



# OBSERVATIONS

Dennis DesRosiers

## The US Administration Threat of Tariffs on Light Vehicles

In what appears to be mixture of both domestic politics and a retaliatory measure against Canada and other nations for standing up to the US President, the US administration has asked the Department of Commerce to assess whether vehicle imports pose a ‘security threat’ to the US and if so to implement a 25 percent tariff. Although most Canadian speculation is whether they would apply this tariff against vehicles coming from Canada, the nature of the inquiry would mean that they would have to be applied against other nations as well and in particular Mexico. It is possible that some vehicle producing nations would be exempt, but this is unlikely especially since the US Administration has been critical of vehicle imports from the EU. There has been no mention of Japan and Korea. Any analysis of the impact of these tariffs therefore has to assume that the tariffs would be applied on a multilateral basis.

Light vehicle imports into the US last year amounted to \$181.2 billion with Japan as the number one importer with \$42.8 billion, Canada second with \$42.5 billion, Mexico third with \$29.8 billion, Germany fourth with \$23.0 billion, and Korea fifth with \$15.7 billion. Imports from any other country were less than \$10 billion last year. No unit volumes are

available, but a good estimate would be around 7 million units were imported by the US last year. We do know that the average transaction price of a vehicle in the US is about \$40k with a duty paid value of about \$25K although European units would be substantially above that level and others below that level.

Understanding the wide variation, a 25 percent duty would amount to between \$5K and as much as \$15K per vehicle and average about \$6K to \$8K per vehicle. A duty of this size would pretty well kill most sales of these imported vehicles in the U.S. so possibly upwards of 7 million units would be affected if the duty was applied on a multilateral basis across the entire market which is likely.

From a pure Canadian perspective, we produced 2.3 million vehicles last year and approximately 85 percent of them were exported to the US; about 1.7 million vehicles. This would be reduced to significantly lower volumes fairly quickly as every OEM producing vehicles in Canada would be affected by this tariff. General Motors, Ford, and FCA export upwards of about 90 percent of their vehicles to the US, while Honda and Toyota export slightly less.

So the first observation is that this tariff would hurt US based companies more than the two

*(continued from previous page)*

Japanese based companies. However, all companies would be seriously compromised.

Second, there is a view that this tariff would result in more vehicles being sourced from US plants and thus produce some job creation in the US. This is likely not true as most US plants are running at or near full capacity. There might be 2 to 3 million added units that could come from existing US plants but this would come at added costs due to the need to run significant over time. It is also questionable whether the vehicles produced in the US would or could replace the vehicles being imported since the types of vehicles imported are radically different than the vehicles produced in the US. Even if some of the lost imports could be replaced with domestic production the prices paid by Americans for these vehicles would be substantially higher.

Third, it takes 2 to 3 years to design and build an assembly plant and another year or two to get it up and running efficiently so in the near term there would be virtually no ability to move plants to the US from other countries, including moving them from Canada and Mexico. With the knowledge that there might be a change in the majority in the U.S. Senate and also possibly the Congress with the

mid-term elections alongside the possibility of a change in Government in 2020 it is also unlikely that any OEM would push the button now but would instead wait and try to use other methods to bring this situation under control.

Fourth, as mentioned Canada produces between 2 and 2.5 million vehicles a year and the majority of the components to build these vehicles come from U.S. parts suppliers. Last year Canada imported about \$30 billion in components from the U.S. which would translate into between 20K and 25K component jobs in U.S. factories. Most of these would be displaced so the US components industry would be seriously hurt by just the impact on Canada. Extend the impact on the US components industry across all nations and the job losses could be north of 40 thousand.

Fifth, with the loss of up to 2 million units from Canada and upwards of 7 million units from all countries there would be a very serious shortage of vehicles for sale in the US. Less supply in a market of 17 million units would definitely lead to an increase in the prices of ALL vehicles for sale in the U.S. not just the ones that attract the tariff. The OEMs

would be foolish not to 'price to the tariff' which always happens when tariffs are applied. Higher prices together with a lack of supply would result in a possible collapse of the US light vehicle market. We do not know how much, but it is possible that it could decline by 5 to 7 million units and possibly more. This would be devastating for the US dealer body which employs about 1.5 million Americans. Again we do not know how many employees would be affected but a loss of 5 to 7 million sales would translate into at least 200 to 300 thousand job losses in the American dealer network.

Sixth, a collapse in the US vehicle market would not only affect imported vehicles where the duty is applied but also domestically produced vehicles. Domestically produced vehicles could decline by a few million units alone. The US production of vehicles and components employ about 600 thousand workers so a decline in domestically produced vehicles would result in upward of a 100K of these workers losing their jobs.

Seventh, the auto sector in Canada and Mexico would be decimated. In Canada we employ about 50 thousand workers in our assembly plants and another 100 thousand in our

*(continued on next page)*

# Observations - "The US Administration Threat of Tariffs on Light Vehicles"

(continued from previous page)

## Canadian Automotive Trade with the U.S. - (\$ Millions)

NAICS		2013	2014	2015	2016	2017	2017/ 2016
<b>Canadian Exports</b>							
3335	<b>Metalworking Machinery Manufacturing</b>	<b>1,262.0</b>	<b>1,346.1</b>	<b>1,752.3</b>	<b>1,785.2</b>	<b>2,051.9</b>	<b>14.9%</b>
32622	Rubber and Plastic Hose/Belting	193.8	192.2	190.0	175.9	188.2	7.0%
32621	Tires Manufacturing	2,023.9	2,030.9	2,085.0	2,110.7	2,009.6	-4.8%
	<b>Total Automotive Tires &amp; Rubber Products</b>	<b>2,217.7</b>	<b>2,223.1</b>	<b>2,275.0</b>	<b>2,286.6</b>	<b>2,197.8</b>	<b>-3.9%</b>
33611	Light Vehicles	44,834.4	47,585.0	54,004.1	59,612.8	55,963.6	-6.1%
33612	Medium and Heavy-Duty Trucks	1,256.7	1,614.0	2,225.0	2,202.7	2,614.4	18.7%
	<b>Total Motor Vehicle</b>	<b>46,091.1</b>	<b>49,199.0</b>	<b>56,229.1</b>	<b>61,815.4</b>	<b>58,578.0</b>	<b>-5.2%</b>
336211	Motor Vehicle Body	438.6	523.2	669.7	723.2	754.1	4.3%
336212	Truck Trailer Manufacturing	207.4	230.8	300.9	298.2	318.6	6.8%
336215	Motor Home, Travel and Camper	179.6	235.4	312.4	366.9	369.4	0.7%
	<b>Total Body, Trailer and Motor Home</b>	<b>825.6</b>	<b>989.3</b>	<b>1,283.1</b>	<b>1,388.3</b>	<b>1,442.1</b>	<b>3.9%</b>
33631	Engines and Assemblies	2,828.2	3,692.4	4,192.9	4,303.9	3,991.8	-7.3%
33632	Electrical Systems	255.5	305.2	344.1	381.1	319.0	-16.3%
33633	Steering and Suspension	1,314.3	1,535.4	1,693.4	1,528.1	1,426.5	-6.6%
33634	Wheel and Brake Systems	458.2	507.9	601.8	530.0	501.7	-5.3%
33635	Transmission & Power Train	2,138.2	2,359.4	2,557.0	2,669.2	2,579.8	-3.4%
33636	Seating and Interior Trim	851.8	986.4	1,186.8	1,189.2	1,119.6	-5.9%
33637	Automotive Stampings	1,848.7	2,050.4	2,352.4	2,403.4	2,285.5	-4.9%
326193	Plastic Parts	1,452.4	1,697.6	2,057.5	2,057.5	1,973.4	-4.1%
33639	Other Parts and Accessories	1,701.7	1,828.6	2,015.1	2,001.7	1,880.2	-6.1%
	<b>Total Automotive Parts</b>	<b>12,848.9</b>	<b>14,963.3</b>	<b>17,001.0</b>	<b>17,064.6</b>	<b>16,077.5</b>	<b>-5.8%</b>
	<b>All Automotive Exports</b>	<b>63,245.3</b>	<b>68,720.8</b>	<b>78,540.4</b>	<b>84,340.1</b>	<b>80,347.3</b>	<b>-4.7%</b>
<b>Canadian Imports</b>							
3335	<b>Metalworking Machinery Manufacturing</b>	<b>993.6</b>	<b>1,130.3</b>	<b>1,223.2</b>	<b>1,069.3</b>	<b>1,137.4</b>	<b>6.4%</b>
32622	Rubber and Plastic Hose/Belting	475.6	539.3	566.1	551.3	611.7	11.0%
32621	Tires Manufacturing	1,728.9	1,755.4	1,855.3	1,732.4	1,808.5	4.4%
	<b>Total Automotive Tires &amp; Rubber Products</b>	<b>2,204.6</b>	<b>2,294.7</b>	<b>2,421.4</b>	<b>2,283.7</b>	<b>2,420.3</b>	<b>6.0%</b>
33611	Light Vehicles	20,904.4	24,018.8	26,636.0	29,114.8	30,137.9	3.5%
33612	Medium and Heavy-Duty Trucks	4,675.8	4,809.9	5,207.6	4,589.0	5,620.0	22.5%
	<b>Total Motor Vehicle</b>	<b>25,580.2</b>	<b>28,828.7</b>	<b>31,843.6</b>	<b>33,703.8</b>	<b>35,757.9</b>	<b>6.1%</b>
336211	Motor Vehicle Body	568.3	582.5	558.8	474.6	368.2	-22.4%
336212	Truck Trailer Manufacturing	1,280.6	1,202.2	1,209.7	1,092.1	1,273.2	16.6%
336215	Motor Home, Travel and Camper	1,729.5	1,872.0	1,548.5	1,495.9	1,794.3	20.0%
	<b>Total Body, Trailer and Motor Home</b>	<b>3,578.4</b>	<b>3,656.7</b>	<b>3,317.0</b>	<b>3,062.6</b>	<b>3,435.7</b>	<b>12.2%</b>
33631	Engines and Assemblies	5,176.6	5,320.6	5,997.4	7,142.6	7,051.1	-1.3%
33632	Electrical Systems	1,279.0	1,419.1	1,690.2	1,884.4	1,934.4	2.7%
33633	Steering and Suspension	2,097.2	2,137.1	2,653.3	2,734.7	2,414.1	-11.7%
33634	Wheel and Brake Systems	1,128.4	1,269.8	1,613.7	1,683.4	1,575.0	-6.4%
33635	Transmission & Power Train	3,860.6	3,596.5	3,685.5	3,976.2	4,317.7	8.6%
33636	Seating and Interior Trim	367.6	478.0	604.2	534.3	525.1	-1.7%
33637	Automotive Stampings	873.3	937.5	875.6	943.0	890.8	-5.5%
326193	Plastic Parts	98.8	148.2	176.7	180.0	157.4	-12.6%
33639	Other Parts and Accessories	8,507.6	9,123.8	10,168.8	11,024.3	10,904.4	-1.1%
	<b>Total Automotive Parts</b>	<b>23,389.1</b>	<b>24,430.6</b>	<b>27,465.4</b>	<b>30,103.0</b>	<b>29,770.0</b>	<b>-1.1%</b>
	<b>All Automotive Imports</b>	<b>55,745.9</b>	<b>60,341.1</b>	<b>66,270.6</b>	<b>70,225.5</b>	<b>72,521.2</b>	<b>3.3%</b>

Note: Exports exclude re-exports.

Source: DesRosiers Automotive Consultants Inc. and Industry Canada

component plants. The assembly sector would lose upwards of two thirds of their jobs but there would be less of an impact in our components sector since they export most of their goods to the US. The lost jobs in the component sector in Canada would likely be in the third to half range so somewhere between 30K and 50K jobs. Together with assembly jobs, Canada could lose upwards of 100K jobs. I have no idea what the job losses would be in Mexico and other

countries but they would be significant especially for Mexico. Eighth, during the financial crisis where GM and FCA declared bankruptcy in the US one of the biggest fears was the collapse of the entire US automotive sector. If these companies failed entirely many if not most suppliers could not survive and their failure would likely domino with the possible collapse of Ford and some of the new domestic assembly plants in the US. A 25 percent tariff could have the

same effect. It is possible that many US component suppliers could not survive a significant and protracted US downturn resulting in tens of thousands of additional job losses.

Ninth, the most significant employment losses would come from the indirect job losses. We know that one in seven jobs in Canada and in the US are tied directly and "indirectly" to the automotive sector. Direct job losses in the US if you add the above numbers would be in the

(continued on next page)

*(continued from previous page)*

300K to 400K range, in Canada upwards of a 100K jobs and in Mexico it would likely be higher than the Canadian numbers but less than the American numbers. This would translate to at least a few million additional indirect jobs in the US and at many as an additional 500K indirect jobs in Canada.

Tenth, the Canadian and other Governments would surely retaliate against this tariff. This is the most difficult part of this equation to forecast. There are two views to consider. Canada may retaliate by matching the U.S. tariff on vehicles brought in from the U.S. This is possible since the value of vehicles is so high it would be hard to find 'other' goods to countervail like Canada has done with the aluminum and steel tariffs. If Canada imposed a tariff on vehicle imports from the US it would decimate the Canadian retail auto sector just like I forecast for the U.S. retail auto sector. Perhaps as many as a third of our 150K retail jobs would disappear. The second view however is more likely. Rather than countervail with a tariff on U.S. vehicles Canada is more likely to target other goods that damage the U.S. more. For instance, agriculture products from the US would be a more likely target. So Canadian automotive consumers would have little

negative impact although higher prices would also flow through to Canada and cause some disruption. But agricultural workers in the US would be hurt badly.

The negative impact from a US 25 percent tariff on light vehicles is so devastating to the US, Canada, and Mexico that it is hard to imagine that it could come forward. Why would the US Administration want to punish US consumers and US automotive and related workers? In addition, election wins in Michigan, Indiana, Wisconsin and Ohio (the core of the US auto sector) propelled the Republicans to victory. I can't imagine the US Congress and or the Senate accepting the negative implications of this proposed tariff if they hope to hold their position in these states.

I do not know how Canada should respond to this threat but it is important to stay calm. As mentioned the biggest loser in this situation will be the US consumer and auto and related workers so although it takes a leap of faith perhaps the best strategy is to let the US figure this out for themselves. Even a high school economics student can determine how negative it will be for the US; certainly the brains in Washington can do so as well.

That being said the White House is totally unpredictable so we have to take this threat very seriously. **DAR**