

## Chapter 12

# INSIDERS AND OUTSIDERS: AUTO INDUSTRY POLICY CHOICES IN THE NAFTA DEBATE

LORRAINE EDEN AND MAUREEN APPEL MOLOT

**C**OMPETITION AMONG MULTINATIONAL enterprises (MNEs) for global market shares has intensified over the last decade. One way for a firm to protect and enhance its market share is to locate production sites in each of the world's three markets, the triad of North America, Japan, and the European Community. Going local in this manner means the MNE must adopt a management strategy responsive to national concerns for employment and economic growth. On the other hand, firms can reduce long-run costs and reap economies of scale from following an integrative, global strategy, that is, through shifting component production to low-cost sites and making generic products that can be sold around the world. The pressures of economics and politics are forcing most MNEs to "go global" and "act local" simultaneously. One way to reconcile these strategies is for multinationals to engage in behavior that enhances the likelihood they will be perceived, by local consumers, producers, and governments, as *insiders* within each regional market. Successful corporations may enter fewer countries but they penetrate each more deeply (Ohmae 1990, 28-29).

Nation states appear to perceive some firms in their midst as "us"—insiders—and other firms as "them"—outsiders. MNEs headquartered within a particular region have been recognized historically as insiders; foreign MNEs are usually seen as outsiders in that market. Governments treat the interests of the local business community, the insiders, as important factors influencing the policy process and occasionally go so far as to identify business interests with the national interest. The voice of outsiders is often disregarded or perceived as MNEs echo-

---

Earlier versions of this chapter were presented at the annual meetings of the International Studies Association Western Region in Phoenix, Arizona, November 5-7, 1992; and in seminars at Harvard, Rutgers, Brandeis, and Trent universities. We would like to thank John Higley, Subi Rangan, Carolyn Rhodes, and Raymond Vernon as well as the seminar participants and book editors for their helpful comments. Research assistance was provided by David Hood.

ing their home governments. Therefore it is to a firm's advantage to be seen as insiders and to commit resources to making states see them that way. Firms want to improve the chances of their being seen as insiders, while reducing the probability that their competition will be similarly viewed. Insider status must be consciously sought by outsiders using strategies such as shifting investment and production inside the country or region, hiring local inputs, engaging in joint ventures with local firms, increasing local value added, and pursuing local R&D activities.

This chapter addresses the issue of insiders and outsiders in the context of lobbying by multinationals during the recent negotiations for a North American Free Trade Agreement (NAFTA), with examples drawn from the auto industry. The insider firms to which we refer are the Big Three auto producers (General Motors, Ford, and Chrysler); some North American auto-parts multinationals, primarily U.S.-owned; and domestic or "national" auto parts suppliers, located mostly in Canada and Mexico. The outsiders are the rest of the auto producers, but in the context of this chapter we refer both to foreign auto exporters to North America and to Asian auto transplant operations in North America (e.g., Toyota, Honda, Nissan). Historically U.S. MNEs have been seen as insiders within the United States, and to a lesser degree in Canada and Mexico. More recently Japanese and Korean firms have sought insider status in North America by setting up transplant operations there. As a result U.S. MNEs are now facing loss of market share at home, not only as a result of imports but also due to foreign transplant production.

Since the late 1970s U.S. auto multinationals have consciously attempted to create this insider-outsider distinction, arguing that they, the Big Three, are insiders while the Asian firms, even the transplant operations, are outsiders. The Big Three have sought voluntary export restraints and antidumping duties to restrain Asian car and auto-parts exports to North America. They have also attempted to co-opt Asian MNEs through joint ventures and imitation of their production techniques. During the CUSTA negotiations, the Big Three lobbied successfully to create a two-tier system that in effect prevents Asian transplants from achieving full insider status.

In this chapter we analyze the positions adopted by the major players in the North American auto industry during the 1991-92 NAFTA negotiations. We first develop a theory of insider-outsider lobbying, briefly examine the health of the auto industry in the 1980s, and then apply our model to the NAFTA automotive industry negotiations. We conclude with some discussion of NAFTA's provisions regarding automobiles and automotive products. We find that where rivals can be portrayed as outsiders, lobbying positions are multifaceted, designed to provide the benefits of a level playing field in a larger market to the insiders while tilting the field against the outsiders. The policy positions may appear to be pro-free trade but in fact are a complex mixture of liberal and protectionist policies.

On issues such as the 1965 Automotive Products Trade Agreement (the so-called Auto Pact), national treatment for investment, rules of origin, duty remission programs, the maquiladoras, and the Mexican Auto Decree, the major players articulated positions that reflect the dichotomy outlined above. The Big Three attempted both to protect their insider status and to reduce the foreign transplants to outsiders in the North American market. This distinction, partly codified in the 1989 CUSTA, clearly influenced lobbying positions during the NAFTA negotiations, and is preserved in the final agreement. The foreign MNEs' fear of NAFTA as "Fortress North America" can therefore be interpreted as fearing the loss of hard-earned insider status and/or the perception that as outsiders they may not ever be able to attain insider status.

### **INDUSTRY LOBBYING STRATEGIES IN FREE TRADE NEGOTIATIONS**

In this section we outline a theory of corporate demands during free trade agreement (FTA) negotiations. What kinds of policies do multinationals seek when their countries are engaged in constructing an FTA?

#### **The Literature on Corporate Lobbying**

The work on corporate lobbying is fairly sparse and has traditionally focused on lobbying by firms as part of the "political economy of trade-policy" literature. The traditional presumption has been that firms seek protection from foreign competition. Firms lobby for tariff and nontariff barriers, and lobbying efforts are more likely the greater the extent of import penetration, the more oligopolistic the domestic industry, the higher the labor intensity, and so on (Baldwin 1982; Bhagwati 1988; Magee, Brock, and Young 1989; Hillman 1989; Pomfret 1991, Chapter 14).

Some authors have looked at policy demands where multinationals and domestic firms are involved. Milner and Yoffie (1989) examine how increased import penetration causes U.S. firms to adopt either offensive (soliciting U.S. government aid to open foreign markets) or defensive (demanding trade protection) political strategies. Milner and Yoffie find that the more rapid the import penetration, the greater the likelihood of a protectionist response. With their cross-border ties, however, multinational firms are more likely to want to keep markets open.

In terms of corporate lobbying during the formation of an FTA, multinationals are generally seen as favoring preferential trading areas because they reduce government-imposed market imperfections (e.g., tariffs and nontariff barriers) within the FTA, thus allowing economic efficiency to determine plant location and trade flows (Rugman and Verbeke 1990). Because MNEs produce in several countries and transship products among their divisions, they have a vested

interest in lower trade barriers. Particularly since the advent of worldwide sourcing in the 1970s and early 1980s, vertically integrated firms have become more interested in lower multilateral barriers to trade, and thus in the national positions taken in GATT negotiations (Ostry 1990, Chapter 2). Faced with cross-cutting pressures from the transnational firms within their borders, countries now have business interests that favor freer trade.

Multinationals have also played a role in promoting regional integration. The United Nations Center for Transnational Corporations (UNCTC) identifies two paths to regional integration: policy-led and investment-led, depending on whether countries or multinationals have promoted the integration process (UNCTC 1992, 34-46). The UNCTC argues that the two paths reinforce each other; e.g., policy-led integration tends to generate investment-led integration which then leads to more policy-led integration.<sup>1</sup>

The literature noted here focuses on multinational-government relations, in particular how corporations can influence trade-policy formulation. Little research has been done on tripartite firm-to-firm-to-state bargaining, however, looking at the strategic interaction of multinationals as they attempt to use corporate lobbying of local governments to expand their share of regional markets at the expense of their rivals. As globalization pressures increase, multinationals are increasingly conscious of the advantages conferred by insider status and actively seek to protect it through lobbying local governments. By accentuating the perceived differences between insider and outsider firms, and by lobbying for policies that benefit insiders at the expense of outsiders, multinationals may be able to increase their regional market share at their rivals' expense. Where the market is large, strategic battles can confer large gains on the winners because gains in one market can be later used to cross-subsidize battles in other regional markets. We develop such a model below.

### **A Model of Lobbying by Insiders and Outsiders**

We hypothesize that MNEs, both domestic and foreign, will engage in lobbying activities designed to foster government perceptions that they are insiders. These lobbying activities are of two types. The first involves policy development per se. This lobbying by firms can be either "self-focused," in the sense of promoting domestic policies that provide them with benefits, or "competitor-focused," in the sense of lobbying for policies that are detrimental to foreign competition. Although both types of policies are designed to increase the insiders' share of the regional market, the first set is designed to work for the insiders while the second works against the outsiders. Some policies may do both, so the distinction should perhaps be seen more in terms of motivation than effect.

The second set of lobbying activities involves the insider-outsider distinction itself and attempts to change government perceptions of this distinction. Firms that historically have been seen as insiders are likely to use strategies that increase

state perceptions of the cohesiveness of the insiders as a group and of the outsiders as a separate group, and accentuate the differences between the two groups in terms of their national responsiveness and contributions to the local economy. Methods for doing this include creating industry associations that exclude outsiders from membership, and circulating position papers that argue insiders make larger contributions to the economy than outsiders. Firms that are perceived as outsiders are likely to adopt strategies aimed at minimizing such distinctions, such as joining local industry associations, documenting their contributions to the economy, putting prominent citizens on their boards, and forming joint ventures with firms perceived as insiders.

In terms of lobbying for regional trading agreements, we hypothesize that MNEs favor policies that facilitate integrative regional strategies (such as reducing interregional trade and investment barriers) while raising barriers against foreign products (such as a higher common tariff wall and tighter rules of origin). In general, MNEs see the advantages of a larger internal market, allowing economies of scale and scope and the ability to rationalize production within the FTA based on comparative advantage. On the other hand, firms are also likely to see threats from new competitors in terms of increased competition both from imports and from production by foreign transplants. Insider MNEs are perhaps likely to focus on outsider MNEs as potential competitors whereas domestic firms are more likely to see both insider and outsider MNEs as threats.

We argue that multinationals are more likely to engage in politically strategic behavior, that is, fashioning themselves as insiders and thus deserving of government treatment that is beneficial to themselves and harmful to their competitors, when the following conditions occur:

1. There are a few large firms in the industry which are multinationals and have invested in production in at least two of the countries that make up part of the proposed FTA. Thus international production and intrafirm trade flows are important intraregionally to the firms and countries where they are located.
2. The industry is oligopolistic and firms can use strategic behavior to shift rents and market shares to themselves. The existing oligopolists see themselves as insiders, i.e., as a strategic group of established firms in the market, but perceive new entrants as potential threats to the stability of the market and thus as outsiders (Caves 1982, 100-110).
3. The insider MNEs see an FTA as offering them economic advantages in the form of increased access to intermediate and final markets and thus worth the lobbying activity costs to support the introduction of the FTA.
4. An FTA is also perceived to offer significant advantages to foreign firms

### **PART III. NORTH AMERICAN ASSESSMENTS**

through increased exports and/or transplant operations; hence lobbying by insiders is necessary to avoid the predicted loss in market share. Insiders are more likely to engage in lobbying if import penetration is already high and they are already on the defensive.

5. Multinationals that have various forms of strategic alliances with foreign firms are less likely to engage in insider-outsider lobbying than are MNEs without such cross-cutting ties. Firms that act as suppliers to both insider MNEs and foreign transplants will also have cross-cutting loyalties.
6. Outsider firms are likely to engage in counter-lobbying if the market is large or strategic and therefore the potential losses from market closure are seen as high. Outsiders with transplant operations have more to lose and thus will invest more in lobbying and have more differentiated preferences than foreign exporter firms. Outsiders will also engage in other activities, e.g., strategic alliances with insiders, in order to preserve their national treatment.

In sum, established multinationals are likely to prefer policies that dismantle trade and investment barriers for themselves while maintaining or raising barriers against outsider MNEs. They may also lobby for grandfathering of their existing preferences. Domestic firms may adopt a more defensive posture, looking for adjustment assistance and the slow phasing in of tariff and nontariff barrier (NTB) reductions. Domestic firms are likely to lobby for high domestic content legislation. Outsider MNEs will be concerned to protect and enhance their access to the potential FTA and therefore will lobby against barriers to third-country exports and for foreign direct investment (FDI). Rules of origin will be a major concern. Domestic firms threatened by competition have single-peaked preferences that are generally protectionist; outsider MNEs have single-peaked, pro-free-trade preferences, while insider MNEs prefer free trade for insiders with protectionist barriers against outsider firms (see also Vernon 1992; Rugman and Verbeke 1991).

### **THE AUTO INDUSTRY IN NORTH AMERICA IN THE 1980s**

The automotive industry continues to be the largest manufacturing industry in North America. It accounts for over 4 percent of combined gross domestic product of Canada and the United States and for approximately 1.2 million direct jobs (1,050,000 in the United States and 500,000 in Canada) and another 1 million directly related jobs. The industry consumes more than 25 percent of the sales of iron, stampings, machine tools, and semiconductors and more than half the sales of lead, rubber, and textiles (United States-Canada Automotive Select Panel

1992, 8). Autos and components are Mexico's second largest earner of foreign exchange, and machinery and transportation equipment comprise nearly half of all Mexican merchandise exports to the United States as well as the largest component of Mexican exports to Canada.

The deteriorating competitive position of the Big Three within the North American passenger vehicle market helped to shape their bargaining stance in both the CUSTA and NAFTA talks (Eden and Molot 1992a; Hufbauer and Schott 1992a; Womack et al. 1990). The U.S. and Canadian auto industries have been in serious difficulty for some time. Although North American multinationals continue to lead in overall world car production, since 1978 the combined Canadian and U.S. share of total world auto production has fallen from approximately 35 to 24 percent in 1991, while Japan's has risen from 22 to 28 percent (Flynn 1992, 75). This represents the equivalent of forgone production in North America of over 5 million vehicles (United States-Canada Automotive Select Panel 1992, 15). Regardless of the strategies adopted over the last decade to rationalize production and increase efficiency, the Big Three's share of the North American car market fell from 83 percent in 1978 to 56 percent in 1991 while employment fell by about 200,000 jobs (United States-Canada Automotive Select Panel 1992, 5-6).

The deteriorating position of the Big Three together with U.S. unhappiness with the terms of the 1965 Auto Pact influenced the outcome of the CUSTA negotiations in autos. Under the Auto Pact, qualifying producers in Canada could import vehicles and auto parts from anywhere in the world, free of Canadian duty, as long as the producers met certain safeguards, which basically ensured one car was assembled in Canada for each car sold in Canada. The Big Three qualified immediately for these performance-related duty remissions since they were well above (and have stayed well above) the thresholds. The Canadian government then began to extend the duty remissions to firms that might eventually meet the safeguards. The U.S. commitment in the Auto Pact, on the other hand, only allowed imports from Canada with a minimum of 50 percent Canadian and/or U.S. content into the United States duty-free.

The safeguards and duty remissions were irritants between Canada and the United States right from the start because U.S. officials saw them as temporary subsidies while Canadian officials treated them as permanent. However, as long as the rebated duty was for imports from U.S. firms, the U.S. government had little reason to complain, because U.S. firms were the beneficiaries. However, once the Asian transplants moved to Canada in the mid-1980s and began to assemble vehicles for export to the United States, this situation changed. Each of the Asian firms qualified for duty rebates, based on the assumption that the transplants would eventually achieve Auto Pact status.

The auto provisions in CUSTA reflected these irritants. Tariffs on Canadian-U.S. trade in automotive vehicles and auto parts were to be phased out over the

### **PART III. NORTH AMERICAN ASSESSMENTS**

1989-98 period. The duty remission schemes, which were instrumental in luring the transplants to Canada, were to be terminated by 1996 and no new programs introduced; however, performance-based waivers given to the Big Three under the Auto Pact were allowed to remain. The provisions of the Auto Pact remained in place; however, no new firms (with the exception of General Motors' CAMI<sup>2</sup> joint venture with Suzuki, which qualified in 1988) were to be granted Auto Pact status unless they qualified by January 1, 1989. Since none did, CUSTA divided the North American auto industry into two groups of firms: insiders (the Auto Pact producers, i.e., the Big Three and CAMI) and outsiders (the non-Auto Pact producers, i.e., primarily Japanese transplant operations).

Thus CUSTA retained Canadian Auto Pact safeguards but changed the rules under which automotive products could enter the United States. With CUSTA there is a clear distinction made between North American-owned and transplant producers. The trade agreement is designed to protect these North American-owned producers. As long as Chrysler, Ford, and GM comply with the provisions of the Auto Pact they are able to import auto parts and vehicles duty-free into Canada from any other production location, including Mexico. The distinction in status among auto assemblers that resulted from CUSTA is an interesting precursor to what the Big Three demanded—and got—from the NAFTA auto provisions.

### **NEGOTIATING THE AUTO PROVISIONS IN NAFTA**

The positions of the North American auto industry stakeholders in the NAFTA talks illustrate the theoretical arguments made above about the policy preferences of insider and outsider firms in an oligopolistic industry faced with the creation of a free trade area. The complexities of status and the effort to use investment strategies to alter them are reflected in the memberships of automotive industry interest associations and in the positions their members and the organizations as a whole adopted, or were able to adopt, on the NAFTA negotiations.

The North American auto industry appears to be a good illustration of how status—insiders versus outsiders—affects a firm's policy positions toward the negotiation of an FTA. The industry has three large U.S. multinationals that have already rationalized production in Canada and the United States as a result of the Auto Pact. All three have plants in Mexico either designed to supply the local Mexican market or linked to U.S. and Canadian affiliates as cost-reducing plants. Thus intraregional trade and investment flows are highly important to these oligopolistic MNEs. Moreover, since the late 1970s, they have been faced with substantial import penetration from Japanese firms, both from imports and more recently through transplant production. Working together to develop common policy positions that treated the Asian MNEs as outsiders, the Big Three lobbied



hard for policies to protect their market share from Asian competition. Those plants run as joint ventures between the Big Three and Japanese MNEs (e.g., NUMMI,<sup>3</sup> CAMI) had policy positions more favorable to the transplants. Similarly, auto-parts suppliers that were linked with both U.S. and Asian downstream firms were more likely to have mixed FTA policy preferences. Let us now look at the policy positions of the stakeholders in more detail. We break our analysis into the various industry stakeholders: the insiders (the Big Three vehicle producers, the auto-parts MNEs, and the national auto-parts suppliers) and the outsiders (the Asian transplants and foreign exporters).

### **Insiders: The Big Three**

Not only were the Big Three automotive firms determined to ensure that they were defined as insiders in terms of the auto provisions of NAFTA, they were equally uncompromising in their demand that the complexities of the NAFTA auto chapter make it costly and difficult for the Asian transplants to become insiders. What was at stake in these bargaining positions was more than semantics: it was the economic viability of the North American auto industries.

The Big Three auto producers, sensitive to their weakening competitive position vis-à-vis the transplants, adopted a protectionist position on NAFTA. As the theory discussed above anticipates, they supported a regional integration proposal that would facilitate further rationalization of production and provide a larger market. Because they had production facilities in all three countries, the Big Three envisioned NAFTA as enabling them to develop a strong position in a growing Mexican economy. At the same time, however, Chrysler, Ford, and GM, all concerned about protecting their insider status, demanded a higher regional content provision than the 50 percent rule under CUSTA; Ford and Chrysler advocated 70 percent while GM, which is the most vertically integrated of the Big Three producers, sought a 60 percent North American content rule.

Moreover, the Big Three sought to ensure some recognition of their years of operation in Mexico “under very restrictive conditions required by a series of Mexican Auto Decrees” (*Inside U.S. Trade* 1991, 1). In effect, the Big Three suggested that their history of investment in Mexico entitled them to a preferential position in that market as it expanded during NAFTA’s phase-in. Thus, the Big Three argued for a fifteen-year transition period during which those vehicle manufacturers (themselves, Nissan, and Volkswagen) that assembled cars and trucks in Mexico on January 1, 1991, would be able to take advantage of a more rapid decrease in tariffs and other trade-restrictive requirements.

What the Big Three recommended was the extension of the “two-tier” system to Mexico, under which those MNEs that came later to the Mexican market—most notably Honda and Toyota—would face higher local Mexican content requirements (36 as opposed to 25 percent for the Tier 1 producers) and tariffs during the transition period. The Big Three were quite adamant in their demand

that "a NAFTA agreement cannot allow Mexico to establish itself as a platform for major new automotive capacity from third-country producers for export to the U.S. market" (*Inside U.S. Trade* 1991, 3).

Overall, the Big Three sought higher North American content rules, a two-tier auto industry in Mexico, the immediate reduction in Mexican auto tariffs and value-added regulations for Big Three producers, and a fifteen-year transition period for the NAFTA accord. Beyond this, they also sought a reduction in the trade-balancing requirements of the Mexico Auto Decrees, the termination of restrictions on ownership of auto-parts and components producers, and continuation of the corporate average fuel economy (CAFE) regulations and the Mexican embargo on the imports of used cars and trucks. The Canadian subsidiaries of the Big Three espoused a position in the NAFTA talks similar to that of their U.S. parents, although the parent firms argued that their affiliates were being nationally responsive in their stance (MVMA 1991). The Big Three's subsidiaries made very clear, as did their U.S. parents, their continuing support for the assembly provisions of 1965 Auto Pact (which, as noted earlier ensure that at least one car is assembled in Canada for every car sold there). In short, the stance of the Big Three on NAFTA was a combination of the anticipated MNE support for enlarging markets and a blatant demand for protection of their insider status in all three markets.

### **Insiders: Auto-Parts Producers**

#### **The Auto-Parts Multinationals**

The auto-parts producers are a more complex group than the assemblers, because each of the three parties to the NAFTA discussions has its own domestic auto-parts industry. Some of the larger auto-parts producers are themselves multinationals with production facilities in all three countries. Most of these auto-parts MNEs are U.S.-owned and belong to the U.S. Motor and Equipment Manufacturers' Association (MEMA).

MEMA in general supported the position of the Big Three; in fact, its original North American content position of 75 percent was higher than that of the Big Three (MEMA 1991, 2). At the same time there was some sensitivity to the need to encourage the transplants to become more fully integrated into North America.<sup>4</sup> Like the Big Three, MEMA argued for special status for the five auto MNEs with production facilities in Mexico, the reduction in Mexican local content regulations for these MNEs, and the imposition of local content provisions at least as stringent as those currently in effect on new entrants to the Mexican market (MEMA 1991, 4). MEMA wanted a rapid phase-out of existing U.S. and Mexican duties on auto parts and vehicles, the elimination of duty drawback provisions, and the termination of Mexican investment restrictions. Because MEMA was sensitive to the characteristics of the Canadian auto industry, it was

prepared to support the continuation of safeguards for Canadian assembly under the Auto Pact (based on interview with MEMA official, 1992).

### **The National Suppliers**

The position of the Canadian auto-parts industry on NAFTA did not vary much from its U.S. counterpart. From their perspective, insider status was very much a function of ensuring their ability to continue to supply components to MNE vehicle assemblers. Canadian auto-parts producers, concerned about recent employment losses and the potential for additional job losses to U.S. and Mexican components producers, and frustrated by the transplants' practice of importing auto parts and components, supported a higher North American content requirement under NAFTA. The Canadian auto-parts industry advocated a 75 percent North American content requirement but, early in the negotiations, went beyond that to suggest the need for a 50 percent Canadian value-added content rule to protect Canadian auto-parts suppliers (APMA 1991; Carter 1991). The demand for a specific Canadian value-added content was dropped when it became clear that this position was not acceptable to the Canadian government (based on interview with official of the Automotive Parts Manufacturers' Association of Canada, 1992).

While phrasing its position in terms of optimal complementarity across the three North American economies, the Mexican supplier industry wanted maximum opportunity to secure its position within its own market. Mexican auto-parts suppliers opposed the two-tier proposal of the Big Three (terming it discriminatory under the GATT), as well as the proposal for higher North American content, preferring the transition period to be structured by the performance requirements of the 1989 Automotive Decree. Mexican suppliers preferred a 50 percent North American content requirement and a fifteen-year phase-in for NAFTA requirements, which would apply equally to firms already operating in Mexico and to potential newcomers. The industry expressed concern that the latter, namely Honda and Toyota, might simply establish components factories in the United States, meet the NAFTA content requirements, and export cars into Mexico; retention of Mexican Auto Decrees would prevent this (Olea 1993).

In sum, the stance of the national auto-parts producers on NAFTA was in large measure a function of their relationships to the Big Three auto producers. U.S. and Canadian auto-parts producers favored content provisions which would force the transplants to augment their purchases of North American-made components, some of which would hopefully emanate from existing auto-parts suppliers. Mexican auto-parts suppliers demanded that the definition of North American content ensure them some opportunity to compete with the U.S. and Canadian auto-parts producers. Suppliers compete on a different basis than assemblers, and the stances of the auto-parts producers exemplify this.

### **Outsiders: The Transplants**

The transplant producers saw NAFTA as providing access to a larger market and the ability to rationalize production across three countries. They also worried about attempts to make it more difficult for them to realize the benefits of a new free trade arrangement. Of the Japanese transplant producers, Nissan is the only one currently with assembly facilities in Mexico. Nissan ranks second in terms of its share of the Mexican domestic market, although its export performance is the least impressive of the five auto assemblers in Mexico (Scheinman 1993). Nissan is now doubling its assembly capacity in Mexico so that it will be able to serve more effectively the growing Mexican market and increase exports.<sup>5</sup>

The transplants approached the NAFTA talks with the knowledge that CUSTA had discriminated against them. CUSTA created two classes of auto producers by making it impossible for the transplants to qualify for Auto Pact status. It established more stringent guidelines for meeting the North American content requirement of 50 percent than existed under the Auto Pact and eliminated the duty remission programs that had originally lured transplant investment in assembly facilities to Canada during the 1980s (Holmes 1993; Macdonald 1989). The rationale for these policy changes was to put pressure on the transplants to either manufacture more components in the United States and Canada or purchase them from U.S. and Canadian suppliers.

When NAFTA talks began, the transplant auto producers "were reportedly not troubled by the proposed pact" because they already had a North American production base (JEI 1991, 15). However, as the talks evolved and the Big Three articulated their stance the viewpoint of the transplants changed. They continued to support the market access and production rationalization opportunities that NAFTA would bring, but made clear their very strong opposition to any increase in North American content requirements. In the words of the Association of International Automobile Manufacturers of Canada (AIAMC), "the 50% North American content requirement represents the maximum level acceptable to AIAMC members in terms of value-added or transformation requirements" (AIAMC 1992, 3).

The transplants criticized the two-tier system proposed by the Big Three, suggesting that equal access to the Mexican market should be given to all auto producers who meet the rules of origin. In their view no preferences should be given to those auto MNEs currently with facilities in Mexico (McArthur 1992). Transplants in Canada wanted to extend the Canadian duty remission/drawback schemes and all wanted the phase-out of Mexico's Auto Decrees (AIAMC 1991).

Like the Big Three, however, the stance of each transplant depended on its particular North American situation. Given its position in the Mexican market, for example, Nissan was less concerned about many of these issues and (along with Volkswagen) abstained when decisions were taken (McArthur 1992). On

the other hand, Nissan will have some difficulty adapting to a rule of origin that runs counter to its philosophy of worldwide sourcing.

### **Outsiders: The Foreign Exporters**

For foreign auto exporters to North America the key issues were trade creation and trade diversion in this sector. A NAFTA which lowers tariffs and nontariff barriers among the signatories should be, on net, trade creating at least in the long run. Trade-diversion effects will tend to occur in the short run as producers shift to duty-free suppliers inside NAFTA that may in fact be high-cost producers, ignoring the differences in tariff rates, relative to fourth-country suppliers. If the three parties are not the lowest-cost suppliers of autos and auto parts and external tariffs remain high, there is possibility for trade diversion; one such case could be a shift in sourcing of auto parts from East Asia to Mexico. Elimination of the duty remissions/drawbacks would also discriminate against vehicle and auto-parts foreign exporters.<sup>6</sup>

Since NAFTA is not a customs union, tariffs on imports from fourth countries would not have to be harmonized, but rules of origin would have to be used to ensure that products have a certain percentage of North American content. Thus the precise definition of origin and the percentage of local content would be key determinants of the trade-diversion possibilities of NAFTA. Foreign exporters therefore pressed for liberal and transparent rules of origin (Eden and Molot 1992b).

## **THE NAFTA AUTO PROVISIONS**

Under the revised version of NAFTA that appeared on October 6, 1992, intraregional barriers to auto trade and investment are to be eliminated over ten years. Upon implementation of NAFTA in January 1994 a number of automotive tariffs will decrease immediately, with others falling over the phase-in period. In 1994 the United States will eliminate its 2.5 percent tariff on auto imports from Mexico and reduce its 25 percent tariff on light trucks to 10 percent; Mexico will halve its 20 percent tariff on cars and light trucks imported from the United States and Canada; and there will be immediate access to the Mexican market for Canadian and U.S.-made heavy-duty trucks and buses.

As Schott (1992, 54) argues, NAFTA does contain "warts and blemishes," the most significant of which are its restrictive rules of origin. The auto rules are particularly onerous. For most products a simple change of tariff classification rule applied under CUSTA, but not in autos, where complex value-added provisions applied. These complex rules have been made even more arcane in NAFTA by the addition of tracing requirements. The value-added rule has also been raised from 50 to 62.5 percent for autos, engines, and transmissions, and to 60 percent for other vehicles and auto parts.

The 1989 Mexican Auto Decree is to end after ten years, with the import restriction to be removed immediately and the trade balancing requirements and the national value-added rules reduced over the period. Mexican restrictions on inward FDI will be reduced, allowing 100 percent FDI in assembly operations immediately and 50 percent FDI in auto parts, increasing to 100 percent over five years (NAFTA 1992, 9). U.S. CAFE rules will be modified so that Mexican-produced cars and auto parts will qualify as U.S. domestics after ten years. A special three-country panel will make recommendations on auto standards and how they can be harmonized under NAFTA.

The fears of the Asian multinationals about Fortress North America may therefore find justification, depending on how customs authorities, particularly in the United States, interpret the new rules. The Japanese Automobile Manufacturers Association, whose membership favored a 50 percent regional content provision and opposed the two-tier system for the Mexican auto industry, labeled NAFTA "a giant step in the wrong direction" (JEI 1992b).

### CONCLUSIONS

Multinational firms in an oligopolistic market want to reduce barriers within the market so that they can integrate production on a more efficient basis regionally. At the same time they are sensitive to their rivals and reap economic rents from getting a larger market share and squeezing out their rivals. By having states perceive them as insiders and thus as part of the policymaking process in trade negotiations they can influence the policy outcome in ways that are beneficial to them and potentially or practically harmful to others that are not at the table. Firms can therefore benefit from a free trade area, not only from reduced tariffs and nontariff barriers that create a more level playing field for the insiders, but also from regulations that make entry into the bloc more difficult by raising the entry costs to outsiders. Insiders have a voice they may be able to use to force outsiders to lose market share and possibly even exit.

There is a general presumption that MNEs are pro-free trade because they want to reduce cross-border transactions costs. Thus, it is argued, their interaction with nation states in the designing of a FTA should be efficiency generating. But this pro-free trade presumption ignores the fact that global corporations are continuously engaged in strategic games with their rivals. Multinationals do not have simple, single-peaked preferences for free trade. They are oligopolistic firms seeking to enhance their market share at the expense of their rivals. Freer trade may not be the best policy for MNEs, nor even increased transparency. Corporate integration can thus influence regional integration and not necessarily in ways that benefit the consumer or national or regional income. A corporate voice in free trade negotiations is not necessar-

ily a voice for efficiency. Negotiations for a free trade area should be seen as another arena for corporate strategic games.

The NAFTA arena appears to have been well used by the Big Three—at least in the short run. They were able to lobby successfully the three governments in North America, achieving in the NAFTA auto chapter most of what they had requested. The Asian multinationals will now have to meet higher content rules; substantial investments are likely to follow, particularly in Mexico. The two-tier status of the Auto Pact is maintained. Mexico's Auto Decree is to be dismantled in ways that give domestic firms time to adjust.

Ironically, though perhaps inevitably, at the same time as the Big Three producers are attempting to ensure their own futures by pressing for a two-tier North American auto industry, they are also establishing the parameters under which status definitions may change in the future. Although the transplants will have to determine whether the economic realities of the North American market make it financially attractive to comply with the new definitions of insider status, should they acknowledge what is necessary and augment their North American investments in components production, the distinction which the Big Three have tried so hard to maintain will eventually disappear.

In the long run the Japanese MNEs may well shift all the stages of production to North America, including the key drive train components. In terms of contribution to the economy, these regional core networks effectively would become insiders in the North American market. The insider-outsider distinction would then lose its importance to governments in the three countries. Accordingly, the key benefit to the Big Three from the NAFTA negotiations would be simply to postpone the day of reckoning—to have provided breathing space before the Asian outsiders have as well developed and as efficient a North American regional network of clustered plants as do the current insiders.

### NOTES

1. The UNCTC argues that NAFTA is investment-led integration. See also Eden and Molot (1991), who argue that U.S. multinationals have been silently integrating the three economies and that this was a factor underlying the push for NAFTA.
2. Canadian-American Motor Manufacturing, Incorporated.
3. Newly United Motor Manufacturing, Incorporated.
4. A MEMA official noted in a 1992 interview that a decision had been made in late spring 1992 that a North American content rule of 70 percent or higher was not politically acceptable because it would be seen as too protectionist. The alternative was a decision to require more extensive tracing of component values, which would add an administrative burden to the implementation of the rules of origin. The official preferred less tracing of components and a higher North American content provision.

### PART III. NORTH AMERICAN ASSESSMENTS

5. Honda currently produces motorcycles and auto parts at its Guadalajara plant and has intimated its interest in entering the Mexican market. Toyota was not prepared to make any public statements about possible investments in Mexico until after the conclusion of NAFTA (Scheinman 1993).

6. However, if the Uruguay Round talks should come to a successful conclusion, all three countries would in addition most likely lower their auto tariffs against imports from the rest of the world, offsetting the intratrade bias of NAFTA.



# **THE CHALLENGE OF NAFTA**

**NORTH AMERICA, AUSTRALIA,  
NEW ZEALAND, AND THE  
WORLD TRADE REGIME**

Edited by  
Robert G. Cushing  
John Higley  
Michael Sutton  
Tain Tompkins  
Sidney Weintraub



A VOLUME IN THE  
**TOM SLICK WORLD PEACE SERIES**

**LYNDON B. JOHNSON SCHOOL OF PUBLIC AFFAIRS  
EDWARD A. CLARK CENTER FOR AUSTRALIAN STUDIES**

### **PART III: NORTH AMERICAN ASSESSMENTS OF NAFTA**

CHAPTER 8:	<b>NAFTA AND THE FUTURE OF U.S. TRADE POLICY IN THE ASIA-PACIFIC REGION</b> MICHAEL YOUNG	139
CHAPTER 9:	<b>IMPLICATIONS OF NAFTA FOR U.S. TRADE POLICY IN THE PACIFIC BASIN</b> JEFFREY J. SCHOTT AND GARY C. HUFBAUER	145
CHAPTER 10:	<b>NAFTA'S IMPLICATIONS FOR CANADIAN TRADE POLICY: A COMMENT</b> ROBERT YORK	159
CHAPTER 11:	<b>MEXICO AND THE ASIA-PACIFIC REGION AFTER NAFTA</b> LUIS RUBIO	167
CHAPTER 12:	<b>INSIDERS AND OUTSIDERS: AUTO INDUSTRY POLICY CHOICES IN THE NAFTA DEBATE</b> LORRAINE EDEN AND MAUREEN APPEL MOLOT	175
<b>PART IV: ANTIPODEAN ASSESSMENTS OF NAFTA</b>		
CHAPTER 13:	<b>HOW SHOULD AUSTRALIA RESPOND TO NAFTA?</b> RICHARD H. SNAPE	193
CHAPTER 14:	<b>A CER-NAFTA LINK?</b> P. J. LLOYD	225
CHAPTER 15:	<b>NAFTA, CER, AND A PACIFIC BASIN INITIATIVE</b> SIR FRANK HOLMES	245
CHAPTER 16:	<b>REGIONALISM IN THE WORLD ECONOMY: NAFTA AND THE AUSTRALIAN RESPONSE</b> BIJIT BORA AND CHRISTOPHER FINDLAY	267
<b>PART V: NAFTA'S POLITICAL RAMIFICATIONS</b>		
CHAPTER 17:	<b>NAFTA AND U.S. POLITICAL RELATIONS WITH AUSTRALIA AND NEW ZEALAND: WHERE'S THE REAL BEEF?</b> RICHARD W. BAKER	289
CHAPTER 18:	<b>FROM HEGEMONY TO GLOBAL COMPETITION: U.S. FOREIGN POLICY AND AUSTRALIAN INTERESTS AFTER THE COLD WAR</b> RICHARD HIGGOTT	303