

The Impact of the NAFTA over the Canadian Automotive Industry throughout 20 Years

O Impacto do NAFTA na Indústria Automotiva Canadense nos

Últimos 20 anos

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Abstract: This research aims to explain the impact that the North American Free Trade Agreement (NAFTA) has had over the Canadian automotive industry since it was signed in 1994. It shows the development of the Canadian production throughout these years, from the beginning, in the early 20th century, until today; compared with those of the American and Mexican production. It also includes an explanation of the commerce with the United States of America's market, its added-value, the trades evolution and how NAFTA countries have faced the new world economic order, focusing on the high-value manufacturing; additionally, it makes a detailed analysis of the main Canadian achievements that have been reached in the sector, and the challenges that Canada has faced as a country and as well as region. Finally the figure is compared and analyzed with the China's manufacturing rise and the manpower factor in these last 20 years and its impact.

Key words: Canadian Industry. NAFTA. Automotive Production. Manpower.

Resumo: Esta pesquisa tem por objetivo explicar o impacto que o Acordo de Livre Comércio Norte Americano (North American Free Trade Agreement- NAFTA) teve sobre a indústria automotiva canadense desde que foi assinado em 1994. Ela mostra o desenvolvimento da produção canadense durante estes vinte anos, desde o início, no século XX, até hoje, comparado com a produção dos Estados Unidos e do México. O trabalho também inclui uma explanação do comércio com o mercado dos Estados Unidos, seu valor agregado, a evolução dos negócios e como os países do NAFTA enfrentaram a nova ordem mundial, focada na produção de alto valor agregado; adicionalmente, a pesquisa faz uma análise detalhada das principais conquistas canadenses alcançadas por este setor e os desafios enfrentados pelo Canadá como nação e como região. Finalmente, o resultado é comparado com o crescimento da produção chinesa e o fator mão de obra nestes últimos 20 anos.

Palavras Chave: Indústria canadense. NAFTA. Produção automotiva. Mão de obra.

Introduction

The Canadian automotive industry has existed for over a century, and after all these years it has undergone several changes and impacts, beginning as a national and

regional industry and becoming now one of the leading automobile manufacturers in the world. Its main target market has always been the United States of America (USA), whose market has traditionally been led by the three biggest American car companies: General Motors, Ford, and Chrysler, which have remained in the market for over a century.

This Canadian industry is always trying to meet the demand of the world's largest market, while covering domestic demand and, in some cases, exporting cars to other countries, like Mexico, England, Brazil and Colombia, among others. Thanks to its perseverance, Canada provides large scale manufacturing, conventional design, good logistics, and export, which contributes to 12% of the manufacturing GDP of Canada (Hino-Motors). Currently its revenues reach USD\$ 97,600,000.00 (STATCAN, 2014), and it hosts other major Asian brands like Toyota, Hino, Honda and Suzuki (Susuki-Canada, 2014); it has also ventured into the manufacturing of electric cars such as Bombardier and Canadian Electric Vehicles (Toyota-Canada, 2014).

The Canadian Automotive Industry

In Canada, the automotive industry began in the early twentieth century. The first company that was established there was Ford Motor Company (Ford, 2013), which was founded in 1904 with the purpose of manufacturing and selling Ford automobiles in Canada and the United Kingdom. At first, its brand name was Walkerville Wagon Works, and its headquarters were then located in Walkerville, Ontario (now part of Windsor, Ontario). An issue to be considered is that Canada has always been dependent on foreign trade since 19th Century (GRANALSTEIN, 1985). Four years later, with the first agreement between The McLaughlin Carriage, Co and Buick Motors in 1908, the second automotive company was opened; and ten years later General Motors (GM) purchased the brand (G.M., 2013). In 1925 Chrysler Corporation of Canada began manufacturing in this country, seeking to gain control of a Maxwell-Chalmers plant in Windsor Ontario that had been used to manufacture some Chrysler models the previous year. (Chrysler-Canada, 2014).

Production increased in the early years, thus satisfying the domestic and American demands, which became greater during of World War I; by 1923 the industry had become the world's second largest. Over the next 20 years, the Canadian automobile industry

continued to produce; and regardless of its position its production was inefficient and had high tariffs. In the late 40s, the General Agreement on Tariffs and Trade (GATT) starts its operations. Despite a bureaucratic sector that wanted to negotiate entry into the GATT, this attempt was rejected by the Canadian prime Minister (FAIRBROTHER, 2013 p. 21). It was not until the 70s that Canada entered the GATT (WTO, 2015). In 1950 the Canadian Manufacturer's Association (CMA) recommended "*no further reduction in tariffs*", in order to protect the domestic industry (FAIRBROTHER, 2013, p. 38). Therefore, high consumer prices and production inefficiencies characterized the Canadian automobile industry.

This issue made the signing of the Canada-United States Automotive Products Agreement a priority. The 1964 Automotive Products Trade Agreement or "*Auto Pact*" (APTA) represents the single most important factor that has made the Canadian automotive industry what it is today, including the NAFTA agreement².

Key features of the Auto Pact were the one-to-one production to sales ratio and the Canadian added value requirements. Before the pact, due to the tariffs, only three percent of the vehicles sold in Canada were made in the United States. Canada began producing far fewer different car models. Instead, much larger branch plants were built that produced only one model for all of North America. By 1964, only seven percent of the vehicles made in Canada were sent to the U.S. From 1965 to 1982, Canada's total automotive trade deficit with the U.S. was \$12.1 billion; this subsumed a surplus of around \$28 billion worth of assembled vehicles and a deficit of around \$40.5 billion in auto parts (C.E., 2009).

The two main benefits of this pact for Canada were the reduction of production costs that increased efficiency in the production of smaller vehicles and their parts and lower vehicle prices for consumers. The agreement is said to have benefitted Canadian workers and consumers, but it neither lowered the vehicle prices nor increased the production to create thousands of jobs and improve wages as it is also said (UNIFOR, 2014). The control of the Canadian automotive operations was transferred to its American parent corporations, which substantially reduced the autonomy of the Canadian operations mainly as to vehicle and component specifications, design, sourcing, manufacturing, production, branding and marketing, corporate policy (C.E., 2009).

Ten years before the NAFTA agreement, Canada had increased the production volume; however it needed to be under the protection of a covenant due to the worldwide threat. The rules and tariffs of such pact were prioritized³.

The North American Free Trade Agreement

Negotiations for a Free Trade Agreement between Canada, Mexico and the United States began in the late 80's, by the time when Canada had many Automotive Union concerns and Mexico was implementing the scheme of Import Substitution (GUILLEN, 2013, p.3). NAFTA's main objective was to eliminate trade barriers, promote fair competition rules, increase investment opportunities, provide adequate protection to intellectual property rights, establish effective procedures for the treaty implementation, dispute settlements, and promote trilateral, regional and multilateral cooperation (SE, 2013). Fairbrother (2013), indicates that the acceleration of globalization was one of the main reason for the agreement to be signed. Therefore, this one broke the barriers to foreign investment (FAIRBROTHER, 2013, p.5-6).

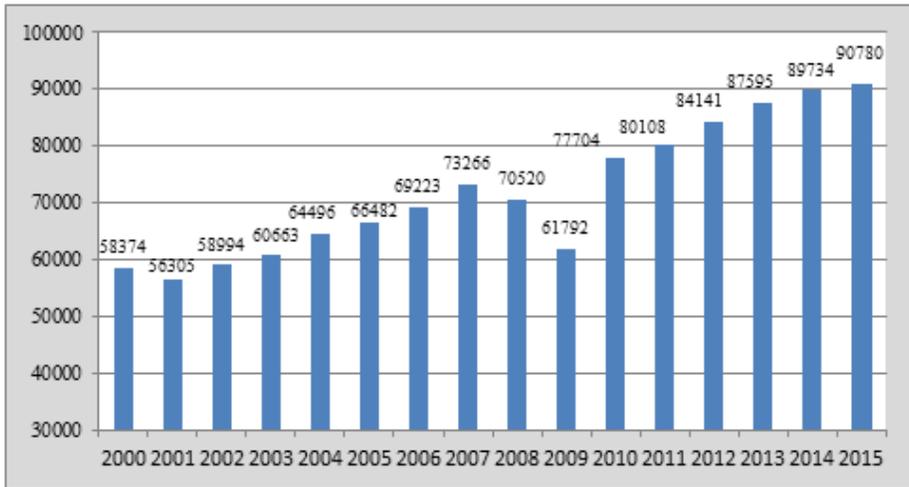
The NAFTA was signed in December 17th. 1992, to enter into force until January 1st. 1994. One year was enough time to the NAFTA countries to get ready for a new endeavor (SRE, 2013). Among the most important points taken into the agreement were: setting objectives and general definitions, including national treatment and access of goods to market, rules of origin, customs procedures, energy and basic petrochemicals and, in the productive sectors, agriculture, animal and plant health measures, emergency measures, standardization measures, government procurement, investment, trade in services, telecommunications and financial services (GUILLEN, 2013, p.6).

Cameron and Tomlin (2000), argue that the NAFTA negotiations were shaped by three factors: "*(a) asymmetries of power between the three states (b) sharply contrasting domestic political institutions and (c) differences in the nonagreement alternatives, patience, and risk orientations of the heads of government and their chief negotiators.*" (CAMERON & TOMLIN, 2000, p. 13), as a free market and pro-globalization policies (FAIRBTJER, 2013, p. 11).

There were three internal factors that led the United States of America (USA) to accelerate the process that somehow pushed Canada and Mexico to sign this agreement. The first factor was its poor growth, if any, and the declining and rising production of certain manufactured goods (commodities), including the automotive sector. Since the end of World War II until the early eighties, the pillar of the U.S. economy was the manufacturing of computers, electronic equipment, primary metals and cloth, but it gradually decreased because of high production costs, specially workforce and the feasibility to transfer the technology to other regions with a cheaper workforce and better tax breaks than in the U.S. (BEA, 2000). Cameron and Tomlin (2000), show that in the beginning Canada was reluctant partner at the start of the negotiations to create NAFTA, due to the Canadian trade and investment ties with Mexico have been weak historically (CAMERON & TOMLIN, 2000, p.63). With a stronger automotive union, every year would require higher wages; besides, workforce, compared with other regions, was not either qualified nor trained enough, which slowed the process, made it inflexible and, consequently, expensive.

The second aspect was the power of American unions, which continues to be present today. It jeopardized the country's productivity because of the high costs involved in trade union organization.

A third aspect was the great Asian threat that had arisen after the signing of the World War II peace armistice. In the early 50s, Japan started to grow until it became an industrially powerful country in the 70s. With companies more competitive due to low labor rates (FAIRBROTHER, 2013, p.28). It remained strongly consolidated for the next two decades. As an example, Figure 1 shows that the three most powerful Japanese automotive brands, Toyota, Honda, and Nissan (Honda-Canada, 2013), had started to participate in the US car market, previously controlled -almost entirely- by General Motors (GM, 2013), Ford and Chrysler. During the late 60s (Wardsauto, 2011), Japanese firms had very little presence, but in the 80s they controlled nearly 25% of the U.S. market (OICA, 2016).

Figure 1. US: Autos Market Share by brand 1951-1994

Source: WardsAuto 2011 & OICA. 2016.

What led the United States to sign the NAFTA was similar to what happened to Canada: first, local labor costs were very high for automotive manufacturers; second, there was a very strong and inflexible union; and third, a strict environmental policy prohibited the manufacturing of certain products because of alleged environmental pollution (use of oils, lubricants, heavy metals, etc.), which led to the closure of several companies in the country and forced them to be transferred to Mexico (VISCA, 2004, p.1-5).

The World Automotive Industry

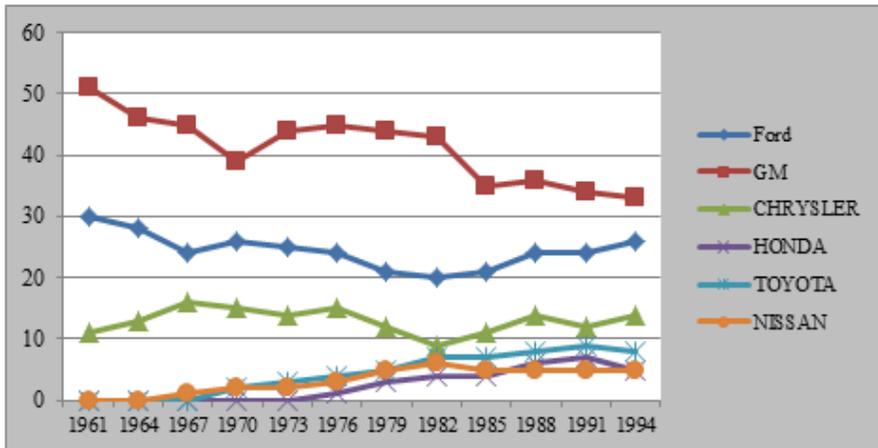
In all these years, the automotive industry around the world has begun to emerge. The sales have increased due to easy access for more people. The growing middle class with purchasing power and more revenues tell us that in the last 20 years the global automotive industry has changed in the North American region: new foreign companies seeking to enter the large American market have joined in. They do not want to leave it all to the three NAFTA countries.

Canada, Mexico and the United States have signed free trade agreements amongst them, but they have also signed automobile-related agreements with other countries and

other geographical blocs. As consequence this industry has diversified and expanded, implying an industrial and commercial global rearrangement (OICA, 2016).

Figure 2 shows how the volume of world automotive production has increased in the XXI century.

Figure 2. Worldwide Annual Production Cars (thousands units)
Including cars & light vehicles

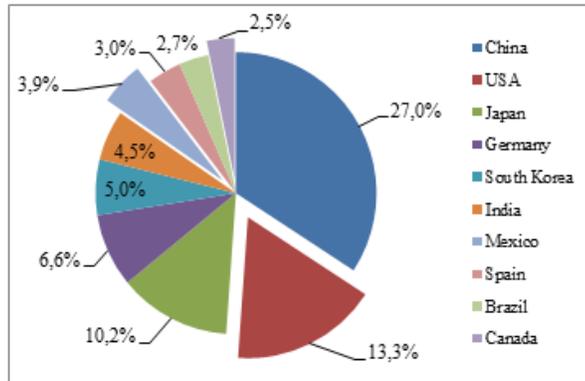


Source: OICA. 2016

Except for 2009, when there was a significant reduction due to the global financial crisis, the trend of the production automotive industry has continued to rise in recent years. The year 2014 ended with more than 89.7 million cars produced worldwide, and 2015 finished with over 90 million cars assembled.

In terms of production by country (sharing), Figure 3 shows that China currently leads the world market with 27% of vehicle production, followed by the U.S. with 13.3% and Japan with 10.2%. Mexico ranks seventh with 3.9% and Canada is tenth with 2.5% of world production. In addition, a sustained growth in South Korea and India, and decreased in Brazil is observed.

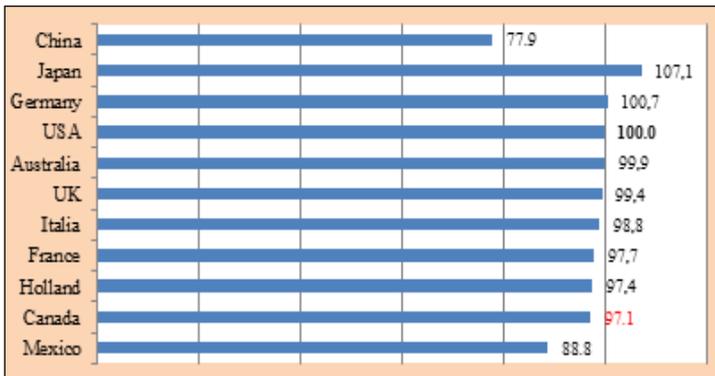
Figure 3. Automotive Producing Countries 2015



Source: OICA 2016

Total indexed costs worldwide have been a key factor for the relocation of automotive plants, as shown in the Figure 4. This explains that, taking the U.S. cost base as 100%, Canada is at 97.1% below the U.S. China, the largest producer of vehicles, currently at 77.9%, 22.1% below U.S. costs; and Mexico, the third NAFTA partner, is placed at 11.2% below the U.S., with 88.8%; in addition, there are more expensive countries, such as Japan and Germany, that are ranked third and fourth respectively as the largest car manufacturers worldwide (KPMG, 2013).

Figure 4. Indexed Cost: Manufacturing International Auto Parts (USA = 100.0)



Source: KPMG. 2013

Canadian Automotive Industry after 20 Years of the NAFTA Agreement

This global scenario has impacted the NAFTA countries, especially Canada which was mostly affected by the closure of several assembly plants and auto part factories. Fairbrother (2013) quoting to Ragin (2008) and Abell (2004), says to expect substantial differences across the pathways by which different countries enact key pro-globalization instances of equifinity, for the three countries, or branching, for new business models, as well as auto parts industry, automobile domestic consumption (FAIRBROTHER, 2013, p.53).

The United States had to restructure its union employment contract, particularly that of the 2009 financial crisis, when labor costs were reduced by almost 50%, in addition to the sudden transfer of several plants not only to Mexico, but also to China, Brazil, India, South Korea and other Asian nations.

Automotive plants settled in Canada include GM, Ford and Chrysler, along with its subsidiaries, as well as four Japanese brands: Toyota Motors, Honda, HINO and Suzuki. The present of Volkswagen was carried by one model manufactured in a Canadian Chrysler plant. The tables below show the current major automotive plants in Canada, as well as the difficulties they have encountered.

Table 1A. Chrysler Canada Operations⁴

Plant	Year Opened	Remarks
Windsor Assembly	1928	4,254 employees. Cars plant
Etobicoke Casting	1986	300 employees. Die casting plant
Brampton Assembly	1986	2,750 employees. Cars plant

Table 1B. G.M. Canada Operations

Plant	Years opened	Remarks
Oshawa Car Assembly	1950	Car plant started in 1907
St. Catharines	1954	Engine/Transmission
Oshawa Metal	1986	Die casting plant
CAMI Automotive	1989	Cars plant

Table 1C. Ford Canada Operations

Plant	Year Opened	Remarks
Oakville Assembly	1953	3,820 employees. Car plant
Windsor Engine	1978	1,850 employees. Car plant
Essex Engine Plant	1981. Closed in 2007	Engine plant
Windsor Aluminum Plant	1992	130 employees. Duractec Blocks production
Windsor Casting Plant	1934. Closed in 2007	Now demolished
Essex Aluminum	1981. Closed in 2009	
Ontario Trucks Plant	1965. Closed in 2004	
Walkerville Plant	1904. Closed in 1953	Oldest GM plant
St. Thomas Assembly Plant	1968. Closed 2011	

Table 1D. HINO Canada Operations

Plant	Year Opened	Remarks
Woodstock Plant	1970	Trucks production

Table 1E. Toyota Canada Operations

Plant	Year Opened	Remarks
Aluminium Wheel Plant	1983	Placed B.C. 310 employees
Cambridge Plant	1988	8,000 employees
Woodstock Plant	2008	1,200 employees

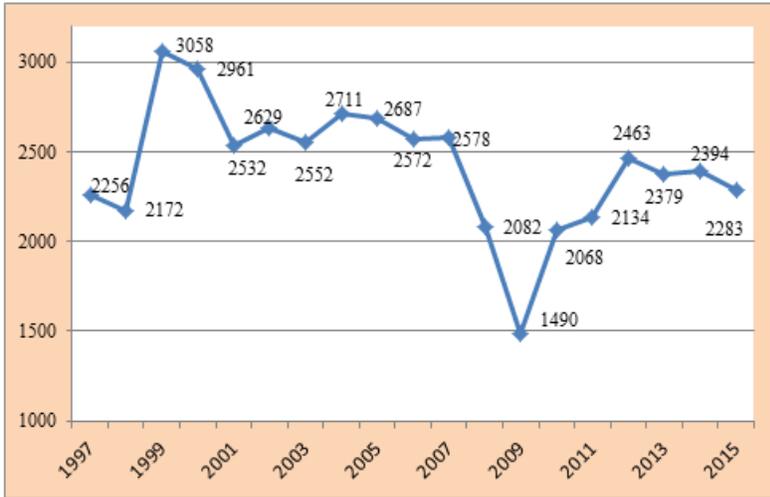
Table 1F. Suzuki Canada⁵

Plant	Year Opened	Remarks
Ingersoll Plant	1989	Will close in 2015

Source: Own development based on G.M. Canada, Ford Motor Company Canada, Chrysler Canada, HINO Motors Canada, Suzuki Canada Inc., Toyota Canada & Honda Canada. 2014.

The overall figures of Canadian automotive production are shown in the Figure 5, where a decrease in volume in the early XXI century is observed. It also shows how Canada cannot regain the production levels of 3 million cars it produced in 1999. Likewise, it illustrates that the Canadian average production remains at about 2.3 million cars in the last three years.

Figure 5. Canada: Annual Car Production (thousands)



Source: Own development based on OICA 2016.

These figures show that Canada has dropped five places in the scale regarding worldwide in the motor vehicles production. In 2000, it ranked 5th, but in 2013 it dropped to the 10th. Other countries, however, have gone up, especially China, Mexico, Brazil and India. Table 2 shows the leading car-producing countries (AMIA, 2013).

Table 2. Comparison of Car-Producing Countries: 2000 vs. 2014

COUNTRY	2000 PLACED	2014 PLACED
USA	1 ST .	2 nd .
JAPAN	3 RD .	3 rd .
CANADA	5 TH .	10 TH .
CHINA	8 TH .	1 ST .
MEXICO	9 TH .	7 th .
BRASIL	12 TH .	9 th .
INDIA	14 TH .	6 th .

Source: Own development based on OICA 2014.

There is concern about job creation for younger generations after the NAFTA signature: Canada has not been able to create the jobs that were promised in the agreement.

This is shown in the Table 3. It is remarkable, however that over the last three years 132,000 new jobs have been generated in Mexico (INEGI, 2013). As for the U.S., after the 2009 financial crisis, 108,000 new jobs have been created. Canada has only generated 2,000 new jobs in this period (ILO, 2013).

Table 3. Automotive Industry: New Job Creation

Country	2010-2012
Mexico	132,000
USA	108,000
Canada	2,000

Source: Owner development based ILO & INEGI 2013

If we compare the cost of new wages (2012) in the NAFTA countries, there is no doubt why Mexico has attracted more new jobs compared with Canada and the U.S.: the gap between the cost per hour in each country is huge (SCOTIA-BANK, 2014). The Canadian rate is 18 times bigger than the Mexican one (Table 4).

Table 4. New Wage Contract

Country	Cost/Hour	Integrated Wage/Hour
Mexico	us\$2	us\$5
USA	us\$37	us\$69
Canada	us\$32	us\$60

Source: Scotia Bank 2014

Canada in the early 21st Century

If we analyze the NAFTA data in the field of the automotive industry, there have been no substantial benefits for Canada; as for Mexico, it has been good and prosperous. The global automotive production in whole NAFTA region has also been thriving (FAIRBROTHER, 2013). The volume of units produced and the consumption have been satisfactory despite the recent financial crises of the last 20 years.

The only advantage for Canada (Table 5) has been that its car assembly plants are producing the most expensive cars to the U.S. The strategy to produce high valued models in Canada instead of mass-produced cars, unlike Mexico (CAMERON & TOMLIN, 2000), has generated more revenues. In this case, Canada has six times more revenues than Mexico, which call for a solid finance business (UCB, 2014).

Table 5. Autos Exported To USA Value (Us\$ Millions)

Company	Models
Chrysler	Chrysler 300/300C, Dodge Charger, Challenger, Town & Country, Grand Caravan, Voyager, Lancia Voyager,
G.M.	Camaro, Regal, Equinox, Impala, GMC Terrain, Cadillac XTS
Ford	Edge, Flex, Lincoln MXK, Lincoln MKT
HINO	HINON Truck
Toyota	Corolla, Matrix, RAV4, RAV4 EV, Lexus RX-350, Lexus RX-450h,
Honda	Civic Coupe, Civic Sedan, CR-V
Susuki	Escudo

Source: US Census Bureau 2014.

The six automotive brands settled in Canada jointly produce 28 different car models, of which 15 (54%) are luxury models (Table 6); that means that each sold vehicle yields greater profits that those sold in Mexico (SCOTIA-BANK, 2014).

Table 6. Current Models Manufactured in Canada

Company	Models
Chrysler	Chrysler 300/300C, Dodge Charger, Challenger, Town & Country, Grand Caravan, Voyager, Lancia Voyager,
G.M.	Camaro, Regal, Equinox, Impala, GMC Terrain, Cadillac XTS
Ford	Edge, Flex, Lincoln MXK, Lincoln MKT
HINO	HINON Truck
Toyota	Corolla, Matrix, RAV4, RAV4 EV, Lexus RX-350, Lexus RX-450h,
Honda	Civic Coupe, Civic Sedan, CR-V
Susuki	Escudo

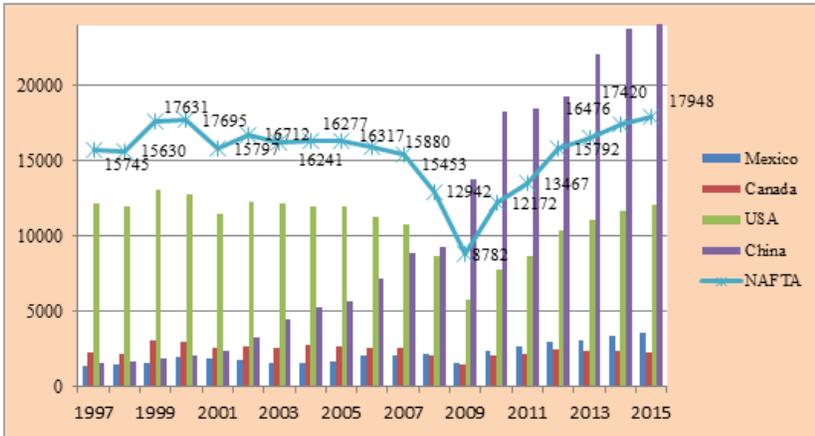
Source: Own development based on G.M. Canada, Ford Canada, Chrysler Canada, HINO Motors Canada, Suzuki Canada Inc., Toyota Canada & Honda Canada. 2014.

The Canadian strategy, from 2008 on (MELGOZA & ALVAREZ, 2014), through processes using only platforms or closing shifts or changing production platforms, has been to manufacture few high end models rather a massive amount of cheaper cars; instead, Mexico has chosen rather to manufacture cars under US\$22,000.00 of market value.

But the main threat for the NAFTA countries is the China car production. China belongs to the WTO since 2001, but since 1995 China applied to enter into force, and in 1999 China and United States signed a bilateral agreement on China's accession (URDINEZ & MASIERO, 2015). Since the Chinese car production has blunted, the Figure 6 provides an overview of the production volume of each NAFTA country and the NAFTA region as a whole; it also includes China's annual car production over the past 19 years, which shows that China exceeded by far the overall NAFTA production volume (INEGI, 2014). In 2015, the total production of NAFTA reached 17.9 million cars, while China produced around 24.5 million units; up to this date the different between NAFTA and China is 6.6 million, and more than number is still rising (OICA, 2016).

The main reason why China is moving to Canada, and to the others members of NAFTA are low-wage manufacturing it has. For the last 20 years, under the Market Socialism Policy, the China's wage has been lower than any country in the world. Reducing labor is one of the main culprits. Based in Dussel (2014) and Guzman and Toledo (2006), since the leader Deng Xiaoping implemented market reforms in 1978, 278 million workers from rural populations have migrated to cities in search of work. For example, in the late 90s, the average wage cost in China was us\$0.60/hrs. in Mexico was us\$2.40/hrs. and in Canada was us\$5.80/hrs (OIT, 2013).

Figure 6. NAFTA: Annual Production vs. China Annual Production. 1997-2015



Source: Own development based on OICA 2016.

Also, the China’s factor is often whether or not there is specialized labour available, the high education implemented in the Communist time, pushed to have high levels of quality of manufacture compared almost with the Canadian and the Mexican. China began to produce high end models as well. Although such units are currently being sold mainly in the domestics market, China has already begun to export some of them to Europe and the Asian region. The Chinese cars have been well received by the new customers. The US market is open, mainly, as Hung, Tse and Cheng (2012), mentioned, it due to a new advertising, shifting cultural values in their exports to the American market and also, at any time China could manufacture and sell cars to this market, just like it is now selling computer devices made by Chinese and American brands, which have been accepted by the American market with no problems; therefore, — as with the computer devices — quality will not be an issue for the Chinese vehicles (HUNG et al., 2012 p. 129).

One thing we should remark is that China’s youth demographic is expected to decline by 44 million over the next 10 years, according to the United Nation’s population projection division (U.N., 2015). Indeed, the average Chinese national is 35-years-old, compared, for example, to the average Cambodian (on 23 years) and the average

Bangladeshi (on 24 years). Therefore, the wage cost will be increased due to the called Lewis' turning point (LEWIS, 1954).

Conclusions

The Impact of the NAFTA over the Canadian Automotive Industry has been severe, has lost leadership in production of cars in the region, and has lost thousands of jobs in the last twenty years. As we have seen, there are a lot of threats, not just Mexico or China, other emerging countries like India and Brazil will be the major competitors in a few years. Canada needs to make an overhaul of its car business. Review its processes, its facilities and its worldwide strategy, including, not only the traditional American car brands, but with the Asian and European car brands. The Canadian automotive industry along with the Canadian government must figure out how to reduce the Chinese impact in the short term (URDINEZ & MASIERO, 2015), not only by selling high end models, but also by establishing high volume, cost reduction and logistic strategies to be competitive.

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Notes

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- ² Auto Pact was signed by Prime Minister Lester B. Pearson and President Lyndon B. Johnson in January 1965 (N.A.).
- ³ The Auto Pact was abolished in 2001 after a World Trade Organization ruling declared it illegal, though by that time the NAFTA had effectively superseded it (UNIFOR, 2014).
- ⁴ The VW Routan within Chrysler plant, but that came to halt in 2012 (N.A.).
- ⁵ In 2013 Suzuki Canada Inc. announced it would discontinue its auto-building operations in Canada as part of its Chapter 11 bankruptcy proceedings in the U.S.