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By Arthur B. Laffer, Ph.D.

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In March 1999, Dr. Laffer was recognized by Time Magazine as one of "the Century's Greatest Minds" for his invention of the Laffer curve, which has been called one of "a few of the advances that powered this extraordinary century." He has received many awards for his economic research, including two Graham and Dodd Awards from the Financial Analyst Federation, the Hayek Lifetime Achievement Award in 2016 from the Hayek Institute and Austrian Economics Center, and the American Legislative Exchange Council's Laffer Award for Economic Excellence. Dr. Laffer was awarded the Presidential Medal of Freedom by President Trump on June 19, 2019. He graduated from Yale with a Bachelor's degree in economics in 1963 and received both his MBA and Ph.D. in economics from Stanford University.

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The United States-Mexico-Canada Agreement (USMCA) has served as a cornerstone of President Trump's first term and has quickly become a dominant feature of North American trade policy, fostering economic growth, stabilizing supply chains, and strengthening the U.S. auto industry. However, the recently proposed 25% tariff on auto imports—including those from Canada and Mexico—threatens to undermine these gains. While the Trump Administration has temporarily exempted USMCA-compliant goods from the tariff, the uncertainty surrounding long-term trade policy poses serious risks to the U.S. auto sector.

The U.S. auto industry, the nation's largest manufacturing sector, contributes approximately $730 billion to GDP, and plays a vital role in job creation and exports. Integrated North American supply chains, strengthened by USMCA, enhance efficiency, cost competitiveness, and long-term investment planning. Imposing a 25% tariff without a permanent USMCA exemption would severely disrupt this ecosystem—raising consumer costs, reducing demand, and weakening purchasing power. It would also create supply chain disruptions leading to significant investment losses and inefficient production shifts, erode industry competitiveness, and trigger broader economic ripple effects across the U.S. economy.

Preliminary estimates suggest that the per-vehicle cost impact of the tariff could reach as high as $10,000, whereas a USMCA exemption would reduce this cost increase by 40%. Given the long-term investment cycles of the auto industry, stable trade policies are essential for maintaining competitiveness and ensuring the viability of North American manufacturing.

Codifying the USMCA exemption into law is the most effective way to safeguard the U.S. auto industry from the adverse effects of tariffs. By preserving a predictable regulatory framework, automakers can continue investing in innovation, maintaining global competitiveness, and securing high-value American jobs. Without this exemption, the proposed tariff risks causing irreparable damage to the industry, contradicting the administration's goals of strengthening U.S. manufacturing and economic stability.

The United States-Mexico-Canada Agreement (USMCA) was a significant achievement of President Trump's first term, replacing NAFTA with updated trade provisions aimed at strengthening North American manufacturing, labor standards, and intellectual property protections. Signed in 2020, the agreement introduced stricter rules of origin for automobiles, increased labor protections in Mexico, and modernized digital trade regulations. Widely seen as a key accomplishment in Trump's trade policy, the USMCA reinforced North American economic ties while addressing concerns over job losses and trade imbalances.

Within the first 100 days of his second term, President Trump has threatened and imposed a series of new tariffs, ranging from universal baseline tariffs to country-specific measures. So far, tariffs have been levied on Canada, China, the EU, and Mexico, prompting retaliatory tariffs from China, Canada, and the European Union. The tariffs seek to leverage the U.S.'s immense gains of trade in order to negotiate for non-trade preferences, including tougher border security from Canada and Mexico.

Imposing tariffs on Canada and Mexico contradicts the significant progress achieved through USMCA in Trump's first term. An industry that would be disproportionately impacted by a 25% tariff without a USMCA exemption for Canada and Mexico is the U.S. auto industry. Recognizing the potential harm, the Trump Administration announced a one-month exemption on 25% tariffs for USMCA-compliant goods, following discussions with the auto industry's "Big 3" – Ford, General Motors (GM), and Stellantis.

The U.S. auto sector is the nation's largest manufacturing sector and a cornerstone of the national economy, serving as a major engine for job creation, innovation, and industrial output. In 2024, motor vehicles and parts generated nearly $730 billion in output, or 2.5% of the U.S. GDP.[1] Additionally, the industry plays a key role in global trade, with motor vehicles and parts ranking as the country's largest export in 2024–totaling more than $143 billion in goods.[2] Since 2008, U.S. motor vehicle exports have increased by 33%, with three-quarters of this growth driven by rising demand from North American trade partners.[3]

USMCA has been instrumental in supporting this growth by providing a stable regulatory framework, streamlined trade rules, and tariff exemptions that bolster the auto industry. However, imposing a 25% tariff on imports from all trading partners without maintaining a USMCA exemption could have catastrophic consequences for the U.S. auto sector, leading to significant downstream effects on the broader U.S. economy.

Preliminary estimates indicate that such a tariff could raise vehicle prices by as much as $10,000, reducing consumer purchasing power and potentially lowering sales volumes.[4] U.S. automakers,

[1] U.S. Bureau of Economic Analysis 2025
[2] U.S. Department of Commerce 2025. Note: 2024 exports calculated using NAICS codes 3361-3363.
[3] Alliance for Automotive Innovation 2025.
[4] *The Wall Street Journal* Editorial Board 2025. Anderson Economic Group estimates of the cost per U.S. car assembled in North America, including for auto manufacturers such as Ford, GM, Honda, Toyota. Estimates are based on tariff policy announced on February 1, which included implementing a 25% tariff on imports from Canada and Mexico and a 10% tariff on imports from China.

which rely on integrated supply chains that often cross national borders, would face higher production costs, further reducing their competitiveness in both domestic and international markets. Additionally, the increased cost burden may prompt reassessment of their production strategies, leading to restructuring or shifts in manufacturing locations.

Beyond the direct cost implications, the proposed tariff is expected to have secondary effects that could ripple throughout the economy, including through supply chain disruptions, declining investor and consumer confidence, and retaliatory measures. Additionally, the auto industry is highly competitive on a global scale. A 25% tariff would not only shrink, or possibly eliminate, profit margins for U.S. manufacturers but also weaken their ability to compete with international rivals. This erosion of competitiveness could result in reduced market share both domestically and abroad, with long-term repercussions for employment, innovation, and economic growth in the sector.

Maintaining and codifying the USMCA exemption into law would clearly provide the U.S. auto industry—and its customers and investors—with the greatest amount of stability and predictability going forward, protecting the competitiveness and resilience of the U.S. auto sector while supporting continued growth and investment.

Current Policy Environment

The implementation of the 25% tariff on imports from Canada and Mexico followed a rapid and evolving timeline in early 2025, reflecting a key policy priority of the Trump administration's second term. The administration had proposed the tariff as part of its campaign platform, positioning it as a tool to bolster U.S. manufacturing and negotiate stronger trade agreements.

In early February 2025, the administration announced a 30-day postponement of the tariff's implementation for Canada and Mexico, temporarily delaying its impact on North American trade. However, on March 4, 2025, the 25% tariff was officially enacted, signaling a significant shift in U.S. trade policy. The following day, on March 5, 2025, after discussions with major U.S. automakers, the administration introduced a one-month exemption—lasting until April 2, 2025—for vehicles and auto parts that comply with USMCA rules. This exemption was designed to mitigate immediate disruptions in the auto industry while maintaining the broader enforcement of the tariff policy.

Table 1: Tariffs Imposed and Imports Affected by President Trump[5]

Target	Dates	Imports affected	Applicable rate
Canada	Announced Feb 1; scheduled Feb 4 but delayed 30 days; effective Mar 4; 30 day exemptions granted Mar 5 & 6	Up to $253 billion while exemptions are in effect	25% non-energy; 10% energy and potash
Mexico	Announced Feb 1; scheduled Feb 4 but delayed 30 days; effective Mar 4; 30 day exemptions granted Mar 5 & 6	Up to $236 billion while exemptions are in effect	25%
China	Announced Feb 1; effective Feb 4; increased Mar 4	$430 billion	10% initially; increased to 20%
European Union	Announced Feb 26	$598 billion	25%
Steel and Aluminum	Announced Feb 10; effective Mar 12	Ending steel exemptions $29 billion; ending aluminum exemptions $12 billion; expanding derivatives $44 billion under chapters 73 & 76 plus metals content of an additional $100 billion	25%
Autos	Announced Feb 12; effective Apr 2	Motor vehicles $224 billion; motor vehicle parts $83 billion	25%

In response to the imposition of tariffs and heightened policy uncertainty, financial markets have faced heightened volatility, consumer sentiment fell to a 29-month low in March, and the probability of a U.S. recession has risen to 40%.[6]

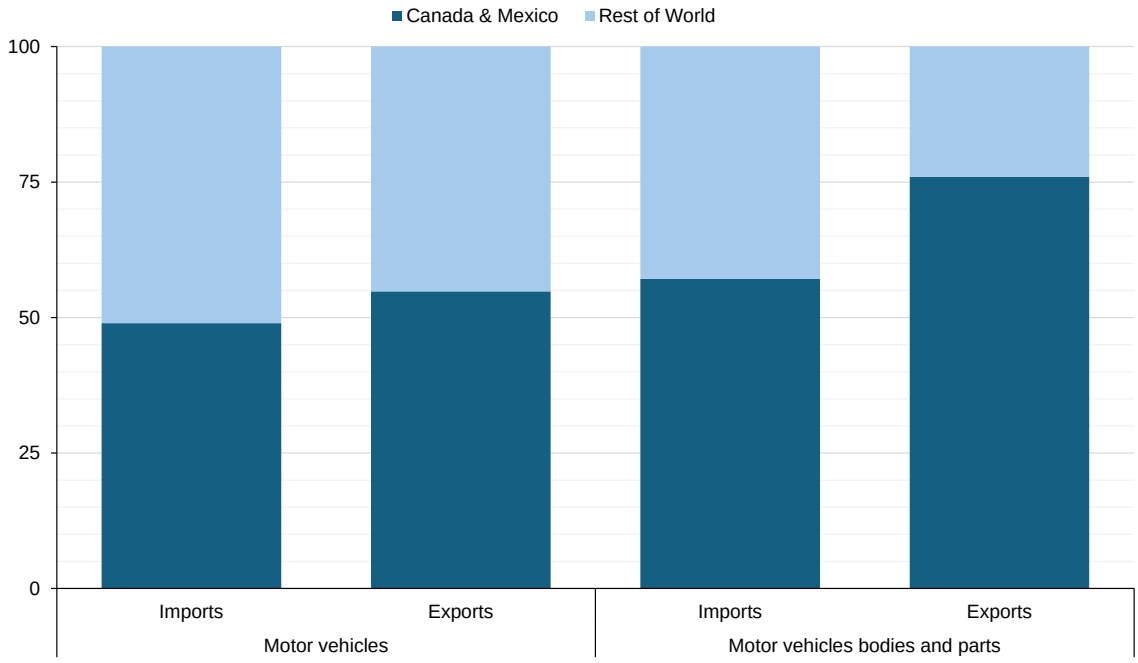
[5] Table based on York and Durante 2025.
[6] Frankl 2025; J.P. Morgan 2025

North American Auto Industry Integration

The automotive industries of the United States, Canada, and Mexico have developed a deeply integrated relationship over decades. This system now represents one of the world's most interdependent manufacturing ecosystems. This integration emerged through the North American Free Trade Agreement (NAFTA) and continued under its improved successor, the United States-Mexico-Canada Agreement (USMCA).

Mexico and Canada are the United States' most critical trading partners in the automotive sector. Together, these two nations account for nearly a third of all U.S. imports and exports and more than half of all U.S. imports and exports of motor vehicles and parts.[7] This bilateral relationship extends beyond finished vehicles to include components, raw materials, and technological expertise that cross borders multiple times during production. Mexico in particular has become a major exporter of motor vehicles to the U.S., with imports growing rapidly since the implementation of the USMCA in 2020. Exports of motor vehicles and parts accounted for nearly a third of Mexico's total exports to the U.S. in 2024, highlighting the automotive sector's significance in bilateral trade relations.[8]

Figure 1: Canada and Mexico Share of U.S. Auto Trade[9]
(Percentage share of U.S. imports and exports in 2024)



[7] U.S. Department of Commerce 2025. Calculated using 2024 two-way trade data.
[8] U.S. Department of Commerce 2025. Calculated using 2024 imports trade data for NAICS-4 codes 3361-3363.
[9] U.S. Department of Commerce 2025. Calculated using 2024 trade data for NAICS-4 codes 3361-3363.

Decades of free trade have fostered a deeply integrated automotive industry across the U.S., Canada, and Mexico, with manufacturers across the three countries routinely exchanging parts and finished vehicles. This interconnected system challenges traditional definitions of a vehicle's country of origin, blurring distinctions between U.S., Canadian, and Mexican production. The regional integration established under NAFTA and strengthened by the USMCA has been crucial to the industry, where the vast majority of North American-made vehicles are also sold within the region.

A hallmark of this integrated system is that throughout the auto manufacturing process, parts cross the border between these three countries multiple times, creating methodological challenges in terms of distinguishing content origin. This complexity can be illustrated with the example of a simple capacitor, which is a small electronic component that can cross the North American border up to four separate times during its journey from initial component to installation in a completed vehicle.[10] The component begins as part of a circuit board, then becomes integrated into seat control electronics, before finally being incorporated into an automotive seat assembly installed at the vehicle assembly plant.

These challenges are exacerbated by long-standing reporting requirements set out in the American Automobile Labeling Act (AALA).[11] Implemented in 1997, the AALA requires manufacturers to disclose specific content information for vehicles sold in the U.S. This includes reporting final assembly location, engine and transmission origins, and any country contributing more than 15% of the vehicle's parts content. The act also combines content percentages for the U.S. and Canada into a single category, making it impossible to distinguish between these sources.[12] Additionally, countries contributing less than 15% of parts content need not be identified, and manufacturers can aggregate data across multiple production locations for the same model, further complicating content analysis.

[10] Klier and Rubenstein 2019
[11] Klier and Rubenstein 2019
[12] Klier and Rubenstein 2019

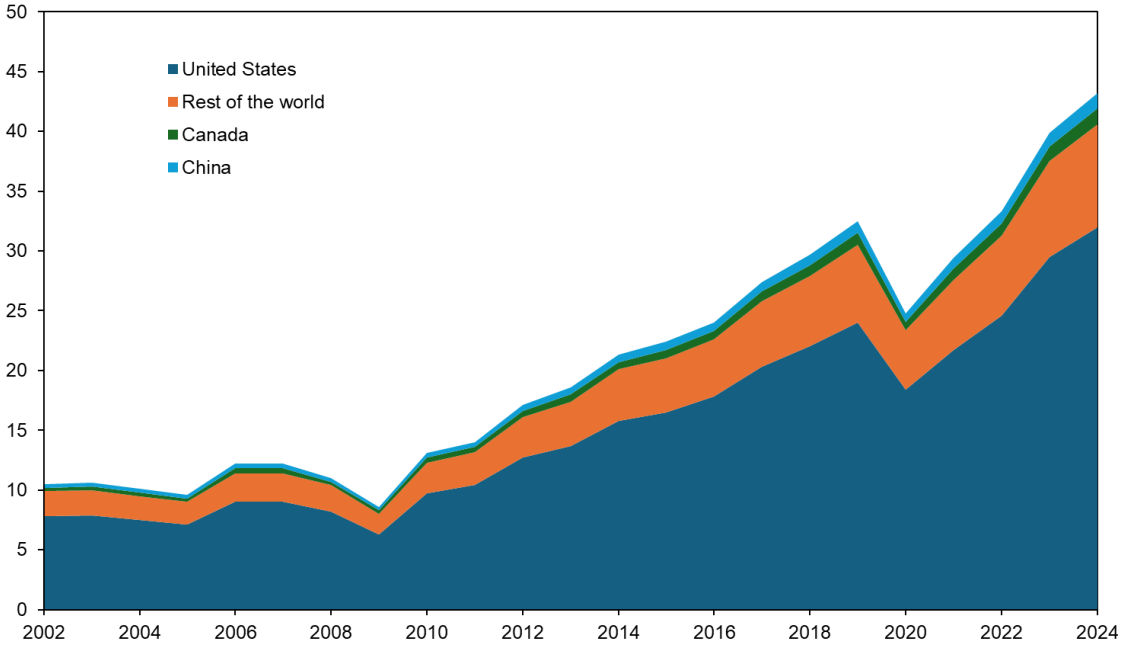
Table 2: Big 3 Vehicles Sold in the U.S.[13]

Brand	Model	Share of North American content	Final assembly countries	Sources of engine/motor	Sources of transmission
Cadillac	CT5	15% (U.S./CAN) 49% (MEX)	U.S.	U.S.	U.S.
Chevy	Malibu	39% (U.S./CAN) 25% (MEX)	U.S.	U.S.	U.S.
GMC	Acadia	35% (U.S./CAN) 22% (MEX)	U.S.	MEX	U.S.
Ford	Bronco Sport	23% (U.S./CAN) 64% (MEX)	MEX	U.S. (2.0L) MEX (1.5L)	U.S.
Ford	Maverick	27% (U.S./CAN) 60% (MEX)	MEX	MEX (2.5L) U.S. (2.0L)	U.S.
Ford	Mustang Mach-E	13% (U.S./CAN) 78% (MEX)	MEX	MEX	MEX

It is important to emphasize that U.S.-manufactured inputs are deeply integrated with Mexican vehicle production. The U.S. accounts for nearly three-quarters (74%) of the foreign value-added for vehicles imported to the U.S. from Mexico, implying that the U.S. comprises more than a third (38%) of the total value-added of vehicles imported by the U.S. from Mexico.[14] It is likely that these figures underestimate the total value of U.S.-made content in Mexican vehicle exports given that they rely on customs data from 2014 before NAFTA was replaced by the USMCA, which increased the minimum North American regional value content (RVC) rules of origin (ROO) requirement from 60-62.5 percent to 75 percent.[15]

[13] Table based on Lincicome and Carrillo Obregon 2025; National Highway Traffic Safety Administration 2025.
Notes: CAN = Canada; MEX = Mexico; U.S. = United States. See source for calculation methodology.
[14] de Gortari, 2019; Contreras 2024
[15] Contreras 2024

Figure 2: Mexican auto exports to the U.S., implied value-added content by origin[16]
(Billions of U.S.$, annual)



Over the past two decades, the integration of U.S. content in Mexican vehicle exports has expanded significantly, with the value of U.S.-sourced components in Mexican-assembled vehicles increasing from about $5 billion in 2002 to nearly $40 billion in 2024.[17] This deep integration means that when American consumers buy "Mexican-made" vehicles, they are also supporting significant employment in the U.S. manufacturing sector.

In contrast, vehicles imported from Europe, Japan, and Korea contain far fewer U.S.-manufactured components. While Mexican-assembled vehicles incorporate about 38% U.S. value-added content, imports from these other regions typically contain almost no U.S. content. This difference stems from global automakers prioritizing regional supply chains within their own economic zones.

For instance, the European automotive industry relies on a tightly integrated supplier network across Germany, France, Italy, and Eastern Europe. Similarly, Japanese and Korean manufacturers have developed strong domestic supply chains, supplemented by strategic sourcing from nearby Asian countries with lower labor costs.

Although many of these automakers operate production facilities in North America to serve the U.S. market, their supply chains remain primarily oriented toward their home regions. Even when they assemble vehicles in the U.S., they typically use a significantly higher proportion of foreign-

[16] Figure based on Contreras 2024 and Lincicome and Carrillo Obregon 2025. See Contreras 2024 for calculation methodology.
[17] Contreras 2024

sourced components compared to North American manufacturers. As a result, the economic impact of their U.S. production is less localized than that of North American-built vehicles.

Tariff Impact

The impact of tariffs is moderated by the substitutability of imports between firms and countries. When a tariff is targeted at specific industries or nations, companies can sometimes offset its effects by shifting to alternative suppliers, whether by sourcing from non-targeted regions or even bringing production in-house. However, in scenarios with broad-based tariffs, such flexibility is greatly diminished because the tariff uniformly applies to all imported goods, leaving little room for substituting.

The U.S. auto sector has built its competitive edge over the past five years by leveraging a regulatory framework that includes the USMCA, which provides critical exemptions for Canada and Mexico. This framework has guided substantial business investments and strategic supply chain decisions. Without a USMCA exemption for a 25% tariff on vehicles and auto parts from these key partners, the U.S. auto industry would face detrimental challenges relative to non-U.S. automakers.

A 25% tariff without USMCA exemptions would create immediate and cascading cost pressures throughout the North American auto industry. The cascading effect would be particularly significant, as components crossing borders multiple times during production would face compounded tariff applications, likely multiplying the effective tariff rate far beyond the nominal 25%. This becomes especially problematic when considering the narrow profit margins within the industry. Manufacturers typically operate at around a 10% margin, with suppliers functioning at even lower margins, leaving minimal capacity to absorb these additional costs internally.

The scale of a 25% tariff on the integrated North American supply chain makes it economically impossible for manufacturers to shield consumers from price increases. In theory, any increase in vehicle prices would unfold in stages, varying by manufacturer. Immediate impact would be felt by low-inventory manufacturers, as companies with only lower inventory would need to raise prices almost immediately to maintain profitability. There would be a delayed but inevitable impact for others, as manufacturers with larger inventories could temporarily delay price increases but would ultimately need to implement them once existing inventory is depleted. This situation would create competitive disruption in the market. Non-integrated foreign manufacturers could potentially pause imports until market conditions stabilize, creating supply shortages that further drive up prices across the industry.

Initial estimates of price increases for new vehicles vary significantly. Due to the interconnected nature of the North American auto market, accurately assessing the price impact is complex, particularly when considering the cascading effects of parts crossing the border multiple times during production. Estimates by Anderson Economic Group indicate a per vehicle cost impact ranging from $4,000 to $10,000 for North American-assembled U.S. vehicles across

manufacturers, including Ford, GM, Honda, and Toyota.[18] These estimates reflect the tariff policy announced on February 1, which imposes a 25% tariff on imports from Canada and Mexico and a 10% tariff on imports from China.

Table 3 presents a high-level per vehicle impact analysis based on USITC import data for automobiles and auto parts under HTS codes related to passenger vehicles. By applying a 25% tariff and distributing the total impact across projected new light vehicles in 2024, the analysis estimates that without a USMCA exemption, the per-vehicle tariff impact could reach $4,711. With a USMCA exemption, this impact would decrease significantly to $2,765. Importantly, these calculations assume auto parts face tariffs only once, whereas in reality, components typically cross North American borders three to four times during assembly. Consequently, an auto manufacturer with 100% North American production could experience even greater vehicle price increases than a manufacturer with no North American production if there is no exemption for USMCA-compliant auto parts.

An advantage of this high-level approach is that it incorporates the assumption that tariff-induced price increases would be distributed across different vehicle models. This assumption aligns with standard industry practices. If tariff impacts were passed through to consumers on a vehicle-by-vehicle basis, the resulting cost differentials could create inconsistent pricing that doesn't accurately reflect the vehicle's value to the manufacturer. Consequently, manufacturers would likely spread any cost increases across their entire model lineup to maintain competitive and coherent pricing structures.

Table 3: High-Level Per Vehicle Tariff Impact[19]

	Without USMCA exemption	With USMCA exemption
Per Vehicle Tariff Impact	$4711	$2765

Any increase in new vehicle prices would also trigger used vehicle market increases. As seen during the COVID-19 pandemic, higher new vehicle prices increased demand for used vehicles, driving up prices in the secondary market. This has resulted in persistently high used vehicle prices that have continued through the initial post-pandemic years.

Broader economic impacts would follow, with auto insurance premiums rising in response to higher vehicle replacement costs. Inflation, which is measured through consumer price index (CPI) would increase as both new and used vehicle prices contribute to inflation metrics.

[18] The Wall Street Journal Editorial Board 2025.

[19] Author calculations based on data from USITC 2025 and FRED 2025. Note: Per vehicle impact is calculated by applying a 25% tariff to UTISC data on imports of motor vehicles and motor vehicle parts. General Customs Value data are used, which reflect the value used for duty assessment by U.S. Customs and Border Protection. HTS codes used are 8703 (valued at $216.8 billion in 2024) and 8706-8708 (including, where possible, parts related to 8703 only, valued at $82.8 billion in 2024). This is then divided by the total number of new light vehicles sold in 2024, 15.8 million.

Consumer purchasing power would also decrease across both auto markets as transportation costs comprise a larger share of household budgets.

The tariff would disproportionately affect key emerging automotive technologies. EV production would face particular challenges, as Canadian-sourced critical minerals (nickel, cobalt, lithium) for batteries would face tariffs that could significantly impair U.S. competitiveness in the growing EV market. Additionally, advanced electronics would experience significant disruption. Semiconductor-based systems with globally sourced components would face multiple tariff applications during cross-border assembly phases, threatening the technological advancement of U.S. vehicles. Traditional powertrain component costs would also increase substantially. Engine and transmission parts manufactured across North American borders would see price escalations that affect even conventional vehicle production, limiting consumer access to affordable transportation options.

Supply Chain Disruptions

The USMCA marked a major achievement during President Trump's first term with updated provisions that strengthened North American manufacturing. Seen as a cornerstone of Trump's trade policy, the USMCA reinforced North American economic ties while addressing concerns over job losses and trade imbalances. By preserving and enhancing North American supply chains, the USMCA ensures seamless trade and provides duty-free access to two of the world's largest vehicle markets.[20] The agreement supports a highly integrated automotive manufacturing ecosystem, honed over decades, enabling manufacturers to optimize production efficiency and reduce costs.

Automotive manufacturing relies on highly sophisticated lean production systems, where thousands of components move across borders daily to reach assembly plants precisely when needed.[21] These finely tuned logistics networks reduce storage costs and improve efficiency. However, the sudden imposition of tariffs threatens to disrupt this delicate balance. Higher import costs and potential retaliatory measures could create critical component shortages, forcing production delays or even halting entire assembly lines. Such disruptions would ripple across the industry, affecting suppliers, automakers, and consumers alike.

Moreover, the added uncertainty compels manufacturers to increase inventory levels, driving up carrying costs and reducing overall efficiency. Multi-tier supplier networks, which depend on steady and predictable trade flows, would face rising operational expenses, leading to higher vehicle prices for consumers. Industry experts stress that transitioning to fully domestic supply chains would take years, requiring significant capital investment, infrastructure development, and workforce adjustments. This prolonged adjustment period would create sustained operational turbulence, reducing competitiveness and making North American automakers vulnerable to global competition.

[20] American Automakers Policy Council 2020
[21] Holweg 2008

As the automotive sector navigates these challenges, maintaining stable trade policies and predictable supply chains remains essential for sustaining industry growth, protecting jobs, and ensuring continued innovation in vehicle manufacturing.

Capital Expenditure Decisions

The automotive industry operates on carefully structured investment cycles with long planning horizons, multi-billion-dollar facility investments, and complex cross-border supply chains. These decisions require policy consistency and stability to ensure investments remain viable throughout their lifecycle.

The current tariff policy significantly disrupts this ecosystem by imposing compressed decision timelines. The one-month exemption period forces manufacturers to make production relocation decisions in weeks that normally require years of thorough analysis and planning. This policy shift creates substantial investment distortions. The administration's directive for manufacturers to quickly move production to the U.S. without allowing for proper economic assessment contradicts market-based capital allocation principles and may lead to suboptimal facility investments.

Furthermore, resources previously dedicated to competitive advantages, such as electrification technologies, automation capabilities, and product innovation, risk being redirected toward defensive supply chain restructuring and redundant manufacturing capacity that adds limited long-term value. The tariffs also jeopardize existing North American investments. Production facilities in Mexico and Canada may become underutilized or completely stranded assets, representing significant value destruction with impacts across regional economies.

As a result, automotive manufacturers face a critical risk: making long-term investment commitments without visibility into future trade policy, particularly when economic analysis shows that many U.S. production scenarios remain viable only within an integrated North American supply chain framework.

Competitiveness Erosion

The United States currently accounts for approximately 12 percent of global vehicle production, reflecting a significant decline from nearly 19 percent in 2004. During this same period, China has experienced tremendous growth in domestic vehicle demand and now produces nearly three times the volume of vehicles as the United States. Despite this relative decline, the U.S. maintains its position as the world's second-largest vehicle producer, manufacturing nearly the same number of vehicles as all of Western Europe combined.[22]

With compressed adjustment timelines, U.S. manufacturers face significant domestic market share challenges due to rising input costs and supply chain disruptions. Their strategic options include absorbing margin reductions that threaten profitability, passing costs to consumers at the risk of demand contraction, or reducing production output, which risks ceding market share to

[22] Alliance for Automotive Innovation 2025

competitors. Meanwhile, international rivals operating outside these constraints can maintain more favorable pricing, potentially capturing customers who might have otherwise chosen American-made vehicles.

The potential damage to North American integration comes at a time when global competitors continue to benefit from their own regionally integrated supply chains. The European automotive sector relies on the seamless trade mechanisms within the EU single market, while Asian manufacturers leverage exceptionally dense supplier networks across China, Japan, and South Korea. Disrupting the USMCA framework would place U.S. manufacturers at a structural disadvantage against these competing regional production networks.

Additionally, tariff-driven cost increases inevitably compress profit margins, leading to reductions in research and development budgets across the U.S. automotive industry. This financial constraint threatens critical technology transitions in electrification, autonomous driving, and connected vehicle systems—areas where global competitors are aggressively investing. The resulting innovation gap could have long-lasting consequences for the U.S. automotive industry's ability to maintain leadership in emerging vehicle technologies that will define the next generation of transportation.

These disruptions coincide with unprecedented Chinese automotive export expansion, raising additional strategic concerns. Chinese manufacturers are leveraging domestic overcapacity to aggressively capture international market share with competitively priced, increasingly high-quality vehicles. The additional burden of tariff-related costs and operational disruptions intensifies these competitive pressures on U.S. producers, potentially accelerating market share erosion in both domestic and international markets.

Absent the protective framework of USMCA exemptions, U.S. automakers would face this intensifying Chinese competition with one hand effectively tied behind their back, creating conditions for accelerated industry disruption that extends beyond immediate price impacts.

Economic Effects and Sentiment

The Tax Foundation estimates that a 10% tariff would shrink U.S. GDP by 0.7% due to reduced incentives for work and investment.[23] With U.S. exports reaching $2.1 trillion in 2022, retaliatory tariffs could impose approximately $200 billion in new taxes from foreign governments, further reducing GDP by 0.4% and eliminating around 322,000 full-time jobs. Cumulatively, a 10% tariff with reciprocal retaliation could contract the U.S. economy by 1.1% and jeopardize over 825,000 jobs.

Previous research indicates that tariffs often lead to job losses in downstream industries—such as those that rely on imported materials like steel. For example, while steel production may benefit from tariffs, industries that use steel, such as automotive manufacturing, face higher costs. These

[23] York 2023

steel-consuming industries employ far more people than the steel industry itself. In fact, for every single job in steel production, there are approximately 80 jobs in industries like automotive manufacturing that depend on steel.[24] This means that when tariffs raise the cost of steel, the impact on job losses is much more significant in industries like automotive manufacturing. Although tariffs may protect steel producers, they can hurt broader industries that rely on these raw materials, leading to a net loss in jobs across the economy.

The automotive sector also contributes substantially to government revenue, generating over $181 billion in federal tax revenue and $90 billion in state government revenue in 2022—representing 6% of all state tax collections.[25] States also collected $56 billion from vehicle sales taxes in 2023. Tariff-induced price increases in this sector could significantly reduce these revenue streams while simultaneously increasing unemployment.

Furthermore, currency fluctuations can amplify these effects. While a stronger dollar may help mitigate price increases for American consumers, it simultaneously makes U.S. exports more expensive in foreign markets, weakening global competitiveness, and harming domestic businesses and workers.

The United States can worry less and less about competitive currency devaluations the more its major trading partners are integrated into its own economy. The more Mexico and Canada trade with the United States, the more the entire region behaves like a common market. In such a market, the respective currencies of each nation increasingly trade against each other at stable rates of exchange. Fewer trade barriers among Mexico, Canada, and the United States in such a central area as the automotive industry, accounting for hundreds of billions in monetary flows across the borders, will serve to stabilize the exchange rate among the peso and the Canadian and American dollars. Minimizing trade barriers is a de facto currency policy as well—extensive trade among countries makes deviations from a currency par among the trading countries less likely.

The theories regarding trade deriving from David Ricardo and Sidney Alexander illustrate these points. Ricardo observed that exchange rates reflect the respective comparative advantage that each country has in producing exportable goods that another country wants and is ready to pay for via exportable goods of its own. When countries trade robustly, their exchange rates stay put at a maximally efficient par deriving from that trade in goods. In Alexander's absorption model, countries that have trade surpluses are seeking an outlet for their investment capital abroad, and countries running trade deficits are a target for foreign investment capital. Lower trade barriers make exchange rates more stable and allocate products and financial resources more efficiently across the cooperating economies.

The impact of tariffs on consumers extends far beyond direct purchasing decisions. Consumer sentiment, a key driver of economic activity, took a significant hit in March, falling to its lowest

[24] Russ and Cox 2018
[25] Alliance for Automotive Innovation 2025

level in 29 months.[26] As tariffs raise the costs of goods—particularly major purchases like vehicles—consumer confidence can decline, leading to a shift in spending behavior. For example, as vehicle affordability decreases due to higher prices, households may begin prioritizing other areas of their budget, cutting back on discretionary spending or delaying large purchases.

Furthermore, as transportation costs rise, household budgets are likely to be reallocated, with consumers paying more for the same products and services. This shift in priorities could result in lower expectations for overall economic growth, particularly if auto sales—an indicator of economic health—decline significantly. The automotive industry, which is highly sensitive to consumer confidence, is particularly vulnerable to these shifts. Purchasing a new vehicle is a significant financial decision, and when consumer confidence is high, buyers are more likely to invest in new cars. However, when confidence is low, consumers may delay their purchases or opt for used vehicles instead, further impacting new vehicle sales.

For decades, the U.S. has benefited from financing its deficits and debt at lower costs than most nations due to global demand for U.S. dollars and assets. However, trade disruptions and policy uncertainty from tariffs could diminish the attractiveness of U.S. assets, potentially leading to higher borrowing costs and reduced capital inflows. This threatens the long-term economic stability that has traditionally supported American prosperity.

Policy Recommendations

This analysis underscores a core policy objective—if tariff increases are implemented, a USMCA exemption should be established. Such an exemption is critical to maintain and ensure North American automotive manufacturers' competitiveness with Asian and European rivals in global markets. Additionally, codifying the exemption would create a stable regulatory environment with predictable expectations for manufacturers, investors, and industry stakeholders. This approach would preserve the integrated supply chain benefits established under the USMCA while still allowing for targeted tariff adjustments in other areas of trade policy.

Conclusion

The proposed 25% tariff on imports from Canada and Mexico presents significant direct cost impacts to the U.S. auto industry, with estimates suggesting substantial increases in vehicle prices. However, the potential longer-term consequences extend far beyond immediate cost concerns. By disrupting capital investment cycles at a critical transition point in the industry, these tariffs could hinder the ability of automakers to invest in the future competitiveness of the U.S. auto sector. Policy uncertainty, created by shifting tariff strategies, may also stymie strategic planning, making it difficult for companies to make long-term decisions regarding production, research, and innovation. Furthermore, the tariffs could potentially further weaken consumer

[26] Frankl 2025.

confidence and alter purchasing patterns, while straining long-established relationships within the North American supply chain.

If the tariffs are extended beyond the temporary exemption period, they could fundamentally reshape the North American automotive landscape in ways that may not align with the stated policy goal of increasing U.S. manufacturing. The automotive industry requires policy predictability to make the substantial investments needed to stay competitive, particularly as the sector transitions to electric vehicles and advanced manufacturing technologies.

The USMCA plays a crucial role in maintaining the integrity of North American supply chains, providing critical duty-free access to two of the world’s largest vehicle markets. The agreement brings certainty and predictability, which American automakers support as essential for staying globally competitive. This stability encourages both foreign and domestic automakers to invest and expand operations in the U.S.

Ultimately, the long-term success of any U.S. automotive facility—whether an assembly plant or a research lab—depends on how international trade policies influence an automaker's ability to compete in global markets. To preserve the strength and future competitiveness of the U.S. auto industry, it is essential to maintain the USMCA exemption for Canada and Mexico and avoid the lasting disruptions that would arise from the implementation of the 25% tariff.

APPENDIX

USMCA Regulatory Framework

The United States-Mexico-Canada Agreement (USMCA), which entered into force on July 1, 2020, replaced the North American Free Trade Agreement (NAFTA) with significantly more stringent ROO for automotive products.[27] The auto industry was granted a three-year transition period for the new automotive ROO, and in some cases up to five years per special requests. These requirements are widely considered the strictest and most complex rules of origin of any free trade agreement globally.

For automakers to qualify for duty-free treatment under USMCA, they must satisfy all four of the following criteria simultaneously:

Table 4: USMCA Rules of Origin (ROO)

1	**Regional Value Content (RVC) of Entire Vehicle** ● 75% for passenger vehicles and light trucks (increased from 62.5% under NAFTA) ● 70% for heavy-duty trucks (increased from 60% under NAFTA)
2	**Core/Super-Core Parts Requirements** ● Seven categories of designated “core parts” must meet specific RVS thresholds ● The “super core” requirement mandates a 75% RVC for these critical components
3	**Labor Value Content (LVC)** ● 40% for passenger vehicles ● 45% for light trucks ● New provision which requires that the specific percentage of a vehicle’s production value be made by workers earning at least $16/hour.
4	**North American Steel and Aluminum** ● 70% of steel and aluminum purchases by value must originate in North America

Table 5: USMCA Core Parts

[27] Kitamura and Wong 2024

Advanced Battery	Cells, modules/arrays, and assembled packs
Axle	Axle shafts, axle housings, axle hubs, carriers, and differentials
Body and Chassis	Major body panels, secondary panels, structural panels, and frames
Engine	Heads, blocks, crankshafts, crankcases, pistons, rods, and head subassembly
Steering System	Steering columns, steering gears/racks, and control units
Suspension System	Shock absorbers, struts, control arms, sway bars, knuckles, coil springs, and leaf springs
Transmission	Transmission cases, torque converters and housings, gears and gear blanks, clutches, and valve body assembly

Despite the intended goal of increasing North American auto production, data reveal a growing trend of manufacturers paying tariffs rather than restructuring their supply chains to meet USMCA requirements. The percentage of U.S. vehicle and auto part imports from Canada and Mexico paying the 2.5% Most-Favored Nation (MFN) tariff increased from approximately 4% in 2019 (under NAFTA) to 16% in 2023 (under USMCA), with most dutiable auto imports originating from Mexico.[28] This trend aligns with economists' predictions during USMCA negotiations that it would be more cost-effective for manufacturers to pay the relatively low 2.5% MFN tariff than to meet the extensive USMCA requirements, which would necessitate significant supply chain restructuring.

One of the USMCA's most significant innovations is its groundbreaking chapter on macroeconomic policies and exchange rates, marking the first time such comprehensive currency provisions have appeared in a major trade agreement. These provisions address the problematic practice where nations artificially lower their currency values through market intervention and monetary operations. When countries engage in such practices, they gain unfair export advantages while disrupting the natural equilibrium of international currency markets, potentially harming their trading partners' economies.[29] This is especially relevant for manufacturing sectors like automotive production, where production costs and export competitiveness are particularly sensitive to currency values. Currency devaluation can enable manufacturers to scale up operations beyond what their domestic market could support alone, creating particular advantages in industries where large-scale production drives down unit costs–a critical factor in automotive manufacturing.

The USMCA establishes clear standards that align with key indicators identified by the IMF for detecting currency manipulation and requires all three countries to:

[28] Kitamura and Wong 2024
[29] Laffer 2014

1. Maintain market-determined exchange rate regimes
2. Refrain from competitive devaluation and exchange rate manipulation
3. Strengthen underlying economic fundamentals to promote strong, sustainable growth and sound macroeconomic policies
4. Provide transparency through regular disclosure of foreign exchange reserves data and intervention activities

These provisions represent a significant advancement over NAFTA, which contained no such protections against currency manipulation. By addressing "beggar-thy-neighbor" policies that can increase a country's competitiveness from a relative price standpoint, USMCA helps ensure that trade advantages are not undermined through currency devaluation.[30]

When viewed alongside the stringent automotive rules of origin, USMCA's currency provisions create a comprehensive framework that promotes fair competition while protecting against both direct tariff avoidance and indirect manipulation through exchange rates. This two-pronged approach demonstrates significant progress in crafting trade agreements that address both traditional and non-traditional barriers to fair trade.

[30] Laffer 2014

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