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Trade and Investment Policy in the Automotive Industry: The Big Three and the Auto Pact

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Trade and Investment Policy in the Automotive Industry:
The Big Three and the Auto Pact

By Kenneth P. Thomas
University of Missouri - St. Louis

The U.S.-Canada Auto Pact, officially known as the Automotive Products Trade Agreement, was signed by President Lyndon Johnson and Prime Minister Lester Pearson at the LBJ Ranch on January 16, 1965. It created free trade between the two countries in the automotive sector, but did so in a way which largely reserved the benefits for the automakers, as opposed to independent parts makers or consumers. This is because the abolition of tariffs applied only to new vehicles and original equipment parts (i.e., those to be built into the car when new) when imported and exported by auto companies meeting North American content requirements, but not to replacement parts, used cars, or cars purchased by individuals. This result came from the interaction of the complex needs of the automakers, parts makers, the UAW, and the two governments.

This paper is part theoretical argument and part detective story. In it I develop the argument that the elements of international openness (free trade + mobility of finance and direct investment) are tightly intertwined and mutually supportive. Part of the reason is that increases in openness along one dimension strengthen the actors who will benefit from increasing openness along other dimensions, thus leading to pressure for openness on those dimensions. Another part of the interconnection is that trade policies (just like any other policies) are fashioned with an eye to their effect on investment. Since investment is increasingly international, governments must consider the effects on inward investment as well as investment by domestic owners of capital. For this reason, trade policy outcomes are most dependent on the preferences of those firms with the greatest investment power. At the same time, changes in trade policy - such as a reduction in tariff barriers - can affect the intensity of competition for investment among countries.

The Auto Pact is a good test because its two-country sectoral focus lets us see the relationships between trade policy and investment with only a few relevant actors. Since there were really only three firms which could make the investment desired by the Canadian government, we have a microcosm of what usually takes place with a much larger number of actors. In the case of the Auto Pact, my arguments imply that if it had not been in the interest of the Big Three automakers to rationalize production, the Canadian government would not have been able to negotiate the intergovernmental agreement integrating the market. Since attracting investment was a precondition to solving its balance-of-payments problems and increasing employment, Canada had no choice

but to design its programs in ways that would encourage the Big Three to invest.[1]

The detective story side comes from finding new empirical evidence indicating the importance of firms' preferences for shaping the actual outcomes in this case. My theoretical claims are supported by this new evidence, much of which is buried in archives and was not available when the hitherto-best studies of the Auto Pact took place. The auto industry has actively tried to hide the ways in which it shaped the agreement,[2] even though at times it had a very direct hand in it. To get crucial evidence on firms' actions, I have used several confidential sources, along with interviews with government officials.

The elements of international openness

National economies have become increasingly open in the postwar period, especially those of the industrialized countries. This idea of openness encompasses three elements: 1) falling trade restrictions, as best exemplified in the GATT; 2) increasing mobility of financial capital; 3) increasing mobility of direct investment.[3] These three elements are tightly connected to each

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[1]My arguments also suggest that in many cases the initiative for trade liberalization integrating markets will come from firms who recognize that they can efficiently integrate their production for those markets.

[2]Two examples: 1) The Motor Vehicle Manufacturers Association of Canada put out a study of the Auto Pact which made the false claim that the manufacturers did not know "the specific form of their involvement" until late November 1964, implying that the two governments had decided everything. (James G. Dykes, "Background on the Automotive Products Trade Agreement," [Toronto: MVMA, 1982], p. 51.) In fact, the Canadian government had briefed the firms on September 19 on how the agreement was shaping up, with a form very similar to the final one. (Canadian National Archives, Accession RG 20, Series B-1, Department of Industry, Mechanical Transport Branch, File V 1021-11, pt. 2.) 2) Despite the fact that there were numerous meetings between automakers (especially Ford) and the Johnson administration during the negotiations, there is virtually nothing at the LBJ Library which reflects this. A letter from Henry Ford II to LBJ 9/16/64 is memorialized by a covering memo with the notation "Nothing else received at Central Files." Similarly, there are a number of documents at the Canadian National Archives which are secret at the companies' request.

[3]My view of capital mobility treats it as a potential, akin to potential energy. In other words, one should talk about the ability to move capital (either financial or direct) rather than the actual movements of capital when discussing capital mobility. This is fully analyzed in my "Capital Beyond Borders: How Capital

other, with increases along one dimension generating political pressures for increases along other dimensions as well. That this should be so follows from Rogowski's analysis of trade cleavages. He argues that the beneficiaries of expanding trade will see their political influence increase, even if it does not necessarily mean they will win their battles on trade and other issues.[4] If their political power has increased, they can use it to push for other policies which benefit them.

It thus remains to be shown that all three elements of openness favor the same actors. Rogowski argues that in a capital-rich, labor-scarce economy like the United States, freer trade benefits capital and harms labor.[5] This seems to be borne out in the battle lines over the North American Free Trade Agreement (NAFTA). I have shown that increasing mobility of production increases the bargaining power of multinational firms vis-a-vis both governments and workers.[6] Frieden, while arguing for a sector-specific model to understand the effects of financial capital mobility, appears to accept that in the long run it, too, strengthens capital.[7]

One interesting example of the connection is transport costs. In Rogowski's analysis, falling transport costs have an impact

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Mobility Affects Bargaining Between Firms and States," Ph.D. dissertation, University of Chicago, March 1992, chapter 4. A similar conception, developed in the context of a libertarian viewpoint, is found in Richard B. McKenzie and Dwight R. Lee, Quicksilver Capital (New York: Free Press, 1991).

[4]Ronald Rogowski, Commerce and Coalitions (Princeton: Princeton University Press, 1989), pp. 5 and 20.

[5]Rogowski, Commerce and Coalitions, pp. 119-121.

[6]"Capital Beyond Borders," chapter 5.

[7]Jeffry A. Frieden, "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," International Organization 45, no. 4 (Autumn 1991), p. 442. His specific-factors model, however, does not directly address distributional consequences between classes rather than among sectors. A problem for the specific-factor model occurs when labor and capital in the same industry take opposite positions on free trade or capital mobility, as is the case in the auto industry today. This was identified by G.K. Helleiner as being increasingly common way back in 1977. See Helleiner, "Transnational Enterprises and the New Political Economy of U.S. Trade Policy," Oxford Economic Papers 29, no. 1 (March 1977), p. 105. Even using a specific-factors model, it seems to me that there will be the same beneficiaries of increased openness in all three dimensions: multinational corporations and international finance.

analogous to reducing trade barriers; in my work it is an indicator of the potential mobility of production.[8]

If all three dimensions of openness have the same beneficiaries, then it will indeed be the case that increasing openness in any of the three ways will strengthen the proponents of increases along the other dimensions. It is therefore unrealistic to argue that a state should pursue a strategy of free trade while at the same time trying to restrict capital mobility.[9]

While the three dimensions are related, the two capital mobility conditions are the most important. Governments depend upon the owners of capital to invest in their country in order to achieve any of their goals; without investment there is neither employment, nor economic activities to tax. Indeed, without investment to increase domestic production, it is difficult to attain balance of payments goals, a consideration that is important in the case of the Auto Pact.[10] Trade policy, then, is fashioned with an eye to its effect on investment. Since much of this investment is carried out by foreigners in a world of increasing capital mobility, the effects on foreign investment must be considered just as much as the effects on domestic investors.

Trade policy also has a reciprocal effect on investment. In particular, a reduction in tariff barriers among countries seems to make for more intense competition for investment.[11]

Trade Policy and Investment

What are the more direct relationships between trade policy and investment? Two important combinations occur frequently. It has often been the case that a tariff attracts investment from firms that can operate behind the tariff barriers. Examples are Canada's National Policy of 1879, in which Canada chose

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[8]Rogowski, Commerce and Coalitions, p. 4; Thomas, "Capital Beyond Borders," pp. 116 and 132; for data on falling real air transport costs, see Table 15, p. 136.

[9]The best example of this position is Robert Gilpin, U.S. Power and the Multinational Corporation (New York: Basic Books, 1975).

[10]For a good survey and analysis of the theory of the structural dependence of the state on capital, see Adam Przeworski and Michael Wallerstein, "Structural Dependence of the State on Capital," American Political Science Review 82, no. 1 (March 1988), pp. 11-29.

[11]See Stephen E. Guisinger, "Summary and Conclusions," in Stephen E. Guisinger and Associates, Investment Incentives and Performance Requirements (New York: Praeger, 1985), p. 314, for the argument that the most competition for investment occurs among member countries of a common market.

protectionism for its manufacturers, and Import Substitution Industrialization (ISI).[12] Generally this requires a market of sufficient size to be worth the trouble of a foreign investor. It frequently results in operations that are too small to take advantage of economies of scale and are hence uncompetitive in world markets. But protection from outside competition means that such operations can nonetheless be profitable for the firm undertaking them.

In other circumstances, the adoption of freer trade can attract investment. This is especially likely to happen in the context of multinational corporations with integrated manufacturing operations, which is to say they manufacture a large proportion of the components to their final product. If a country has advantages for such firms which can reduce their costs, by adopting free trade the country can serve as a supply station for other nations.[13] In addition, the anticipation that free trade may bring faster economic growth may attract firms that want to serve a growing market.

The U.S.-Canada Auto Pact does not fit exactly into either of the cases described above, though of course it is closer to the second case. On the Canadian side it was an explicit trade of tariff elimination and a toleration of higher prices in Canada for investment guarantees from the automakers. Automotive tariffs were also eliminated by the U.S., and the overall agreement let carmakers further reduce their costs by accessing cheaper Canadian labor at the same time they were able to obtain longer, more efficient production runs. On the U.S. side, it was a clear violation of Most Favored Nation norms, and it required an explicit waiver from GATT. Thus, while tariffs were abolished, not everyone could take advantage of it. Individual Canadians who wanted to buy a lower-cost North American car were stuck with whatever the Big Three sold in Canada, because they still could not cross the border and buy a car in Detroit, Buffalo, etc., on a duty-free basis.

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[12]On Canada's National Policy, see Alan M. Rugman, Multinationals and Canada-United States Free Trade (Columbia, South Carolina: University of South Carolina Press, 1990), p. 17. For ISI, see Sylvia Maxfield and James H. Nolt, "Protectionism and the Internationalization of Capital: U.S. Sponsorship of Import Substitution Industrialization in the Philippines, Turkey and Argentina," International Studies Quarterly 34, March 1990, pp. 49-81.

[13]For this reason, multinational corporations are likely to support free trade generally. See Helleiner, "Transnational Enterprises and the New Political Economy of U.S. Trade Policy," pp. 108-109, and Helen Milner, "Resisting the Protectionist Temptation," International Organization 41, no. 4 (Autumn 1987), pp. 645-47.

Policy Preferences of the Main Actors

To evaluate who won and who lost in the Auto Pact, we have to start out with who wanted what. The main actors are the auto manufacturers, U.S. and Canadian parts makers, the United Auto Workers union, and the two governments.

Automakers

Chrysler and Ford were both enthusiastic about integrating production for the two markets to improve the efficiency of their Canadian plants. Chrysler president Lynn Townsend extolled the second duty rebate program (see below); Ford made the most detailed study of integrating production for Bladen. Ford also began studying the possibility of integrating part of its hub and drum production for the two countries months before the first duty rebate program was announced.[14] In line with my argument above, this suggests that it already made economic sense to integrate the two markets, and that the firms supported tariff changes that further increased the advantages of doing so.

GM, on the other hand, seemed to pay more attention to how integration would affect its relative position in the market. As the largest producer, it had the longest and therefore most efficient production runs. Free trade would reduce its cost advantage over the other producers since they would all wipe out many of their inefficiencies, and GM apparently opposed integration.[15] In addition, General Motors imported over 30,000 cars annually from the United Kingdom under the Commonwealth Preference tariff, a benefit that would be wiped out under many plans for reform. GM's apparent reluctance, despite certain investments the company made, worried the Canadian government that the firm would sink the prospective agreement.[16]

Both AMC and Studebaker supported the idea of integrating the two markets, with the latter, in desperate shape financially, even

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[14]Townsend's speech is in Canadian National Archives, Accession RG 20, Series B-1, Vol. 2053, File V1021-11, part 1. For Ford's integration proposal to the Bladen Commission, see Accession RG 33/45, Vol. 18, File 52. My source on the hub and drum integration is confidential.

[15]See "Canadian Carmaking Has Its Own Problems," Business Week, January 26, 1963, p. 136, and James F. Keeley, "Constraints on Canadian International Economic Policy," Ph.D. dissertation, Stanford University, 1980, pp. 225-26 and 243-44.

[16]See State Department, Memorandum of Conversation, "Possible Free Trade Arrangement in Automotive Products," July 7, 1964, Files of Christian Herter, Special Representative for Trade Negotiations, Box 15, JFKL, p. 6; and interview with C.D. Arthur, then of the Mechanical Transport Division, Department of Industry, 8/10/92.

transferring all its assembly operations from Indiana to Ontario.[17] Under the existing system of duties and content requirements, both firms had to import some components that the Big Three could afford to make in Canada. According to the Bladen Commission, "Studebaker paid an average duty of $85 per vehicle while General Motors paid only $20."[18]

Parts Makers

Large multinational parts makers such as Borg-Warner and Kelsey-Hayes generally supported the Auto Pact. It was the smaller parts firms such as Modine Manufacturing Company, which saw the move as against their interests. Small Canadian parts firms had initially (in their testimony before the Bladen Commission) preferred protection, but in general Canadian parts firms favored the Auto Pact, partly because replacement parts were kept out of the agreement.[19]

UAW

The UAW, it should be remembered, represented autoworkers on both sides of the border until recently. The international union had a consistent pro-integration stand from the Bladen Commission through the Auto Pact, but with proviso that there be eased requirements for adjustment assistance (which indeed were enacted). Canadian locals had asked Bladen for more protection, but supported the Pact. Many U.S. locals opposed the agreement.[20]

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[17]See "Canadian Carmaking Has Its Own Problems" and, for American Motors, "Background paper, Recent Trends in Canadian Foreign Trade," in National Security Files, Countries, Box 19, JFKL, "Canada: Subjects: Joint U.S.-Canadian Committee on Trade and Economic Affairs Meeting, 3/13/61-3/14/61 (3), Part 2" file; for Studebaker, White House Central Files, LBJL, Box 10, File TA6/Automotive Parts 11/22/63 - 10/20/65.

[18]Report, Royal Commission on the Automotive Industry, p. 31.

[19]On U.S. parts makers, see Memorandum to President Johnson from Francis Bator and Lee White, 3/25/65, White House Central Files, Box 156, "LE/TA 6/A" file, LBJL. For the position of Canadian parts makers at the Bladen Commission, see Report, Royal Commission on the Automotive Industry, pp. 41-42. For the exclusion of replacement parts to help Canadian parts makers, see Memorandum from Drury to Pearson, 12/17/64, Canadian National Archives, Accession RG 20, Series B-1, Volume 2053, File V1021-11, pt. 4, Dec. 1964-Jan. 1965.

[20]Keeley, "Constraints on Canadian International Economic Policy," pp. 224-25, 234-35, and 256-57; and Memorandum to President Johnson from Francis Bator and Lee White, 3/25/65, White

Canada

The Canadian goals in the Auto Pact negotiations and in the duty rebate programs which preceded them were relatively straightforward. They included a reduction in the bilateral trade deficit in automotive products (making up more than half of its current account deficit in 1962) and increased employment in the auto industry, both of which required more investment, primarily by the Big Three. Finally, the auto industry was expected to hold the line on price increases.[21]

United States

There was some division among different U.S. government departments. The Commerce Department generally supported the smaller domestic parts makers, with Commerce Secretary Luther Hodges publicly criticizing Canada's duty rebate program. After Modine filed its countervailing duty complaint with the Treasury Department, that department largely played the role of neutral arbiter; however, Secretary Dillon indicated that the department had flexibility as to its timing of an investigation should a complaint be filed, and could drop the matter should the complainant(s) lose interest, which he felt unlikely in this case.[22] Because of this stalling, the available time for negotiations was lengthened.

The State Department largely wanted to avoid conflict (especially a trade war) and focus on larger GATT goals with the Kennedy Round coming up. Led by George Ball, it favored integration of the two markets as the solution. It was able to point to the non-discretionary form of the countervailing duty law as a way to increase pressure on the Canadians during negotiations.

The most important thing to note about this line-up of interests is the basic congruence between Canada's goals and those of the automakers. Integration of production for the two markets would mean lowered operating costs in Canada, which meant that the Big Three would be willing to make the investments so necessary to the achievement of Canadian goals. Interestingly enough, this seems not to have been understood at State, where officials thought

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House Central Files, Box 156, "LE/TA 6/A" file, LBJL.

[21]Keeley, "Constraints on Canadian International Economic Policy," pp. 228-31.

[22]See Keeley, "Constraints on Canadian International Economic Policy," p. 235; and Memorandum from C. Douglas Dillon to McGeorge Bundy, 11/15/63, in National Security Files, Countries, Box 19, JFKL, "Canada: Subjects: Joint U.S.-Canadian Committee on Trade and Economic Affairs Meeting, 3/13/61-3/14/61 (3), Part 2" file.

the Canadians were out to "blackjack" the car makers, as one put it.[23]

The Road to the Auto Pact

Canada's once-strong automotive industry suffered serious problems during the 1950s and early 1960s. From a large net exporter of vehicles as recently as 1952, Canada by 1955 imported more vehicles than it exported; in 1960, Canada imported 180,000 vehicles and exported only 23,000.[24] Moreover, the country had a large deficit in auto parts - C$290 million in 1960 - virtually all of it with the U.S.[25] Not only were exports down, so was total production, with auto production falling from 375,000 in 1955 to 298,000 in 1958, and truck production decreasing from 120,000 in 1953 to 61,000 in 1958. Production employment in the industry also fell, from 44,000 in 1956 to between 30,000 and 33,000 in the years 1958-60.[26] A large part of the reason for this was that its production was controlled by the Big Three automakers, whose subsidiaries in what had been strong export markets such as Australia and the U.K. began to be supplied more and more by their subsidiaries in those countries.

The auto industry thus contributed to a declining balance of payments position for Canada into the early 1960s. A Royal Commission was appointed to study the problem of the auto industry and what could be done about it. Dean Vincent Bladen of the University of Toronto, the sole commissioner, was heavily influenced by a plan published by Hugh Keenleyside that would give individual companies in any country duty-free trade in both directions if they would agree to place an appropriate amount of their production in Canada.[27] Bladen asked the auto companies to consider the possibility of integrating their production on both sides of the border, in which case it might be possible for some models to be produced only in Canada, but most models sold in Canada would not be produced there. This would enable the

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[23]Robert O. Keohane and Joseph S. Nye, Power and Interdependence (Boston: Little, Brown, 1977), p. 207.

[24]Report, Royal Commission on the Automotive Industry, p. 15, Table II.

[25]Carl E. Beigie, The Canada-U.S. Automotive Agreement: An Assessment (Montreal: Canadian-American Committee, 1970), p. 36, Table 8.

[26]Keeley, "Constraints on Canadian International Economic Policy," p. 221.

[27]See Keeley, "Constraints on Canadian International Economic Policy," p. 225. Keenleyside's original article is "Treatment for Our Lopsided U.S. Trade," Financial Post, 5/7/60, p. 1.

companies to get rid of their inefficiently short production runs in Canada.[28] Ford went the furthest in studying the possibility of such integration, and recommended that strong consideration be given to it, while GM only submitted the idea of producing automatic transmissions in Canada, and then only if the Canadian government would give the company all sorts of concessions.[29]

Bladen ultimately proposed what he called "extended content," the idea being that instead of having to have 60% (for the Big Three; less for AMC and Studebaker-Packard) Commonwealth content on vehicles produced in Canada, companies had to have 60% content of vehicles produced in Canada + imports, but that exports could be used to meet the content requirement.[30]

The Canadian government set up an interdepartmental Committee to Study the Bladen Report, with Simon Reisman as its chair, and it was this committee which made the proposal for the duty rebate programs. In the first, effective 11/1/62, the previous exemption of automatic transmissions from duty was made contingent on increasing exports over the previous year. Also included were stripped engines, an ambiguous term that may have been a special provision for an individual firm (in the committee's discussions, there was talk of exempting a small number of engines for each firm so that AMC and Studebaker would not have to keep eating duty for engines which they could not afford to make in Canada. It would also help the Big Three with engines they used in very small quantities and also imported.). General Motors responded in February 1963 with a decision to begin making automatic transmissions in Canada by converting an engine plant in Windsor, Ontario, to transmissions.[31]

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[28]That production runs in the Canadian auto industry were inefficiently short was widely known. For example, on February 17, 1953, Ford Canada president Rhys Sale told the House of Commons, "Without the tariff, we could not possibly compete with the United States manufacturers, and the reason is solely one of volume. In 1952 the Canadian industry produced 435,000 cars and trucks for the domestic and export markets. Production in the United States was 5,555,000. Because the volume in the U.S. is 13 times that in Canada, unit costs of production are substantially lower." Cited in James G. Dykes, Background on the Automotive Products Trade Agreement (Toronto: Motor Vehicle Manufacturers Association, 1982), p.26.

[29]Canadian National Archives, Briefs submitted to the Royal Commission on the Automotive Industry, Accession RG 33/45, Volume 18, File 41A (GM confidential submission) and File 52 (Ford confidential brief).

[30]Report, Royal Commission on the Automotive Industry, pp. 67-73.

[31]See "New GM Plant to Hire 1,750," Windsor Star, 3/19/64.

Since this program was introduced in the midst of a serious balance-of-payments crisis for Canada, the U.S. reaction was muted. In October 1963, however, the Canadians introduced an expanded version of the duty rebate program which covered all automotive products, including completed vehicles. While the Canadians were trying to figure out exactly what shape it should take, Chrysler (of Canada) official John MacMillan was in Ottawa telling Canadian officials that if the export incentive program were "satisfactory," Chrysler would put a planned engine plant in Windsor rather than Michigan. Evidently the new program satisfied Chrysler, although the plan did not completely follow its preferences (including completed cars, which Chrysler did not favor), because the company subsequently expanded the engine plant in Windsor as promised.[32]

Canadian archives show clearly that the program was designed to attract investment, and the Departments of Industry and Finance expended a great deal of effort to ensure that sales taxes, the corporate income tax, dividend withholding policy, etc., did not dilute this investment-attracting function.[33] Although their ultimate goals were an improvement in the balance of payments and obtaining employment, it was obvious to them that they could only do this in ways that induced the automakers to invest more in Canada.

The Canadians fully recognized that the new duty rebate program was an export subsidy, but did not worry about it too much because a) lots of other countries, including the U.S., subsidized their exports;[34] b) they felt it was of a sort that did not violate

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[32]Memo 9/26/63 from C.A. Annis to Reisman, Canadian National Archives, Department of Industry, Accession RG 20, Series B-1, Vol. 2066, File V8001-260/A4 - Auto industry 1963-65. On Chrysler's engine expansion in Windsor, see "Auto Industry's 'Big 3' Grow Even Bigger," Financial Post, April 3, 1965.

[33]Canadian National Archives, Accession RG 20, Series B-1, Volume 2052, File V1021-10, pt. 2, Memo from MacDonald to Barrow 2/10/64.

[34]That the U.S. also had such programs is shown most clearly in "Legal Aspects of the Canadian Plan for an Import Rebate Export Subsidy on Automotive Parts," by John C. Wagner, Office of General Counsel, Department of Commerce, 9/12/63. He said a potential problem with countervailing duties against the Canadians was that "we anticipate the somewhat artificial encouragement of our own exports under the proposed legislation for tax benefits to new American exports. If we impose, after finding of subsidy, countervailing duties on the Canadian exports, we undercut our hopes that foreign countries will not object to or retaliate against any tax break we give our own businessmen for expanding exports." John F. Kennedy Library, Files of Christian Herter, Special Representative for Trade Negotiations, Box 7, "Canadian Automobile Parts" file.

GATT rules; c) under GATT, to apply countervailing duties a petitioner had to show injury. Unfortunately for them, under U.S. Section 303 of the Tariff Act of 1930, a petitioner did not have to show injury, and there was virtually no discretion involved in the process. As soon as the program was announced, small independent parts makers started complaining to the Department of Commerce, and subsequently Commerce Secretary Luther Hodges publicly criticized the Canadian program. As of Nov. 4, four companies had already complained.[35] Various official complaints were lodged with the Bureau of Customs, but for a while that arm of Treasury stonewalled them. On April 15, 1964, however, Modine Manufacturing Co., a radiator maker in Wisconsin, filed a complaint that was technically perfect and the Treasury Department took up the question in detail of whether the duty rebate program constituted a "bounty or grant," the technical test for whether countervailing duties would be applied.[36]

While independent parts makers were opposed, the Big Three were very happy with the program. Henry Ford apparently praised the program to Canadian Prime Minister Lester Pearson.[37] Lynn Townsend strongly endorsed it in a speech at the Empire Club of Canada 2/24/64.[38] GM announced several major investments, including a new assembly plant at Ste.-Therese, Quebec, and a trim plant at Windsor, Ontario. Ford said it would make a major move in Canada, and in 1964 it announced a truck plant at its main complex in Oakville, Ontario.[39] Behind the scenes, it was studying a wide

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[35]John F. Kennedy Library, Files of Christian Herter, Special Representative for Trade Negotiations, Box 7, telephone message from Franklin D. Roosevelt, Jr., to Herter, 11/4/63.

[36]James Keeley, "Cast in Concrete for All Time? The Negotiation of the Auto Pact," Canadian Journal of Political Science XVI: 2, June 1983, p. 287. The internal quote comes from United States, Department of State, memorandum of conversation, "Auto Parts," June 25, 1964.

[37]So Walter Gordon told Dean Rusk. See Telegram, Rusk to Butterworth, 11/8/63, "Canada General 10/10/63 - 11/8/63" folder, National Security Files, Countries, Box 19, John F. Kennedy Library.

[38]The text is found in Canadian National Archives, Accession Number RG 20, Series B-1, Volume 2053, File V1021-11 pt. 1.

[39]On Ste.-Therese, see "GM Unit in Canada Plans to Build Auto Plant North of Montreal," Wall Street Journal, May 4, 1964, p. 5. On the GM Windsor trim plant, see "New GM Plant to Hire 1,750," Windsor Star, March 19, 1964. For the Oakville Truck plant, see "Ford of Canada Starts Building of $25 Million Truck Plant in Ontario," Wall Street Journal, August 28, 1964, p. 3.

range of ways to increase its Canadian content.[40] In addition, because the duty rebates potentially made Canadian production cheaper than U.S. production for a wide range of parts, it began putting pressure on its U.S. suppliers to reduce their prices to Ford, saying it could shift to Canadian supply cheaper.[41] Moreover, Ford "...urged some of its suppliers to buy more of their parts ingredients from Canada."[42] Finally, Studebaker, which was in very bad shape financially, closed its plant in South Bend, Indiana, and moved all final assembly work to its Hamilton, Ontario, plant.[43]

Diplomatic discussions began with the United States even before the new program was introduced. U.S. officials told the Canadians that they understood their motivations for the program, but informed them that the countervailing duty process was not discretionary.[44] Reports from the Treasury Department suggested that Modine would probably win its case, arguing that if Modine won, the courts would clearly uphold the decision, whereas if Modine lost at that level, there was a very good chance that the courts would reverse on appeal.[45]

The U.S. favored some sort of integration of the industry as its preferred solution, an idea which seems to have come from George Ball, Under-Secretary of State.[46] Indeed, U.S. negotiators told their Canadian counterparts on July 7, 1964, that even if the rationalization of the industry meant Canada received a disproportionate share of new investment, that would be an

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[40]Confidential source.

[41]Confidential interview with parts maker, 8/14/92.

[42]John F. Kennedy Library, Files of Christian Herter, Special Representative for Trade Negotiations, Box 7, telephone message from Franklin D. Roosevelt, Jr., to Herter, 11/4/63.

[43]White House Central Files, Box 10, File TA6/Automotive Parts 11/22/63 - 10/20/65, LBJL. Report of the US Tariff Commission on HR 6960, the Automotive Products Trade Act of 1965.

[44]See, for instance, telegram, Dean Rusk to Butterworth (U.S. Ambassador to Canada), 11/8/63, "Canada General 10/10/63 - 11/8/63" folder, National Security Files, Countries, Box 19, John F. Kennedy Library.

[45]Telegram, Rusk to Butterworth 11/14/63, "Canada, General 11/9/63 - 12/2/63" folder, National Security Files, Country Files, John F. Kennedy Library.

[46]Interview with Sidney Weintraub, Lyndon B. Johnson School of Public Administration, University of Texas, 7/23/92. Weintraub was in the State Department at the time and said that he first heard of the integrationist idea from Ball. He speculated that Ball may ultimately have gotten it from the companies.

acceptable outcome. One U.S. negotiator reported that that was exactly what the auto makers told him would be the outcome of free trade in automotive products between the two countries.[47] Canada, however, insisted on some sort of production guarantees to accompany tariff removal, which the State Department was not willing to include in an intergovernmental agreement. This disagreement led to an impasse in the talks at their August 17 meeting. Ultimately, the two pieces were decoupled, with the Canadians negotiating the production guarantees directly with car makers in Letters of Undertaking.

In November, when the agreement's final outlines were clear, Herbert Wilson of the White House staff approached Ford lobbyist Rod Markley to get his assessment of Wilbur Mills' likely reaction to it. Markley did not know, but promised to have Henry Ford II approach Mills to find out his views, without mentioning that the Johnson Administration was behind his asking.[48] Evidently, Mills considered the agreement satisfactory, as he became the sponsor of the implementing legislation in the House of Representatives, and LBJ felt he was able to go ahead and finalize the agreement. All that remained then was for Canada to obtain Letters of Undertaking from the main automakers; as soon as they were in hand, Pearson and Johnson signed the agreement.

The Letters of Undertaking provided one final means by which the Big Three affected the shape of the Pact. Ford was able to veto a plan to exclude large trucks from the agreement, something the Canadian government was considering to help two small domestic truck producers, by threatening not to give a commitment on the government's overall program.[49] GM used its negotiations to raise again the question of what was expected to happen to the price differential between U.S. and Canadian cars. The company's representatives were told by the Canadians that they understood the price differential would not disappear overnight.[50]

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[47]Memorandum of Conversation, "Possible Free Trade Arrangements in Automotive Products," July 7, 1964, Files of Christian Herter, Special Representative for Trade Negotiations, Box 15, John F. Kennedy Library, pp. 1, 4.

[48]LBJ Library, Aides, Files of Herbert Wilson, Memo, Wilson to Bill Moyers, 11/25/64.

[49]Barrow to Reisman, 12/23/64. Canadian National Archives, Accession RG 20, Series B-1, Vol. 2053, File V1021-11, pt. 4.

[50]C.D. Arthur Memo to File 12/4/64 re 11/26 meeting with GM, Canadian National Archives, Accession RG 20, Series B-1, Vol. 2053, File V-1021-11, pt. 3. David L. Emerson argues that maintaining some of the price differential was the price paid by the Canadian government for securing the cooperation of the auto companies. See Emerson, Production, Location and the Automotive Agreement (Ottawa: Economic Council of Canada, 1975), pp. 70-76. This would appear to

The agreement's provisions included the removal of tariff barriers for qualified manufacturers, allowing the duty-free export and import of vehicles and original-equipment parts. These privileges did not, however, apply to consumers, nor to the replacement parts market. As a result, the benefits were largely restricted to the automakers who, in return, had to maintain a minimum proportion of their production in Canada to remain "qualified" under the agreement's meaning.[51]

The aftermath of the Auto Pact was that, as agreed in their Letters of Undertaking, the Big Three increased their investment in Canada. More importantly for the future, Canada and the United States had been put into more direct competition for automotive investment. This was shown most clearly in the bidding war between Ontario and Ohio for a Ford engine plant in 1978, ultimately won by the former.[52]

Winners and Losers

The general congruence of interest between the automakers and the Canadian government led to an overall outcome that favored both their positions. The U.S. government, to the extent it favored the position of the Big Three for integration, had little conflict with the Canadians, but its efforts to avoid production guarantees failed. The Big Three were willing to give production guarantees because integration of production for the two markets indeed meant that they would put a disproportionate share of their investment in Canada on the basis of cost alone. In the abstract, the firms would have preferred not to have a local content or value-added requirement, and to have been free to locate production wherever it would be least expansive for them to produce and distribute automobiles. In 1964-5, however, this conflict with the Canadians was latent, because the savings from efficient production in Canada made the Pact's 60% Canadian value-added requirement something they would have achieved anyway.[53] (The automakers may finally get their way on this now-open conflict if the North American Free Trade Agreement is approved.) The longer-run balance-of-payments effects favored Canada and hurt the United States.

Modine and other smaller parts makers in U.S. were hurt by the agreement because it basically legalized the pre-existing Canadian program. The same is probably true for some smaller parts makers

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have been especially important for GM, because as the largest producer it had the most to gain from higher prices, whereas other aspects of the agreement eroded its #1 competitive position.

[51]For the text of the agreement, see Beigie, Canada-U.S. Automotive Agreement, pp. 139-144.

[52]See Thomas, "Capital Beyond Borders," pp. 212-215.

[53]See Thomas, "Capital Beyond Borders," pp. 205-207.

in Canada, because as the Big Three bought out some of their Canadian suppliers, it is reasonable to suppose they favored them over independent Canadian parts producers.

The United Auto Workers came out of the battle unscathed, as Canadian workers benefitted from the increased investment and the union was able to obtain expanded trade adjustment assistance for U.S. members threatened by the pact.[54]

Finally, Canadian consumers did not see all of benefits of integration because of persistence of much of price differential.[55]

Conclusion

The Auto Pact gives us a striking example of investment power being fungible into control over trade policy outcomes, as shown by the Big Three's tremendous influence on the final outcome. First, the intergovernmental agreement simply could not have been achieved without the Letters of Undertaking from the firms. Canadian negotiators repeatedly expressed their fear that General Motors could sink the whole agreement by itself. Second, the companies achieved their two biggest goals, "free trade" for themselves, and the maintenance of a major portion of the price differential between the two markets, the latter being especially important to GM. Third, Ford was able to veto the exclusion of heavy trucks from the intergovernmental agreement. And the documentary record shows that the companies had frequent high-level contacts with both governments while the negotiations were taking place. The fact that the White House used Ford to sound out Wilbur Mills is especially indicative of the closeness of these business-government contacts.

This outcome should be no surprise. Given the ownership pattern of the Canadian automobile industry, and the extraordinarily high barriers to entry, the only way for Canada to get the automotive investment it wanted was to undertake programs which satisfied the interests of the Big Three. The firms had this

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[54]Keeley, "Constraints on Canadian International Economic Policy," p. 256; "U.S., Canada Agree to Drop Tariffs," _Wall Street Journal_, 18 January 1965, p. 24.

[55]Emerson, _Production, Location and the Automotive Agreement_, pp. 73-74, argues that the price differential between the two countries was not much different from the extra cost of building cars in Canada. His own data, however, show that on three popular models the factory prices were 5%, 6%, and 10% higher in Canada, while the cost difference per car in final assembly was only 4.3%. Moreover, his data showed that parts production was less expensive in Canada than the U.S., and this should reduce the differential for the total cost of cars in the two countries. Thus, there appears to be a case for the existence of excess profits in his base year of 1969. Moreover, subsequent to 1969, the differential increased, rather than decreasing, as it had been predicted to do.

power because of the government's need for investment as a precondition for accomplishing either of its main goals, improving the balance of payments and increasing employment. Not only did the overall agreement have to be compatible with the Big Three's interests, as shown above the companies were able to dictate in detail the content of the intergovernmental agreement on several points. And in both details and the overall shape of the agreement, the Canadian government attached more weight to the preferences of the Big Three than to Canadian parts makers or to small Canadian truck makers.

This does not mean that firms with investment power will always get their way on trade policy. They are not the only actors with power on these issues. The UAW, for example, favored the removal of automotive tariffs as long as its U.S. members received adjustment assistance, which it successfully obtained. But had the UAW favored tariff removal and the Big Three had not, there would not have been an Auto Pact. Today, the Big Three favors the NAFTA, and the UAW opposes it. It will probably be approved.

Moreover, governments can resist the pressure of firms to integrate areas economically. However, if they do so, they will pay a price for it. Because sometimes governments can tolerate these prices there is no automatic mechanism from potential integration to trade changes. But this price will rise with increasing capital mobility. In the case of the protected Canadian automobile market, the price of maintaining an uncompetitive auto sector was that cars sold for more in Canada than in the U.S.,[56] that exports fell, and consequently employment fell, also. After 1960, the mobility of production in the auto industry increased due to the introduction of tri-level rail cars, which reduced the cost of transporting finished automobiles, and made it economically preferable for automakers to have centralized plants specialize in one or two models to supply all of North America rather than to let decentralized plants supply all the models for their immediately surrounding areas.[57] Thus Canada faced increasing costs (compared with integrating the two markets) if it continued protecting the automobile sector.

Faced with this pressure, Canada finally decided to stop paying the costs of protection. The Big Three, already benefitting from increased capital mobility, were able to gain tariff abolition as well. With the removal of tariffs, a new era in the North American automotive industry began.

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[56]Moreover, this price differential had been increasing in the late 1950s and early 1960s. Telephone interview with C.D. Arthur, 8/21/92.

[57]James M. Rubenstein, "The Changing Distribution of U.S. Automobile Assembly Plants," Focus 38, no. 3 (Fall 1988), p. 14.