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North America: vertical integration to increase manufacturing production and employment, develop resilient supply chains and diversify from Asia

1. Introduction: New Trade Policy Context

The new trade policy in North America has become a powerful incentive for complying with the rules of origin (ROO) under the U.S., Mexico and Canada Agreement (USMCA) and to more deeply vertically integrate. To further this objective, it is important to enhance the incentives for ROO compliance. This implies discouraging non-regional sourcing and exempting goods that fully comply with ROO from most favored nation (MFN) import duties but also those related to national security or safeguards Parties might implement in accordance with the body of trade laws.[1]

North America's long-term competitiveness depends on strengthening the vertical integration of its production value chains. In particular, Mexico is an important enabler of U.S. reindustrialization and competitiveness. While the United States, Mexico, and Canada are deeply interconnected through the USMCA, the region remains dependent on Asia, particularly for upstream intermediate goods in strategic industries such as machinery, electronics, transport equipment, and advanced manufacturing. In contrast, Asia has developed a tightly integrated regional production architecture in which roughly two-thirds of trade in intermediate goods takes place within the region, supported by dense supplier networks and sustained investment flows. There is a clear need for the U.S. and its North America partners to deepen industrial integration, increase supply-chain resilience, retain value added within the region, reduce external vulnerabilities and diversify exposure to Asian risk.

Recent changes in U.S. tariff policy have created new incentives not only for relocating investments but for greater vertical integration within North America. The imposition of tariffs in 2025 significantly increased the value of complying with USMCA rules of origin, encouraging Mexican and Canadian exporters to raise North American value content in their products and substitute inputs and components sourced from Asia with those produced within the region, including from the U.S. Relative tariff preferences for USMCA goods have increased following these policy changes, shifting corporate sourcing strategies to regional suppliers. In this context, exempting regional exports that comply with USMCA rules of origin from existing and future tariffs, including those applied under Section 232, other national security exception or

[1] In the case of the U.S. this might include import tariffs under the International Emergency Economic Power Act (IEEPA), section 232 of the Trade Expansion Act of 1962, section 122 of the and section 301 of the Trade Act of 1974, section 338 of the Tariff Act of 1930, and those under safeguards according to Section 201 of the Trade Act of 1974. In the case of Mexico those potentially imposed under safeguard provisions under title VI of the Foreign Trade Law (*Ley de Comercio Exterior*) and those under national security considerations.

safeguard duties, would reinforce these incentives and further strengthen regional value chains, and reduce the region's reliance on Asian intermediate goods and trade deficits with that region.

2. Asia is more vertically integrated than North America

There is abundance and variety of competitive key inputs and components in Asia Pacific that support their manufacturing value chains. The region registers an important concentration of producers of key inputs, intermediate goods, and specialized components which allows manufacturers to source regionally at competitive prices while maintaining quality, delivery times, and technical specifications. The depth of these markets strengthens Asia Pacific's position as an integrated manufacturing hub.

USMCA countries are also well integrated, but North American supply chains are less self-reliant regionally and more externally dependent on Asia, especially for some upstream intermediate goods for the auto industry and a substantial share of high-tech components (electronics, and machinery).

One indicator of vertical integration in the different regions is trade in intermediate goods. In Asia, intraregional trade of intermediate goods represents 65 percent of the total. Such share has remained relatively stable between 2017 and 2024.

In contrast with Asia, in North America intraregional exports of intermediate goods represented around 48 percent of the total in the same period, a difference of some 18 percentage points with respect to Asia.

North America must deepen its own vertical integration and develop a large base of available intermediate goods. Building competitive regional capacity in upstream intermediate goods is essential for supply chain resilience, technological upgrading, and long-term competitiveness. Strengthening intra-regional production would not only reduce exposure to external shocks but also retain greater value-added within North America. The challenge is not simply to trade more within the region, but to produce more goods in the upstream segments of the value chains. This is the only way to reduce both dependence and the regional trade deficit vis-à-vis Asia.

3. Incentives for vertical integration

There are significant structural advantages in North America for the diversification of the supply chain risk away from Asia Pacific, particularly China, and for a stronger vertical integration.

The change in U.S. tariff policy in 2025 with the imposition of tariffs created a strong incentive for Mexican and Canadian exporters to comply with USMCA ROO to be exempt from IEEPA tariffs first, section 232 for auto-parts and then from section 122 tariffs. The exemption reflects the importance of each other's markets, the integration of value chains and the high level of regional co-production.

Before 2025, the incentive for Mexican and Canadian exporters to comply with rules of origin was limited, as U.S. MFN duties were zero or low for a large proportion of imported goods. Accordingly, exporters assessed the cost of complying with ROO versus the MFN duty. In many cases, they could opt for global sourcing and rather pay the MFN duty; not anymore.

The incentive structure has now changed: USMCA origin effectively became the channel for preserving market access and competing with third countries strengthening the business case for raising regional value content and reshoring upstream inputs within North America. The compliance with the ROO means the incorporation of higher U.S. and regional value content by exporters, displacing sourcing from Asia Pacific including China. This is illustrated by the fact that the rate of compliance of ROO by Mexican exporters before IEEPA tariffs was close to 50 percent; now it is more than 80 percent.

The incentive to substitute extra regional value content in Mexican and Canadian exports to U.S. would be much stronger if such goods were exempt from Section 232 or other such tariffs.[2] Such exemption would foster vertical integration in the region through, among other things, greater incorporation of direct and indirect U.S. content in Mexican inputs and finished goods exported to the U.S.; an expanded U.S. role as a supplier of key commodities to Mexico (i.e., natural gas, grains, minerals); and a reduced reliance on extra-regional suppliers.

Given the deep North American integration, the U.S. imposition of high tariffs to Mexico and Canada hurts their exports, but also American suppliers of inputs and intermediate components and machinery necessary to manufacture such exports. In fact, that is why Mexico and Canada are the largest markets in the world for U.S. exports. This is not the case for Asian as U.S. content in their exports is negligible.

According to OECD TiVA data[3], U.S. content in value-added embodied in Mexico's total and manufacturing exports were 12.0 and 14.9 percent, respectively, in 2022. In the case of Canada's, 9.9 and 15.5 percent. As can be appreciated in the following table, those of the rest of the world were much smaller, including in key sectors such as automotive and machinery and equipment. These figures reflect the sharp contrast of U.S. content in total exports in different countries and regions. Mexico and Canada have the largest shares of U.S. value-added in their exports of manufacturing, more than six and nine times those of Eastern and South-Eastern Asia and China, respectively.

[2] The consultation process shows that dozens of trade associations argued that originating goods under USMCA should be exempt from this class of duties. Full docket: https://comments.ustr.gov/s/docket?docketNumber=USTR-2025-0004. For a list see: https://cmmsc.com.mx/wp-content/uploads/2026/04/2026.04.14-Comments-section-232-USMCA-Review-Docket-3.pdf.

[3] Trade data based on value-added rather than export and import receipts.

Table 1. Share of U.S. value added embodied in gross exports relative to the total value added embodied in those exports by country, as a percentage, 2022

Sectors	Mexico	Canada	China	Eastern and South-Eastern Asia	Europe	South and Central America	Africa
Total Exports	**12.0**	**9.9**	**1.4**	**2.4**	**3.3**	**3.2**	**1.4**
Manufacturing	**14.9**	**15.5**	**1.6**	**2.5**	**3.6**	**4.4**	**2.2**
Motor Vehicles	16.9	25.1	1.3	2.5	2.7	3.6	3.1
Other Transportation Equipment	16.9	16.7	1.9	3.8	6.6	12.6	4.9
Machinery and Equipment	12.5	13.9	1.3	2.1	2.5	3.3	2.2

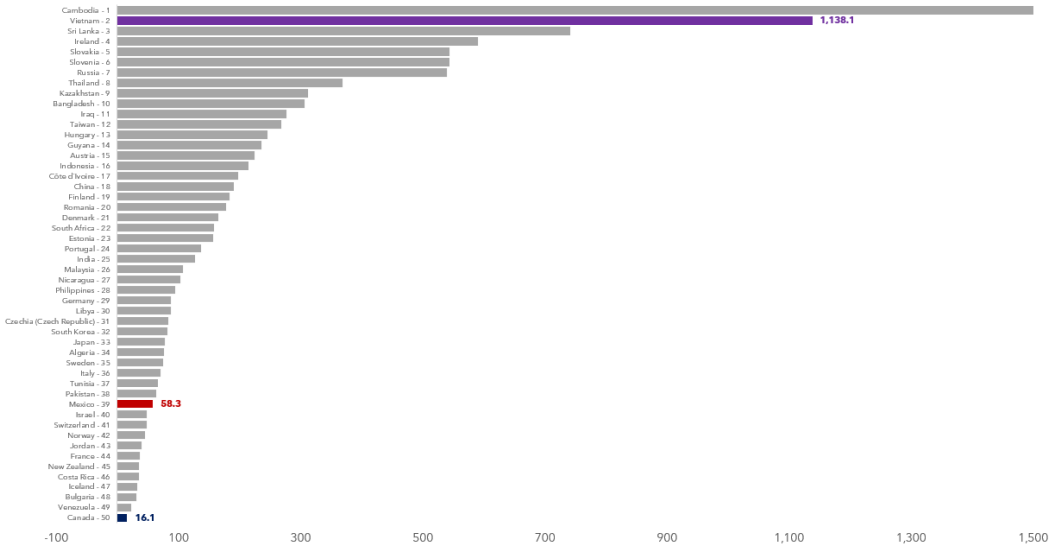
Source: OECD TiVA.

In this context, the U.S. trade deficit with Mexico and Canada should be interpreted as a measure of regionalization. When normalized by exports, the U.S. trade deficit with Mexico and Canada is significantly lower than with countries such as China or Vietnam. This indicates a reciprocal trade relationship within North America, driven by intra-industry trade and co-production. Mexico and Canada act not only as suppliers but also as essential markets for U.S. goods, reinforcing interdependence rather than asymmetry.

This pattern contrasts sharply with trade relationships the U.S. holds with more distant partners, where the flow of goods tends to be one-directional. The U.S. imports a large volume of goods from China, though decreasing, and Vietnam but with limited reciprocal exports. In contrast, U.S. exports to Mexico and Canada often feed into products that are reexported back to the U.S., embedding U.S. value in final imports. Thus, trade deficits in North America should be interpreted as symptoms of tight co-production integration, not of imbalance or unfair trade practices.

When analyzing the size of U.S. deficit in relation to its exports to a given destination, it is clear Mexico and Canada have a much smaller trade surplus than the rest of the largest trading partners of the U.S. The U.S. trade deficit with Mexico and Canada is the expression of decades of integration of North American supply chains, which has intensified recently due to changes in global trade patterns and U.S. tariffs for China. This is also clear in key sectors such as vehicles and auto parts, medical devices and many others.

Graph 1. U.S. trade deficit as a proportion of U.S. exports 2025, in percentage



Source: USITC.

In conclusion, the 2025 shift in U.S. tariff policy significantly strengthened incentives for deeper vertical integration within North America by making compliance with USMCA ROO essential for maintaining preferential access. As a result, trade balances within North America should be understood as the outcome of co-production and shared value chains rather than simple bilateral trade, meaning that U.S. deficits with Mexico and Canada largely reflect integrated supply networks that also support U.S. exports and upstream industries.

4. Offensive agenda to attract key value chains to North America

Regardless of the ongoing USMCA review process, it is important to identify key value chains that could be competitively attracted into the region.

One of the elements of such strategy must be energy integration among USMCA countries, for its importance for strategic manufacturing value chains and to compete with other major regions. Unlike Europe or East Asia, North America benefits from a unique combination of abundant resources, extensive cross-border trade in oil, natural gas, refined products, and electricity.

Mexico is the one country that needs to make the most far-reaching changes to accomplish an integrated energy market, but also the one that stands up to benefit the most. Benefits would come from energy itself, but more so from more domestic value-added in manufacturing and exports. In fact, the country should undertake an ambitious promotion for investment in the energy market almost regardless of U.S. policy in light of the enormous opportunity that derives from energy demand related to AI, to the incentive to comply with USMCA and to uncertainty in the Persian Gulf.

Further integrating this energy platform would lower total production costs and reduce volatility for sectors such as automotive, aerospace, air-conditioning equipment, household appliances, medical devices, and advanced machinery, among others. For instance, bringing investments of specialized steel and entire chemical chains to the region would provide key components for the vertical integration agenda of North America.

Similarly, effective logistics and competitive border crossing of goods is also an important element for successful vertical integration in North America. It is important to design a system to binationally fund border transportation infrastructure and to ensure trade facilitation so that the vertical integration can take place.

North America should also attract high-value segments of manufacturing value chains including automotive dashboards, printed circuit boards (PCBs) and advanced telecommunications equipment, among others.

Other elements of the strategy are: a strategic engagement with high-tech industries of other countries, such as Japan, Taiwan, South Korea, Germany, and the Netherlands to bring key investments into North America; create a B2B platform specifically designed to help small and medium-sized enterprises to integrate into North American value chains; working with the capital ecosystem (private equity, investment banking, venture capital) to attract investment in key supply chains in North America; and joint efforts and coordination of governments and private sectors across the region.

5. Conclusions

North America faces a clear strategic imperative to deepen its vertical integration to strengthen competitiveness, resilience, and long-term industrial capacity. While the region benefits from strong trade linkages under the USMCA, it remains structurally dependent on Asia for critical upstream inputs, particularly in high-value manufacturing sectors. Bridging this gap requires not only expanding intra-regional trade, but more importantly, developing competitive, robust regional production capabilities in intermediate goods that retain value-added within North America and reduce exposure to external shocks.

Recent changes in U.S. trade policy have significantly reshaped incentives by making compliance with USMCA rules of origin essential for maintaining preferential market access. This shift has already driven higher regional value content, increased sourcing from within North America, and accelerated the substitution of Asian inputs. In this context, further reinforcing these incentives, particularly through broader tariff exemptions for USMCA-compliant goods, would consolidate these gains, deepen co-production networks, and strengthen the region's integrated supply chains.

Looking ahead, a coordinated North American strategy is needed to attract key value chains, integrate energy and logistics systems, and mobilize investment across strategic sectors. Mexico plays a pivotal role as a platform for industrial expansion and U.S. reindustrialization, while Canada complements regional capabilities. Advancing a joint agenda—supported by public-private collaboration, targeted industrial policies, and international partnerships—will

be essential to transform North America into a more self-reliant, innovative, and globally competitive manufacturing hub.

The most important steps must be taken by Mexico.