

# Intelligence MEMOS



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

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**B**eyond the possibility of his renegeing on US trade agreements, what if President Trump simply imposed a 35 percent tariff on vehicles coming out of Mexico? Most vehicles manufactured in Mexico are small entry-level models that are the most price sensitive vehicles in the market. It wouldn't take a 35 percent tariff to kill this end of the market, and indeed, with low gas prices these vehicles are already struggling. Protectionist theory says that with a high tariff, the vehicle companies would simply move the production back to the U.S. Free traders say that the vehicle companies wouldn't move production but instead "price to the tariff," i.e.: increase prices to account for the tariff. This would also negatively impact demand for vehicles and it wouldn't stop with the 'affected' goods. These price increases would, to a degree, flow to all vehicles in the market and higher prices would push North American auto sales into a cyclical downturn with a commensurate level of job losses.

I believe both the cancellation of NAFTA and or the imposition of a Mexican tariff would be seriously negative for North American auto sales and thus seriously negative for the Canadian automotive sector. Both the assembly as well as the component side of the sector would be seriously hurt.

There is hope in either of these scenarios. Perhaps Adam Smith and his invisible hand are more powerful than Donald Trump.

If I am correct on the outcomes of either of these policies, I also believe that the negatives would develop very quickly, possibly this year. So here we have a new President who gets elected based on the basis of bringing jobs back to America and in short order finds one of his most important industries in a serious cyclical downturn with thousands of jobs losses.

This leads me to believe that a more likely scenario is the use of his 'bully pulpit'. Criticize, yell and scream at the major players in the sector, and embarrass them and/or negotiate behind the scenes with them to invest more heavily in the U.S. rather than Mexico and likely Canada as well. This may be what happened at Ford and FCA with their investment announcements.

Trump has a major bargaining tool at his disposal. He is not an advocate of the impact of climate change. The auto sector and particularly American-based producers are struggling with the Corporate Average Fuel Economy (CAFE) standards imposed by Obama. Consumers have yet to embrace alternate powertrains like hybrids, fuel cells, or plug-in electric vehicles. They also have moved to almost 70 percent light truck in their purchasing of new vehicles. And by their nature, light trucks are less fuel-efficient than passenger cars.

So here's a very likely scenario: Detroit says to Trump, "give us a break on CAFE and we'll play very vocally and visibly to your 'America First' philosophy." The cost to the industry of less efficient investments in the U.S. versus Mexico would likely be lower than meeting tough CAFE rules and or getting into a trade war. Trump could still make a lot of noise about NAFTA and threaten high tariffs but then could legitimately cite the progress on automotive investments to not implement draconian measures.

This would still have negative implications for Canada in that we would see reduced capital investments but it would avoid a trade war and possibly offer a way out of this mess for both the U.S. and Canada with minimal damage to one of our most important sectors.

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