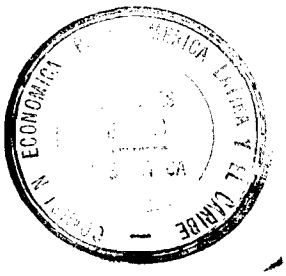
UNITED NATIONS

ECONOMIC COMMISSION
FOR LATIN AMERICA
AND THE CARIBBEAN

Distr.
LIMITED
LC/WAS/L.22
26 October 1993

ORIGINAL: ENGLISH



THE MAKING OF A NEGOTIATING POSITION: THE U.S. TRADE POLICY STAFF COMMITTEE (TPSC) HEARINGS

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The U.S. Trade Policy Staff Committee (TPSC) Hearings

I. INTRODUCTION

On June 11th, 1990, the United States and Mexico announced their intention to negotiate a free-trade agreement. This announcement, soon followed by the launching of the Enterprise for the Americas Initiative (EAI), on June 27, 1990, raised the prospects of future free-trade agreements between the U.S. and other Latin American countries. After much debate, Canada decided to join the negotiations. On February 5, 1991, all three countries, Mexico, Canada, and the United States, declared their intention to negotiate a trilateral regional agreement, the North American Free Trade Agreement (NAFTA).

A successful NAFTA raises the possibility of additional free trade agreements (FTA) between the U.S. and other nations of the region. Beyond this possibility, lessons for countries entering into trade negotiations with the United States may also be drawn from the NAFTA process. This process proves that much can be learned from the debate on the formulation of the U.S. trade negotiating position.

This paper surveys a set of testimonies presented at several regional hearings on the NAFTA held by U.S. trade negotiators. These unprecedented hearings provide a clear illustration of the interests that will be potentially affected by the negotiating issues contained in the NAFTA. The ebb and flow of the hearings emerges from how different interests perceive that they would be affected by a free-trade agreement. The remainder of the paper is divided into four sections. Section II examines recent amendments to U.S. trade legislation that made the NAFTA an unprecedented negotiation. Section III considers the participants and the issues they addressed in the hearings. Section IV focuses on specific testimonies and analyzes the positions of certain interests groups with regards to eleven negotiating issues. This section serves as the core of the paper, highlighting the arguments presented by some of the witnesses that testified. The final section makes observations about how these hearings may be of relevance in the context of future free trade negotiations.

II. THE REQUIREMENTS OF THE OMNIBUS TRADE AND COMPETITIVENESS ACT OF 1988

The U.S. political system is characterized by the dynamic of "checks and balances" between the branches of government as a means of preventing the undue concentration of power. A manifestation of this concern for diffusion of authority can be found in how the legislative branch is invested with the constitutional jurisdiction over the conduct of foreign trade, with the executive branch in charge of policy implementation. This structure has remained the base of trade policy since the enactment of the U.S. Constitution over two centuries ago.

Since at least the Great Depression of the 1930's, "tension" in U.S. trade policymaking has existed between the legislative and the executive branch. This tension or "cry and sigh" syndrome,[1] arises as mounting protectionist pressures from constituents and industry converge on the U.S. Congress-- the "cry". After grave predictions, heavy legislative horsetrading, and executive prodding, the debates conclude with the "sigh" --the approval of a trade bill. However, the resulting legislation has not been as protectionist as expected and remains congruent with the open trading relationships that have characterized the postwar international trading system.

The approval of the Omnibus Trade and Competitiveness Act of 1988 (OTCA) may be seen as an illustrative example of the "cry and sigh" syndrome. It is one of the most sweeping pieces of commercial policy legislation ever approved in the United States, stemming in part from concern with increasing trade deficits.[2] The OTCA provided a new framework for U.S. commercial relations, specifically clarifying issues regarding U.S. responses to foreign trade barriers and outlining the present structure for the formulation of U.S. trade policy.

Specifically, the OTCA frames the negotiating process necessary to arrive at a trade agreement into three stages:

> Stage 1 can be defined as the debate in Congress of whether to extend fast-track authority to the President, with the intention of consolidating and facilitating the negotiation and approval of the agreement.
>
> Stage 2 occurs after fast track authority has been extended to the Executive. With the trade "football", as it were, in the Executive's camp, the process moves to an information gathering period, in order to shape the negotiating position prior to the actual negotiation of the agreement.
>
> Stage 3 develops as the final agreement text is presented to both Houses of Congress for a vote. Given that the agreement was negotiated under fast-track authority, the Congress may vote only on the final version without adding amendments. Hence, while the Executive has added authority in the negotiating process to avoid overdrawn congressional battles over the fine points of an agreement, Congressional oversight was enhanced and its authority over foreign commerce affirmed by the OTCA.

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[1]Robert Pastor, "The Cry and Sigh Syndrome: Congress and Trade Policy," in Making Economic Policy In Congress, ed. Allen Schick (Washington D.C.: American Enterprise Institute for Public Policy, 1983), pp. 158-195.

[2]Omnibus Trade and Competitiveness Act of 1988,(Washington, DC: US Government Printing Office, April 20, 1988).

To be sure, the OTCA redefined the roles of the Presidency and the Congress, in part by "requiring increased consultation". Part 2 of Title I of the OTCA, entitled "Hearings and Advice Concerning Negotiations", includes provisions that force the USTR, the chief negotiating arm of the Executive, to seek advice from: 1) the International Trade Commission, 2) executive departments and other sources, and 3) public hearings. If the Executive fails to comply with these provisions, the Congress has the prerogative to enact a "procedural disapproval resolution" which would remove the President's fast-track authority if approved by both chambers. In these terms, public hearings may be held by Congress when the extension of fast track authority is being debated. Additionally, the stipulation that the USTR should also hold public hearings when the negotiating position is still to be defined is a key and distinct component found in the OTCA.

As a point of comparison, the Canadian trade policy process does not include this type of "bottom-up"mechanism. Michael Hart, Canadian negotiator of the U.S.-Canada Free Trade Agreement, describes the Canadian process as more top-heavy. In Canada, the negotiating positions are crafted from the top, designed by experts and technicians. Only when the negotiating position is defined are consultations initiated. This approach contrasts with the U.S. system, where open consultations take place during the construction of the negotiating position.[3]

III. THE TRADE POLICY STAFF COMMITTEE (TPSC) HEARINGS

The NAFTA negotiating process did follow the three stages framed by the OTCA. The first set of hearings in the Congress with regards to the extension of fast-track authority were initiated in March and April of 1991. The key hearings were held in the Senate Finance and House Ways and Means Committee, the primary legislative committees for trade matters.[4] These hearings marked the first stage of the U.S. trade formulation process and dealt with the transfer of negotiating authority. Since only the extension of fast-track authority was being considered, the hearings were broad and general. By contrast, the hearings held in the next stage by the USTR Trade Policy Staff Committee (TPSC) were significantly more detailed.[5]

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[3]Michael Hart, Reconcilable Differences: Negotiating the Free-Trade Agreement, (Ottawa: April 3, 1990), pp. 17-18

[4]Statement of Ambassador Carla A. Hills, US Trade Representative before the Subcommittee on Trade, Committee on Ways and Means, United States House of Representatives, (Washington, DC: February 20, 1991)

[5] The Brock Group, LTD., The Formulation and Implementation of US Trade Policy, (Washington, DC: July 24, 1992)

The TPSC is the front-line mechanism for handling trade responsibilities in the Executive branch. It is chaired by the United States Trade Representative (USTR) staff but also depends on input from other agencies. These federal agencies include: the U.S. Departments of Agriculture; Commerce; Energy; Labor; State; Treasury; the Environmental Protection Agency; and the International Trade Commission (ITC). Senior civil servants with the most knowledge on trade matters in their respective agencies serve on the TPSC, which is made up of 60 subcommittees and several ad-hoc task forces. Besides chairing the committee, the USTR assigns responsibilities, thus, coordinating in this way U.S. trade policymaking.

With the extension of fast-track authority, the USTR set out to formulate the position to be adopted in negotiating NAFTA. In a report, transmitted to the Congress on May 1, 1991, the Executive committed itself to consulting fully with the Congress and the private sector, as well as undertaking a review of environmental issues.[6] In addition to consulting heavily with both Congress and the private sector, the administration also decided to hold an "unprecedented series of public hearings on NAFTA in six American cities."[7]

The administration solicited public comments on the proposed agreement through these hearings because it was "intensely interested in how the public views free trade with Mexico. These hearings [would] be an invaluable aid to our negotiators in their effort to obtain an agreement that is beneficial to the United States."[8]

The USTR advertised the hearings in the Federal Register, stating that a series of six public hearings before the Trade Policy Staff Committee (TPSC) would be held in: San Diego on August 21, Houston on August 26, Atlanta on August 29, Washington D.C. on September 3-5, Cleveland on September 9, and Boston on September 11.[9] Persons interested in testifying were asked to contact the USTR and could testify in person at the hearings and/or submit a written testimony. Over 200 witnesses testified in person and over 400 written submissions were received. The information gathered at these hearings would be disseminated to all negotiating groups and interested officials, consonant with prior announcements.

The hearings' objective was further clarified by David Weiss, the Chairman of the TPSC, in his opening statement presented at the initiation of the testimonies. He stated that the goal of the committee was "to concentrate on developing information, conducting

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[6]President George Bush, Response of the Administration to Issues Raised in Connection With The Negotiation of A North American Free Trade Agreement, (May 1, 1991), p.12

[7] The White House, Report of the Administration on The North American Free Trade Agreement and Actions Taken In Fulfillment of the May 1, 1991 Commitments,(Sept. 18, 1992).

[8] Office of the USTR, Official Press Release, (July 15, 1991)

[9]Federal Register Notice, (July 16, 1991), pp. 32454-32457

domestic consultations and seeking advice from those concerned on the nature and scope of the negotiations, and on identifying the key issues for negotiation." Addressing the participants in the first hearing, he also added that the timing of the hearings had been designed "to enable you to present your views so that your testimony and briefs may be fully considered and taken into account prior to the nitty-gritty of the negotiations." Outlining the agenda and stressing the fact that these were information-gathering hearings, David Weiss added that "we seek your input on the full range of issues. We seek your comments in particular on the economic costs and benefits to U.S. producers and consumers of removal of tariff and nontariff barriers to trade, on potential service sectors to be included in an agreement and the economic costs and benefits of removal of such service barriers, on the costs and benefits of removing restrictions on direct investment, on the adequacy of existing customs measures and on appropriate rules of origin, and on possible environmental effects of a NAFTA."[10]

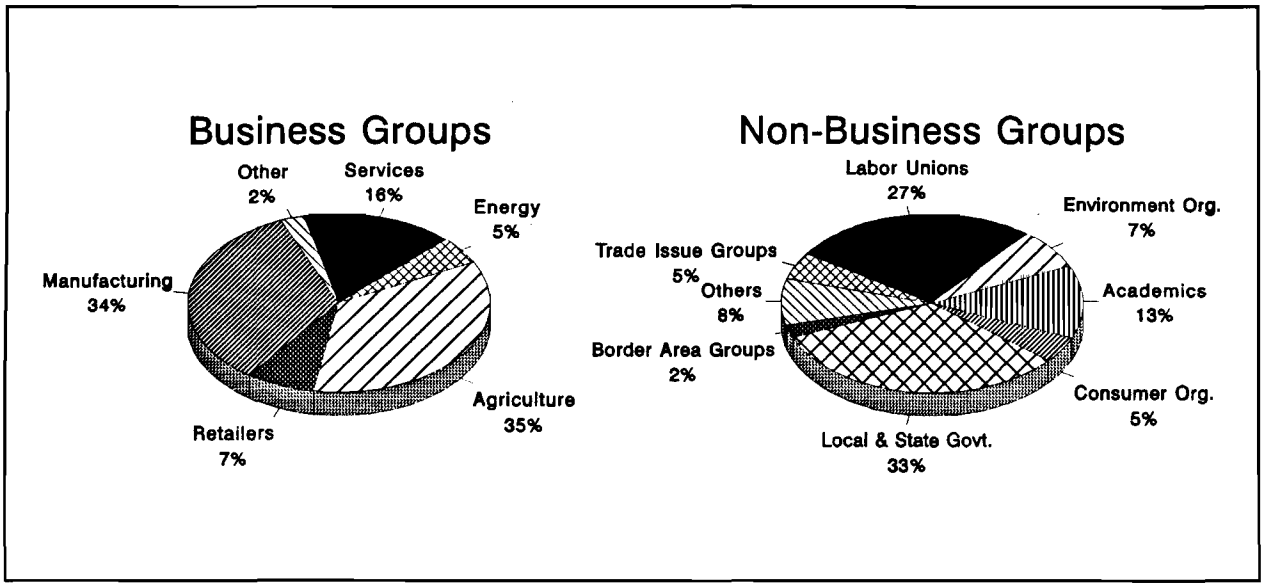
Of the 223 oral testimonies presented to the TPSC, 148 were randomly chosen and surveyed for this study, serving as a sample of the range of issues raised during the hearings. The testimonies examined were taken from all six of the hearings held in August and September of 1991. A breakdown of the participants and issues raised during these hearings follows below.

1. The Participants

Witnesses at the hearings represented a vast spectrum of interests which included: corporations; producers; consumer and trade associations; labor and environmental groups; local governments; academics; and religious groups. The majority of witnesses were from the U.S., although several Mexican firms and associations participated as well. Figure 1 shows the diversity of the groups and interests represented at the hearings, drawing the percentages from the 223 oral testimonies presented.

[10]David Weiss, Chairman of the Trade Policy Staff Committee, Opening Statement for the TPSC Hearings: North American Free Trade Agreement, (San Diego: August 21, 1991) pp. 6-8.

Figure 1 Testimonies by Activity



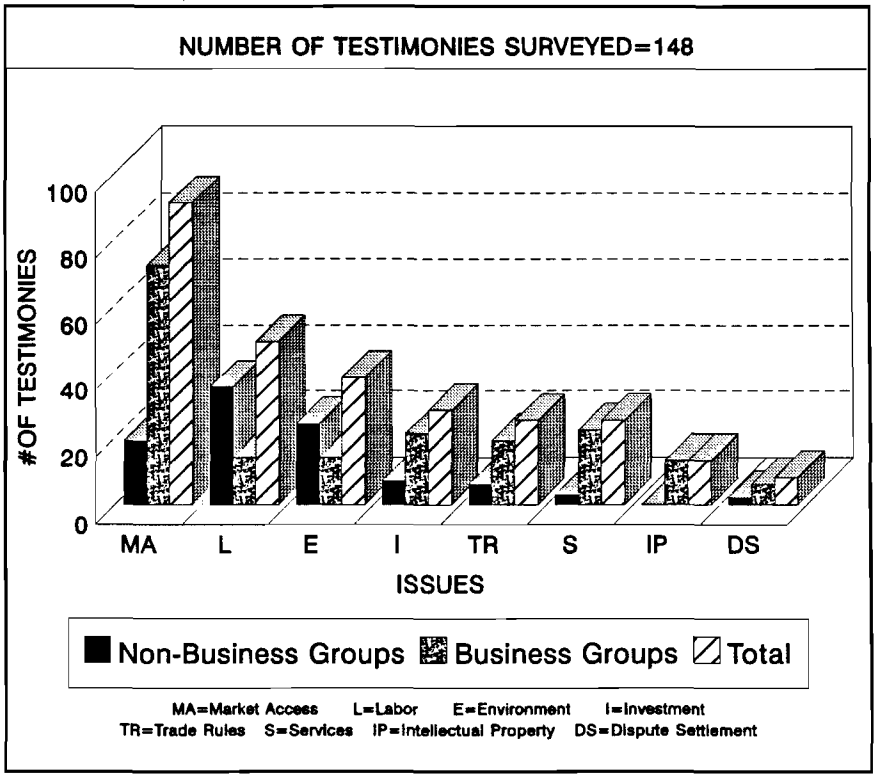
2. The Issues

The issues were determined according to the structure of the NAFTA negotiating groups, as described by Chairman Weiss in his opening statement. He stated that they would break down the issues "into 18 negotiating groups falling under 6 broad categories: **Market Access** (including tariffs and nontariff barriers, rules of origin, and government procurement), **Trade Rules** (such as standards and safeguards), **Services**, **Investment**, **Intellectual Property Rights**, and **Dispute Settlement**."[11] **Labor** and the **Environment** were also named by Weiss as additional issues. All these categories served as the principal framework for the negotiations.

[11] Ibid., p. 6.

Figure 2 presents the breakdown of the issues raised by the 148 testimonies analyzed. The testimonies proved not to be mutually exclusive; many of the witnesses at the hearings discussed more than one of the categorized issues. This graph shows the frequency with which the issues were mentioned by business or non-business interest groups. Market access issues clearly raised the most concern, as approximately 50% of the testimonies surveyed discussed them. The graph is arranged in descending order, ending with Dispute Settlement as the issue that was least mentioned. Predictably, non-business interests mentioned labor and environmental issues more frequently than business groups.

Figure 2 Breakdown of the Issues



IV. THE TESTIMONIES

The themes of the hearings surveyed reveal the clash of conflicting views on free trade. Both at a specific and at a general level, witnesses asserted their opposition or support, justifying their position with facts that varied from careful statistics to anecdotal evidence, with other witnesses ready to rebut these arguments in their testimonies. In sum, the hearings reflected the contentious nature of free trade, a subject which provokes strong reactions among many witnesses.[12]

In addition to the testimonies presented by U.S. and Mexican participants, some Caribbean representatives also provided testimonies, using the opportunity to voice concerns from a general perspective regarding the possible effects of NAFTA on their own economies.

[12]All of the following information was drawn directly from the written testimonies.

For instance, the Governor of the U.S. Virgin Islands, Alexander A. Farrelly, expressed fear that NAFTA would undermine the gains from the Caribbean Basin Initiative (CBI)-- the preferential trading regime that exists between the U.S. and the Caribbean states-- by diverting trade of sensitive commodities, such as rum, to Mexican producers. He emphasized his point by noting that rum sales, as the greatest source of revenue, of some Caribbean economies, were helping to pay for necessary repairs in the aftermath of Hurricane Hugo.

The Secretary of State of the Commonwealth of Puerto Rico, Antonio J. Colorado had similar concerns to those of Governor Farrelly. In addition to concerns regarding the rum trade, he wanted to see better security for CBI benefits under NAFTA and also asked for adjustment assistance for Puerto Rico, in the areas of textile, apparel and leather goods.

The discussion that follows will provide a narrative of specific case studies of testimonies, using the framework of the 6 negotiating groups adopted by the TPSC and the USTR. In addition, the issues of labor and the environment will also be considered. Given that market access issues proved to have elicited the most concern at these hearings, special attention will be granted to issues such as tariff and non-tariff barriers, rules of origin, agriculture, and automobiles.

The case studies were chosen to highlight the unprecedented role that the TPSC public hearings had in the formulation of the U.S. trade negotiating position. Also, a comparison of the testimonies provided with the references to the NAFTA text reveal the influence that a given industry or organization had in the formulation of the U.S. position. Other factors clearly contributed to the formulation of the U.S. trade position in a given area. However, the influence a given industry or group had in setting tariff schedules, phase-outs, or the maintenance of quotas can be inferred from the position adopted at the hearings.

1. Corn Brooms: Phase-Outs

With reference to tariff reduction, prior to the initiation of the hearings, the USTR adopted a "no exclusions" stance, meaning all products and industries would be considered for tariff reduction. Specific and in-depth information was needed to best allocate products for immediate, medium-term or long-term phase-out periods. One such testimony highlighted these challenges. One of the smaller companies to testify was Vining Industries, Inc. Harry Levanthal, the founder and president of the company, made a heartfelt plea for the exclusion of corn-brooms from the NAFTA. As a small broom-manufacturer based in Springfield, Ohio, and as a representative of the broom factories, he pointed out that 30 years ago there were about 800 such factories in the U.S. Now, the number of these small factories, the majority family-owned businesses, have dwindled to 200. He blamed the huge, low-production cost of Mexican broom factories for this decrease, and felt that the elimination of tariffs on Mexican brooms would eventually lead to the disappearance of the U.S. broom-

making industry, under a deluge of cheap imports. He stated that the industry:

> "desperately need[s] an exclusion of corn brooms from the new trade bill under consideration and that tariffs and quotas should remain intact. Please do not disturb this already fragile industry, so these small family companies can stay in business."[13]

Although much smaller than many of the other firms testifying, Vining Industries provided stirring testimony that was indeed considered by the committee. Given that the preliminary stance had been one of "no-exclusions", it was impossible to exclude brooms from the NAFTA. However, the corn broom industry was granted the longest phase-out period available, that of 15 years, in order to facilitate adjustment to the free market.[14] This phase-out period was granted only to very sensitive products. The broom industry, considering its size, would perhaps have been overlooked had they not testified so forcefully at these hearings.

2. Orange Juice: Market Share

In contrast to Vining Industries, the much larger citrus industry from the state of Florida was able to mobilize a potent network in opposition to the NAFTA. Stating that the NAFTA would be "catastrophic to the market" in the United States, the governmental Florida Department of Citrus and the trade association, Florida Citrus Packers, among many others, made a strong argument for complete exclusion of the citrus industry. Testifying on August 29, 1991, in Atlanta, Georgia, these groups described several ways in which free trade with Mexico in this market sector would be harmful and dangerous to the U.S. industry. One of their primary complaints was that of lower production costs in Mexico. They identified lower labor costs, government subsidies and a lack of necessary capital investment in land as the primary factors leading to the Mexican lower prices and, by extension, their unfair competitive edge. The citrus network also cited the following as unfair Mexican advantages:

* lax environmental and food safety standards that allow the Mexican producers to avoid these regulations and thus lower their production costs as well.

* the Mexican industry poses an even greater threat in the future as they hold

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[13]Testimony by Harry Levanthal, President, Vining Industries, (Cleveland: September 9, 1991)

[14]Tariff phase-out period applies to all Mexican corn brooms after the first 100,000 dozen. The first 100,000 dozen brooms, under the NAFTA provisions, would enter duty-free beginning January 1994. See Office of the USTR, NAFTA Tariff Reduction Schedules, (Washington, DC: September 8, 1992), sections 9603.10-9603.40

more acreage dedicated to citrus production than Florida; moreover, 45% of that area is not bearing yet.

* safety and phytosanitary standards are flaccid at best and will pose health and safety standards.

* rules of origin raise fears that other countries will use Mexico as a transshipment point for duty free entry into the U.S.

In a word, this strong coalition of both government and trade associations characterized the citrus industry as a precarious sector in need of nurturing trade protection that, hence, should be excluded from NAFTA.

However, the Mexican industry was able to counterargue. During the hearings held on September 5, 1991, in Washington D.C., the Mexican interests stressed that Mexican exports would not inundate the U.S. market. More clearly, The Mexican National Citrus Processors Association contradicted assertions that Mexican producers of frozen concentrated orange juice (FCOJ) for manufacturing and fresh juice were thriving in the U.S. market. Mexico remains a "very distant source of supply for the U.S. market", and Mexican imports are used for blending with U.S. or Brazilian juice. U.S. sources currently supply about 65% of the orange juice needed by the U.S. processors, with Brazil being the primary external source, supplying about 85% in 1990 of imported FCOJ. The Mexican producers stated that there is an insufficient supply in the U.S. to satisfy the demand, therefore 35% of the orange juice must be imported, primarily from Brazil.[15] It was also suggested that Mexican imports would basically replace some of the Brazilian imports and therefore they would not hurt the U.S. domestic market. The Mexican Citrus Association further highlighted constraints to the industry's potential to increase their U.S. penetration under NAFTA. Besides legal restrictions on land ownership which are in the process of being reformed, "relatively unsophisticated grove management and care techniques and poor land productivity result in the yield per acre in Mexico being only 1/4 of that in the U.S. and 1/2 of that in Brazil." Thus, Mexican groves are relatively less productive.

Both U.S. and Mexican citrus groups presented cogent cases. On account of its sensitivity, orange juice became a special case in the final agreement. Although it was not excluded, it was granted also the longest phase-out period of fifteen years. However, indicative of the strength of the arguments lodged by the Mexican producers, the in-quota tariffs for FCOJ were reduced by 50%, effective January 1994. Additionally, the phase-out was set so that in 15 years, the quotas and tariffs, following different phase-out schedules, would both be eliminated. In order to best protect both U.S. and Mexican interests and to

[15]Testimony by Juan Carlos Zambrano, Alberto de la Fuente, and Irwin P. Altschuler of the Mexican National Citrus Processors Association, (Washington, D.C.: September 9, 1991)

respond to the concerns regarding transshipment of citrus from other countries, a high rule of origin of 100% is set on both fresh and frozen concentrated orange juice.[16]

3. Glassware: Import Penetration

Glassware also was a polemical issue between U.S. industries and their Mexican counterparts. United States glassware producers made a strong case for the exclusion of glassware products from the agreement, based on the import sensitivity of this industry. A witness from Libbey Glass (a unit of Owens-Illinois) argued that GSP law, tariff schedules themselves, trade statistics, and an International Trade Commission (ITC) study attest to the sensitivity of the industry, as well as to the fact that the share of foreign penetration in the U.S. glassware market has grown, on a value basis, from 22% to 45% in the last ten years. This representative from Libbey Glass stated that glassware imports from Mexico alone increased from $8 million in 1979 to almost $19 million in 1991 (the current year) and that Mexican products account for over 15% of the total volume of glassware imports. The impact of foreign penetration was illustrated by a representative of Anchor Hocking Consumer Glass Company (a division of Newell Company) who stated that: "Since 1978 more than half of the glass manufacturing plants in the United States have closed, including two of Anchor Hocking's plants, one in Clarksburg, West Virginia, and another in Lancaster, Ohio."[17] In terms of the impact on employment, the witness stated that "excess capacity, declining production and operating losses have caused more than 21,000 American glassware workers to lose their jobs since 1979." The president of the industrial glass company of Anchor Hocking emphasized that import penetration for industrial glassware, at 55%, was currently even higher than for consumer glassware.

Differences in labor costs were cited as part of the explanation for import sensitivity. The deposition of Libbey Glass stated that labor represents about 50% of the U.S. industry's total costs and that, according to the Bureau of Labor Statistics, the U.S. industry's wage is $15.26 per hour, compared with the Mexican industry's rate of $1.39 per hour. In addition to emphasizing the wage differential between Mexican and U.S. industries, Anchor Hocking identified the lower energy costs of Mexican producers as well.

Several Mexican glassware manufacturers took advantage of the hearings to also state their case. Orion, S.A. argued that Mexican exports did not have the impact that the U.S. industry had stated. Rather, "Mexican exports account for only 3% of total U.S. domestic consumption and basically compete in the low end of the market. Further, these exports

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[16] Office of the USTR, NAFTA Tariff Schedule, (Washington, DC: September 8, 1992), section 2009.11.00

[17] Testimony by Fredric Contino, Representative of Anchor Hocking Glassware, (Washington, DC: September 4, 1991)

compete with exports from other countries such as Taiwan, Brazil, Venezuela, and Colombia and do not compete with most of the U.S. production."[18] The general director of Vitromex, S.A., Rodolfo Fernandez also argued against the claims that Mexican companies were subsidized and that labor conditions were below standards. He stated that "we want to emphasize that the working conditions in the major Mexican tile plants are comparable to the U.S. plants and all other ceramic tile plants worldwide."[19]

However, attesting to the sensitivity to foreign penetration into the U.S. glassware markets is the slow pace of tariff elimination stipulated for these products in the NAFTA text. More clearly, the liberalization phase-in period for about 67% of glassware product lines, whereby all tariffs would be eliminated, is 15 years, the longest transition period stipulated in the NAFTA text.[20]

4. The Textile Industry: A New Stance

The hearings also revealed new tendencies among the U.S. producers. For example, the textile sector, traditionally protectionist, was more open and came out in favor of the NAFTA. The Retail Industry Trade Action Coalition (RITAC), a broad-based coalition of American apparel manufacturers, apparel retailers, retail trade associations, and other associations involved in international trade, testified at the hearings in Washington D.C. on September 5, 1991. Representing companies such as the GAP, The Limited, J.C. Penney, K-Mart, Warnaco, Macy's and others, RITAC stated its strong support for the negotiation of a NAFTA, specifically requesting not to be excluded. In its own words: "RITAC has one basic request to make of the negotiators: don't forget textiles and apparel in the trade liberalization process." They added that "without the many obstacles to production-sharing that still exist, U.S. manufacturers could draw on the differing competitive advantages of Mexico and the U.S., producing a more robust industry able to take on competitors from Europe and the Pacific Rim."[21]

Specifically requesting the elimination of quotas, the phase-out of tariffs, a strong, single rule of origin, and uniform labelling, the textile industry basically used the opportunity of the hearings to present a new stance and to try to influence the negotiation platform of the

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[18]Testimony by Jorge Foster, Representative of Orion, S.A., (Washington, DC: September 4, 1991)

[19]Testimony by Rodolfo Hernandez, General Director, Vitromex, S.A., (Washington, DC: September 4, 1991)

[20] See Office of the USTR, NAFTA Tariff Reduction Schedule (Washington, DC: September 8, 1992), for HTS items 7010.10.00 to 7014.00.50. for information on the specific product lines involved.

[21]Testimony provided by Doral S. Cooper, President, C&M International, on behalf of RITAC, (Washington, DC: September 5, 1991)

USTR. In the NAFTA text, the textile industry is accorded the medium range phase-out of 10 years, with most of the tariffs being essentially phased-out in 6 years. There is also a strong rule of origin stipulation, significantly stronger than that of the U.S.-Canada FTA.[22] In the NAFTA, textile and apparel goods must pass a "triple transformation test", essentially meaning that all finished products must be cut and sewn from fabric spun from North American fibers. However, goods that are made from fibers that are in short supply in North America, such as silk and linen, are partially exempt from this "fiber forward" rule.[23]

5. The Automobile Industry: Rules of Origin

Rules of origin were discussed by many witnesses and clearly were a major concern for the automobile producers. Foreign competition intensified throughout the past decade, while profits and employment declined in the North American automotive sector. Major producers (including the U.S. Big Three: General Motors, Ford and Chrysler) have increased their global sourcing of parts and components. More recently, the Mexican automotive industry has been expanding, with a strong presence of the Big Three, as well as Nissan and Volkswagen. The fastest growth has taken place in the auto parts industry, which is clearly dominated by the U.S. firms. The Mexican increase in automotive production and auto part sales resulted from the slight relaxation in Mexico of foreign direct investment measures introduced by the 1989 Auto Decree and the flourishing of exports of auto parts entering the U.S. under preferential HTS subheadings 9802.00.60 and 9802.00.80.

Therefore, it comes as no surprise that the issue of rules of origin in NAFTA, which affects global sourcing and investment decisions in the region, was such a concern to the automobile companies which testified at the hearings. When the Big Three released their demands regarding NAFTA, rules of origin were a major component. General Motors, Chrysler, and Ford were emphatic about maintaining the 50% ad valorem rule as stipulated in the U.S.-Canada FTA regarding trade of auto parts with Canada. However, Chrysler and Ford were pressing for 70% regional content, while GM wanted only 60% in trade with Mexico. This divergence within the industry illustrates the difficulties of achieving a consensus on this issue, which was one of the last to be resolved during the negotiations.

The central question was how to resolve the so-called "roll-up" problem. The problem surfaced publicly when Honda of America was accused by U.S. Customs that its accounts allegedly showed that the firm's sourcing practices produced autos that did not meet the 50%

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[22]In the US-Canada FTA there is a rule of origin of "double transformation"; that is, finished products are required to be cut and sewn into garment parts in either Canada or the United States, in order to qualify for FTA preferential treatment.

[23]Office of the USTR, The North American Free Trade Agreement, (Washington, DC: September 6, 1992), Section XI, Chapters 50-63, pp. 4-58 thru 4-78.

value-added test specified in the U.S.-Canada FTA. During the TPSC hearings, Honda also testified to complain about the vagueness of the rules of origin established under the bilateral free trade agreement.

The roll-up problem resulted from the method used to determine the origin of parts. Under the U.S.-Canada FTA, auto parts were accounted for as being 100% North American, whenever 50% of their content was produced in either country. Hence, in the calculation of the total North American content of motor vehicles, there seemed to be a bias in favor of lower regional content. However, Honda explained that U.S.-Canada FTA rules were vague concerning what constituted production costs. For instance, is plant depreciation a cost that should be included in the value contents of products?

The NAFTA, as initialed, attempts to resolve the issue of rules of origin for automobiles. Although the value contents requirement has been raised, the method of calculation has been replaced by a "net cost" approach. This method takes into account the total cost of production, establishes that 62.5% of the net cost of autos, light trucks, engines, and transmissions, and 60% of the net cost for other vehicles and parts must be incurred within the NAFTA area.[24]

6. Investment: Opening the Door

The opinions expressed by the witnesses were on a whole receptive to the investment opportunities a NAFTA would provide. Generally, NAFTA was seen as an equalizer that would "level the playing field", as a means to increase the opening of Mexico's capital markets and corporations. The prompt removal of restrictions to foreign investment in Mexico was the main focus of some testimonies. Removal of restrictions, it was argued, would benefit Mexico's interests as well as those of the U.S. To this end, the American Petroleum Institute, a trade association representing over 250 companies, argued that since Mexico's petroleum sector will be unable to reverse recent declines in its productive capacity, removing restrictions to investment in petroleum could attract capital and technology that would increase productivity. Mexican refineries, it was stated, operated at about 97% capacity during the first quarter of 1991, while one of Mexico's nine refineries was forced to close down for environmental reasons. Declining production combined with growing domestic demand may turn Mexico into an oil importer before the turn of the century. By removing restrictions and attracting investment, the Mexican industry would thus be able to meet growing demand, shift the product mix, and satisfy more stringent environmental standards. Overall, NAFTA was seen by both U.S. and Mexican firms as a means of stabilizing financial markets, "locking in" Mexico's recent macroeconomic adjustments, and ensuring a level of transparency in investment.

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[24]Office of the USTR, The North American Free Trade Agreement, (Washington, DC: September 6, 1992), Chapter 4, Article 403, pp. 4-6 thru 4-10

7. Services: Gaining Access

Under the framework of the NAFTA negotiating groups, transport and financial services were negotiated separately. Views on the restrictiveness of the Mexican market were abundantly represented by varied interests, with the bulk of the testimonies addressing obstacles to U.S. transport access and issues of reciprocity. It was argued that barriers to trade in services produce inefficiencies that hamper the price competitiveness of traded merchandise. The Texas Motor Transportation Association suggested that motor carrier transportation be excluded from NAFTA, if Mexico were to remain unwilling to remove impediments to free access. There have been subsequent efforts at deregulation but foreign nationals are still restricted from operation. The Association also asserted that this was in contrast to U.S. regulations which already allow Mexican trucks to operate in the U.S. within a 25 mile radius.

The North American Committee on Agricultural Trade and the United Fresh Fruit and Vegetable Association, maintaining that their perishable shipments were at a disadvantage under current Mexican statutes, also supported the idea of pressuring Mexico to allow U.S. truckers circulation through Mexico within a designated area.

U.S. banks also expressed concern regarding access to the Mexican market and supported the harmonization of regulations in banking services, to ensure "equal opportunity". In the words of a representative of Citicorp that characterized the perspective of the U.S. banking industry: "They want to be able to branch out and conduct credit card business on an equal footing with Mexican banks".[25]

In a similar vein, U.S. banks voiced interest in expanding ownership of Mexican banks. Under current Mexican law, foreign ownership is limited to 30%, while Mexicans may freely invest in U.S. banks. According to the International Bank of Commerce, Mexican citizens have directly purchased banks in Brownsville, Laredo, and El Paso, Texas and have direct ownership of banks in California.[26]

While such issues are highly sensitive, the USTR generally pressed for the harmonization of regulations and increased access to the Mexican market by services, in the interests of transparency.

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[25]Written testimony by Ford W. Hall, Vice-President, Citicorp (Houston: August 26, 1991)

[26]Other financial issues mentioned included brokerage, insurance, and bonding services. The key concerns were again those of access and harmonization.

8. Intellectual Property Rights: Enforcement

Concerns about intellectual property rights were centered on the ubiquitous question of enforcement. While these rights were mentioned tangentially in most testimonies, witnesses would frequently allude to the weak enforcement mechanisms present in Mexico. One witness in particular, the Industrial Biotechnology Association, used its entire statement to discuss the issue of intellectual property rights. Richard Godown, the president of the company, expressed concern regarding Mexico's recent Industrial Property Protection and Development Law. He gave several specific examples as to how the law failed to provide adequate patent protection for many types of biotechnology inventions. In his concluding statement Mr. Godown expressed hope that NAFTA would make it a priority to improve the Mexican intellectual property law which he said "discriminates against biotechnology intellectual property."[27]

9. Dispute Settlement: The Need for Mediation

One of the few testimonies on this issue was given by Matthew L. Benson, an attorney from the law firm of Evans, Kosut, & Reed. Urging the committee to include a clause in the text providing mediation as a form of dispute settlement, he saw it as the fairest way to settle future disputes. Furthermore, "mediation will encourage trade development between our nations by minimizing the hazards of litigation and arbitration." Stressing his viewpoint that mediation was the easiest and best method of dispute settlement, he said that it "will increase the likelihood of success of the NAFTA agreement overall."[28] Indeed, in the subsequent NAFTA negotiations, the importance of mediation was stressed, as questions of dispute settlements necessarily touch upon sensitive issues of national sovereignty.

10. Environment: Standards and Enforcement

While several industries raised the allegedly lax enforcement of environmental regulations in Mexico as an unfair obstacle to free trade, several environmental groups also insisted on the inclusion of environmental regulations in the agreement. Several environmental groups simply expressed their disgruntlement in general terms. Groups such as the Sierra Club and Friends of the Earth, represented by the umbrella group "Public

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[27]Testimony by Richard Godown, President of the Industrial Biotechnology Association, (Washington, DC: September 3, 1991)

[28]Testimony by Michael Benson, Attorney, Evans, Kosut & Reed (Houston: August 27, 1991)

Citizen", offered no specific critiques or suggestions. Rather these organizations merely expressed their concern for the environment and their opposition to the manner in which the NAFTA was being negotiated.

By contrast, Edward K. Stimpson of the National Wildlife Federation testified on Sept 4 that "under a NAFTA, U.S., Canadians, and other foreign investors will move to Mexico in search of weaker enforcement of environmental rules and regulations."[29] Even so, while offering several criticisms of the NAFTA, the National Wildlife Federation did extend its support for the trade agreement, provided there were some enforcement mechanisms included. Also, the National Resource Defense Council offered its support for the agreement along with numerous specific constructive suggestions regarding the environment.

The environmental movement was, in essence, split down the middle. Some of the groups viewed NAFTA as a possible constructive solution to environmental problems along the border region. Others, namely the Sierra Club, Friends of the Earth, and Public Citizen, completely opposed the agreement. In fact, the latter went as far as to file a lawsuit calling for an Environmental Impact Statement (ESI), which would measure the effects of a free trade agreement on the environment, to be formulated by the administration under the National Environmental Protection Act (NEPA). The subsequent ruling favored these environmental groups, stating that the "NAFTA will have significant environmental effects" and "may worsen the environmental problems already existing in the United States-Mexico border areas."[30] However, this ruling was rejected on appeal.

11. Labor: Disparities in Wage Levels

Labor proved to be a rather contentious issue given the large disparities existing in U.S. and Mexican average wage levels. Particularly, U.S. labor unions were resolute in their vehement opposition to the free trade treaty. At the Boston TPSC meeting, the Massachusetts division of the AFL-CIO provided emotional testimony. The union viewed the proposed NAFTA as a threat to employment in the U.S., citing lower wages and lax enforcement of safety and environmental standards in Mexico as the reason for the "exodus" of jobs to the south. Expressing their concern with worker displacement, they urged the committee to include enforceable health, safety and environmental regulations, and also a "decent trade adjustment assistance program". The deposition presented on behalf of the president of the AFL-CIO offered specific examples of plant closings. In 1992, Foster Grant in Leominster, Massachusetts closed its eyeglass plant. Over 600 jobs were lost to a new plant in Nogales,

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[29]Testimony given by Edward K. Stimpson, the National Wildlife Federation, (Washington, DC: September 4, 1991)

[30]"Judge in a Ruling That Could Delay Trade Pact", The New York Times, July 1, 1993

Mexico. The Raytheon Company in Waltham, Massachusetts, which produces, among other things, the Patriot missile, established two divisions in Tijuana, "costing hundreds" of jobs.[31]

Other groups also stressed the plant closings that resulted from companies shifting operations to Mexico in order to lower production costs. As stated earlier, Libbey Glass alluded to the wage differences existing between the United States and Mexico. The testimony presented by the International Brotherhood of Electrical Workers was based on "what has happened under the Maquiladora program." The union believes that approximately 30,000 jobs in U.S. manufacturing have been lost over the past six years, and that approximately 25,000 of these jobs were lost to Mexico. In addition to these organizations, the United Paperworkers International Union, the Association of Farmworker Opportunity Programs, and the United Automobile, Aerospace, and Agricultural Workers of America also presented testimonies. They all shared a fear of a further erosion of the U.S. job base.

V. CONCLUDING OBSERVATIONS

The TPSC hearings enabled the U.S. Trade Representative to gauge the position to be adopted in the NAFTA negotiations. It is impossible to accurately assess the full impact of the hearings on the USTR position. On the one hand, a careful reading of the NAFTA text to ascertain which points raised at the hearings were included in the text would only give partial evidence of the weight these hearings bore, given that the NAFTA text was the result of a painstaking negotiation process between three sovereign states. On the other hand, the testimonies were distributed to the respective negotiators, depending on the specific issues they addressed. In considering the various case studies, it remains clear that the hearings were instrumental in providing the USTR with an indicator of the level of support or opposition to specific issues that range from phase-out periods to harmonization in financial regulations. Negotiators also became aware of the political context of the NAFTA.

In addition, testimonies given by foreign interests provided U.S. negotiators with information that balanced testimony presented by U.S. private firms. In this sense, all concerned interests have the possibility of participating in a public forum while the U.S. trade position is still in the process of being defined.

As the content of the hearings attest, market access issues are of significant concern to most U.S. firms. Environmental and labor questions, especially with regards to standards and regulations, the groundskeepers of a "levelled playing field", carry a sizable weight in negotiations and assuredly will grow in importance in future free trade agreements. Dispute

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[31]Testimony provided by Joseph C. Faherty, President of the Massachusetts AFL-CIO, (Boston, MA: September 11, 1991)

settlement and enforcement mechanisms will continue to wield attention in future negotiations.

Moreover, the issue-by-issue approach to trade negotiation indicated by these hearings promotes the formation of issue-specific political coalitions. This suggests that governments and private interests may find it beneficial in future trade agreements to build alliances with different interests on a variety of issues. Indeed, these coalitions should be pursued at an initial stage before domestic interests, as well as negotiators, have consolidated their position. As the TPSC hearings suggest, much can be learned with regards to the positions of different interests groups and their role in the formation of the U.S. negotiating position.