Auto Industry Awaits Effects of NAFTA Tariff Elimination on New Automobiles

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The Mexican auto industry, already facing a slump in sales and increased global competition, has an additional concern this year: the elimination of tariffs for new vehicles imported from the US and Canada under the North American Free Trade Agreement (NAFTA). A NAFTA timetable stipulated that Mexican tariffs on imports of new automobiles from the two partner countries in the agreement were to be eliminated in the 10th year of the agreement, which is 2004.

The tariff elimination started with a whimper rather than a bang, with very few Mexicans taking advantage of the opportunity to acquire a new automobile in the US or Canada without having to pay import duties to bring the vehicle back to Mexico.

Through mid-January, customs authorities at locations near the US-Mexico border had not received a single request from Mexican nationals to import US or Canadian vehicles duty free. This is attributable to a variety of factors such as the weakness of the Mexican economy, which has limited the purchasing power of Mexican nationals, and the extreme security measures implemented by the US government at border points. Also, many Mexicans in a position to bring back cars are undocumented workers, who tend to buy used automobiles (see SourceMex, 2001-03-21).

The Asociacion Mexicana de la Industria Automotriz (AMIA) said another factor is the NAFTA requirement that vehicles have 2,000 km or less on their odometer and the paperwork involved in proving that the imports have a 62.5% or more North American content, thus eliminating many European and Japanese models.

Mexican dealers concerned about US prices, incentives

Still, the tariff elimination has raised some concerns within the AMIA and other industry groups because it has removed an important safeguard that had been in place for the past 10 years. This concern is tied in part to the traditionally higher retail cost of vehicles in Mexico, especially given the recent inclination of the government to levy a special tax on new cars (impuesto sobre automoviles nuevos, ISAN) in addition to the value-added tax (impuesto al valor agregado, IVA).

Among the proposals considered in some versions of tax reform presented before Congress was to eliminate or reduce the ISAN. This proposal, and all others, have not advanced because of the failure of Congress to agree on what taxes should be included in the reform package (see SourceMex, 2003-12-17 and 2004-01-07). Industry officials said they fear that imports of compact and subcompact models will begin to increase once Mexicans better understand the procedures to bring back new vehicles from the US. "We will also see some imports of luxury automobiles, but not more than 8,000 or 10,000 units per year," said Eduardo Berlanga, president of the Asociacion Mexicana de Distribuidores de Automotores (AMDA).
US dealers have other marketing tools like rebates that are not yet available in Mexico. In the US, a rebate can reduce the sticker price by as much as US$3,000. "With the rebates, there is a difference for Mexican consumers worth looking at," said Armando Soto, an auto-industry analyst with Kaso and Associates in Mexico City. "But, in Mexico last month, we started seeing similar discounting that helped sales. Still, in Mexico, discounts are limited to those who pay cash."

For now, the AMIA has launched an informal campaign citing the advantages of buying a car in Mexico. "People should know that Mexico remains the best option to acquire an automobile because of the ease in documentation as well as the warranties that we can offer," said AMIA president Cesar Flores Esquivel.

**Domestic sales, exports slump in 2003**

The concern about the opening of the Mexican auto market comes on top of the country’s weak economy, which resulted in a weak performance for the industry last year. Statistics in an AMIA report published in mid-January showed the Mexican auto industry registered flat sales at the domestic level and suffered a major decline in exports. The report said only slightly more than 977,000 passenger vehicles were sold in Mexico in 2003. Even though the total was about 300 units higher than in 2002, sales fell short of the industry's target of 1 million vehicles.

The AMIA said economic and political uncertainty prompted many Mexicans to delay purchases last year. "The year 2003 was one of ups and downs, uncertainties and expectations," said Flores Esquivel. "All this was generated by political developments, first the July midterm elections, followed by the debates on tax reform, and then the tug of war over control of the Congress." Flores Esquivel said the silver lining in the sales data is the strong domestic sales during the month of December, which bodes well for 2004.

Mexican auto dealers sold almost 122,000 units during the last month of the year, surpassing levels for December 2002 by about 14.6%. Sales were especially strong for models offered by General Motors de Mexico and Nissan de Mexico. The industry was also buoyed by the increasing popularity of sports utility vehicles among Mexican drivers, industry analysts said. The auto industry’s fortunes were worse in the export market, which relies on the US for 75% of its sales. A total of 1.17 million units were exported in 2003, a decline of 10.8% from 2002.

The slump in exports led Volkswagen de Mexico, one of the Mexico's steadiest producers, to announce a reduction in its work force at its huge Puebla complex in July (see SourceMex, 2003-07-09). Volkswagen later agreed to consider rescinding the layoffs in exchange for pay cuts (see SourceMex, 2003-07-30). The AMIA said the slump in domestic and export sales resulted in a reduction of more than 13% in total motor-vehicle production.

This trend was reflected in the decline in Mexico's ranking among the world's largest producers of motor vehicles. China and Brazil surpassed Mexico in a global ranking of motor-vehicle producing countries during 2003, with the Mexican industry ranked 11th globally. The most dramatic gains were in the Chinese auto industry, whose ranking climbed to fourth from 11th the previous year.

The Brazilian auto industry ranked 10th last year. Industry projects recovery in 2004 and beyond The AMIA and other organizations are forecasting a recovery for their industry during the next several
years, based on major expansion projects announced by several manufacturers at the end of last year. These projects include a US$1.6 billion expansion of a Ford de Mexico plant in Sonora state to produce its Futura model; a US$100 million refurbishing of the Volkswagen plant in Puebla to accommodate production of a new Golf model; and a decision by DaimlerChrysler to spend US$45 million to modernize its complex in Mexico state to produce the PT Cruiser convertible.

Additionally, Mercedes Benz plans to invest about US$15 million to expand facilities in Mexico state and Nuevo Leon to produce new models of passenger vehicles. The truck business is also expanding for the motor-vehicle industry, with Volkswagen launching construction of a plant to assemble heavy truck and bus models similar to those produced at the company's complex in Resende, Brazil.

The Mexican operation is expected to initially produce about 2,000 units for sale in the domestic market. Some motor-vehicle companies are also developing financing schemes to stimulate domestic sales. For example, Nissan and Renault have created Nissan Renault Financial Mexico (NRFM) to facilitate the purchase of their motor vehicles in the domestic market. NRFM will be able to serve 50,000 clients with low-interest loans of 12 to 60 months, said Nissan Motor Co. president Carlos Ghosn. (Sources: Associated Press, 10/20/03; The Herald, 10/07/03, 12/18/03; El Universal, 10/07/03, 10/09/03, 11/13/03, 12/17/03, 01/12/04; El Sol de Mexico, 10/24/03, 11/06/03, 12/11/03, 01/13/04; Dow Jones news service, 10/07/03, 10/08/03, 11/12/03, 12/09/03, 12/10/03, 01/09/04, 01/12/04, 01/14/04; Milenio Diario, 10/11/03, 12/17/03, 01/14/04; La Cronica de Hoy, 10/21/03, 11/13/03, 12/11/03, 12/17/03, 01/13/04, 01/14/04; El Financiero, 12/31/03, 01/14/04; La Jornada, 01/13/04, 01/16/04; The Dallas Morning News, 12/11/03, 01/19/04)

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