in Canada to source energy intensive materials and standard parts for their world wide operations. At the same time, the Japanese producers would likely purchase some standardized parts from Canadian producers and possibly establish a facility to assembly imports of knock down vehicles. These actions would allow them to optimize the level of imports to Canada at a level above the proposed content threshold but significantly below their current volume.

The most compelling argument in Canada and the United States for imposing content regulations is that everybody else is already protecting their own domestic industries through export promotion programs, content schemes, financial incentives and import restrictions. This argument for protectionism is further advanced by the two corollaries that, relative to others, Canada and the United States are open automotive markets, and that given considerable excess global automotive capacity, the North American market is the main target of foreign export policies.

It is clear that foreign policies could be disruptive to both the adjustment process in North America and the future export potential of North American producers in the internationalized automotive market. However, this does not necessarily mean that long term counter protection is the solution. If anything, the imposition of content regulations in the United States would likely result in trade retaliation from its main offshore trading partners. In many respects, it would not matter if Canada imposed content regulations of its own should the United States do so, as it would get caught in the crossfire. More important, the creation of a content barrier around North America would be a major blow to the already fragile GATT system which would threaten the broad range of Canadian and U.S. trade interests. While the threat to impose content regulations may offer leverage to reduce offshore automotive trade barriers, their implementation in Canada and the United States would impose major economic costs on Canada and the United States.
The U.S. Administration has stated its strong opposition to the proposed U.S. content bill and expressed the view that such a bill would be inconsistent with the provisions of the GATT and would lead to retaliation by U.S. trading partners which would threaten the broad range of existing and future U.S. trade and foreign investment interests. This raises a major bilateral question; what are the implications if Canada imposes content requirements, especially during the policy deliberation process underway in the United States. As both the economic and political pressures to deal with the developmental problems in the automotive sector are intense, Canada may feel compelled that it must act. With offshore imports accounting for more than 23 per cent of Canadian vehicle sales, the effectiveness of the APTA is diluted as it does not cover a significant share of the Canadian market. Moreover, the APTA, the duty remission programs and the other incentive programs have proved to be ineffective in solving the structural problems in the parts industry. With little prospect of exporting outside of North America and high unemployment in the manufacturing sector, the Canadian federal government may decide to take its chances and implement a content law, probably less stringent than the current proposal, and accept the economic costs on the arguments of industrial and technological policy imperatives.

The act by Canada of imposing content regulations on imports is certain to cause a major disruption in the already unsettled bilateral automotive and general economic relationships. Such an action by Canada would directly threaten existing U.S. multilateral interests and the current U.S. multilateral initiatives at the GATT. The United States has a large stake in the existing trading system and in advancing trade and investment liberalization in the world trading system. Neither the United States or its major offshore trading partners accept or treat the Canada-United States trade relationship as separate or divorced form the multilateral trade policy arena. The United States would be compelled to counteract any Canadian action, especially if other countries view the Canadian action as establishing a new precedent for trade policies acceptable to the United States. For the United States, issues and problems with Canada are no longer limited to a philosophical conflict, internal to North America, over government intervention in the economy. Bilateral relations and Canadian trade policies are now a major concern for U.S. multilateral trade and investment interests.

The United States would also likely react strongly to an unilateral action by Canada to set automotive content regulations because of the perception that this would be followed by similar performance requirements in other sectors. One major concern of the United States regarding the Natural Energy Program was this view that such a program would be employed elsewhere. The implementation of Canadian content requirements would be interpreted as further evidence of Canadian industrial policies that directly affect the bilateral and multilateral interests of the United States. While the United States would likely ask for a GATT panel to examine any unilateral action, as it did for certain performance requirements under FIRA, a larger danger would be the U.S. threat to unilaterally change the APTA. Given that the United States remains unsatisfied with the current safeguards and commitments, the unilateral abrogation of the APTA could be argued by the United States as a move to freer
trade. This would then set U.S. unilateral policy directly against Canadian unilateral policy.

The bilateral issues regarding the content proposal are not strictly limited to whether or not they should be passed. Just having the proposals on the table, particularly on the U.S. table, is directly influencing automotive Japanese investment in North America. Clearly the reason for much of the recently installed Japanese automotive facilities in the United States is to reduce the threat of further U.S. barriers to Japanese exports such as content regulations. The current situation resembles that in the mid-1970s when Japanese investment in the U.S. television sector was largely influenced by U.S. trade policies and the fear of higher U.S. trade barriers.22

The location of automotive investment, be it by the Japanese, European or U.S. vehicle companies, has been one of the dominating issues on the Canada-United States bilateral agenda since the mid-1970s. Canada's insistence on retaining the safeguards and commitments has been largely due to concerns over political economic factors which directly influence private sector investment decisions by the U.S. companies. The automotive sector in Canada has been traditionally very profitable and, on the whole, Canadian locations for production facilities are not disadvantageous. The investment expenditures by the North American companies in the past few years have been largely in product design and production technology. As expected, on economic grounds, most of this research and development has occurred in the United States. However, the United States should not expect Canada to sit and do nothing as it actively solicits offshore automotive investment in production capacity.

Conclusion and Policy Consideration

The current state of Canada-United Stated automotive trade and trade policy relations is dominated by factors originating outside of North Americans. Policy makers in both countries face the dual problem of managing major adjustments in their domestic automotive sectors and dealing with increased import competition from abroad. Currently, both Canada and the United States are considering the introduction of content requirements for offshore vehicle producers selling in their respective domestic markets. If such policies are enacted, both economies will suffer major economic costs and the bilateral economic relationship will be severely strained.

A major problem confronting North America is the export promotion and import substitution policies of other nations. It is the interest of both Canada and the United States to individually and jointly act to stem and reverse the rise of foreign protectionism in automotive markets. It will become increasing difficult to control domestic demands for permanent trade barriers if foreign trade policies disrupt both the adjustment and performance of the North American automotive sector. Both countries should also move strongly against foreign trade barriers in non-automotive markets. To the degree that other trade interests of Canada and the North America are frustrated by foreign policies, the greater the pressure for protectionism in the automotive sector in Canada and the United States. The process of linking automotive trade issues to other trade interests should be made explicit but advanced at the multilateral level and based on the principles underlying the GATT.
Within North America, Canada and the United States face the important question about what to do about the APTA. It would seem that serious consideration should be given to replacing it with a less stringent arrangement that recognizes the problems faced in Canada but does not establish detailed, fixed and rigid annual requirements. The rationale for this is twofold. First, it has fulfilled its basic purpose but has proved to be inadequate in addressing such bilateral problems as competitive location incentives, Canada's low technological base in the automotive sector, international changes in the automotive sector and market, and direct offshore competition. Moreover, it was not designed to deal with high uncertainty, rapid economic changes or broad ranging structural adjustment to match offshore cost and product competitiveness. Second, the APTA, as it stands now, has become a major bilateral problem in itself; the basis of the general bilateral economic relationships has changed dramatically since 1965 and the APTA is as likely to cause more harm than good to future bilateral automotive and overall trade relations.

A broader issue arises with regards to bilateral automotive trade and trade policy issues. This is the affect of each government's policy responses to the problems in the automotive sector on the general bilateral relationship. The automotive sector is at the forefront of the economic and political economic challenges posed for North America by the integration of global economy activity and internationalized production. How each country addresses its domestic automotive problems, and the response by the other, will likely set the tone and nature of the broader bilateral economic relationship.

On pure economic grounds there is no justification for protectionism. However, the policy issues in the automotive sector are largely in the realm of political economy and will involve political decisions. As this sector is a major employer, producer and purchaser of industrial goods, the ability of the domestic automotive sector to respond and adjust successfully to the changing environment is of prime concern to policy makers in both Canada and the United States. While this fact is not stated to justify the current political demands for protectionism, the critical importance of this sector in public policy matters must be recognized.
Footnotes


2. For purposes of clarity, automotive sector refers to all industries which produce automotive parts and vehicles. Those industries producing automotive components will be referred to as the parts industry while industries producing vehicles are referred to as the vehicle industry.


4. Readers are asked to go through the table as the information relates directly to the discussions in the text.


6. This, in itself is not necessarily bad given the Canadian government's willingness to sacrifice consumer interests for interests of specific groups. However, a policy constraint could prohibit policies which would correct market failures or provide direct non-economic benefits in such areas as safety.


8. One of the "costs" of governments intervention is taking political responsibility and accountability for the current year performances of the industry.

9. This discussion here is based on the results of econometric simulations with the CANDIDE 1.2 M model of the import of the APTA on the Canadian automotive sector and economy from 1965 to 1976. See Martin and Moroz (1979), Moroz (1978a) and Moroz (1986).

10. It is ironic that the Canadian federal government has pursued since 1972 a foreign policy to reduce Canada's economic dependence on the United States.

11. The second safeguard, or ratio safeguard, stipulates that assembly will be the main automotive activity in Canada. The U.S. automobile companies have made the corporate decision, based on economics and politics, to use mostly imported parts in the assembly of vehicles in Canada; with most of these parts re-exported in finished vehicles. This basic pattern of producing and exporting vehicles and importing OE parts is partially amended by the Canadian Value Added requirements specified in the third safeguard and the two commitments. Since the CVA requirements do not have to be met inside vehicles produced in Canada, each U.S. assembly company has the option to substitute CVA on OE parts exported to U.S. assembly operations for CVA in vehicles produced in Canada. This flexibility of meeting the CVA requirements has also allowed the U.S. companies to substitute OE parts exports for vehicle exports, which partly explains why the margin between the actual and the APTA stipulated production-sales ratio declined from 1968 to 1981. Between 1965 to 1978 - ignoring this post 1978 period because of the rapid change in consumer preferences - the production-sale ratio declined from 1.66 to 1.30. During this period, total CVA per dollars of net sales and non-parts in vehicle CVA per dollars of net sales was relatively stable. However, in-vehicle parts CVA per dollar decline steadily throughout the period matched by an offsetting increase in CVA in exported OE parts increased on a per dollar of vehicle basis. While there is not a fixed relationship between the cost of sales and net sales value - as demonstrated in 1982 - and a number of other qualifications must be accepted, the offsetting in-vehicle CVA per vehicle by exported OE parts CVA measured per vehicle, would explain partly why the declining ratio and the deterioration trend in Canada's automobile trade surplus.

12. Individually the record is mixed. Ford Canada in 1982 experienced difficulties in meeting the commitment in each class of vehicle and has been allowed to combine their Canadian value added across all classes to meet the company's commitment.

13. All figures in Canadian dollars unless indicated.

14. This advantage, assuming the export price is the same, would be about 20 per cent lower for Canada because of the lower Canadian dollar.


17. For example, the break-even point of U.S. automobile companies collectively has been reduced from over 11 million units to under 8.5 million units.


19. Three interesting recommendations are to establish an Automotive Council, and Office of Automotive Affairs and have the Minister of ITC/DREE report annually on the state of the automobile industry in Canada. While the three would provide annual forums to discuss current issues, they would further institutionalize both the mechanisms of political pressure on the Canadian government and the misguided preoccupation with current year production and trade performance.

20. Three speculations: First, the MNEs have accepted the fact that the rules of the game will be different in Canada and the U.S. so they have moved to support protection in Canada to protect their existing interests. Second, that the current level of commitments would not prevent Japanese production facilities establishing in Canada but the higher commitments
would severely limit Japanese investment. Third, the higher commitments would provide the U.S. MNEs with enough protection to meet the higher commitments through controlling the market and higher prices to Canadians for cross subsidize exports and import Japanese small as captive imports.

21. It is estimated in Wharton (1983) that the U.S. content proposal would increase U.S. automotive employment by 56,000 jobs by 1990; 6.6 per cent of the 1981 automotive work force. Lavalie-White (1983) argue that 40,000 automotive jobs would be saved, 36.7 per cent of the 1981 automotive work force.


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