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ON A COLLISION COURSE

China's Existential Threat to America's Auto Industry and its Route Through Mexico

In February 2024, Chinese auto giant Build Your Dreams (BYD) unveiled a fully electric crossover sport utility vehicle priced at an astonishingly low \$14,000.¹ News of this ultra-cheap electric vehicle (EV) had the auto industry media abuzz, with one outlet² declaring that “Americans would eat this up,” and that the vehicle would “sell like hotcakes.”

But there is always a cost. In this case, it may very well be the U.S. auto industry.

A Bad Bargain

The introduction of cheap Chinese autos – which are so inexpensive because they are backed with the power and funding of the Chinese government – to the American market could end up being an extinction-level event for the U.S. auto sector, whose centrality in the national economy is unimpeachable.

The U.S. auto sector accounts for 3% of America's GDP. It is annually responsible for tens of billions of dollars of annual research and development spending. It supports an entire ecosystem of manufacturers, from steelmaking to semiconductor fabrication. And for nearly a century, it has provided reliable, well-compensated employment for millions of American workers of various levels of educational attainment, making it a pillar of the American middle class. As such, the U.S. auto industry's health has been the yearslong focus of U.S. trade policy, and a more recent focus of U.S. industrial policy. This includes longstanding tariffs on imported light trucks, and more recent rules of origin (ROO) content requirements for vehicle imports from Mexico and Canada, as well as clean vehicle consumer tax credits that reward domestic production as U.S. automakers undertake an industry-wide pivot to the manufacture of EVs.

The U.S. auto sector and its extensive domestic supply chain, however, face a growing threat from Chinese competitors, buoyed by the Chinese state. While direct imports of Made in China automobiles have until now been extremely limited, China's auto sector is hardly the uncompetitive laggard of decades past. Thanks to the Chinese Communist Party's (CCP) industrial planning and generous assistance that began in the wake of the 2009 financial crisis, its state-owned and state-supported manufacturers are poised to dominate the burgeoning global EV market. China is estimated to have spent tens of billions of dollars to create an auto sector ready to take advantage of the clean energy shift, with support including tax breaks, favorable lines of credit, land use agreements, extremely limited import competition, and often direct subsidization.³ Chinese automakers have also benefitted from mandatory joint ventures with⁴ and forced technology transfers from⁵ foreign firms seeking to gain access to the vast Chinese auto market. And, most egregiously, they benefit from the use of forced labor in their supply chains.⁶

The state support has paid off. The Chinese auto industry's growth has been exponential. The country became the world's leading auto exporter in 2023, selling cars in Europe, Australia, Africa, Mexico and Southeast Asia, and Chinese automakers lead the world in EV production and sales by wide margins. China's technological lead and its extensive supply chains, particularly for critical battery raw materials and components, are deep and secure because of its defined and deliberate industrial policies. Beijing has prioritized reducing dependencies on other countries, which in turn makes the world increasingly dependent on its own supply chains.

The CCP's objective is no secret: Global market dominance, made explicit in economic blueprints like Made In China 2025⁷ and China's most recent Five Year Plan.⁸ And the results of China's industrial bets – mammoth entities like BYD, SAIC Motor and battery maker CATL – are this effort's champions. They are expanding rapidly, without consideration to supply and demand and basic market forces, so much that the Chinese auto sector is estimated to have a production overcapacity of millions of vehicles per year. That overcapacity is now facing outward, in search of new markets to soak up the largesse.

China's automakers currently face significant barriers to entry into some western markets, including the United States. The European Union in 2023 began an investigation into the raft of subsidies that underpin Chinese auto exports' competitiveness, while U.S. tariffs have successfully kept these cars, electric or otherwise, off American highways.

But Chinese automakers are not idle. BYD, which became the world's largest EV manufacturer in 2023, is building a factory in the heart of the European Union and is among half a dozen Chinese companies preparing to manufacture in Thailand, thereby gaining access to nearby markets through regional trade pacts.⁹

More alarming, however, are Chinese firms' heavy spending on plants in Mexico, through which they can access the United States by way of the more favorable tariffs under the United States-Mexico-Canada Agreement (USMCA). This strategy is, in effect, an effort to gain backdoor access to American consumers by circumventing existing policies that are keeping China's autos out of the U.S. market.

This is an auto industry backed by the Chinese state. It has invested heavily in foreign markets in order to access more of them. And there is cause for alarm that Chinese vehicles and parts will only increase their access to the U.S. market, overcoming existing tariffs and evading existing trade enforcement measures, to directly challenge domestic automakers and threaten the jobs of millions of American manufacturing workers.

The United States must adopt a proactive and evolving strategy to stymie the CCP's penetration. Washington should raise tariffs further on Made in China vehicles, tighten and fully enforce the USMCA's ROO so they are not allowed to leak in, and exclude from the pact's preferential treatment components and vehicles made by companies headquartered in non-market economies like China. Washington must strictly enforce its own industrial policies, like the clean vehicle tax credits included in the Inflation Reduction Act, so that upstream content and raw materials from China do not benefit. Washington also must fully implement and enforce the Uyghur Forced Labor Prevention Act to keep goods and inputs produced in the Chinese police state of Xinjiang and by other oppressed minority ethnic groups out of the U.S. market, so that none of this content reaches American consumers.

The threat posed to the American auto industry by heavily subsidized Chinese imports is significant, and the level of its severity will depend greatly on how federal policymakers respond to it. A dedicated and concerted effort to turn those imports back requires greatly strengthened trade enforcement and fully implementing existing domestic industrial policies. This effort should be undertaken immediately; there is no time to lose.

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Why Chinese companies are flocking to Mexico

The country offers a back door to the United States

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Shunned by US, China investors use Mexico to keep grip on North American market

- New-energy giant Tesla's reported demands of Chinese suppliers to support upcoming Mexican 'gigafactory' show how firms are shifting supply chains amid geopolitical tensions
- But risks to China in Mexico include unionised factory labour and the public perception that Chinese enterprises are competitors, according to analysts



An Essential Industry

It is not hyperbole to suggest that the auto sector is American manufacturing's keystone. It directly supports more than 1 million jobs in the United States, which pay an average of \$29 per hour. And, like the wider manufacturing sector, an auto job's multiplier effect is substantial. Because of the myriad inputs each vehicle takes to produce – be it aluminum, steel, rubber or electronic components – each auto job in the U.S. supports approximately 11 others, according to the Alliance for Automotive Innovation.¹⁰

The annual value of U.S. auto exports is roughly \$55 billion, and significant spending is reinvested into the national economy. Domestic and foreign automakers spent \$117.3 billion in their U.S. assembly, engine and transmission plants, R&D labs, headquarters, offices, and other facilities from 2009 to 2019, and approximately 70% of that spending came from Ford, General Motors, and Stellantis, according to the American Automotive Policy Council (AAPC). A substantial amount is also spent by automakers and their suppliers on actual R&D – approximately \$26 billion in 2019, according to the AAPC.¹¹

This is not to mention the astounding amount of investment the auto sector is currently making into emerging clean technologies that are expected to drive growth in the next century. Between April 2020 and September 2023, \$16.3 billion was invested in the manufacture of zero emission vehicles in the United States. Over \$12 billion went to the manufacture of those vehicles, batteries and the extraction of critical minerals took place in the third quarter of 2023 alone.¹²

The auto sector is a fundamental American industry. Eight decades ago, it was the bedrock of American military capacity during World War II. Four years ago, automakers retooled to make ventilator equipment at the height of the Covid-19 pandemic.¹³ Its development of next-wave technologies like autonomous vehicles will have enormous strategic and competitiveness implications. The auto industry's preservation is essential to U.S. national security.

The Threat

The CCP has targeted electric vehicle technology since 2001, when it was introduced as a priority science research project in China's tenth Five-Year Plan, the country's recurring high-level economic initiative.¹⁴

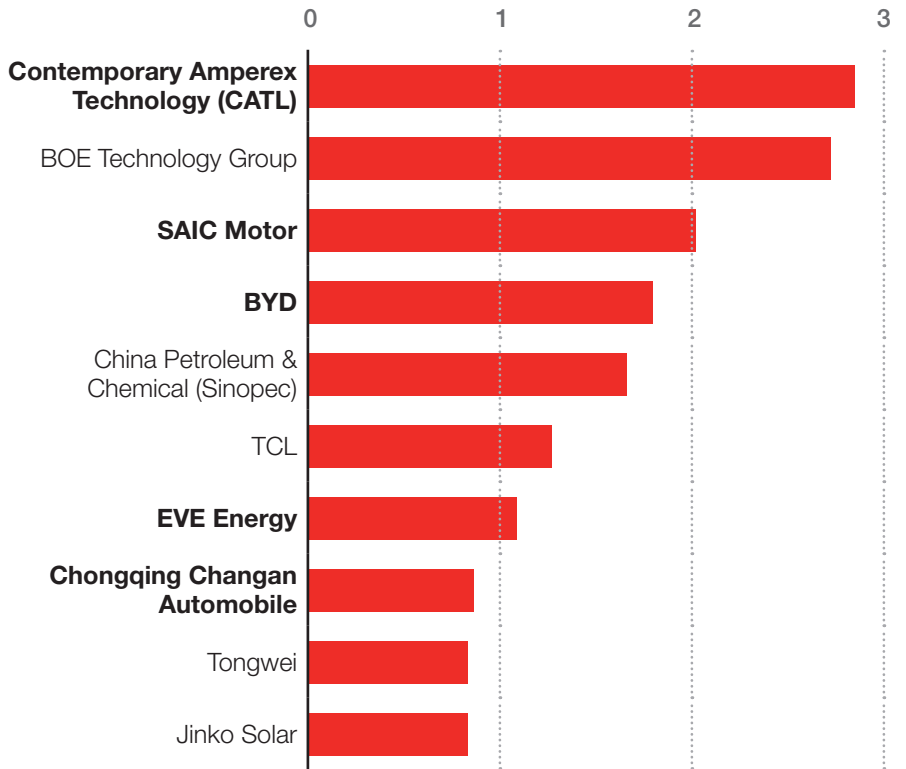
Eight years later, as the global economy reeled from the 2009 financial crisis, China had made the decision to subsidize EV production – not only buses and taxis but consumer automobiles.¹⁵ In that year, fewer than 500 EVs were sold in China.¹⁶ But in an environment suddenly flush with state cash, Chinese automakers were able to focus on improving the efficiency of their products. A protected domestic market and plenty of consumer-side subsidies have long kept sticker prices down and increasingly have made EVs a reasonable choice for Chinese car buyers.

“Beijing focuses on the EV industry as a leapfrog domain,” an analysis of the Chinese auto industry by consultancy Horizon Advisory explained.¹⁷ “This industrial policy rests on the calculus that incumbents will maintain control over the legacy auto sector, but that the EV disruption provides an opportunity to overtake the incumbents.”

A whole-of-government approach has been employed to accomplish this leap. From 2009 to 2022, the state fronted its EV automakers over \$29 billion via subsidies, R&D spending and tax breaks.¹⁸ It spent heavily on inflating domestic demand via consumer-side subsidies and incentives. The state's industrial policy encouraged technology transfer¹⁹ and forced joint ventures upon foreign manufacturers to access the Chinese market, including foreign automakers.²⁰ Many state-owned or -invested companies executed a “buying the dip” strategy in the wake of the crisis by scooping up depreciated international assets at low cost.²¹ Municipal governments bought fleets of Chinese-made electric buses and taxis.²² Shenzhen, a city of 12.5 million people, electrified its entire fleet of 16,000 buses. Nearly all of them were purchased from BYD, which is headquartered there.²³ Local authorities in other cities fast-tracked license plates for EV buyers that, owing to population density and congestion problems, would take an internal combustion vehicle years to acquire and at a significantly higher cost.

Top 10 Subsidy Recipients Among China A-share Companies

(in billions of yuan, for H1 of 2023)



EV-related companies in **bold**

Source: FT.com, based on Wind information, company filings

Chinese and other international auto manufacturers also continue to rely upon supply chains that run through the Xinjiang Autonomous Region, where the government has subjected at least 100,000 Uyghurs and other ethnic minorities to forced labor.²⁴ Xinjiang is a major producer of aluminum, a key input in automobile production. Human Rights Watch warns that any aluminum sourced from that region should be assumed to be tainted.²⁵

Fifteen years of heavy government support has worked; China has made itself the world’s EV production leader just as the global auto industry accelerates its pivot to new battery technology. There is widespread adaptation in China’s domestic market. Sales of such vehicles there grew 37% year-over-year in the first 11 months of 2023, according to the China Association of Automobile Manufacturers. More than one in three cars sold in China were EVs. And, of the 158 new car models expected in China in 2024, 80% of them will be electric.²⁶

China in 2023 passed Japan to become the world’s largest car exporter. BYD, chief among China’s auto-making giants, surpassed Tesla as the world’s largest EV company. In 2024, the company launched its first vehicle ship, setting sail from the southern city of Shenzhen loaded with 5,000 vehicles to sell in Europe.²⁷

Western competitors saw all these new cheap vehicles coming, and began to raise alarm bells.

Chinese car companies are the “most competitive” and “will have significant success outside of China, depending on what kind of tariffs or trade barriers are established,” said Tesla CEO Elon Musk in January 2024.²⁸

“If there are no trade barriers established, they will pretty much demolish most other car companies in the world,” he said. “They’re extremely good.”

The Threat's Avenues

As part of the U.S.-China trade investigation action plan in 2018, the Trump administration subjected Chinese finished vehicle imports to a 25% tariff that, in addition to the existing 2.5% tariff on all auto imports, brought the overall rate to 27.5%.²⁹ For now, this barrier has proven sufficient enough that Chinese brands have not yet meaningfully permeated the U.S. market. But industry analysts say it is a question of when, not if, those brands will emerge here.

Chinese EV overcapacity is estimated to be between 5 and 10 million vehicles per year.³⁰ And with significant state support implicit for Chinese auto companies, the U.S. tariffs at their current rate will ultimately be overcome. China is in the midst of a foreign investment spree of its own, not unlike the one undertaken by Japan's auto giants in the 1980s. It is meant to position Chinese automakers for the benefits of regional trade agreements and sidestep import restrictions.

Through the \$1.44 billion in new factory spending Chinese automakers have laid down in Thailand³¹, they will capitalize on that country's position as an

established regional export hub. Through the more than \$11 billion worth of component, battery and assembly factories announced last year in Hungary, home to a Chinese-friendly government and a member of the European Union, they will gain access to the European market.³² The significant capital spending by Chinese firms taking place in Mexico, and that country's trade agreements with the United States, they hope to gain access to the U.S. market.³³

The United States-Mexico-Canada Agreement (USMCA) was meant to address many of the flaws in the original North American Free Trade Agreement (NAFTA), which went into effect in 1993. Under the NAFTA framework, Mexican auto industry employment grew by 620,000 between 1999 and 2016, while the U.S. lost 360,000 auto jobs during the same period, according to the Economic Policy Institute. Mexican workers, meanwhile, made an estimated 12% of the wages of their U.S. counterparts.³⁴

The USMCA was meant to help correct this imbalance that weighed heavily on U.S. autoworkers by including

Chinese Auto Exports to the U.S. are Rerouting Through Mexico

U.S. Import Partner	Share of U.S. Parts Imports, 2023	Real Growth in Parts imports, 2017-2023	Chinese Real Manufacturing Machinery Exports (% Change 2017-2022)	Chinese FDI position (Change 2018-2022, millions of dollars)	Chinese FDI position (% Change 2018-2022)
Mexico	38%	20%	134%	940	126%
Canada	10%	11%	82%	3624	19%
China	9%	-17%	.	.	.
Japan	8%	-17%	34%	10082	88%
South Korea	7%	57%	43%	546	9%
Germany	6%	5%	78%	6563	55%
Thailand	3%	45%	92%	5487	40%
India	2%	75%	79%	5313	246%
Vietnam	1%	60%	149%	9875	119%
Malaysia	1%	222%	159%	9785	97%
Indonesia	1%	4%	62161%	10394	73%
Philippines	1%	33%	119%	505	12%

Source: EPI analysis of USITC Dataweb, UN COMTRADE, IMF Consolidated Direct Investment Survey, and Bureau of Labor Statistics data. Chinese machinery exports include HTS codes 84-85. U.S. parts imports comprise 80 6-digit HTS codes, available <https://www.trade.gov/automotive-parts-tariff-codes>.

rules of origin designed to guarantee that products qualifying for duty-free status would be produced regionally, as well as average wage thresholds meant to raise pay for workers across the trading bloc. So far there are strong indications that it has not rebalanced trade, but rather has created disproportionate investments into Mexico including from Chinese entities. Indeed, between 2018 and the first 11 months of 2023, the automotive trade imbalance between the U.S. and Mexico increased by \$12 billion, and the auto parts trade imbalance increased by \$9 billion.³⁵ The rules of origin are pulling in significant Chinese investment made by automakers looking to duck U.S. tariffs. Behind announcements from BYD and state-owned Chery and SAIC Motors, Chinese direct investment in Mexico has increased by 126% between 2018 and 2022. A full 22% of foreign direct investment that entered the country in the third quarter of 2023 went to the auto industry.³⁶

As such, following trends in other industries, including steel and aluminum products, production chains oriented around Chinese-owned and -affiliated companies are increasingly penetrating North American automotive supply chains via Mexico. It benefits from the USMCA's liberal methodology for calculating regional content, which in turn can qualify it for the consumer tax credits that subsidize EV purchases in the United States. While Chinese auto part imports to the United States fell by 17% between 2017 and 2023 after a sustained period of growth, imports from Mexico grew by 20% during the same time.³⁷ The data strongly suggests that Chinese inputs are beginning to circumvent U.S. tariffs by entering through the southern border.

“The leakage problem undercuts U.S. and North American workers by pitting them in competition against non-USMCA producers without commitment to the same worker, environmental, and consumer safety standards and without extending reciprocal market access to similar U.S.-based producers,” wrote the Economic Policy Institute’s Adam Hersh. “What’s more, the subterranean content can qualify for U.S. taxpayer subsidies under Inflation Reduction Act policies.”



What’s at Stake

China made a sizeable bet that it could use the economic instability of the 2009 financial crisis to catapult its auto industry into a dominant global role. That bet is paying off. Backstopped by heavy state support, Chinese automakers and suppliers have grown into industrial powerhouses that control the nodes of production for virtually the entire electric vehicle value chain. These companies are poised to profit greatly as the international community grapples with the shift to renewable energy sources.

They are now branching out, investing heavily in foreign countries to access new markets. And there is no market more enticing than the United States. A deluge of heavily subsidized auto and parts imports is at our borders.

We have already seen in steel and aluminum industries what happens when unfairly traded imports are allowed to swamp the U.S. market: Job losses, bankruptcies and deindustrialization. It has taken some deindustrialized communities decades to revitalize. Others continue to struggle. The domestic auto industry, with its millions of American workers and intricate ties to hundreds of other industries, is integral to American manufacturing. It is simply too important to the country’s economic security to be exposed to such blatantly unfair competition.

The commercial backdoor left open to Chinese auto imports should be shut before it causes mass plant closures and job losses in the United States. Washington should undertake the following policy recommendations to preempt their entry.

Policy Recommendations

TRADE ENFORCEMENT TOOLS TO COMBAT OVERCAPACITY AND UNFAIR TRADE

1. **Impose exclusionary tariffs on all Chinese automobile imports to the United States, including both electric vehicles (EV) and internal combustion engine (ICE) vehicles.**

This could be accomplished through the existing Section 301 tariffs, imposed in 2018 and currently under review, or by way of launching a new investigation under Section 301 or other U.S. laws.

2. **Enact the Leveling the Playing Field Act 2.0 (S. 1856 / H.R. 3882) to stay ahead of new and evolving circumvention tactics used by the China's government.**

The legislation 1) addresses "country hopping," 2) counters Belt and Road subsidies to 3rd party countries, and 3) accelerates investigation timelines.

3. **Reinstate the Section 421 import surge protection safeguard against China's automotive sector and related industries.**

This tool was authorized at the time of Beijing's WTO accession to address import surges as China was expected to transition to a market economy. China has failed to make such reforms or meet its WTO commitments.

4. **Improve the Steel Import Monitoring and Analysis (SIMA) System, under the Department of Commerce.**

This important tool collects and publishes early warning data of steel mill product imports. Improved visibility into steel products and steel-containing products such as auto parts will provide policymakers with early identification of troubling trade flows, allowing for actions to prevent damage to the U.S. economy before it is too late.

TRADE AGREEMENTS MUST SUPPORT AMERICAN WORKERS, NOT THE CCP

5. **Fully enforce and tighten USMCA rules of origin (ROO) for all automobile content to ensure that its signatories benefit from the agreement in an equitable manner.**

With the 2026 joint review of USMCA approaching, the United States should insist on robust and transparent application of the agreement's ROO – including regional value content (RVC) and labor value content (LVC) requirements – with emphasis on metals, batteries, and other new technologies. Similar mechanisms should be adopted in all U.S. trade agreements as well as in reforms to the Generalized System of Preferences (GSP) program.



6. **Exclude automobiles and component parts manufactured by companies headquartered in a non-market economy, such as China, from gaining any preferential treatment under USMCA, GSP, and any other trade agreement.**

U.S. negotiators should also insist on excluding China's state-owned or affiliated companies from benefiting from USMCA by setting up facilities in Mexico or Canada as a means of avoiding U.S. trade policies and enforcement mechanisms. Data indicates an alarming flow of investments into Mexico at the expense of the United States. Similar mechanisms should be adopted as part of reforms to the GSP program and other trade agreements.

ELIMINATE FORCED LABOR FROM THE AUTO SUPPLY CHAIN

7. **Fully implement and enforce the Uyghur Forced Labor Prevention Act (UFLPA) with additional emphasis on metals, automotive parts, and battery content and raw materials utilized in EVs.**

No American consumer should unwittingly aid the Chinese Communist Party's genocide against vulnerable ethnic populations, and no American business should be made to compete with forced labor overseas.

AMERICAN-MADE INCENTIVES AND PROCUREMENT POLICIES

8. **Strictly enforce the Clean Vehicle Tax Credits authorized under the Inflation Reduction Act (IRA) to ensure that upstream content and raw materials from China do not benefit.**

This includes closing loopholes for leased vehicles and ensuring that critical minerals agreements are tightly constructed to prevent backdoor access. Foreign Entity of Concern provisions in U.S. law should be strictly implemented and aggressively enforced.

9. **Fully enforce domestic content preference policies (including Buy American and Buy America laws) for automobile content and related transit rolling stock (rail and buses).**

Current standards overlook upstream content and raw materials used in batteries so long as the final stages of manufacturing and assembly occur domestically with minimal benefits accruing to U.S. workers.

10. **Tighten existing laws that block China's state-owned and state-supported companies from accessing taxpayer funded infrastructure projects by enacting the Airport Infrastructure Vehicle Security Act (H.R. 2912).**

Congress already enacted legislation in 2019 to block access to transit projects, but further steps are necessary to stop Chinese automakers (including BYD) from supplying electric buses for taxpayer-funded airport projects.

11. **Enact the Invent Here, Make Here Act (S. 1956) to prevent China from accessing taxpayer-funded research and innovations.**

China has already accessed breakthrough battery technology invented in a federal lab due to weak licensing review processes.

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