

The China Challenge to Manufacturing in Mexico

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Introduction

- Cross-border integration of manufacturing (production sharing) in North America was well-developed long before NAFTA was conceived. NAFTA was product of that integration rather than a cause. The agreement facilitated the further integration of North American manufacturing clusters.
- Over 80% of the exports from both Canada and Mexico go to the United States. In 2006, U.S. imports from companies registered under the Maquiladora and PITEX programs accounted for over 80 percent of total U.S. imports from Mexico. Nearly all manufactured goods imported from Mexico came from companies operating under these programs, with 2/3 coming from companies registered under the Maquiladora Program.
- As stated recently by President Calderon in a conversation with President Obama, when the United States catches a cold, Mexico catches pneumonia. Today, the United States has pneumonia. What will happen to Mexico?
- Many in the U.S. Congress and media accuse China of being a leading cause of the downturn in U.S. manufacturing as well as the crisis in the housing market and they are prescribing protectionist remedies.
- This discussion updates a paper written in 2006 and published in 2007 by the United Nations Economic Commission for Latin America and the Caribbean (Spanish)¹ and the Journal of the Flagstaff Institute.²
- It tries to put the China challenge to manufacturing in Mexico in perspective and attempts to identify the factors that influence competition between imports from the China and Mexico in the U.S. market.

1 Ralph Watkins, "El Reto de China a las Manufacturas de Mexico," en Enrique Dussel Peters, compilador, *Oportunidades en la Relacion Economica y Comercial Entre China y Mexico*, Naciones Unidas, 2007.

2 Ralph Watkins, "The China Challenge to Manufacturing in Mexico," *Journal of the Flagstaff Institute*, June 2007.

Background

- ! The United States experienced a recession during 2000-2002 in which U.S. manufacturers' shipments declined by 7.5% and the economy lost 2.5 million manufacturing jobs.

- ! Between October 2000 and March of 2002, the maquiladora industry lost 288,000 jobs:
 - 145,000 in electronics sector (1/2 of the total)
 - 71,000 in apparel (1/4)
 - 32,000 in auto parts (1/8)

- There were many press reports about factories closing in both the United States and Mexico either because of competition with imports from China, or because companies were shifting production from North America to China.

- Many voices on both sides of the border blamed China for the decline in manufacturers' shipments during 2000-2002 and the loss of manufacturing jobs.

U.S. Context

- ! While imports from China were up by \$25 billion during 2000-2002, U.S. manufacturers' shipments declined by \$317 billion.

- ! The rise in imports from China was only 8% as large as the decrease in manufacturers' shipments.

- ! At the same time, imports from Japan declined by \$25 billion, offsetting the increase from China.

- Total U.S. imports declined by \$40 billion during 2000-02.

- Bottom line: China was only a minor factor in the decline in U.S. manufacturing during the recession of 2001 and 2002.

- This is not to minimize the hardships of those workers who lost their jobs during this period, be it because of competition with imports from China or because of other factors.

Mexican Context

- ! To what extent was the decline in the Maquiladora sector in 2000-2002 attributable to China? How much was due to the downturn in manufacturing in the United States?
- ! There was a 25% appreciation of the Mexican peso against the U.S. dollar during June 2000 through March 2002. Meanwhile, the dollar was appreciating against most other currencies, making Mexican goods less competitive with goods from Asia.
- While some high-profile plants did close in Mexico as production shifted from Mexico to China, declining manufacturing in the United States was a more important cause of falling maquiladora production and employment.

Recent Trends

- Since 2002, U.S. producers' shipments of manufactured goods have grown by 33% (**table 1**).
- ! Despite the growth in shipments, manufacturing employment continued to fall, with a loss of 1.8 million jobs (12%) during 2002-08.
- ! Although imports from China nearly tripled during this period, blaming China for the loss of jobs masks the role that productivity improvements play in the employment trends.
- Despite the sharp rise in U.S. imports from China during 2002-08, Mexico has been able to nearly maintain its share of the U.S. import market (**table 2**).
- During 2002-08, China's share of the U.S. import market rose by 50 percent, from 10.8% to 16.2%, while Mexico's share slipped by 11%, from 11.6% to 10.3%.
- While there is some erosion of the competitive position of Mexico versus China in certain sectors, Japan is the country that should be most concerned about the hollowing out of its manufacturing base as its share of U.S. imports fell by 36%, from 10.5% to 6.7% during 2002-2008.

Mexico vs. China

- ! Overall trends mask the fact that certain manufacturing sectors in Mexico (and the United States) are under intense competitive pressure from China.
- ! **Table 3** shows that Mexico and China are both leading suppliers to the U.S. market for computer hardware, telephone equipment, and apparel. This is where the job losses were in the maquiladora industry in 2000-2002.

A.	Table 3 , leading imports from Mexico in 2008 (except agricultural and petroleum products)	<u>%</u>
	Motor vehicles and auto parts	21
	Televisions and other consumer electronics	9
	Telephone equipment	5
	Chemicals and articles of plastics	3
	Computer hardware	3
	Textiles and apparel	3
B.	Leading imports from China in 2008	<u>%</u>
	Computer hardware	16
	Textiles and apparel	11
	Consumer electronics	7
	Telephone equipment	7
	Toys and games	6
	Chemicals and articles of plastics	6
	Footwear	4
	Furniture	4

- ! Products for which Mexico had an appreciably larger share of the U.S. import market than China in 2008:

1. See **tables 10, 11, and 14**:

- Motor vehicles
- Auto parts
- Medical goods

2. For these categories, Mexico supplied 21 percent of U.S. imports in 2008 and China supplied just 3 percent.
3. Mexico is most competitive relative to China in products with the following characteristics

- a. High ratio of weight to value
 - (1) Motor vehicles
 - (2) Large screen televisions
 - (3) Major household appliances
- b. Quality (rather than price) intensive
 - (1) Medical goods
 - (2) Process control instruments
- c. Are inputs for industries that require just-in-time delivery, customized production, or require frequent design changes
 - (1) Auto parts
- d. Protection in intellectual property is important

! Products for which China supplied over one half of U.S. imports in 2008

1 See **table 15** for:

Computers and parts
 Toys and games, sporting goods, & bicycles
 Leather goods, footwear, luggage, & handbags
 Furniture, lamps, & lighting fittings
 Cooking, kitchenware, table flatware, & ceramic household articles
 Portable electric hand tools, light bulbs, & flashlights
 Costume jewelry
 Umbrellas, brooms, & brushes

2. For these categories, China supplied 61 percent of U.S. imports in 2007 and Mexico, just 5 percent.

3. These products for which China has a competitive advantage are:

- (1) Labor intensive (many require sewing)
- (2) Have long production runs
- (3) Require few style changes

4. For all products other than the 17 listed in **table 15**:

- (1) For articles accounting for 90 percent of U.S. imports in 2008

(2) Mexico and China each accounted for 11 percent of U.S. imports

! Products where competition between Mexico and China is most intense:

Computer hardware (**table 5**):

Product life cycle:

Mexico at the start up phase and end (customization)

China during mature phase with long production runs

Apparel (**table 4**):

China—light weight & labor intensive (infants and children's wear; men's dress shirts)

Mexico—heavier items, quick turn around, less sewing—denim jeans

Telephone equipment (**table 6**):

China—hand sets & cell phones

Mexico—switch gear & other equip. for phone companies

(Investment in a new Nokia plant in Reynosa led to a resurgence in cell phone production in Mexico in 2006.)

Consumer electronics (**table 8**):

Large screen televisions—Mexico

Other consumer electronics—China

Furniture (**table 9**):

China—wood household furniture (lathe work)

Mexico—furniture for the Southern California market

Household appliances (**table 7**):

China—counter top appliance

Mexico—major appliances (washers, dryers, refrigerators, kitchen stoves)

Motors and generators (**table 13**):

Mexico leads China in all categories, especially medium/larger sizes

China—competitive only in the smaller-sized motors

! China=s competitive advantages

1. Lower costs for
 - a. Labor

- b. Taxes
- c. Energy
- d. Water
- e. Property (often free land use)
- 2. Better developed supply chain
- 3. Yuan is undervalued by an estimated 20-30 percent
- 4. No taxes for companies that export.
- 5. Reported inducements of free raw materials for companies that set up export processing plants

! Mexico=s advantages:

- 1. Proximity to the U.S. market
 - a. Lower transportation costs
 - b. Quicker response time
 - c. Easier communication & oversight
- 2. Better protection for intellectual property
- 3. Less unwanted technology transfer
- 4. More transparent government regulations
- 5. Greater flexibility in the both the workforce and management

● Opportunities for today's maquilas

- 1. Higher value-added, higher technology products
 - a. Medical goods
 - b. Aircraft parts
 - c. Precision manufactures
- 2. Customized production for U.S. SMEs
- 3. Develop more parts production capacity in Mexico to have greater Mexican participation in the supply chain
- 4. Foster manufacturing clusters

What can Mexico do to improve its competitive position?

A. Tax reform

- 1. Tax collection in Mexico represents 11% of GDP, compared with 36.5% in Chile and 35.5% in Brazil.
- 2. People evade income taxes; not prosecuted.
- 3. Forced to use VAT or sales taxes (regressive).
- 4. Much of the nation=s workforce is employed in Aoff the record jobs@ that are not taxed.

5. Increased tax revenues are necessary to finance other reforms and investments in transportation infrastructure and education.
 6. PEMEX revenues are used to finance government expenses, diverting funding away from improvements in technology upgrades, expansion of operations, and further development of reserves.
 7. Businesses are taxed heavily to compensate for evasion of personal income taxes and those business taxes discourage foreign investment.
- B. Judicial reform
1. Investors need greater confidence that contracts will be enforced.
 2. Lack of the Rule of law has discouraged investment in sanitation projects.
 3. Although protection of IPR is better in Mexico than in China, improvements in enforcement would encourage even more investment in Mexico.
- C. Reduce corruption, which is a tax on the economy
1. In the *2005 Perception of Corruption Index*, Mexico ranked 66 out of 158 countries.
 2. The President of Transparency International has commended the Fox Administration for its firm commitment to reduce corruption and notes that perception sometimes lags behind the new reality in Mexico. Significant advances have been made in the past 10 years.
- D. Energy reform
1. Allow foreign investment in building power plants, electricity distribution, upgrade the transmission network.
 2. Encourage investment in developing natural gas resources & building LNG facilities.
 3. Allow foreign participation in deep water petroleum exploration & modernizing PEMEX infrastructure.
- E. Labor reforms—allow for a more flexible work force.
- F. Regulatory reforms to speed up approval of permits to start new businesses.

- G. Invest more in (true for all nearly all countries, including the U.S.)
1. Education
 2. Health care
 3. Transportation and port infrastructure

Table 1								
U.S. producers' shipments of manufactured goods, U.S. manufacturing employment, and total U.S. imports from China, 2002-2008								
Category	2002	2003	2004	2005	2006	2007	2008	Change 2002/08 (percent)
Total employment in U.S. manufacturing (thousands)	15,259	14,510	14,315	14,226	14,155	13,879	13,431	-12
U.S. producers' shipments of manufactured goods (billion U.S. dollars)	3,892	3,999	4,374	4,546	4,934	5,081	5,185	33
Total imports from China (billions dollars)	125	152	196	243	287	323	338	270
Ratio of total U.S. imports from China to U.S. producers shipments of manufactured goods (percent)	3.2	3.8	4.5	5.3	6.0	6.5	6.5	n.a.
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce and the U.S. Bureau of Labor Statistics.								

Table 2									
U.S. imports from leading suppliers, 2002-2008									
Supplier	2002	2003	2004	2005	2006	2007	2008	Change 2002/08	Share in 2008
	<i>Billion U.S. dollars</i>							<i>Percent</i>	
EU 15	231	251	281	307	319	340	351	52	17
China	125	152	196	243	287	323	338	170	16
Canada	211	224	256	288	303	313	335	59	16
Mexico	134	137	155	169	197	210	216	61	10
Japan	121	118	130	138	148	145	139	15	7
All other	340	377	453	529	591	612	711	109	34
Total	1,155	1,250	1,460	1,662	1,845	1,943	2,090	81	100
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.									

Table 3
Leading U.S. imports from Mexico and China in 2008

Mexico			China		
Category	Value	Share of total (per-cent)	Category	Value	Share of total (per-cent)
	Billion dollars	Percent		Billion dollars	Percent
Crude petroleum	37.6	17.4	Computers and parts	52.6	15.6
Motor vehicle parts	22.2	10.3	Textiles and apparel	36.4	10.8
Motor vehicles	22.2	10.3	Telephone equipment	24.0	7.1
Consumer electronics	19.7	9.1	Consumer electronics	22.2	6.6
Agricultural products	12.1	5.6	Toys and games	21.3	6.3
Telephone equipment	10.5	4.9	Chemicals and related products, including plastics	20.9	6.2
Chemicals and related products, including articles of plastics	6.8	3.1	Footwear	14.4	4.2
Computers and parts	6.6	3.1	Furniture	13.6	4.0
Textiles and apparel	6.0	2.8	Household appliances	7.4	2.2
Electrical circuit apparatus	4.8	2.2	Forest products	7.4	2.2
Medical goods	4.5	2.1	Steel mill products	6.0	1.8
Household appliances	4.4	2.0	Luggage and handbags	5.9	1.7
Steel mill products	3.3	1.5	Motor vehicle parts	5.8	1.7
Precious metal	2.8	1.3	Agricultural products	5.6	1.7
Measuring, testing, and controlling instruments	2.7	1.2	Sporting goods	4.1	1.2
Electrical motors	2.5	1.2	Lamps & lighting fittings	3.9	1.2
Air-conditioning equipment	2.4	1.1	Air-conditioning equipment	3.2	0.9
Non-automotive insulated wire	2.1	1.0	Electrical circuit apparatus	3.2	0.9
Electrical transformers	2.0	0.9	Electrical transformers	2.5	0.7
All other	41.1	19.0	All other	77.12	22.8
Total	216.3	100.0	Total	337.5	100.0

Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.

Table 4								
Apparel: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
China	11.4	13.6	20.0	23.2	27.2	27.3	140	35
Mexico	7.2	6.9	6.3	5.5	4.7	4.2	-42	5
Canada	1.7	1.7	1.5	1.3	1.1	0.8	-53	1
Japan	0.3	0.3	0.1	0.1	0.1	0.1	-67	*
All other	47.7	49.9	48.7	49.2	48.1	46.6	-2	59
Total	68.3	72.4	76.5	79.3	81.4	79.0	16	100
* Less than 0.5 percent.								
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.								

Table 5								
Computer hardware: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
China	22.1	33.9	33.9	46.6	52.3	52.6	138	51
Japan	7.0	6.8	6.8	6.7	7.4	7.9	13	8
Mexico	7.6	7.8	7.8	7.1	7.0	6.6	-13	6
Canada	1.5	1.7	1.7	1.7	1.9	1.9	27	2
All other	38.6	39.1	39.1	40.4	38.2	33.3	-14	33
Total	76.9	89.3	89.3	102.5	106.8	102.3	33	100
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.								

Table 6								
Telephone equipment: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
China	5.9	9.6	14.4	18.1	23.8	24.0	307	37
Mexico	4.7	5.9	5.6	7.1	9.0	10.5	123	16
Canada	2.5	2.7	3.3	3.3	3.1	3.1	24	5
Japan	1.5	1.6	1.9	1.7	1.8	1.8	20	3
All other	16.4	19.5	24.0	24.8	23.0	24.9	52	39
Total	31.0	39.3	49.2	53.3	60.7	64.3	107	100
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.								

Table 7								
Household appliances: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
China	4.1	4.9	5.7	6.3	6.9	7.4	80	40
Mexico	2.1	2.3	2.7	3.9	4.3	4.4	110	24
Canada	1.0	1.0	1.0	1.2	1.0	1.0	0	5
Japan	0.2	0.2	0.3	0.3	0.3	0.2	0	1
All other	4.0	4.1	4.8	4.9	5.4	5.4	35	29
Total	11.6	12.5	14.5	16.6	17.9	18.4	59	100

Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.

Table 8								
Consumer electronics: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
China	10.3	14.0	18.8	22.7	22.6	22.2	116	40
Mexico	7.8	10.0	12.2	16.5	20.8	19.7	153	36
Japan	6.7	7.5	6.9	5.7	5.4	4.8	-28	9
Canada	0.1	0.1	0.2	0.3	0.3	0.3	200	1
All other	9.6	10.3	10.5	9.6	8.5	8.3	-14	15
Total	34.2	41.4	48.6	54.8	57.6	55.3	62	100

Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.

Table 9								
Furniture: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
China	8.0	9.8	11.7	13.5	14.3	13.6	70	54
Canada	3.8	4.0	4.1	4.1	3.8	3.4	-11	13
Mexico	1.0	1.2	1.2	1.3	1.2	1.1	10	4
Japan	*	0.1	0.1	0.1	0.1	0.1	*	*
All other	6.1	6.7	7.2	7.1	7.3	7.1	16	28
Total	19.0	21.8	24.3	26.1	26.7	25.3	33	100

* Denotes less than \$50 million or less than 0.5 percent.
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.

Table 10								
Motor vehicles: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
Japan	33.1	33.2	35.9	44.6	45.0	42.4	28	30
Canada	41.0	46.7	48.5	48.5	47.6	37.1	-10	26
Mexico	19.3	19.1	18.5	23.5	23.3	22.2	15	16
China	*	*	*	*	*	*	*	*
All other	41.0	43.8	43.3	42.7	43.1	40.8	*	29
Total	134.4	142.8	146.2	159.3	158.9	142.5	6	100

* Denotes less than \$50 million or less than 0.5 percent.
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.

Table 11								
Auto parts: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
Mexico	17.3	19.4	21.0	22.8	24.4	22.2	28	30
Canada	15.5	16.9	18.1	17.0	17.2	13.6	-12	19
Japan	13.3	15.0	16.1	15.1	14.0	12.9	-3	18
China	1.7	2.4	3.2	4.3	5.3	5.8	241	8
All other	14.0	15.8	18.4	20.0	20.2	18.7	34	26
Total	61.8	69.5	76.8	79.0	81.1	73.2	18	100

Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.

Table 12								
Measuring, testing, and controlling instruments: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
Mexico	3.1	2.9	2.9	2.8	3.1	2.7	-13	14
Japan	2.0	2.4	2.4	2.4	2.6	2.5	25	13
China	0.8	1.2	1.3	1.5	1.7	2.0	150	11
Canada	1.0	1.2	1.3	1.5	1.7	1.6	60	9
All other	5.6	6.7	7.5	8.4	9.6	10.0	79	53
Total	12.6	14.4	15.4	16.6	18.7	18.8	49	100

Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.

Table 13								
Electric motors, generators, and related equipment: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
Mexico	2.2	2.2	2.3	2.4	2.6	2.5	14	19
China	0.7	0.9	1.1	1.5	1.8	2.0	186	16
Japan	1.0	1.1	1.3	1.3	1.4	1.8	80	14
Canada	0.5	0.5	0.6	0.6	0.8	0.7	40	5
All other	2.4	2.3	3.1	4.5	5.8	5.9	146	46
Total	6.8	7.0	8.5	10.3	12.4	12.9	90	100
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.								

Table 14								
Medical goods: U.S. imports from selected trading partners, 2003-2008								
Country	2003	2004	2005	2006	2007	2008	Change 2003/08	Share of total in 2008
	<i>Billion U.S. dollars</i>						<i>Percent</i>	
Mexico	2.3	2.6	3.0	3.5	4.1	4.5	96	16
China	0.6	0.7	0.9	1.2	1.6	2.0	233	7
Japan	1.3	1.5	1.7	1.7	1.7	1.7	31	6
Canada	0.5	0.5	0.6	0.6	0.6	0.6	20	2
All other	11.4	13.7	14.3	15.2	16.9	18.7	64	68
Total	16.1	19.0	20.5	22.2	24.9	27.5	71	100
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.								

Table 15					
U.S. import categories for which China supplied over one half of total U.S. imports in 2008					
Category	U.S. imports in 2008			China's share of total	Mexico's share of total
	China	Mexico	Total		
	<i>Millions of U.S. dollars</i>			<i>Percent</i>	
Umbrellas	403	1	443	91	*
Toys and games	21,272	357	23,809	89	1
Table flatware, related products	434	1	556	78	*
Costume jewelry	1,070	10	1,400	76	1
Luggage and handbags	5,900	43	7,833	75	1
Footwear	14,444	255	19,451	74	1
Sporting goods	4,099	162	5,817	70	3
Ceramic household articles	1,020	24	1,538	66	
Lamps & lighting fittings	3,875	1,003	5,988	65	17
Brooms and brushes	907	120	1,404	65	9
Cooking & kitchen ware	1,597	36	2,505	64	1
Portable electric hand tools	1,481	498	2,349	63	21
Bicycles	1,022	4	1,732	59	*
Electric lamps (bulbs), and flashlights	1,473	207	2,745	54	8
Furniture	13,600	1,081	25,285	54	4
Certain other leather goods	246	37	466	53	8
Computers and parts	52,556	6,556	102,338	51	6
<i>Subtotal</i>	<i>125,399</i>	<i>10,395</i>	<i>205,659</i>	<i>61</i>	<i>5</i>
All other	212,105	205,933	1,884,824	11	11
Total	337,504	216,328	2,090,483	16	10

* Denotes less than 0.5 percent.
Source: Compiled by the U.S. International Trade Commission from official statistics of the U.S. Department of Commerce.