WILL THE NORTH AMERICAN AUTO INDUSTRY SURVIVE BIDEN AND AMLO'S POLICIES?

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I. INTRODUCTION

The highly integrated North American auto industry, which is built on duty-free, quota-free trade in autos (and other manufactured products) under the North American Free Trade Agreement (NAFTA)[1]—and since July 1, 2020, under the United States-Mexico-Canada Agreement (USMCA)[2]—is in many respects an outstanding success story for integrated North American manufacturing. With co-production between auto and auto parts producers in high wage cost countries, Canada and the United States, and lower-wage Mexico, automobiles made in North America compete economically with those made in Europe and Asia. The auto industry is also vital to the three North American economies with such trade (where a particular component may cross North American borders six to eight

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1. North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 7, 1992, 32 I.L.M. 289 [hereinafter NAFTA].

2. *See* Agreement between the United States of America, the United Mexican States, and Canada, July 1, 2020, U.S.T.R. [hereinafter *USMCA*].

times[3]) accounting for more than 20% of total manufactured goods trade[4] under NAFTA and the USMCA.[5] This integration has been achieved despite the low 2.5% U.S. Most Favored Nation (MFN) duties on imported automobiles[6] and sport utility vehicles and the considerable administrative costs that come with NAFTA/USMCA Rules of Origin compliance.[7]

According to experts, auto parts and final assembly "account for a large share of U.S. manufacturing employment: more than 900,000 jobs in 2021, with 712,000 in parts manufacturing and 188,000 in vehicle assembly."[8] Some automotive components cross the Canada and/or Mexico borders as many as eight times before they are assembled into a finished automobile in one of the three NAFTA countries.[9] It is thus not surprising that auto industry was the focus of the NAFTA renegotiations. The elements of the USMCA that directly address the auto industry include modifications to the NAFTA Rules of Origin and related content requirements, as well as some protections for Mexico and Canada should the United States, as former President Trump threatened, impose 20-25% tariffs on U.S. auto and auto part imports (on "national security" grounds under Section 232 of the Trade Expansion Act of 1962).[10] Automotive trade was extensively managed under NAFTA and is dictated even more so under the USMCA. Whether these increasingly strict rules in the medium or long term will help or hurt the global competitiveness of the North American auto and auto parts industries will not be known for at least half a decade under the USMCA rules. Regardless, early indications are

3. *See* Scott Tong, *When it Comes to NAFTA and Autos, the Parts Are Well Traveled,* MARKETPLACE (Mar. 24, 2017), https://www.marketplace.org/2017/03/24/when-it-cones-nafta-and-autos-parts-are-well-traveled/.

4. BILL CANIS ET AL., CONG. RESEARCH SERV., R44907, NAFTA AND MOTOR VEHICLE TRADE 10 (Jul. 28, 2017), *available at* https://sgp.fas.org/crs/row/R44907.pdf.

5. KEVIN HIMM ET AL., CENTER FOR AUTO. RESEARCH, CONTRIBUTION OF THE AUTOMOTIVE INDUSTRY TO THE ECONOMIES OF ALL FIFTY STATES AND THE UNITED STATES, vii, 1-2 (Apr. 2010).

6. HARMONIZED TARIFF SCHEDULE OF THE UNITED STATES REVISION 2, U.S. INT'L TRADE COMM'N, CHAPTER 87: VEHICLES OTHER THAN RAILWAYS OR TRAMWAY ROLLING STOCK 87-5 (2022).

7. NAFTA, *supra* note 1, Annex 300-A.

8. M. Angeles Villarreal, Bill Canis and Lianna Wong, *USMCA: Motor Vehicle Provisions and Issues,* CONG. RESEARCH SERVICE (Oct. 14, 2021), https://crsreports.congress.gov/product/pdf/IF/IF11387.

9. *See* KRISTIN DZICZEK ET AL., CENTER FOR AUTO. RESEARCH, NAFTA BRIEFING: TRADE BENEFITS TO THE AUTOMOTIVE INDUSTRY AND POTENTIAL CONSEQUENCES OF WITHDRAWAL FROM THE AGREEMENT 7 (Jan. 2017).

10. Such tariffs were never imposed. U.S. DEP'T OF COM., THE EFFECT OF IMPORTS OF AUTOMOBILES AND AUTOMOBILE PARTS ON THE NATIONAL SECURITY 5-6, 8-9, 11-12, 13, 14-17 (Feb. 17, 2019).

inconclusive, complicated by the gradual conversion from gasoline powered vehicles to the production of electric vehicle (EVs) and their batteries in North America and world-wide.

Can the North American auto industry survive the various U.S. federal and state subsidy policies for electric vehicles (EVs) and EV batteries? In the future, will this poster child for efficient North American integration, where annually, the U.S imports \$29.5 billion worth of car parts from Mexico, exports \$5.9 billion to Canada, exports \$11.7 billion worth of completed vehicles to Canada, and \$67.5 billion to Mexico,[11]continue? What would be the result if EV and EV battery producers are strongly discouraged from establishing facilities in Canada and Mexico? While the BBBA EV subsidies will never be resurrected now that a different program has been established under the Inflation Reduction Act of 2022,[12] both bills strongly suggest that when there are conflicts between the Biden Administration's "Buy American, Invest American, Employ Americans" focus[13] and the principles of the USMCA, there exists a risk that the former will prevail, to the potential detriment of North American economic integration and to other foreign suppliers of autos and auto parts, and to consumers who may ultimately pay more for their vehicles.

At the time of this writing (August 2022), the future of this integrated auto market remains uncertain. Still, three factors suggest to many observers that with the gradual shift to electric vehicles (EVs) over the next ten to fifteen years, and demand for the batteries that power them, auto and auto parts production in both Mexico and Canada will decline, with the United States reaping the lion's share of new investment and related employment. This essay discusses the three factors in the following sections: new Rules of Origin that are designed to discourage production in Mexico and, to a lesser extent, Canada, and favor investment and job creation in the United states (Part II); massive subsidies for EV and EV battery production and sales offered by the U.S. federal and state governments (Part III); and anti-capitalist, statist investment policies under the Lopez-Obrador presidency (December 1, 2018 to November 30, 2024) that are having a substantial negative impact on new investment in Mexico (Part IV). Part V provides key conclusions.

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11. M. ANGELES VILLAREAL ET AL., CONG. RESEARCH SERV., IF11387, USMCA: MOTOR VEHICLE PROVISIONS AND ISSUES 2 (Oct. 14, 2021) (citing U.S. Dept. of Com. data).

12. See Inflation Reduction Act of 2022, CONGRESS.GOV, 2021-22, https://www.congress.gov/bill/117th-congress/house-bill/5376 (last visited Aug. 19, 2022).

13. *See Fact Sheet: Biden-Harris Administration Delivers on Made in America Commitments,* WHITEHOUSE.GOV (Mar. 4, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/04/fact-sheet-biden-harris-administration-delivers-on-made-in-america-commitments/.

II. USMCA RULES OF ORIGIN[14]

NAFTA itself incorporated Rules of Origin that were designed to assure that autos and small trucks that were traded duty-free in North America would have substantial North American, not just U.S., content. Most significantly, 62.5% of the total cost of the vehicle was required to be derived from North American sources.[15] It was intentionally made difficult for a major component, such as a transmission, to qualify as entirely of North American origin simply because the final production or assembly took place in one of the NAFTA countries. This was accomplished by a rule that required the tracing of the individual parts for such major components.[16] For example, if a transmission produced in Mexico was valued at $1,000 and it incorporated $750 worth of North American parts and $250 of third country parts, only $750 of its value could be counted toward the 62.5% North American content requirement.

In assessing the new USMCA rules, the United States did *not* achieve much of what it sought in the negotiations. The United States sought to depart from the *regional* content rules used in NAFTA and other U.S. free trade agreements reached over the past twenty years. Rather than NAFTA's requirement that 62.5% of the net cost of the auto be made from North American content, the United States initially demanded that the threshold be raised to 82.5%, of which 50% must have been from the United States[17] (including steel and aluminum).[18] Due to strong opposition from Mexico during bilateral negotiations in August and September 2018, the United States was forced to compromise.[19] Still, by adding a $16 per hour wage requirement to the agreement, as discussed below, the United States assured that a higher percentage of total automotive content would be produced in

14. Portions of this section are adapted from David Gantz's work. *See* DAVID A. GANTZ, AN INTRODUCTION TO THE UNITED STATES-MEXICO-CANADA AGREEMENT: UNDERSTANDING THE NEW NAFTA ch. 2 (2020).

15. NAFTA, *supra* note 1, Annex 403.5.

16. *Automotive Products: Rules of Origin,* U.S. CUSTOMS & BORDER PROT. (May 29, 2014), https://www.cbp.gov/trade/nafta/guide-customs-procedures/provisions-specific-sectors/automotive-products.

17. DAVID A. GANTZ, BAKER INSTITUTE, THE UNITED STATES-MEXICO-CANADA AGREEMENT: TARIFFS, CUSTOMS, AND RULES OF ORIGIN 5 (2019).

18. *Exclusive – U.S. Seeks to Include Steel, Aluminum in NAFTA Autos Rules – Sources*, REUTERS (Oct. 13, 2017, 7:29 AM), https://uk.reuters.com/article/uk-trade-nafta-steel-exclusive/exclusive-u-s-seeks-to-include-steel-aluminum-in-nafta-autos-rules-sources-idUKKBN1CI1XC.

19. GANTZ, *supra* note 17, at 3.

the United States (or Canada), given higher wages in the United States when compared to Mexico.[20]

The USMCA changes for the automotive industry also include raising the percentage of regional value content required for automobiles and light trucks from 62.5% to 75%.[21] These requirements are to be phased in over three years from July 1, 2020; certain core components such as engines, advanced batteries for electric cars and transmissions must originate in North America.[22] In addition, 70% of the steel used in the manufacturing of cars and small trucks must originate in USMCA countries.[23] The full significance of the 70% rule was clarified only by the December 10, 2019 Protocol of Amendment to the USMCA.[24] In a further step, designed by the Trump Administration rather than the Democratic Congress, the steel rules (but not those relating to aluminum), were further tightened. Steel automotive products such as chassis and bodies, will not count toward the 70% after a seven-year grace period unless the steel is "melted and poured" in North America.[25]

The USMCA Protocol also added a requirement that ten years after the USMCA enters into force, the Parties will consider the application of similar requirements to aluminum.[26] Mexico apparently resisted these latter changes until a seven-year grace period was added, and was reluctant to accept such rules applied to aluminum, as Mexico does not produce raw aluminum.[27] The full impact of the 70% rule, including regional value calculations, depends on the USMCA uniform regulations and their ultimate interpretation by the Parties, to determine, for example, whether the rule means 70% by company, brand, plant, or something else.[28]

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20. *Id.*

21. *Id.*

22. *USMCA*, *supra* note 2, at 4-B-1-19.

23. *Id.* at 4-B-1-25.

24. *See Protocol of Amendment to the United States-Mexico-Canada Agreement*, U.S OFF. OF THE U.S. TRADE REPRESENTATIVE (Dec. 10, 2018), https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Protocol-of-Amendments-to-the-United-States-Mexico-Canada-Agreement.pdf [hereinafter *Protocol*].

25. *USMCA, supra* note 2, at 4-B-1-25.

26. *Id.*

27. *See Foreign Minister: Mexico Considering U.S. Steel Demand, With Conditions*, WORLD TRADE ONLINE (Dec. 8, 2019, 9:43 PM), https://insidetrade.com/daily-news/foreign-minister-mexico-considering-us-steel-demand-conditions.

28. *See Seade: Uniform regulations for USMCA auto rules under development*, WORLD TRADE ONLINE (Jan. 13, 2020, 1:21 PM), https://insidetrade.com/daily-news/seade-uniform-regulations-usmca-auto-rules-under-development (discussing the ongoing negotiations of uniform regulations for autos and auto parts).

Most significantly for Mexico, 40% of the materials for cars and 45% of the components for light trucks must be produced by enterprises that pay workers at least $16 per hour.[29] Some employees of automotive enterprises that conduct research and development or assemble advanced components such as batteries, engines, and transmissions in Mexico would count toward up to 15% of these thresholds, if the workers are paid at this level.[30] These calculations are subject to complex tracing rules,[31] which will add to auto manufacturers' administrative costs in North America, even though some other NAFTA tracing rules for parts and components have supposedly been relaxed.[32] Whether these minimum pay rules will be less harmful to Mexico than the original Trump administration proposals remains to be seen.

Since typical auto industry hourly wages in Mexico have recently been approximately $3.60-$3.90 (a level some studies attribute in part to the lack of union support for workers),[33] this wage requirement means most of the materials and components counting toward the 40%-45% content rule must be produced in the United States or Canada.[34] It is possible that wages in Mexico will eventually increase to $16 per hour; Mexico President Andrés Manuel López Obrador (AMLO) or his successor may eventually seek to implement policies encouraging higher wages for Mexican workers, including policies that strongly support workers' rights to organize independent unions, as required under USMCA.[35] However, as of mid-2022, he had not done so.

One supposedly positive change in the Rules of Origin from NAFTA was the elimination of tracing of parts in major subassemblies as noted above, in the USMCA.[36] However, as Bloomberg News reported on August 24, 2021, Mexican officials believed that U.S. interpretation of certain new Rules of Origin under the USMCA threatened a reduction in Mexican car

29. At least at present, the $16 per hour rate is not indexed to inflation, although with inflation in the United States averaging about 2% per year ($0.32), the lack of indexing probably would not significantly help Mexico. *USMCA*, *supra* note 2, at 4-B-1-26-27.

30. *Id.*

31. *See, e.g., USMCA*, *supra* note 2, at 4-B-1-20, 4-B-1-22.

32. *Id.* at 4-B-1-20.

33. *Study Points to Large Wage Gaps for Mexican Auto Workers*, MEX. DAILY NEWS (July 2, 2014), https://mexiconewsdaily.com/news/study-points-large-wage-gaps-mexican-auto-workers/.

34. GANTZ, *supra* note 17, at 3.

35. *See USMCA*, *supra* note 2, at 23-A-1 ("Worker Representation in Collective Bargaining in Mexico"), 4-B-1-27.

36. *See USMCA*, *supra* note 2, at 4-B-1-20.

production and investment,[37] a matter that was formally referred to the USMCA dispute settlement procedures.[38] Mexico (and Canada) are right to be worried. The new USMCA Rules of Origin have been interpreted by both the Trump and Biden administrations in a manner that is much less favorable to Mexico (and Canada) than many believe was intended during the USMCA negotiations. The panel proceeding is ongoing at the time of this writing. And could be concluded before the end of 2022.

As I understand the U.S. position, the effect of the U.S. approach is to ban any "rounding up" or substantial transformation of major subassemblies, as with my transmission example noted earlier. Even if there is no longer any formal tracing, Mexican or Canadian production is disadvantaged if only $750 of that $1,000 transmission made in Canada or Mexico can be counted toward the 75% regional value content despite a substantial transformation of parts and components into a finished transmission. This, in practical effect, does not appear to differ from the NAFTA tracing requirements that were supposedly removed under the USMCA. For Mexico in particular, the non-rounding up and the $16 per hour wage requirements combined could make Mexico less attractive as a location for autos and auto parts production even disregarding the challenges of U.S. subsidies for EV and EV battery production. (Part III, below) and Mexico's current negative investment climate (Part IV, below).

Should the United States prevail on its interpretation of the Rules of Origin, it may be that the producers of some models of autos and SUVs in Mexico, Canada, and third countries will simply forego the benefits of the 2.5% USMCA tariff savings and pay the MFN duty because the costs of complying, including administrative costs like higher wages, are more than 2.5% of the cost of producing the vehicles. This is perfectly legal but makes a mockery of the objective behind free trade agreements.[39]

37. *See* Maya Averbuch, *Mexico Warns of Automaker Exodus If Car Dispute Not Settled,* BLOOMBERG (Aug. 24, 2021, 5:00 PM), https://www.bloomberg.com/news/articles/2021-08-25/mexico-warns-of-automaker-exodus-if-car-dispute-not-settled.

38. *See Mexico Requests USMCA Panel in Auto Rules-of-Origin Dispute*, WORLD TRADE ONLINE (Jan. 6, 2022, 6:40 PM), https://insidetrade.com/daily-news/mexico-requests-usmca-panel-auto-rules-origin-dispute (discussing Mexican objections to the U.S. approach that resulted I the request for a panel); *Canada and Mexico Seek Panel* at *Proceedings in USMCA Dispute with United States Concerning Auto Rules of Origin,* WHITE AND CASE (Jan. 13, 2022), https://www.whitecase.com/insight-alert/canada-and-mexico-seek-panel-proceedings-usmca-dispute-united-states-concerning.

39. This approach does not work with small trucks, since the U.S. MFN tariff is 25%. Producers of small trucks for the U.S. market if located in Mexico and Canada must fully comply with the Rules of Origin or move their production of such vehicles to the United States.

III. U.S. PROPOSED AND ENACTED EV SUBSIDIES

The Build Back Better Act (BBBA)[40] was a mammoth legislative package costing over $1.8 trillion designed to address a wide range of issues ranging from childcare to climate change. Separate legislation addressing, inter alia, the rebuilding of America's roads, bridges, ports and dams, expanding the national network of EV charging stations, improving the reliability of the U.S. electrical grids, and extending the availability of high-speed internet was signed by President Biden into law on November 15, 2021.[41]

Without much doubt, encouraging the substitution of EVs, the "qualified plug-in electric drive motor vehicle… which is propelled to a significant extent by an electric motor which draws electricity from a battery"[42] for gasoline powered vehicles by American consumers is desirable. Of course, some question the availability of sufficient supply of clean energy from America's aging electrical grid within the next eight to ten years, particularly in states such as California and Texas, to assure that the shift to EVs actually results in less carbon dioxide pollution.[43] In 2020, coal still produced almost 20% of US electrical power demand, 40% natural gas, 20% nuclear, and 20% renewables.[44]

However, the BBBA EV subsidy provisions were blatantly inconsistent with the USMCA, WTO rules (discussed below), and the best interests of

40. The legislation passed by the House was effectively rejected in the Senate because West Virginia Senator Manchin objected to the cost of the proposals at a time when inflation in the United States, over 6% in recent months, was at a twenty-year high. Moreover, as discussed in this section, the "Buy American" and pro-union provisions, not surprisingly, faced broad opposition from multiple sources including various auto producers with factories in the non-union South and governors of some such states.

41. *See President Biden's Bipartisan Infrastructure Law*, THE WHITE HOUSE, https://www.whitehouse.gov/bipartisan-infrastructure-law/ (last visited Jan. 8, 2022) (summarizing the contents of the law); *See also* Infrastructure Investment and Jobs Act, Pub. L. No. 117-58, 135 Stat. 429 (2021).

42. It is unclear the extent to which the subsidies would be available for plug-in hybrids, such as those manufactured by Toyota as well as pure electric vehicles. However, minimum battery size—7 kilowatts per hour in 2022-2023 rising to 10 kilowatts per hour after 2023—could make it difficult or impossible for plug-in hybrids to qualify over time. *See* Build Back Better Act, H.R. 5376, 117th Cong., Pt. 4—Greening the Fleet and Alternative Vehicles § 136401(36C)(e) (2021).

43. *See* Gavin Dillingham, *The Great Texas Blackout of 2021: How Does This Not Happen Again?,* HOUSTON ADVANCED RES. CTR. (Feb. 22, 2021), https://harcresearch.org/news/the-great-texas-blackout-of-2021-how-does-this-not-happen-again/?gclid=Cj0KCQiAieWOBhCYARIsANcOw0wApec0yQx1Y70l8Rlwt2WVU62jk7nMGT2EZdDRz_ZdQXFSHcHwJfIaAuyeEALw_wcB.

44. *Electricity Explained: Electricity in the United States,* U.S. ENERGY INFO. ADMIN. (Mar. 18, 2021), https://www.eia.gov/energyexplained/electricity/electricity-in-the-us.php.

American (and North American) auto producers, workers, and consumers. Also, the full subsidies would have been provided only for EVs produced in the United States with U.S. batteries, union labor and 50% U.S. content, by reducing consumer choices, seem inconsistent with another Biden administration objective, realistic or not, of EV sales of 50% of the U.S. market by 2030.[45]

Under the now defunct subsidy scheme specified in the draft legislation, for the first five years, EV buyers would have received a federal income tax credit of $7,500 regardless of where the vehicle is made. For the ensuing five years, the base credit would have applied **only** to EVs produced in factories located in the United States. Otherwise, the credit would not have applied and the effective cost to the consumer would have increased. An additional $500 tax credit would have been applicable only to the sale of any car with U.S.-made battery cells, and a further $4,500 credit (for the entire ten-year period) only if the car had been produced in a unionized plant in the United States.[46] The Act would also have established "domestic content qualifications" which required that the component parts for final assembly of an EV must be of U.S. origin.[47] The provisions were, in theory, need based, with the subsidies reduced for taxpayers with an adjusted gross income of over $800,000 for a joint return, $600,000 for heads of households, and $400,000 for all others.[48] This means that almost everyone with an income below the top one percent would have been eligible for the full tax credit.[49] Since many low income taxpayers do not purchase new cars, either because the costs are high despite subsidies, the lack of charging facilities in poor neighborhoods, or for other reasons, these subsidies, like those under the IRA, would be primarily enjoyed in practice by upper middle class and wealthier Americans.

What ultimately was much more important to the administration in the ill-fated BBBA debate than staunch opposition from Canada and Mexico was opposition from West Virginia Senator Joe Manchin—whose

45. *See* David Shepardson, *U.S. Automakers to Say They Aspire to up to 50% of EV Sales by 2030*, REUTERS (Aug. 4, 2021, 6:07 PM), https://www.reuters.com/business/autos-transportation/us-automakers-say-they-aspire-up-50-ev-sales-by-2030-sources-2021-08-04/.

46. *See* Build Back Better Act, *supra* note 42, Pt. 4—Greening the Fleet and Alternative Vehicles.

47. *Id.*

48. *Id.* at Pt. 4—Greening the Fleet and Alternative Vehicles, § 36C(c)(2).

49. *See* Tom Kertscher, *Fact-Check: Does the Top 1% Pay 90% of Federal Income Taxes?*, AUSTIN AMERICAN-STATESMAN (Sept. 16, 2021), https://www.statesman.com/story/news/politics/2021/09/16/examining-claims-against-aoc-tax-the-rich-dress-met-gala/8350769002/ (indicating that the earning of over $540,009 puts a taxpayer in the top 1%).

unwillingness to support the BBBA was crucial with the Senate divided fifty-fifty—apparently in part because Toyota has a major non-unionized auto plant in West Virginia.[50] However, Manchin's opposition to the BBBA, which ultimately doomed its passage, was said to be far more a result of his fears about rising inflation, debt and foreign supply chains.[51] In the more recent discussion of what he was willing to accept in the IRA, Senator Manchin apparently insisted on a reduced total per-buyer subsidy amount and the removal of any tie-in between the subsidies and unionized production. He was also quoted in July 2022 as emphasizing that the bill gives incentives to make new car batteries in America "and not only be able to assemble them but be able to extract the minerals that we need, critical minerals, in North America."[52]

Most significantly for this article, the new subsidies regime enacted in August 2022 removes the obvious discrimination against auto and auto parts production in Canada and Mexico. The reduced subsidies, up to $7,500 for new vehicles and $4,000 for used EVs (an incentive for lower-income Americans to go electric), are available for vehicles and components produced anywhere in North America., with particular attention to production of the batteries with North American materials. The IRA, in addition to maintaining the current $7,500 subsidy, lifts the 200,000-vehicle cap for manufacturers as of January 1, 2023, a significant boon for major EV producers such as Tesla and General Motors. Further, it makes the subsidies available only for individual taxpayers making up to $150,000 and couples reporting up to $300,000, still a boon for the auto industry since higher income Americans are those most likely to be able to afford the steep prices for EVs[53] (although they presumably are less likely to need the incentives offered by the subsidies)

50. *See* Jameson Dow, *Sen. Manchin, Whose State was Built by Unions, Joins Toyota to Oppose Union-Made EV Credit,* ELECTREK (Nov. 11, 2021, 5:09 PM), https://electrek.co/2021/11/11/sen-manchin-whose-state-was-built-by-unions-joins-toyota-to-oppose-union-made-ev-credit/.

51. *Read Manchin's Statement Announcing Opposition to Build Back Better,* THE HILL (Dec. 19, 2021, 10:32 AM) https://thehill.com/homenews/senate/586460-read-manchins-statement-announcing-opposition-to-build-back-better.

52. Burgess Everett and Marianne Levine, *Manchin's Latest Shocker: a $700 billion Deal,* POLITICO (Jul. 27, 2002), https://www.politico.com/news/2022/07/27/manchin-schumer-senate-deal-energy-taxes-00048325.

53. For a detailed analysis of the IRA see Beia Spiller, *Inflation Reduction Act: Electric Vehicle Subsidies for Passenger Vehicles,* RESOURCES (Aug. 11, 2022), https://www.resources.org/common-resources/inflation-reduction-act-electric-vehicle-subsidies-for-passenger-vehicles/; Nik Popli, *The Inflation Reduction Act Will Soon Make it Cheaper to Buy EVs—If They Have North American Batteries*, TIME (Aug. 16, 2022), https://time.com/6206639/electric-vehicle-tax-credits-inflation-reduction-act/.

Other limitations apply which will probably strictly limit the availability of the subsidies for most EVs sold in the United States for at least several years. The subsidies are not available for automobile purchases above $55,000 (take that Cadillac, Lexus, Mercedes and Porsche!) but do apply to North American produced small trucks and SUVs up to a purchase price of $80,000. Some vehicles that were previously eligible for the earlier $7,500 subsidy thus are no longer eligible as of the signing of the law on August 16, 2022. As of August 2022, only about 15 EVs currently sold in the United States are expected to qualify for the credits.[54] Still, experts suggest that U.S. based automakers (regardless of ownership) with North American-centered battery supply chains and North American-based producers of battery raw materials will eventually reap significant benefits as should North America itself in terms of lower pollution.

The new law also provides subsidies of some $2 billion in grants and $20 billion in loans for auto and parts producers to retool for EVs, batteries and motors, conditioned on achieving higher domestic content over next several years. Other provisions would offer additional tax credits for clean technology manufacturing.[55] Auto and battery manufacturers (e.g., Ford, General Motors, Toyota, LG Energy Solutions, Samsung and others) have already committed billions of dollars to EV and EV battery production in Kentucky, Michigan, Tennessee among other states.[56] These additional subsidies provide an additional incentive to focus on investing in the United States rather than in Canada or Mexico, along with the substantial state-offered subsidies in each instance noted above to locate production in their jurisdictions.[57]

Under such circumstances, will the elimination of limits on consumer subsidies to US produced EVs and EV batteries in favor of North American production stem the otherwise pernicious "Buy American, invest American, employ Americans" policies of the Trump and now Biden Administrations? Certainly, the revised law is a very positive step in favor of USMCA

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54. Popli, *supra* note 53.

55. Robert Rapier, *Energy Provisions in the Inflation Reduction Act*, FORBES (Aug. 14, 2022), https://www.forbes.com/sites/rrapier/2022/08/14/energy-provisions-in-the-inflation-reduction-act/?sh=59fe9f483422.

56. Claire Bushey, *Subsidies Spark EV Manufacturing Race in U.S. States,* FINANCIAL POST (Feb. 4, 2022), https://financialpost.com/commodities/energy/electric-vehicles/subsidies-spark-ev-manufacturing-race-in-u-s-states.

57. *See* Diego Mendoza-Moyers, *Tax Break Program to Cost Texas $1 Billion a Year by 2022. Tesla Will Soon be a Beneficiary,* HOUSTON CHRON. (Aug. 22, 2000, 6:33 PM), https://www.houstonchronicle.com/business/article/Tax-break-program-to-cost-Texas-1-billion-a-year-15507765.php (discussing state and local subsidies granted to Tesla).

integrated auto production compared to the BBBA, but it falls short of resolving Canada and Mexico's competitiveness problems.

It is notable that even if vehicles and key battery and other components produced in Canada and Mexico as well as the United States are eligible, vehicles imported from significant auto exporting nations (and key U.S. allies) such as Germany, Japan and South Korea are not. As noted earlier, eligible vehicles must be produced with battery materials from the U.S., or from a country that has a free trade agreement with the U.S., e.g., from Canada, Mexico and South Korea among others, but not Japan, The European Union or (of course) China. Some foreign officials have complained about the discrimination and charged that the subsidies specific to EV and EV battery manufacturers are a violation of the WTO's Agreement on Subsidies and Countervailing Measures if they cause injury to other producers.[58] (Injury is difficult in practice to demonstrate). Moreover, while Canada and Mexico have not committed resources to subsidize their EV industries, it may be that subsidies offered by Germany, Japan and South Korea to their own EV producers will undercut the practical risk of a WTO action. (In any event, since December 2019 when the WTO's Appellate Body ceased to function, the risk of trade sanctions against the US or any of the other WTO Parties has been negligible.)

Politically, one downside of the U.S. EV subsidies, even in their reduced IRA form, is that they make it more difficult for the U.S. to take the high road while criticizing China's own massive (and illegal) subsidies for EV and battery production in China (and for many other items such as AI, robotics and chips), and may effectively encourage other major producing countries, particularly Germany, Japan, and South Korea, to institute their own subsidy programs. This probably does not concern anyone except for the relatively few U.S. trade lawyers and policy makers who are skeptical of industrial policies that necessarily pick winners and losers, and/or believe the U.S. should adhere to international trade rules. One might, more logically, consider whether—from a political point of view—it makes sense for the United States to risk significantly weakening the auto industries, and thus the manufacturing economies, of its major trading partners as the EU, Korea and Japan, even if Canada and Mexico have now been given more equal treatment.

Auto and auto parts manufacturers are not likely to pull out of Mexico regardless of the interpretation of Rules of Origin or the negative

58. See *EU Says US Electric Vehicle Tax Credit Could Break WTO Rules,* ASSOCIATED PRESS (Aug. 11, 2022), https://federalnewsnetwork.com/world-news/2022/08/eu-says-us-electric-vehicle-tax-credit-could-break-wto-rules/ (quoting Commission spokeswomen Miriam Garcia Ferrer).

investment climate. Their billions of dollars in investments over more than thirty years and generally successful operations, as well as Mexico's lower labor costs, argue strongly against it. Ford, for example, has been producing the Mustang Mach-E in Cuautitlan, Mexico, for more than a year and apparently intends to continue to do so, although the vehicles are exported to more than twenty countries, not just to the United States.[59] However, it seems more probable that major new auto-related investment, coming at a time of a gradual shift from gasoline engine to battery-powered cars and to more North American-sourced steel, may take place in the United States instead.

Mexico's competitive position in North America may be further weakened by the massive U.S. subsidies to be offered to producers of chips (including those used in the auto industry), batteries, and key battery components for electric car production. Such U.S. industrial policies may further skew investment decisions as the auto industry slowly shifts from gasoline powered to electric cars. Mexican states and Canadian provinces typically do not have the resources to compete with such incentives.

Thus, when U.S. investors balance the benefits and costs of investment in Mexico, where investment in the United States means more expensive up-front purchases of robots and other automation, the various U.S. and state subsidies as well as the investment climate in Mexico must have some impact on many companies' decision-making. The advantages of doing business in Mexico include, among others, a quality, relatively low-priced labor force, proximity to the U.S. Interstate highway system, and a rules-based system under the USMCA. However, these advantages may no longer be sufficient as discussed in the next section.

IV. AMLO'S ANTI-BUSINESS, ANTI PRIVATE INVESTMENT POLICIES

Aside from the differences over Rules of Origin, existing and new enterprises in the auto, steel and many other industries may not be as likely to make major new investments in Mexico when the investment climate overall is perceived as strongly negative. A spillover effect is likely even though President Lopez Obrador's principal targets to date have been existing and new private investment in hydrocarbons and electricity, given his obsession with supporting the government monopolies Pemex and the Corporation Federal de Electricidad (CFE). Still, other evidence of the anti-business climate beginning with the termination of the mostly

59. *Mustang Mach-E Celebrates One Year of Production in Mexico,* MEX. NOW (Nov. 5, 2021), https://mexico-now.com/mustang-mach-e-celebrates-one-year-of-production-in-mexico/.

completed Mexico City airport project at the outset of his presidency with the substitution of a different one has been widely reported.[60]

Thus, AMLO's anti-business, anti-private-investment policies have become an equally significant threat to the future of the Mexican auto industry and to investment in Mexico in general.

The overall rate of investment in Mexico was down 24% from 2016-2019.[61] The current policies, which focus on rolling back Mexico's 2013 energy reforms under President Peña Nieto to something approaching the statist, monopolistic approach of the 1970s, have already engendered several notices of intent to bring investor-state dispute settlement procedures to bear against Mexico.[62] While the focus of the policies have been on hydrocarbons (both exploration and distribution) and on elimination of private foreign investments in clean energy (windmills and solar arrays), other sectors are being affected.

As noted earlier, auto and auto parts manufacturers are not likely to pull out of Mexico in the foreseeable future but may be inclined to make major new investments in the United States instead, in partial response to AMLO's policies. Francisco Garza, chief of General Motors' local operation, noted in 2021 that while GM wished to continue investing in Mexico, the risks of such measures exist and "if the conditions are not in agreement with our long-term vision, then obviously Mexico will not be a destination in the short term, unfortunately."[63] It also seems likely that the AMLO policies favoring Pemex and CFE to the exclusion of private developers and energy importers will lead to increases in the costs of

60. *See* Kendrick Foster, *Building (and Canceling) an Airport for Mexico City,* HARVARD POLITICAL REVIEW (Apr. 12, 2021), https://harvardpolitics.com/mexico-city-airports/; Michael Stoff, *Three Shocks Unsettle Business Confidence across Latin America*, FIN. TIMES (Nov. 29, 2021), https://www.ft.com/content/292eef73-e585-4b8d-a4ff-e17360de93ea?shareType=nongift; Daniel Martinez Garbuno, *Scrapping Mexico City's New Airport is Costing Over $16 Billion,* SIMPLE FLYING (Feb. 23, 2021), https://simpleflying.com/scrapping-mexico-citys-new-airport-cost/.

61. *Mexico Foreign Direct Investment 1970-2022,* MACROTRENDS, https://www.macrotrends.net/countries/MEX/mexico/foreign-direct-investment (last visited Jan. 9, 2021).

62. *See* Gary McWilliams and Marianna Parraga, *U.S. Oil Service Group Seeks $100 Million from Mexico in Arbitration Claim,* REUTERS (May 18, 2021, 11:35 AM), https://www.reuters.com/business/energy/us-oil-service-group-seeks-100-million-mexico-arbitration-claim-2021-05-18/ (discussing Finley Resources oil services based claim); Press Release, Talos Energy, Talos Energy Files Notice of Dispute Regarding Zama in an Effort to Achieve a Mutually Beneficial Resolution (Sept. 3, 2021), https://www.talosenergy.com/news/press-release-details/2021/Talos-Energy-Files-Notices-Of-Dispute-Regarding-Zama-In-An-Effort-To-Achieve-A-Mutually-Beneficial-Resolution/default.aspx (challenging Mexico's decision to exclude Talus from joint development of an oil concession, in favor of Pemex).

63. Stoff, *supra* note 60.

petroleum and electricity, and the reduced reliability of supplies, for auto (and other) energy-intensive producers in Mexico. The lack of clean energy, even for factories that (if authorized by the government) would produce their own clean power, may be forced to use dirty Pemex fuel oil, which would make it more difficult for multinationals, including those providing financial and other cloud services, to meet their commitments to future carbon neutrality.[64]

In many respects, Mexico has seldom been an easy place to invest. Corruption is rampant at all levels, leading to dismal Transparency International ratings.[65] Despite much talk from AMLO about restraining violence in Mexico, conditions have not improved under his watch, with more than 36,000 recorded murders in 2020[66] and much of the country controlled by drug lords. The court system, despite some improvements over time, suffers from widespread corruption and a lack of independence.[67]

Although it is not discussed extensively in this paper,[68] the timing of AMLO's anti-private investment policies could not be much worse. Many American companies and foreign enterprises that serve the U.S. market are considering whether to relocate some or most of their export production from China and elsewhere in Asia to North America, avoiding future U.S. regulations which make importation of many goods from China more difficult, shortening long Asian supply lines, and diversifying suppliers where COVID-19 and natural disasters have exposed vulnerabilities.[69] For many such enterprises moving low-wage-cost production from Asia to Mexico would be a no brainer; Mexican wages are comparable to those of

64. For example, multinational enterprises that operate in Mexico such as Netflix, Facebook, and Apple have made carbon neutrality pledges. *See* Briana Dodson, *These 7 Major Companies are Pledging to Go Carbon Neutral—Here's When (and How)*, BRIGHTLY (Jul. 23, 2022), https://brightly.eco/when-big-companies-are-going-carbon-neutral/.

65. The transparency rating in Mexico is currently 124 out of 180. *See Corruption Perceptions Index,* TRANSPARENCY INT'L (2020), https://www.transparency.org/en/cpi/2020/index/mex (last visited Apr. 5, 2022).

66. Associated Press, *Mexico Homicides Remained at High Levels Despite Pandemic*, U.S. NEWS (July 27, 2021), https://www.usnews.com/news/world/articles/2021-07-27/mexico-homicides-remained-at-high-levels-despite-pandemic.

67. *See Mexico Corruption Report*, GAIN INTEGRITY (July 2020), https://www.ganintegrity.com/portal/country-profiles/mexico/.

68. *See, e.g.,* David A. Gantz, *North America's Shifting Supply Chains: the USMCA, COVID-19, and the U.S.-China Trade War*, CTR. FOR THE U.S. AND MEX.: BAKER INST. FOR PUB. POL'Y (Nov. 2020), https://www.bakerinstitute.org/media/files/files/6ed66d98/usmx-pub-supplychains-111120.pdf.

69. *Id.*

many Asian countries[70] and Mexican production benefits from easy road access to most of the United States, ample relatively low-cost labor and a language spoken by forty million Americans, among others. But the same negative factors discouraging new auto industry investment apply to other sectors. Relocation decisions once made are not likely to be reversed once AMLO leaves office in October 2024. Once a company moving operations from China bites the bullet and invests in high-tech production in the United States, it is not likely to shift to Mexico even if a more pro-private investment president takes over in late 2024. Rather, the investment and resulting new job losses are likely to continue in the long term.

In July 2022, the United States requested consultations with Mexico on Mexico's controversial energy policies.[71] The request for consultation addresses measures that "appear to breach Mexico's commitments under the USMCA" violations the Electric Power Industry Law, Inaction, Delays, Denials, and Revocations of Private Companies' Abilities to Operate in Mexico's Energy Sector; Postponement of Requirement to Supply Ultra-Low Sulfur Diesel for Pemex only; certain Actions Regarding the Use of Mexico's Natural Gas Transportation Service."[72] As a former Mexican trade negotiator noted at the time, "What we're seeing is a virtual train crash between his vision of how to develop Mexico—and the energy sector in particular—and commitments and obligations under the USMCA." [73] AMLO mocked the request, playing a song with the lyric, "Oh, how scary. Look at how I'm Shaking" at a news conference and branding the U.S. request as "political sanctions."[74] The consultation and arbitration processes are likely to require any months before the issues are resolved; even if Mexico loses, as some observers believe is very likely,[75] the actual application of sanctions could well take place only after AMLO leaves office in October 2024.

70. *See Mexico vs. China Manufacturing: How the Two Countries Compare,* N. AM. PROD. SHARING, INC., https://napsintl.com/manufacturing-in-mexico/mexico-vs-china-manufacturing-comparison/ (last updated Sept. 30, 2019) (in 2019, hourly wage costs in Mexico were $3.95 compared to $4.50 in China).

71. *U.S. Requests USMCA Consultations over Mexico's Energy Policies*, INSIDE US TRADE (Jul. 20, 2022), https://insidetrade.com/daily-news/us-requests-usmca-consultations-over-mexico%E2%80%99s-energy-policies.

72. *Id.*

73. Kenneth Smith Ramos, quoted in INSIDE US TRADE, *supra* note 71.

74. Cody Copeland, *Lopez Obrador Defends Energy Policy, Accuses US Companies of Trying to "Loot" Mexico,* COURTHOUSE NEWS SERVICE (Jul. 21, 2022), https://www.courthousenews.com/lopez-obrador-defends-energy-policy-accuses-us-companies-of-trying-to-loot-mexico/.

75. *Id.*

V. CONCLUSIONS

The Mexican government and auto industry enterprises throughout North America have good reason to be worried about the future. It will take time to resolve the dispute over Rules of Origin. Countering U.S. federal and state subsidies to automotive producers is very difficult even if the consumer-oriented IRA subsidies no longer discriminate against Canada and Mexico. AMLO could immediately take steps to repair the damage caused to Mexico's investment climate during his first three and a half years. Reversing the decline in foreign investment should be a top priority for the Lopez-Obrador administration, even though more than half-way through his term any major policy change is highly unlikely as his comments quoted immediately above demonstrate, unless it is forced by trade sanctions imposed by the United States and Canada.

The new USMCA Rules of Origin have been interpreted by both the Trump and Biden administrations in a manner that is much less favorable to Mexico (and Canada) than many believe was intended during the USMCA negotiations, a disagreement that is at the early stages of binding state-to-state dispute settlement under the USMCA. Presumably, a win by Mexico and Canada would remove one of the obstacles to continued regional integration of the automotive markets, but probably not the most important one. The Biden administration and many Democrats in Congress with the heavy union backing are in lockstep with the Trump administration, as they were during the latter part of the USMCA negotiations, when it comes to creating new American jobs and investing in the auto industry in the United States.[76]

Perhaps most importantly in the long term given the replacement of the BBBA subsidies with the reduced and more complex ones in the IRA, along with the treatment in the IRA of North America as a single unit for the new subsidy regime there is some cause for optimism. It can be hoped that the Biden Administration will see the benefits of expanded North American economic integration as a matter essential to the competitiveness of the United States globally, in the automotive industry and elsewhere. Such a commitment would be reinforced if the United States were to abandon its questionable interpretation of key Rules of Origin instead of insisting on it through the arbitral process, even though that does not seems likely given the domestic political constraints. While the administration

76. *See Opinion: on Electric Cars, President Biden Should Meet Mexico and Canada Halfway*, THE WASH. POST (Nov. 20, 2020, 9:00AM), https://www.washingtonpost.com/opinions/2021/11/20/electric-cars-president-biden-should-meet-mexico-canada-halfway/.

may seek to comply promptly with the USMCA Rules of Origin if it loses the arbitration, additional positive steps in support of North American integration even when there is a possible conflict with "Buy American" policies, would benefit industry and consumers in all three countries, in the automotive as well as other sectors, and help to ensure that the North American auto industry remains competitive with those in Europe and Asia.