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How NAFTA and Changes in Mexico Have Primed Companies for a Nearshoring Move

White Paper

We love to put order in your chaos.

Morai Logistics Inc. is a 3rd party logistics provider with an operating agency agreement representing Mode Transportation. We are a powerhouse logistics team based in the Greater Toronto Area and do business throughout North America, including Mexico. Our team is dedicated to our terrific clients and we strive to take the chaos out of your supply chain. We are always on the lookout to do exceptional work with remarkable people and companies!

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How NAFTA and Changes in Mexico Have Primed Companies for a Nearshoring Move

MANY readers in the logistics industry may already be aware of the coming trend that North American companies are either already taking into consideration or have already begun implementing what is known in the industry as "nearshoring." It is the process by which outsourcing is done closer to home; in terms of North American manufacturing this means moving from the usual outsourcing in China to somewhere much closer like Mexico.

There are many reasons that suggest nearshoring is a benefit for many US-based businesses both in time and in costs. For example, the full landed cost of Chinese production rose to 87% of US costs from 2005-2010, while Mexican costs fell to 75% of US costs. China's fuel costs grew at approximately 20% per year in the past few years. Furthermore, ocean freight from Altamira, Mexico to the port of Miami takes about six days while a similar shipment from China can take up to a month to arrive.

Mexico has been slotted as a prime logistics choice for manufacturing for many years; China has maintained its competitive advantage. Developments such as NAFTA and efforts by the Mexican government to further improve its conditions for which outsourcing country makes the best choice for American companies has been underway for several years. This paper seeks to explore the history of NAFTA and its goals, and how it has facilitated in making Mexico the prime contender for outsourcing and why American companies are seriously considering nearshoring.

A Brief History of NAFTA

The concept of free trade within the North American continent was spearheaded in 1911 by both the Taft administration and Wilfred Laurier, the Canadian Prime Minister at the time. The move was proposed in the hopes of having a reciprocity agreement that would reduce, or eliminate, tariffs on both sides of the border in such a way that would benefit both the US and Canadian borders. At the time the focus was mainly on both of these countries and Mexico had not been introduced to the concept. Although it was rejected and not addressed for about another half-century, the concept of free trade did return.

In 1965, a new proposal, the "US-Canada Automotive Products Agreement" was passed and was the foundation of a real free trade agreement began. Indeed, the agreement spearheaded the now bustling and integrated US-Canada automotive industry that you see today. Estimates from the Canadian Vehicle Manufacturer's Association suggest that the agreement saved the Canadian economy CAD $10 billion and a five-year cumulative job loss of approximately 116, 900 Canadian person years.

In 1989, President Reagan and Prime Minister Brian Mulroney negotiated on a more comprehensive US-Canada Free Trade Agreement. It was seen the most comprehensive bilateral Free Trade Agreement in the world at the time and included some revolutionary proposals, primarily elimination of all tariffs by 1998 and facilitation of border crossings for professional service providers and business people. During this time, Mexico invested heavily in dismantling its anti-trade policies became a signatory of the General

Agreement of Tariffs and Trade (GATT). Signing the GATT ensured tariff rates were not higher that 50% and Mexico ended up reducing its tariff rate from 100% to 20%. At this time though, strict barriers of entry on US imports were still in effect, including strict quotas and licensing requirements.

In 1991, US President George HW Bush, Canadian Prime Minister Brian Mulroney and Mexican President Carlos Salinas wrote the beginnings of a North American Free Trade Zone Agreement. By 1993, the US Congress ratified the agreement and President Bill Clinton signed the North American Free Trade Agreement into law on January 1st, 1994.

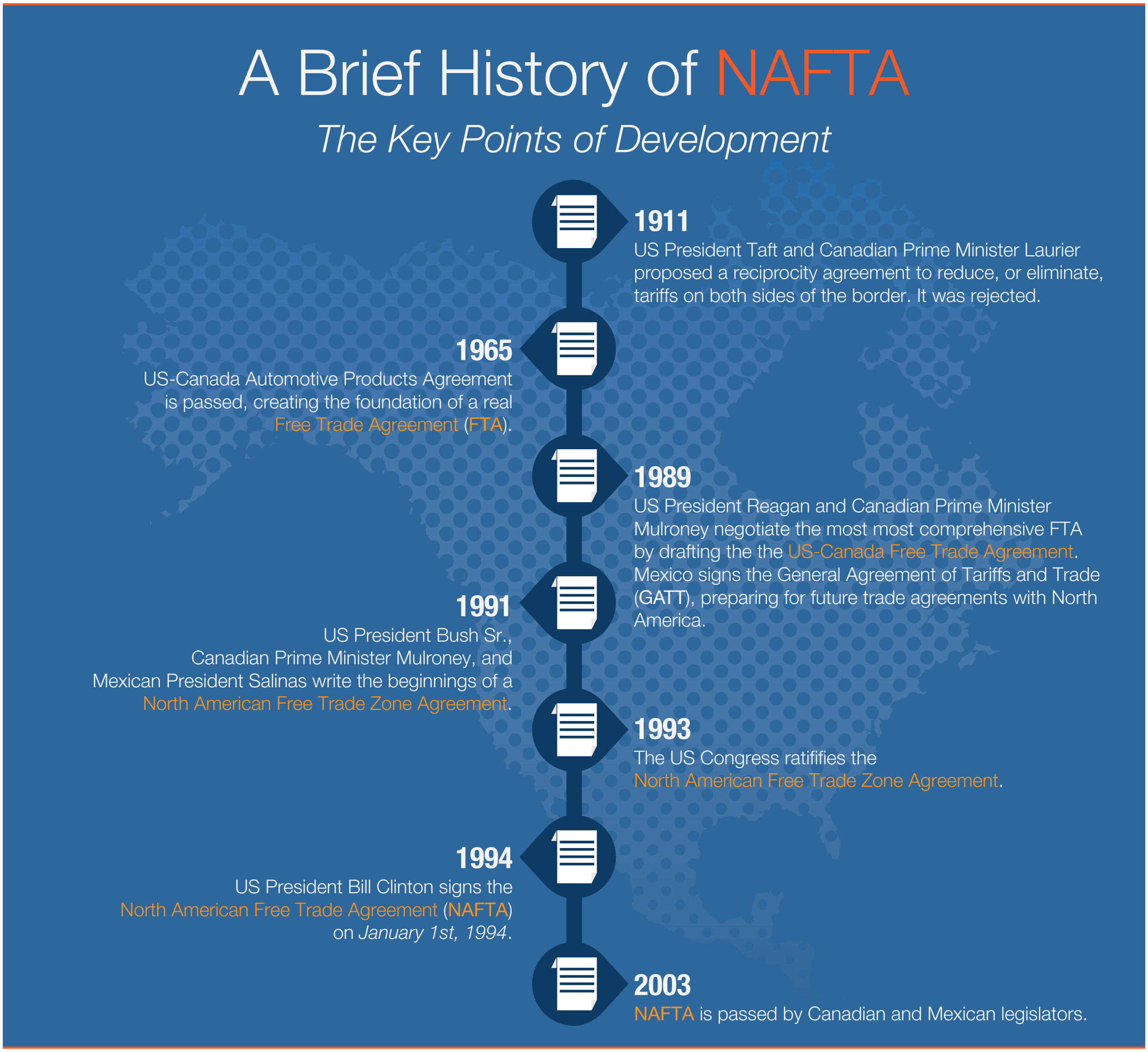

Figure 1: A Brief History of NAFTA. A timeline of the key points in NAFTAs development from the conception of a reciprocity agreement to eliminate taxes between borders to intergration of Mexico into a full North American Free Trade Agreement.

NAFTA and the Supply Chain

In what seems to be a reaction to changes in Chinese economic growth, Mexico has been further priming itself to be the next largest outsourcing hub and NAFTA is part of what facilitated these changes. Most of the market opening measures that NAFTA granted mainly benefited the remaining barriers from the GATT that were not covered.

The signing of NAFTA resulted in the removal of US tariffs and quotas applied to Mexico; both to imports from Mexico as well as imports into Mexico from the US and Canada. By this point in the history of the free trade agreement most the US-Canada agreements had already been in place, NAFTA was a means to secure Mexico as a legitimate nearshoring opportunity.

NAFTA is further facilitated by changes in the Mexican government to further create initiatives to be a true competitor as an outsourcing choice.

Transportation infrastructure, especially in rail development, has created a niche market for intermodal transportation between borders and can be up to 30% cheaper than truck transportation alone due to increasing freight costs. It also saves time; clearance for a 250-container train only needs about 30 minutes of inspection time while a single truck container can take up to two hours.

Mexico and Nearshoring

Nearshoring is already creating an impact in the logistics and supply chain industry. Research from Barclays has shown that in North America, the contract logistics market grew by 1.5% in 2013.

The total market size exceeded pre-crisis levels (i.e. 2008) and it was mainly driven by increased manufacturing production in Mexico. Mexico experienced a 5.2% increase in contract logistics in 2012, followed by a 2% growth in 2013.

Changes in the growth forecast for 2013-2017 in North America is estimated to be 6.3% by Barclays; researchers suggested that this will be primarily due to the continued growth in Mexico and Canada. The Boston Consulting Group recently suggested that some manufacturers are bringing it even closer (i.e. bringing manufacturing back to the US) and that Mexico is a definite contender. Other outsourcing options outside of China can tackle the lower labour costs, such as Vietnam and Indonesia.

> **MEXICO EXPERIENCED A 5.2% INCREASE IN CONTRACT LOGISTICS IN 2012.**
>
> *SOURCE: BARCLAYS*

Yet the countries struggle when it comes to handling higher-end manufacturing that would otherwise go to China.

Vietnam and Indonesia have limited infrastructure, skilled workers, scale, and domestic supply chain networks. They also run intellectual property and political risks.

While Mexico can be prone to similar challenges, steps have been taken to reduce factors like low worker productivity, corruption, theft, and risk of personal safety through governmental change and intervention. The Boston Consulting Group notes Mexico has the potential to be a big winner when it comes to supplying North America.

Figure 2: Top 7 Considerations for Outsourcing from Logistics Professionals. A list of the most important factors that logistics professionals consider for outsourcing. *Source: AlixPartners*.

Conclusions

Mexico has been set up to be a prime nearshoring choice thanks to history and the creation of NAFTA. By 2015, wages in Mexico will be significantly lower than in China, due to China's entry in to the WTO in 2001.

The Boston Consulting Group forecasts that by 2015, the fully loaded cost of hiring Chinese workers will be 25% higher than the cost of using Mexican workers. This and the fact that Mexico directly borders the US lead to it being not just a cost-saver, but a time-saver as well.

American companies are now faced with a serious dilemma when it comes to manufacturing, and Mexico has been taking steps to position themselves as a solid choice.

Nearshoring is happening, and manufacturers that stay in China for economic strategic reason will soon be left the task of finding how to improve efficiency so that they can optimize their supply chain to compete with Mexico's growing advantages.

3 Facts You Should Know About Us.

1 Our Philosophy

The Greek word "moira" means 'part' or 'portion.' Morai Logistics is based on the three Fates of Moira from Greek mythology. They are composed of three sisters that represent the past, present, and future and they are responsible for every individual's 'thread of life.' Similar to how the three Fates are cognizant of one's fate from beginning to end; our logistics services *control your shipments from pick-up to delivery.*

Our Services 2

As a 3rd Party Logistics Provider, we pride ourselves in giving you the highest quality customer service matched with the lowest total cost. Our core services range from truckload (TL), less-than truckload (LTL), intermodal, and small package transportation. This includes cross-border services (Canada, US, Mexico) as well as domestic within each country. We also cater to specialized services, here are just a few:

Alcohol Permitted	*beer, wine and spirits carriers*
Hazardous Materials	*dry van, tanker, etc.*
Temperature Controlled	*refrigerated and frozen*

3 Our Affiliations

Our President, Kelli Saunders has taken initiative as an entrepreneur and started Morai Logistics as an agency of Mode Transportation in 2011. Outside of Morai Logistics, Kelli is very active in various organizations and events. She is a proud member of the Women Presidents Club, WeConnect Canada, and Worldwide Who's Who. She was also the former president of the Toronto Transportation Club.

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