THE NORTH AMERICAN FREE TRADE AGREEMENT: A LEGAL ANALYSIS OF EFFECTS AND OPPORTUNITIES

by

Richard H. Steinberg
Morrison & Foerster

Appearing in CORPORATE COUNSEL'S QUARTERLY
April 1994
Published by BUSINESS LAWS, INC., Chesterland, Ohio

CHAPTER 1410

The North American Free Trade Agreement: A Legal Analysis of Effects and Opportunities*

*Richard H. Steinberg***

**Dr. Steinberg practices in the San Francisco office of Morrison & Foerster. He was previously Assistant General Counsel to the U.S. Trade Representative. The views expressed herein are those of the author and are not to be ascribed in any way to Morrison & Foerster or its clients.*

I. General Background on the North American Free Trade Agreement

On December 17, 1992, former Canadian Prime Minister Mulroney, Mexican President Salinas, and former U.S. President Bush signed the North American Free Trade Agreement (NAFTA). President Clinton has begun negotiating 'supplemental" agreements relating to labor and the environment. Most analysts expect that, in late summer of 1993, a bill to implement the NAFTA will be submitted to Congress. Ratifying legislation has passed the Canadian Parliament, and will be submitted to Mexico's legislature. The NAFTA would enter into force after ratification by the legislative branches of all three North American countries./1/

Successful conclusion and ratification of the NAFTA would create the world's largest free trade area, including a market of 360 million people and U.S. $6 trillion in annual production. The agreement will have substantial effects on business in all three countries,/2/ offering new opportunities and requiring new resource allocations./3/ Most of the effects will involve new opportunities in and increased competition from Mexico for U.S. and Canadian businesses, due largely to lower wages in Mexico and the fact that trade between Canada and the United States has already been largely liberalized under the U.S.Canada Free Trade Agreement (FTA).

The NAFTA has the potential to radically alter the way businesses plan and function in each country involved. This chapter, however, focuses on what the NAFTA will mean to businesses in the United States and Canada. In particular, it analyzes the expected effects of the NAFTA in each of seven industrial sectors: energy and natural resources; basic industries; high-tech manufacturers; financial services (banking, securities, insurance); telecommunications; transportation and other services; and agriculture. This chapter also analyzes the NAFTA's likely impact on environmental regulation and opportunities./4/

II. Energy and Natural Resources

A. Oil, Petrochemicals, and Natural Gas

Negotiations in this sector were shaped by U.S. and Canadian demands that Mexico open its oil, petrochemicals, and natural gas markets, a Mexican Constitutional provision forbidding foreign participation in Mexico's oil industry, and the need for an infusion of capital in the Mexican energy sector. The resulting text has eight principal effects on the oil, petrochemicals, and natural gas sectors.

1. Opening of Secondary Petrochemicals Market

While foreign investment in Mexican oil and some basic petrochemicals will be reserved exclusively for Mexican government participation, most basic petrochemicals and all secondary petrochemicals will be opened to foreign investment. Five of the basic petrochemicals for which Mexico may restrict the granting of import and export licenses are: heptane, ethane, hexane, pentane, and butane. Foreign investment in the following primary petrochemicals will be restricted: ethane, propane, butane, pentane, hexane, heptane, naphtha, and raw materials for carbon black. The remainder of primary and secondary petrochemicals, however, will be opened to foreign investment when the NAFTA enters into force.

2. Participation in Oil Exploration

As a service to PEMEX, the Mexican government's oil monopoly, /5/ Canadian and U.S. oil service companies will be allowed to drill Mexican oil fields./6/ Initially, U.S. and Canadian companies will be permitted to bid on up to 50 percent of service contracts of over U.S. $250,000 offered by PEMEX; that figure will rise to 70 percent over eight years, and the restrictions will end after ten years. /7/ While joint ventures and risk-sharing will not be permitted, the United States interprets the agreement to permit performance incentives: drilling in return for a flat service fee plus a bonus if the well produces oil. It is unclear whether foreign oil service companies will be required to use PEMEX union workers.

3. Cross-Border Trade in Natural Gas, Electricity, and Petrochemical Feedstocks

Cross-border trade in natural gas, petrochemical feedstocks, and electricity will be permitted. However, direct sales to end-users in Mexico by U.S. sources will be prohibited: PEMEX will be the purchaser and owner of all natural gas and petrochemical feedstocks the instant they cross the border, and *Comision Federal de Electricidad* (CFE)/8/ will be the purchaser and owner of all electricity the instant it crosses the border. Tariffs on electricity exported from the United States to Mexico will be reduced in stages from the current level of 10 percent to zero over a period of five years./9/ From the outset, however, there will be no duties or controls on U.S. imports of electricity from Mexico, other than those imposed by the Federal Electricity Regulatory Commission (FERC). Most analysts expect these changes to result in a substantial increase in Mexican purchases and use of natural gas in the coming years, but little change in the level of cross-border, bulk utility electricity sales until at least 1996. After 1996, bulk utility electricity sales from the United States to Mexico are expected to increase.

4. Elimination of Duties on Petrochemicals

Duties on petrochemicals will be eliminated over a period ranging from zero to ten years, depending on the product. Duty on many pesticides not currently produced in Mexico will be immediately reduced to zero. Duties on most chemicals will be eliminated over five years at a reduction rate of 20 percent per year. Duties on highly sensitive products will be eliminated over ten years.

5. Rule of Origin for Petrochemicals

Chemicals will have a special rule of origin:/10/ for a chemical to be deemed of North American origin, at least 50 percent of the chemical product's value must be North American.

6. Establishment of Self-Generation Projects

Under the NAFTA, U.S. and Canadian firms will be permitted to acquire, establish, and/or operate an electric generating facility to meet the supply needs of their own operations in Mexico. Such firms must sell excess energy to CFE under mutually agreed-upon terms and conditions. The NAFTA will require CFE to provide nondiscriminatory treatment (the better of national or most-favored-nation (MFN) treatment) to U.S. and Canadian energy companies located in Mexico, when CFE purchases energy or transmission services for commercial resale. In the past, Mexican law has been unclear as to how much participation a foreign co-participant would be allowed in such a project.

7. Establishment of Co-Generation Projects

U.S. or Canadian firms may acquire, establish, and/or operate co-generation projects/ I I/ in Mexico. Such projects must sell all excess energy production to CFE under mutually agreed-upon terms and conditions. Owners of the industrial facility, however, need not be the owners of the co-generation facility.

8. Establishment of U.S. or Canadian Independent Power Producers

Out hundred percent U.S. or Canadian investment in independent power producers (IPPS) on Mexican soil will be permitted./12/ IPPs will be required to sell their output to CFE. However, CFE will be permitted to reject IPPs based on fuel use. In the event an IPP in Mexico and an electric utility of another party consider a cross-border trade in electricity, the entities and CFE have the right to negotiate the terms and conditions of power purchase and power sales agreements./13/ Mexico reserves the exclusive right to generate nuclear energy and will likely mandate special pollution control requirements for coal-fired IPPS.

B. Metals and Mining

The NAFTA will liberalize metals and mining trade and investment in two key respects.

1. Ownership of Mining Operations

The NAFTA will permit direct foreign investment in and ownership of Mexican mining operations,/ 14/ permitting better vertical integration in metals and mining. The agreement achieves liberalization by guaranteeing national treatment for ownership of mining operations. Foreign ownership of Mexican mining operations will be limited initially to 49 percent, but commencing on the sixth year after the NAFTA is in force, foreign investment in the extraction or exploitation of minerals may be 100 percent.

Foreign investment in existing mining or smelting operations is subject to more stringent rules: all such investments will be screened during the first five years of the NAFTA; thereafter the general rules on large investments in Mexico will govern. Specifically, Mexico will review the acquisition of more than 49 percent of the ownership interest of a Mexican enterprise by a Canadian or U.S. investor if the value of the gross assets of the Mexican enterprise is: U.S. $50 million or more in the sixth year of the agreement; U.S. $75 million or more in years seven through nine of the agreement; U.S. $150 million or more in the tenth year of the agreement; and for year eleven forward the threshold will be adjusted for growth in nominal Mexican GDP.

The opportunity for foreign investment in Mexico's mining and smelting operations will be particularly significant for the United States and Canada as Mexico is a leading producer of silver, sulfur, zinc, copper, manganese, coal, and iron ore.

2. Improved Cross-Border Transportation

The NAFTA will streamline and reduce restrictions on cross-border transportation, making it easier and cheaper to transport metals and minerals. For example, three years after signature of the agreement, Mexico will allow U.S. and Canadian truck operators to make crossborder deliveries to, and pick up cargo in, Mexican border states, and the United States will grant Mexican truck operators the same rights. Six years after the agreement goes into effect, Mexico and the United States will provide cross-border access to their entire territories./15/

In addition, the agreement will end government preference pricing to government-owned metals and mining companies and will reduce Mexican tariffs on metals./16/

Mexico will phase out, at the rate of 10 percent per year over ten years, most duties imposed on the sale of semi-finished/finished metal products (e.g., stainless steel rods and bars, woven iron or steel, steel wire rope, or cable) from the United States or Canada.

III. Basic Industries (Including Automobiles and Textiles)

The NAFTA's effects on basic industries will derive largely from new rules of origin and tariff reductions. The NAFTA's textile and automobile rules of origin generally have been constructed strictly and narrowly. The intent is to reduce the extent to which Mexico or Canada can be used as an assembly platform for duty-free export into the United States of products made with non-North American inputs; similarly, tariff levels and rates of tariff reduction will shape business opportunities.

A. Automobiles

1. Tariff Reductions

The United States will immediately eliminate its tariffs on passenger automobiles manufactured in Mexico. With respect to light trucks from Mexico and Canada, the 25 percent U.S. tariff will be immediately cut to 10 percent, then phased out over a period of five years. U.S. tariffs on all other vehicles from Mexico will be eliminated over a ten year period.

Mexico will immediately reduce its tariffs on U.S. and Canadian passenger automobiles by 50 percent and eliminate the remaining tariffs over a period of ten years. Mexico will immediately reduce its tariffs on U.S. and Canadian light trucks by 50 percent and eliminate the remaining tariffs over a five-year period. Mexico will phase out its tariffs on all other U.S. and Canadian vehicles over ten years.

Canada will reduce and eliminate tariffs on Mexican autos on the same schedule as Mexico will follow for imports from Canada and the United States.

2. Eliminating Mexican Nontariff Barriers

Mexican nontariff barriers will be lifted slowly over a ten-year period. Currently, the Mexican automobile market is highly protected by means of three rules, each of which will be relaxed and eliminated.

First, the 1989 Mexican Automobile Decree imposed a 2-to-1 finished vehicle export-to-import ratio (a requirement that has declined to 1.75-to-I in 1993), and a 1-to-I ratio of finished vehicle exports to imported parts. Under the NAFTA, both ratios will be immediately dropped to 0.8-to-1, and then incrementally reduced to 0.55-to-I over 10 years. The export-to-import ratio requirement will be eliminated after ten years.

Second, in addition to the export-to-import ratios, Mexico has sought to increase domestic production by limiting auto imports to a proportion of a manufacturer's total sales in Mexico. This requirement will be immediately eliminated.

Third, there is currently a 36 percent domestic content requirement for vehicles and a 30 percent domestic content requirement for parts made and sold in Mexico. Under the NAFTA, a complex formula will be used to reduce the domestic content requirements. Generally, manufacturers will be required to apply domestic content rules to a "base factor" and a 'growth factor." The "base factor" will equal the average total value of autos produced and sold in Mexico in 1991 and 1992 by each auto manufacturer. The "growth factor" will equal the level of growth in Mexican auto production and sales beyond the "base factor" (i.e., beyond the 1991-92 average). With respect to the base factor, the domestic content requirement will be reduced immediately from 36 percent to 34 percent for five years, phased down to 29 percent by the tenth year, then eliminated thereafter. With respect to the growth factor, the content requirements will apply initially to 65 percent of Mexican market growth, falling incrementally to 50 percent of market growth by the tenth year of the agreement. After ten years, the requirement will be eliminated./17/

3. The NAFTA Automobile Rules of Origin/18/

The origin determination for duty-free treatment within North America will depend on two factors.

First, domestic content will be calculated by tracing the foreign value of a component,/19/ considering the actual foreign value of *each part* according to a "net-cost" method (i.e., excluding royalties, sales promotion, shipping, etc.). Content will be determined on the basis of averaging by model: generally, each company can average the regional content across a model line produced within one country./20/

Second, in order to receive duty-free treatment, 62.5 percent of an automobile, light truck, engine, or transmission will have to be of North American domestic content. All other vehicles and auto parts (other than engines and transmissions) will have to be 60 percent North American./21/ These thresholds will be phased in over eight years.

These changes, along with elimination of the U.S. tariff on regionproduced automobiles, will probably have the effect of increasing sales of U.S. auto parts in North America, reducing sales of foreign auto parts in North America, and replacing some North American sales of Asian-produced automobiles with autos produced by General Motors, Ford, and Chrysler in Mexico.

4. Application of CAFE (Corporate Average Fuel Efficiency) Standards

Under the U.S. Corporate Average Fuel Efficiency (CAFE) regulations, an auto manufacturer's fleet must average a targeted CAFE, or a 'gas guzzler" tax will be assessed on its autos. For purposes of applying CAFE standards, manufacturers are deemed to have two fleets: (a) a domestic fleet, including all cars with at least 75 percent domestic (U.S. - Canadian) content, and (b) a foreign fleet, including all cars with less than 75 percent domestic (U.S.-Canadian) content.

The NAFTA will calculate CAFE standards in different ways in three periods. In the first three years of the NAFTA, it will treat Mexican value-added as foreign content. In years four through ten, the manufacturer may choose whether Mexican value-added is domestic or foreign value. After the tenth year, all Mexican value-added will be considered domestic content.

These rules will permit U.S. automobile manufacturers, in the middle years four through ten, to reduce their potential liability for CAFE assessments by electing to treat Mexican value-added in Mexican-produced small cars as domestic content, thereby reducing their own domestic fleet's CAFE.

5. Net Effect on the Location of Automobile Production

Analysts predict that the net effect of all these changes will be a decrease in Asian production of cars and light trucks bound for North America and an increase in production of small cars and light trucks in Mexico. While analysts disagree over effects on U.S. and Canadian production levels, most predict slight increases in the production of larger cars in the United States and slight decreases in the production of small cars and light trucks in both the United States and Canada.

B. Textiles and Apparel/22/

1. Tariff and Quota Elimination

The United States, Canada, and Mexico will eliminate immediately or phase out over a maximum of ten years their customs duties (with respect to one another) on textile and apparel goods manufactured in North America that meet the strict NAFTA textile rule of origin (qualifying goods)./23/ The rates of tariff elimination vary by product type (yam, fabric, made-up articles, carpets, apparel, and hosiery). Tariffs need not be reduced for most products manufactured in North America that do not meet the NAFTA origin rule (nonqualifying goods).

In addition, the United States will immediately remove import quotas on qualifying textiles (including all qualifying apparel) from Mexico. The United States will gradually phase out import quotas on nonqualifying Mexican textile and apparel goods that meet the normal U.S. rule of origin, "substantial transformation."/24/

2. The NAFRA Textile Rule of Origin

The parties have agreed to a 'yam-forward" rule of origin. /25/ This means that most textiles and apparel goods must be of North American origin, from yam to the end product (yam-forward), in order to receive the full benefits of the NAFTA. In most textile subsectors, there are some exceptions to the yam-forward rule of origin./26/ Nonetheless, the general yarn-forward rule is strict and will temper the increase in imports into the United States that would otherwise result from liberalization.

Significant exceptions to the yam-forward rule are made for certain apparel: man-made fiber sweaters are under a fiber-forward/27/ rule between the United States and Mexico; apparel made from fabrics in short supply in North America (Harris tweed, velveteen, wide wale corduroy, and others), brassieres, silk and linen apparel, and men's dress shirts made from certain specific cotton or cotton and man-made fiber blend fabrics are under a single substantial transformation rule of origin;/28/ and linings are to be of North American origin from the fabric stage forward for tailored clothing and coats,

Another significant exception to the basic rule of origin makes some nonqualifying yam, fabric, and apparel that is made in North America eligible for preferential duty treatment up to agreed annual levels. This is achieved through tariff rate quotas (TRQS) that give preferential access to limited quantities of such products as,. nonqualifying cotton and man-made fiber spun yam (but not sewing thread), fabric, made-up products, and apparel;/29/ nonqualifying wool apparel;/30/ and some nonqualifying hosiery.

3. Safeguards against Damage to Domestic ndustry from Excess Imports

If textile or apparel producers face serious damage as a result of increased imports from another NAFTA country, the importing country may, during the 'transition period," provide temporary relief to the industry by either: (a) increasing tariffs or (b) imposing quotas on imports, provided that the import quotas apply only to trade between Mexico and the United States and the targeted goods are not of North American origin.

4. Net Effects on Apparel and Textiles

Analysts have predicted that the main effects of these rules will be a moderate shift in the production of apparel from the United States to Mexico, a sharp shift in apparel production from Asia to Mexico, and a substantial increase in U.S. sales of textiles bound for apparel production (i.e., labor-intensive cutting and sewing) in Mexico. In short, reduced tariffs and quotas will mean that the U.S. apparel market can take advantage of inexpensive Mexican labor, while the yam-forward rule will mean that Mexican manufacturers will have an incentive to use U.S. yarn to enjoy the benefits of the agreement. The TRQ exceptions will reduce harm to Canadian textile and apparel manufacturers that use yam purchased outside North America, which otherwise might result from the yarn-forward rule.

C. Effects on Other Basic Industries

Analysts have projected that the following U.S. industries will benefit from the NAFTA tariff and nontariff barrier reductions: chemicals; plastics; tooling and machinery; instruments; large-scale baking; cement; transportation equipment; paper; and forest products. Almost all of these benefits will derive from increased access to and growth in the Mexican market.

Projected U.S. industrial sectors that will face greater challenges include: houseware glass; furniture; retail trade; and seamless steel pipe. Most of these effects will result from increased Mexican access to the U.S. market.

For a general discussion of the NAFTA's rules of origin, see Appendix A, below. For a discussion of how the NAFTA will address disputes concerning antidumping and countervailing duty measures, see Appendix B, below.

IV. High-Tech Manufacturers

The NAFTA's effects on high-technology manufacturers derive largely from new rules of origin, reduced intra-regional tariffs, and enhanced protection of intellectual property rights. These changes are likely to have their greatest impact on the semiconductor and computer manufacturing industries and the U.S. and Canadian pharmaceutical industries.

A. Semiconductors

The intellectual property text requires the parties to provide protection to the layout designs of integrated circuits, the equivalent of what is known in the United States as "mask work" protection. The level of protection required in the NAFTA is higher than the level set forth in the provisions of the Washington Treaty./3 I/ The parties have agreed to consider unlawful (unless authorized by the rightholder) the importation, sale, or other distribution for commercial purposes of a protected layout design, an integrated circuit in a protected layout design, or an article incorporating such an integrated circuit.

The NAFTA establishes levels of protection higher than those set forth in the Washington Treaty in three respects. First, while the Washington Treaty provides for only eight years of protection for layout designs and integrated circuits,/32/ the NAFTA requires a ten year term of protection. Second, the NAFTA prohibits compulsory licensing of layout designs. Third, the NAFTA will impose strict rules on the use of infringing chips in cases where the user has been put on notice of infringement./33/

In addition, the NAFTA provides a special rule of origin for semiconductors. Under the general NAFTA transshipment rule, the shipment outside North America of a North American-manufactured product results in the loss of that product's duty-free status in North America. A special exception to that rule was adopted for semiconductors: diffusion of a chip in any NAFTA country will entitle the chip to duty-free status, even if it is shipped outside North America for testing and assembly.

It was also agreed that marks of origin will not be required in North America. While North America will be using a "diffusion" rule of origin for semiconductors diffused in the region *(i.e.,* the rule described in the preceding paragraph), the United States will continue to use an "assembly and test' rule of origin *(i.e.,* a semiconductor is deemed to have originated in the country where it was assembled and tested) for semiconductors diffused outside the region. The EC currently uses a diffusion rule of origin for semiconductors diffused outside Europe. This web of origin rules, which has changed several times in the last decade, could lead to inconsistencies between North America and various non-North American countries in the designation of origin. Thus, the absence of an origin-marking requirement will provide flexibility for North American chip designers and manufacturers to work with this shifting web of origin rules.

Analysts suggest that the combined result of these changes will be to make Mexico a more hospitable location for computer assembly.

B. Computer Hardware and Software

1. Hardware

The negotiators agreed to phase in, over a ten year period, a common external tariff in North America on computers and computer parts, except for printers and CRT monitors, which will have their own rules of origin and will not be subject to a common external tariff./34/ This will effectively create a North American computer customs union. Mexico currently imposes a duty of 20 percent on computers and 5-10 percent on computer parts; the tariff on computers will drop to the U.S. rate of 3.9 percent over 10 years, and the tariff on parts will drop to the U.S. rate of 0 over 5 years.

During the ten-year transition period, computers will be considered of North American origin and eligible for duty-free treatment if the motherboard is of North American origin. After the transition period, all computers assembled in North America will be deemed of North American origin, regardless of the origin of their inputs. These rules may encourage increased assembly of computers in Mexico at the expense of Asian manufacturing sites.

2. Software

The NAFTA's principal effects on computer software will derive from the intellectual property chapter of the agreement. Software protection will be enhanced in three ways.

First, computer programs are to be treated *as "literary* works' *as* defined and protected under the Berne Convention. The parties have also agreed to "confine limitations or exemptions to the rights to certain special cases which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interest of the rightholder.'/35/ U.S. government lawyers have stated that insofar as the intellectual property chapter contains a right to decompilation of computer software, it rests in this provision and the corresponding provision in the Berne Convention.

Second, the parties have agreed to the establishment of rental rights for computer programs, making it clear that the exclusive right of a copyright holder to "use and exploitation' of a copyrighted work includes the right to authorize or prohibit its rental. Currently, Canada does not provide the copyright holder the right to prohibit rentals of sound recordings; Mexico did not provide such a right-for either computer programs or sound recordings prior to enactment of its 1991 Intellectual Property Law.

Third, the NAFTA makes it clear that the right to "use and exploitation" of a copyrighted work includes a right to authorize or prohibit importation,/36/ including importation of pirated copies.

C. Pharmaceuticals

The U.S. pharmaceutical industry won a major victory in the NAFTA: Canada must eliminate its special rules for compulsory licensing of prescription pharmaceuticals./37/ The United States pressed hard for such a change.

In addition, the NAFTA will eliminate pharmaceutical tariffs in Mexico, open Mexican government pharmaceutical procurement contracts to competition from U.S. and Canadian firms, and apply the principle of national treatment to pharmaceutical investments in Canada./38/

D. Biotechnology Patent Protection in Mexico

The NAFTA provides that each party must offer patent protection for microorganisms, and nonbioiogical and microbiological processing for the production of plants or animals, but the parties are not required to offer protection for: (1) "essentially biological processes"/39/ for the production of plants or animals; (2) plants/40/ and animals, other than microorganisms; and (3) any invention the "commercial exploitation" of which will undermine "public order or morality." U.S. negotiators have said that their intention was to exclude from protection "natural means" of biological production, but to include 'mechanical means."

Under the NAFTA's formulation set forth above, the parties will apparently be required to offer protection for DNA transfer to mammalian cells by use of bacteria or viruses (and the resulting cells), human genes that have been manipulated and placed in a foreign vector, and DNA transfer by micro-injection. None of the parties will be required to protect a hybrid animal resulting from DNA transfer by micro-injection,/41/ but Mexican negotiators informally told U.S. negotiators that there may be a way of crafting claims to protect "aspects of the animal."

In addition, under current Mexican law, "genetic material" is-not patentable./42/ Mexican negotiators reportedly told U.S. negotiators that they do not intend to change that law and that they believe the NAFTA's "public morality" exception will permit maintenance of that law. Specifically, the "public morality" portion of the NAFTA provides that if preventing the commercial exploitation of a particular invention is necessary to protect the *ordre public* or morality in its territory, then a party may exclude that invention from patentability. The protection referred to in this provision includes protecting human, animal, or plant life or health or avoiding serious prejudice to nature or the environment, provided that the exclusion is not based solely on the ground that the particular country prohibits commercial exploitation of the subject matter of the patent.

U.S. negotiators have informally said that they do not believe that the NAFTA's "public morality" exception can save the Mexican .genetic material" exclusion, which they argue is at least overly broad, insofar as the NAFTA exception requires a nexus between "morality" and "commercial exploitation" that will not always be present with respect to patented genetic material.

It is expected that a clarification of Mexican biotechnology law will be available when the Mexican Patent Office issues regulations on the subject.

E. Other Effects on High-Tech Industries

Analysts predict that the following U.S. high-tech industries will benefit from the reduction of the tariff and nontariff barriers under the NAFTA: optical instruments; medical technology; high-technology items used in manufacturing; telecommunications equipment; and pollution control equipment.

High-tech industries will also benefit from enhanced patent and copyright rules, reflected in the NAFTA intellectual property chapter.

V. Financial Services: Banking, Securities, and Insurance

A. Banking

The NAFTA negotiations succeeded in securing U.S. and Canadian entry into the Mexican banking system./43/

The NAFTA financial services provisions will permit U.S. and Canadian banks and trust companies to provide retail and specialized banking services upon entry into force of the agreement. During a "transition period" (until January 1, 2000, or six years from the date the agreement enters into force), Mexico will gradually increase the aggregate market share limit on Canadian and U.S. banks from 8 to 15 percent (by capital) *of the Mexican market for banking services*. During the same period, Mexico will apply individual market share caps of 1.5 percent, so that no single U.S. or Canadian institution will be permitted to secure greater than 1.5 percent (by capital) participation in the Mexican banking market. During the transition period, most U.S. banks are expected to focus on short-term lending (one year or less) and retail banking./44/

After the transition period, bank acquisitions will remain subject to reasonable prudential considerations and a 4 percent market share limit on the resulting institution. In addition, the end of the transition period will signal the end of several capital limits imposed on U.S.- and Canadian-held commercial banks. If, however, the sum of the authorized capital of a U.S.- *or Canadian-he)d commercial bank,* measured as a percentage of the aggregate capital of all financial institutions of such type in Mexico, reaches 25 percent for such type of institutions, then Mexico has reserved the right to freeze such aggregate capital percentage at its then-existing level. Mexico may exercise its right to such "safeguard" action only once during the four years following the end of the transition period, and the restriction may last no more than three years.

Moreover, Mexican subsidiaries of Canadian and U.S. entities will be permitted to launch takeover bids for many of Mexico's eighteen banks. Privatization of those banks is now almost complete. High purchase prices have resulted in some financial vulnerability of those banks. Their *need for additional capital may make joint ventures, or* even outright sale of those banks, more attractive.

Under the U.S.-Canada FTA, U.S. individuals and firms are exempt from the nonresident provisions of Canada's "10/25" rules. Under those rules, nonresidents' aggregate acquisitions of more than 25 percent of the shares of a federally regulated Canadian financial institution are prohibited. Under the NAFTA, Mexican firms and individuals will enjoy an extension of this exemption. Mexico and the United States will also be exempt from the Canadian 12 percent asset ceiling that applies to non-North American banks, and Mexican individuals and firms will not require approval of the Canadian Finance Ministry prior to opening multiple branches in Canada.

B. Securities

he NAFTA will also permit Canadian and U.S. securities firms to establish operations in Mexico or to purchase Mexican securities firms. However, until the end of the transition period, no individual U.S. or Canadian securities firm established in Mexico will be permitted to control securities dealers with assets of greater than 4 percent market share (by capital). During the six-year transition period, Mexico will gradually increase the aggregate market share limit on U.S. and Canadian securities firms from 10 to 20 percent (by capital) of the Mexican securities market. Once during a period of four years following the end of the transition period, if U.S. and Canadian aggregate investment in Mexican securities firms reaches 30 percent (by capital), then the Mexican government will have the right to freeze that aggregate capital percentage at its then-existing level.

C. Insurance

The NAFTA will permit three means of increasing access for U.S. and Canadian insurance companies to the insurance market in Mexico.

First, firms that enter into joint ventures with Mexican insurers may increase their foreign equity participation in those ventures in steps from 30 percent in 1994 to 51 percent by 1998, and to 100 percent by the year 2000. Joint venture partners will not be subject to individual or aggregate market share limits.

Second, foreign insurers may establish subsidiaries subject to aggregate limits of 6 percent of market share, gradually increasing to 12 percent in 1999, and subject to market share caps of 1.5 percent. These market share limits will be eliminated on January 1, 2000.

Third, Canadian and U.S. firms that currently have an interest in Mexican insurers may increase their equity participation to I 00 percent by January 1, 1996, or two years following the date the agreement enters into force.

When the agreement goes into effect, intermediate and insurance service companies will be permitted to establish subsidiaries with no ownership or market share limits.

VI. Telecommunications

A. Basic Telecommunications Services

The parties did not agree to open competition for "basic telecommunications services" (i.e., voice telephony and telex services), and the government of Mexico has made it clear that it is unwilling and unable to open its basic telecom market until 1997, at the earliest, in light of the monopoly granted in conjunction with the privatization of Mexico's telecommunications industry. However, the parties reportedly agreed to a provision that would require consultations about opening the Mexican basic telecom market after entry into force of the NAFTA.

B. Other Aspects of Telecommunications

While basic telecom will not be opened under the NAFTA, negotiators have agreed to liberalize other aspects of telecommunications through five central rules.

1. Fair Access to Public Networks

There has been agreement that public service providers must provide to purchasers fair, equitable, and nondiscriminatory access to telecommunications transport networks (public networks). This includes the ability to lease private lines under reasonable conditions of access; to attach terminal or other equipment to public networks; to interconnect private circuits to public networks; to perform switching, signalling, and processing functions; and to use operating protocols of the user's choice. Conditions on access and use may be imposed only if necessary to safeguard the public service responsibilities of network operators or to protect the technical integrity of public networks. However, one such condition on access and use may include restrictions on resale or shared use of public telecommunications transport services, a condition that could hamper the competitiveness of value-added service producers who could otherwise share use or resell any excess not used on their leased line./45/ Nonetheless, these rules of access to public networks should be of great value to providers of "enhanced" or "value-added" telecommunications services (including electronic mail, voicemail, and database retrieval systems), as well as to providers of computer information services and financial services, since Mexico's postal, telegraph, and telecommunications services are currently operated by a government-sanctioned monopoly.

2. Nondiscriminatory Authorization for Enhanced Telecommunications Services

Enhanced telecommunications service providers will also benefit from a rule that each country will ensure that its licensing or authorization procedures for the provision of such telecommunications services are transparent and nondiscriminatory.

3. Limited Regulation of Enhanced Telecommunications Services

Enhanced telecom providers of the three NAFTA countries will not be subject to obligations normally imposed on basic telecom providers, such as cost-justifying their rates. In addition, Mexico will permit 100 percent ownership to investors of another party in an enterprise established or to be established in Mexico that provides enhanced or valued-added services, but only 49 percent ownership in an enterprise that provides videotext or enhanced packet switching services.

4. Harmonization of Technical Standards

There is agreement to harmonize and discipline certain technical standards relating to telecommunications. Each NAFTA country must establish procedures for the acceptance of equipment test results conducted in other NAFTA countries. Measures imposed on the attachment of telecommunications equipment to public networks must be necessary to prevent technical damage to, or interference with, public networks and services, to prevent billing equipment malfunctions or to ensure user safety and access.

5. Public Information about Public Network Specifications

The NAFTA requires public network and service operators to make public any information affecting access and use of their network and services, including specification of network and service technical interfaces, conditions for the attachment of terminal or other equipment, and notification, permit, registration, or licensing requirements.

C. Cable Retransmission

Compulsory licenses for cable retransmission of television broadcasts are not currently available under Mexican law. The United States and Canada sought to establish such a compulsory licensing system, but the final text does not contain a provision on the subject.

D. Required Changes in Domestic Law of the United States, Canada, and Mexico

The NAFTA will not require any major changes in U.S. or Canadian telecommunications law. In both countries, there may have to be relatively minor changes in regulations or laws to ensure greater transparency of information affecting access and use of public networks and acceptance of equipment test results conducted in other NAFTA countries.

Mexican laws and regulations will undergo substantial changes to comply with the NAFTA provisions described above.

VII. Land Transportation and Other Service Sectors

A. Trucking and Bus Services

Currently, U.S. trucking firms and U.S. bus companies are largely prevented from operating in Mexico, but the NAFTA negotiations have succeeded in liberalizing those markets. Liberalization will occur in several stages.

When the NAFTA goes into effect, the United States will grant full access for Mexican charter and tour bus operators to the U.S. crossborder market. Mexico will grant equivalent rights to U.S. and Canadian charter and tour bus operators./46/ Canada will continue to permit U.S. and Mexican truck and bus operators to obtain operating authority in Canada on a national treatment basis. Three years after the NAFTA goes into effect, the United States will permit Mexican bus firms to begin scheduled cross-border bus service to or from any part of the United States; Mexico will provide the same treatment to U.S. and Canadian bus companies.

Three years after the NAFTA enters into force, Mexico will allow U.S. and Canadian truck operators to make cross-border deliveries to, and pick up cargo in, Mexican border states, and the United States will grant Mexican truck operators the same rights. At the same time, Mexico will allow 49 percent Canadian and U.S. investment in bus companies and in truck companies providing international cargo services (including point-to-point services within Mexico). The United States and Canada will permit Mexican truck companies to distribute international cargo as well. The United States will maintain its ban on grants of operating authority for truck carriage of domestic cargo and for domestic passenger service.

Six years after the agreement goes into effect, Mexico and the States will provide cross-border trucking access to their entire territories.

Seven years after the NAFTA goes into effect, Mexico will allow 51 percent Canadian and U.S. investment in Mexican bus companies and in Mexican truck companies providing international cargo services. The United States will simultaneously lift its ban on domestic operating authority for Mexican bus companies.

Ten years after the NAFTA goes into effect, Mexico will permit 100 percent investment in truck and bus companies in Mexico. No NAFTA country will be required to remove restrictions on truck carriage of domestic cargo.

In addition, there have been several understandings reached in the course of negotiating the NAFTA, some of which have been embodied in texts other than the NAFTA itself. In June 1991, in anticipation of the NAFTA, the Mexican government announced plans to open its roads to private truck and bus operators and to simplify its transport regulations. In addition, Mexico has agreed to develop hazardous materials transport rules modeled after U.N. recommendations and U.S. and Canadian regulations. In return, the United States has reportedly agreed to preempt California's tough licensing regulations for commercial drivers, giving reciprocity to Mexican-issued commercial driver licenses (CDLS) in place of nonresident CDLs previously issued by the state of California.

B. Port Services

Mexico will immediately allow 100 percent U.S. and Canadian investment in, and operation of, port facilities, such as cranes, piers, terminals, and stevedoring companies, for enterprises that handle their own cargo. For enterprises handling other companies' cargo, 100 percent U.S. and Canadian ownership will be allowed after screening by the Mexican Foreign Investment Commission.

In addition, the NAFTA is expected to be a boon to the ports of San Diego and Los Angeles/Long Beach.

C. Other Services

The NAFTA will also result in unhindered U.S. access to the Mexican markets for environmental clean-up services,/47/ oil service contracts,/48/ and construction contracts, and greater Mexican access to U.S. service industries near the U.S.-Mexican border.

In contrast, investment in and access to the television, radio, newspaper, and publishing industries will be limited, pursuant to a "cultural industries" exemption carried over from the U.S.-Canada Free Trade Agreement.

VIII. Agriculture

A. Projected Effects of Tariff and Nontariff Barrier Elimination

The NAFTA effectively contains three bilateral understandings on agriculture. Agricultural trade between Canada and the United States will be governed by the relevant sections of the U.S.-Canada Free Trade Agreement (FTA), which have been incorporated into the NAFTA. Trade between Canada and Mexico will be governed by another schedule in the NAFTA, and trade between the United States and Mexico will be governed by still a third schedule. The discussion below will focus on how the NAFTA will affect U.S.-Mexico bilateral agricultural trade.

The NAFTA will gradually open the relatively large and highly protected Mexican agricultural market to U.S. producers. It also will open the U.S. agricultural market to Mexico, including some U.S. sectors that will be highly vulnerable to Mexican competition. Currently most U.S.-Mexican trade is affected by a combination of tariff and nontariff barriers (NTBs).

When the NAFTA goes into effect, Mexico and the United States will immediately eliminate NTBs to their bilateral agricultural trade; most of those NTBs will be converted to a tariff rate quota (TRQ), but some will be converted to simple tariffs (tariffication). For those products subject to a TRQ,/49/ a specified quantity (based on recent average trade levels between the United States and Mexico) will generally be permitted to enter duty free. This quantity will grow generally at 3 percent per year, but the precise growth rates will vary product by product. Generally, the overquota duty will be initially prohibitive, but will progressively decline to zero during either a ten year or fifteen-year transition period, depending on the product./50/

For those products currently subject only to a tariff (i.e.,--not currently subject to an NTB), the tariffs will either be eliminated immediately,/51/ phased out,/52/ or replaced by a TRQ. The tariffs resulting from tariffication of NTBs will also be phased out.

The phase-out period for products that will be subject to a simple tariff will vary by product. Tariffs on most of these products/53/ will be eliminated over a ten-year period. During this ten-year period, those tariffs generally will fall by 24 percent over the first six years, then decline to zero along a straight line in the remaining four years.

U.S.-Mexican trade in products subject to a tariff (i.e., not those subject to a TRQ) may be limited in the first ten years of the NAFTA by a special safeguard provision./54/ If the level of imports of a product subject to a tariff exceeds a specified "trigger" level,/55/ those imports will be subject to the lower of the MFN rate (to which all non-North American products are subject) or the tariff rate in effect when the NAFTA went into effect. Once used, a safeguard may remain in place only temporarily.

The NAFTA provides only precatory language pertaining to the reduction of domestic price support programs and export subsidies.

Agricultural tariff liberalization is expected generally to hurt U.S. and Canadian producers of labor-intensive *agricultural products, but to* benefit U.S. and Canadian producers of agricultural products with high economies of scale. U.S. products with increased opportunities and those which would face increased competition include the following./56/

- ***Major opportunities for U.S. and Canadian companies:*** Corn, soybeans, wheat, tobacco, dairy products, and sorghum.

- ***Opportunities for U.S. and Canadian Companies:*** Cattle breeders, feeders, and slaughterers; beef packers and processors; and deciduous fruits (apples, pears, peaches).

- ***Increased Competition from Mexican Producers:*** Citrus, melons, cucumbers, broccoli, onions, asparagus, frozen vegetables, and avocados.

- ***Greatly Increased Competition from Mexican Producers:*** Sugar, tomatoes, and lettuce.

B. Sanitary and Phytosanitary Measures

Four basic rules related to sanitary and phytosanitary (S&P) measures are contemplated in the NAFTA. First, use of S&P measures that conform to international standards, guidelines, or recommendations will be deemed consistent with the rules of the NAFTA.

Second, all other measures must be based on scientific principles and not arbitrarily or unjustifiably discriminatory between contracting parties.

Third, S&P measures must not be applied in a manner that would constitute a disguised restriction on international trade, and may be applied only to the extent necessary to protect human, animal, or plant life or health.

Fourth, the parties may agree to accept the S&P measures of other parties as equivalent, even if those measures differ from their own, *i.e.,* if the exporting party objectively demonstrates to the importing party that its measures achieve the importing party's level of protection.

Generally, existing U.S. Food and Drug Administration (FDA) and Environmental Protection Agency (EPA) rules for establishing pesticide tolerances would continue. Nonetheless, this aspect of the NAFTA has been subject to broad attack by envirorunental and consumer groups in the United States./571

C. Plant Variety Protection

The NAFTA negotiations have resulted in Mexican agreement to offer intellectual property protection for new varieties of plants. U.S. pressure on the Mexican goverinnent resulted in an August 1991 change to Mexico's patent law, permitting Mexican patent protection for new varieties of plants. However, applications for patents under that law were not accepted until late 1992, and the Mexican government has just recently begun to process and evaluate those applications.

The NAFTA ensures that Mexico will comply with the International Convention for the Protection of New Varieties and Plants (UPOV), 1978 or later text, 'as soon as possible" and "shall do so within two years of signature' of the NAFTA. Upon entry into force of the NAFTA, Mexico must accept applications from plant breeders for all plant genera and species and must grant protection promptly thereafter. In addition, insofar as Mexico chooses to limit UPOV-type protection according to manner of reproduction *(i.e.,* grant UPOV protection only to asexually reproduced plants), it must still protect all plant varieties (including sexually reproduced plants) by "an effective *sui generis* regime. "

IX. Environmental Regulations and Opportunities

A. Maintenance and Toughening of Environmental Standards for New or Expanded Facilities

The linkage of environmental issues and trade in the NAFTA indicates that adoption of the NAFTA should lead to the adoption and enforcement of stricter environmental controls in Mexico. Moreover, the United States and Canada will not want their companies to be at a competitive environmental disadvantage with companies operating in Mexico. U.S. environmentalists will likely continue to exert political pressure through the U.S. Congress to require Mexico to increase its environmental protection efforts in exchange for more favorable trade terms. With these concerns and pressures in mind, President Clinton has instructed the U.S. Trade Representative to negotiate an environmental agreement to supplement the NAFTA. Those negotiations are underway.

Consequently, companies operating, or planning to operate, in Mexico will have to pay closer attention to the emerging strict environmental standards and enhanced enforcement efforts in -Mexico. Companies operating in Mexico may need to undertake current planning to develop programs and controls to comply with the emerging new standards. They should know that Mexico's environmental standards may come to be more in line with U.S. requirements after the adoption of the NAFTA.

The NAFTA text negotiated by the Bush administration ensures that environmental standards will be maintained or toughened through three sets of rules.

1. Each Country May Maintain Nondiscriminatory Environmental Standards

The NAFTA ensures that each signatory may generally establish and maintain its own environmental, human, plant, and animal health standards, subject only to rules intended to ensure that such measures are not adopted discriminatorily. Thus, for example, the NAFTA provisions on sanitary and phytosanitary measures permit the U.S. EPA and FDA to continue present practices and regulations./58/ Similarly, the text reflects that subnational governments may establish and maintain their own environmental goals and standards.

2. Mexico Will Adhere to International Environmental Conventions

The agreement confirms that Mexico will adhere to several international agreements to which it is already a signatory, including the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal (1989),/59/ the Montreal Protocol on Substances that Deplete the Ozone Layer (1987),/60/ and the Convention on International Trade in Endangered Species of Wild Fauna and Flora (1973)./61/ Moreover, each party has the explicit right to enforce trade restrictions in those agreements.

3. Joint U.S.-Mexico Border Cleanup Plan

In the context of the NAFTA, the United States and Mexico have adopted a border cleanup plan to which the United States committed U.S. $379 million for the first two years and Mexico committed U.S. $466 million for the first three years. These cleanup operations will undoubtedly present opportunities for U.S. firms specializing in environmental cleanup activities.

B. New Environmental Opportunities in Mexico

Mexico's recent sustained economic growth, its expected additional growth and expansion after the adoption of the NAFTA, and its enhanced commitment to enforcing its environmental regulations and controlling pollution within its boundaries will increase opportunities for U.S. and Canadian providers of envirorunental cleanup services.

One of the best opportunities for investors in Mexico is marketing pollution control equipment and services. Mexico's pollution control market is estimated at nearly U.S. $250 million per year by the U.S. Commerce Department.

International sources of funding are earmarked for enhanced Mexican environmental protection efforts and will further fuel the growth in Mexico's pollution control market. The World Bank currently has proposed loans to Mexico in the amounts of U.S. $40 million (to increase the government's capacity to implement environmental protection and to strengthen its enforcement efforts) and U.S. $200 million (to assist in developing a comprehensive program for the control of air pollution in Mexico City).

Several major sewage and collection treatment systems are scheduled to be built in the next few years along the U.S. -Mexico border, many as part of the border cleanup plan described above, and as a result tremendous opportunities exist for providers of water treatment equipment and services.

Further areas of investment opportunities in Mexico's environmental sector are related to the *maquiladora* industry. These assembly and manufacturing plants along the U.S.-Mexico border have accounted for severe degradation of the border area environment.

Enhanced regulation and enforcement efforts provide increased opportunities for equipment and service providers in the management of waste, the control of hazardous waste, and the development of water treatment facilities. Existing *maquiladora* facilities may also have to be upgraded with enhanced pollution control equipment. Any new manufacturing facilities in Mexico may also have to be equipped with enhanced pollution control equipment.

Three sets of the NAFTA rules ensure that U.S. and Canadian environmental cleanup firms will be able to compete for the large and growing Mexican market for such services.

1. National Treatment for Cleanup Firms

The NAFTA provides national treatment for U.S. and Canadian environmental engineering, hazardous and municipal waste management, and treatment service firms. This means that such providers will be subject to Mexican rules and regulations on terms no less favorable than those applied to Mexican providers.

2. Opening of Mexican Government Procurement for Such Services

The NAFTA provides for the elimination of Mexican restrictions on bidding by U.S. and Canadian entities for Mexican government-funded environmental cleanup contracts. This is of particular significance since much of Mexico's environmental needs lie in the development of the public infrastructure, such as drinking water, sewage treatment, and solid waste disposal facilities.

3. Decreased Mexican Tariffs on Importation of U.S. Pollution Control Equipment

The NAFTA provides for the phased, and for a few immediate items, elimination of tariffs on U.S.- and Canadian-produced pollution control and cleanup equipment./62/ Such tariffs currently range from 10 to as high as 20 percent, depending on the product.

X. Prospects for Completion and Ratification of the NAFTA

Negotiation of the NAFTA text is complete, and the leaders of Canada, Mexico, and the United States signed the NAFTA in December 1992. The parties are now negotiating supplemental texts concerning the environment and labor.

The legislative branches in the United States, Mexico, and Canada are required to approve the NAFTA before it enters into force. The Canadian parliament has already approved the pact. Mexican ratification is very likely. In the United States, the NAFTA has been strongly opposed by many labor unions and some environmental groups, and President Clinton has stated his intention to first negotiate the supplementary agreements concerning labor and the environment. If the negotiation of those supplementary agreements is successful, then the NAFTA will enjoy President Clinton's full support and ratification in the United States will likely occur.

APPENDIX A

RULES OF ORIGIN/64/

Purpose of the Rules of Origin

Rules of origin are necessary to define which goods are eligible for the NAFTA's preferential tariff treatment for intra-North American trade.

The stated purposes of rules of origin are: (1) to ensure that the NAFTA benefits are accorded only to goods produced in the North American region - not to goods made wholly or in large part in other countries; (2) to provide clear rules and predictable results; and (3) to minimize administrative burdens for exporters, importers, and producers trading under the NAFTA.

The NAFTA Rules of Origin

The NAFTA rules of origin specify that goods originate in North America if they are wholly North American. Goods containing nonregional materials are also considered to be North American if the nonregional materials are sufficiently transformed in the NAFTA region so as to undergo a change in tariff chapter. Certain products may also be required to include a specified percentage of North American content in addition to meeting the change in tariff chapter classification requirement. The rules of origin chapter of the NAFTA also contains a provision, similar to one in the U.S.-Canada FTA, that allows goods to be treated as originating in North America when the finished product is specifically named in the same tariff subheading as its parts and meets the required value content test.

A *de minimis* rule prevents goods from losing eligibility for preference solely because they contain minimal amounts of "nonoriginating" material. Under this rule, a product that would otherwise fail to meet a specific rule of origin will, nonetheless, be considered to be North American if the value of non-NAFTA materials comprises no more than 7 percent of the price or total cost of the product.

Calculating Regional Value Content

As noted above, certain products may also be required to include a certain amount of North American content. Regional value content may be calculated under the NAFTA using either the "transaction-value" or the "net-cost" method. The transaction-value method is based on the price paid or payable for a product; this avoids the need for complex cost accounting systems. The net-cost method is based on the total cost of the product less the costs of royalties, sales promotion, and packing and shipping. Additionally, the net-cost method sets a limitation on allowable interest. Although producers generally have the option to use either method, the net-cost method must be used where the transaction value is not acceptable under the GATT Customs Valuation Code, and must also be used for various specified products, such as automotive goods.

APPENDIX B/65/

REVIEW OF ANTIDUMPIN('Y AND COUNTERVAILING DUTY MATTERS

The NAFTA establishes a mechanism for independent binational panels to review final antidumping (AD) and countervailing duty (CVD) determinations by administrative authorities in each country. Each country will make those changes to its law necessary to ensure effective panel review. The NAFTA also sets out procedures for panel review of future amendments to each country's AD and CVD laws. In addition, it establishes an "extraordinary challenge" procedure to deal with allegations that certain actions may have affected a panel's decision in the panel review process. Finally, the NAFTA creates a safeguard mechanism designed to remedy instances in which application of a country's domestic law undermines the functioning of the panel process.

Panel Process

Binational panels will substitute for domestic judicial review in cases in which either the importing or the exporting country seeks panel review of a determination based on a request by a person entitled to judicial review of that determination under the domestic law of the importing country.

Each panel will be comprised of five qualified individuals from the countries involved, drawn from a roster maintained by the three countries. Each country involved will select two panelists, with a fifth selected by agreement of those countries or, in the absence of agreement, the parties shall decide by lot which of them shall select the fifth panelist from the roster.

A panel must apply the domestic law of the importing country in reviewing AD or CVD determinations. The three countries will develop rules of procedure for panels. The panel will either uphold the determination or remand it to the administrative authority for action not inconsistent with the panel's decision. Panel decisions will be binding with respect to the particular matter between the parties before the panel.

Retention of AD and CVD Laws

The NAFTA explicitly preserves the right of each country to retain its AD and CVD laws. The agreement, however, *requires the countries* to make changes to their domestic laws to the extent necessary to ensure effective panel review. After the NAFTA takes effect, each country may amend its AD and CVD laws. Any such amendment, to the extent it applies to imports from another NAFTA country, may be subject to panel review for inconsistency with the object and purpose of the agreement, the GATT, or the relevant GATT Codes. If a panel finds such an inconsistency, and consultations fail to resolve the matter, the country that requested the review may take comparable legislative or administrative action or may terminate the agreement with regard to the amending party.

Extraordinary Challenge Procedure

The NAFTA also provides for an extraordinary *challenge procedure* and establishes certain grounds for invoking this procedure. Following a panel decision, either of the countries involved may request the establishment of a three-person extraordinary challenge committee, comprised of federal judges or former federal judges from those countries. If it determines that one of the grounds for the extraordinary challenge has been met, it will vacate the original panel decision or remand it to the original panel for action not inconsistent with the conimittee's decision. If the original decision is vacated, a new panel will be established.

Special Committee to Safeguard the Panel Process

The NAFTA provides a safeguard mechanism to ensure that the panel process functions as intended, A NAFTA country may request a "special committee" to determine if the application of another country's-domestic law has: (1) prevented the establishment of a panel; (2) prevented a panel from rendering a final decision; (3) prevented the implementation of a panel's decision or denied it binding force and effect; or (4) failed to provide opportunity for judicial review of the basis for the disputed administrative determination by an independent court applying the standards set out in the country's domestic law.

If the special committee makes an affirmative finding on any of these grounds, the countries involved will attempt to resolve the matter in the light of this special committee's finding. If they are unable to do so, the complaining party may suspend the binational panel system with respect to the other country or may suspend other benefits under the agreement. If the complaining country suspends the panel system, the country complained against may take reciprocal action. Unless the countries involved resolve the matter, or unless the country complained against demonstrates to the special committee that it has taken the necessary corrective action, any suspension of benefits may remain in effect.

ENDNOTES

/1/ For a brief analysis of the prospects for ratification, *see* "Prospects for Completion and Ratification," at X.

/2/ Its effects on some sectors may be different from those projected if the Uruguay Round of trade negotiations is successfully concluded and implemented.

/3/ The Bush administration estimated that the NAFTA will result in a net addition of 170,000 U.S. jobs over the next ten years. Some academic economists project that the NAFTA will result in a net increase of between 100,000 and 220,000 U.S. jobs over the next ten years. Some labor unions estimate that the NAFTA will result in a net loss of up to 500,000 jobs over the next ten years.

/4/ This chapter has been drafted to provide general information on a significant current development involving commercial and international trade law. Because of the generality of this discussion, readers are cautioned to seek specific legal advice based on detailed analyses of particular facts and situations before acting upon information presented herein.

/5/ PEMEX has a monopoly in oil, natural gas, and basic petrochemical production and distribution in Mexico and is controlled by the government of Mexico.

/6/ Moreover, there will be a phased elimination of Mexican tariffs that now effectively assess oil service industry equipment and supplies at a tariff rate as high as 20 percent. Tariffs on about half of all oil field and gas field equipment tariff lines will be immediately eliminated. Tariffs on other pieces of oil field and gas field machinery will be phased out in equal annual percentages over five or ten years *(e.g.,* tariffs on lifting and handling machinery will be phased out at 20 percent a year over five years and tariffs on rock drills and earth bore tools will be phased out at 10 percent a year for ten years).

/7/ Because PEMEX could comply with that requirement by concentrating open procurement bidding in a small number of sectors, the agreement will also provide that no more than 10 percent of the general target percentage may be applied within a single Federal Supply Classification.

/8/ CFE has a monopoly on the supply and transmission of electricity in Mexico and is controlled by the government of Mexico.

/9/ PEMEX and CFE will be required to act in an increasingly nondiscriminatory manner in their procurement decisions: initially, 50 percent of PEMEX and CFE contracts will be set aside exclusively for Mexican firms, declining to 30 percent after eight years, and to zero at the end of ten years.

/10/ The general rule of origin under the NAFTA is that a product is deemed to be of North American origin if North American processing or other activities result in a change of the product's Harmonized Tariff System (HTS) number. For more information on the NAFTA's rules of origin, *see* Appendix A.

/11/ A "co-generation project" is a factory or other operation that yields energy output, some of which is usually consumed by the factory or operation and the excess of which may be sold to other users or distributors.

/12/ Unlike co-generation projects, these independent power production facilities do not require any tie to an industrial facility or thermal use.

/13/ Currently, most U.S. power project developers in Mexico operate under "BLT" arrangements, whereby they build, lease, and transfer ownership of power plants to CFE.

/14/ Currently, while direct foreign investment in Mexican mining operations is restricted or prohibited, existing Mexican legal vehicles may be used to effectively permit foreign investment in some cases.

/15/ *See generally* "Land Transportation and Other Service Sectors," at vii.

/16/ For example, the Mexican tariff on copper is currently 10 percent, whereas the U.S. tariff on copper is 4 percent. As tariffs are reduced, U.S. producers and suppliers of copper should find enhanced business opportunities in Mexico.

/17/ More precisely, under the formula, in the first five years, domestic content for each manufacturer must equal .34 multiplied by the greater of: (1991 and 1992 average of value of that manufacturer's Mexican produced cars sold in Mexico + [.65 x (total value of cars produced and sold in Mexico by that manufacturer - 1991 and 1992 average of value of that manufacturer's Mexican-produced cars sold in Mexico)]); or (total sales of that manufacturer's Mexican-produced autos in Mexico + exports-imports).

/18/ For a general discussion of the NAFRA rules of origin, see Appendix A.

/19/ Under the current U.S.-Canada FTA, companies "roll up" the value of a component, counting the part as 100 percent regional if its regional value exceeds 50 percent. The "roll up" approach will be abandoned under the NAFTA.

/20/ However, for purposes of entry into the United States at the preferential rates, vehicles produced at the CAMI joint venture plant in Ingersoll, Ontario (Geo Metro and Tracker models) may be averaged with the rest of GM Canada's production within a specific class of vehicles, whether passenger cars or light trucks. This exceptional rule for CAMI will not be used by Mexico; thus, CAMI vehicles may not be shipped to Mexico at preferential rates under the rules.

/21/ The current U.S.-Canada FTA provides for a 50 percent domestic content requirement. Canada wanted to maintain that requirement, while the United States wanted it raised to 65 percent. The tracing requirement and use of a "net-cost" calculation in determining origin will effectively add approximately 2.5 percent to the origin calculation. Thus, the 62.5 percent figure represents a real increase of approximately 10 percent in the origin requirement.

/22/ This analysis of the NAFTA's effects on the textiles and apparel industry is based partly on a document issued by the Chief Textile Negotiator at the office of the U.S. Trade Representative which has authorized its distribution and republication. See "Textiles and Apparel in the North American Free Trade Agreement," August 11, 1992.

/23/ More precisely, with respect to apparel: Mexico's duties on 97 percent of U.S. apparel exports will be eliminated after five years for the NAFTA-qualifying products. United States duties on 99 percent of Mexico's exports of apparel will be eliminated after five years for the NAFTA-qualifying products, including all "special regime" trade. Duties will be eliminated immediately between the United States and Mexico on key items of export interest for U.S. producers such as tee shirts, sweat shirts, man-made fiber jogging suits, and swimwear. Duties on all apparel trade between the United States and Canada will be eliminated on January 1, 1998 (as set out in the U.S.-Canada Free Trade Agreement).

/24/ With respect to apparel, all import quotas on nonqualifying apparel from Mexico will be eliminated after the sixth year, except for mens' and boys' wool suits and suit coats, which will be eliminated after ten years.

/25/ For a general discussion of the NAFTA rules of origin in areas other than textiles, *see* Appendix A.

/26/ Many of these exceptions were insisted upon by Canada, which said that it could not otherwise agree to a yarn-forward principle. Canada objected to the yam-forward principle because it would limit Canadian access to the U.S. market and open up the bottom end of the Canadian market to Mexican commodity goods. Canada is particularly sensitive on this issue because of the importance of the apparel industry in Quebec in the midst of Canada's on-going Constitutional tension.

/27/ Fiber, not merely the yarn, must originate within a NAFTA country.

/28/ Apparel must be cut or knit to shape and sewn, or otherwise assembled, in a NAFTA country.

/29/ Exceptions are apparel made from blue denim, oxford cloth, and cotton and man-made fiber circular knit fabric under 100 metric yam number, which will not be allowed access to U.S. and Mexican TRQS. Thus, apparel made from these fabrics woven or knit outside the United States, Canada, and Mexico, or incorporating non-NAFTA yarns, must pay full MFN duties.

/30/ Canada received a 1 percent larger wool-apparel TRQ than it currently enjoys for access to the U.S. market, plus I percent annual growth of that TRQ in the first five years of the agreement.

/31/ Formally, the Treaty on Intellectual Property in Respect of Integrated Circuits, done in Washington and opened for signature on May 26, 1989, 28 I.L.M. 1477 (1989).

/32/ *See* Articles 2(i), 2(ii), and 8 of the Washington Treaty. Article 3(l)(c) of the Washington Treaty permits contracting parties to elect to limit *the protection afforded by* their *laws to semiconductor integrated* circuits.

/33/ Mexico must make every effort to implement these requirements as soon as possible, but no later than four years after the date the NAFTA enters into force.

/34/ Until near the end of the NAFTA negotiations, the United States was not pressing for a common external tariff and instead was seeking a new rule of origin whereby North American origin would be designated if: (1) two of three critical components (motherboard, flat panel display, hard disk drive) are of North American origin, or (2) foreign parts constitute 40 percent or less of the computer's sales price. Under the current U.S.-Canada FTA, a computer imported into the United States from Canada receives duty-free treatment if it contains a motherboard made in either the United States or Canada. U.S. display and hard-drive manufacturers sought to change this rule of origin for NAFTA purposes, arguing that motherboards no longer constitute as much of the value of a computer as they did when the United States was negotiating the U.S.-Canada FTA; they represented that motherboards now constitute typically only 18 percent of a computer's value. IBM and eleven of the largest U.S. computer manufacturers vehemently opposed any change in the rule of origin, arguing that motherboards still constitute 40-60 percent of a computer's value. The U.S. Department of the Treasury originally accepted the arguments of the display and hard-drive makers. Eventually, however, *the U.S. government* withdrew its proposal in the face of active lobbying by IBM and others, opting instead to support a transition to a common external tariff on computer parts and computers, and to continue basing origin determinations for intra-North American computer trade during the transition on the origin of the motherboard.

/35/ This mirrors language in the Reme Convention.

/36/ The agreement is silent on the question of parallel importation. For NAFTA purposes, "parallel importation" occurs when a rightholder has authorized the sale of a product in a third country, and that product is exported from the third country to a country that is a party to the NAFTA.

/37/ Under Canada's existing rules, a foreign pharmaceutical patent-holder must license a Canadian manufacturer to produce the patented pharmaceutical if that patent-holder is not selling, distributing, or manufacturing the patented pharmaceutical in Canada.

/38/ While not part of the NAFTA, Mexico's 1991 Intellectual Property Law (which was enacted in an effort to allay U.S. government concerns, begin the transition to the NAFTA regime, and attract transfer of technology to Mexico) extended the term on all patents (including pharmaceuticals) to twenty years from the date of filing and provided an additional three-year extension for all pharmaceutical patents licensed to a Mexican company within ten years of the beginning of the patent term,

/39/ This language is identical to that in the GATT TRIPs text and the European Patent Convention.

/40/ However, plant variety protection will be required under the NAFTA. *See* "Plant Variety Protection," at VIII.

/41/ Such as the "Harvard Mouse."

/42/ This suggests that Mexico will not patent DNA sequences or segments.

/43/ New regulations in late 1990 and 1991 allowed limited foreign participation in Mexico's banking system. However, aggregate foreign ownership of each individual bank has been limited to 30 percent, with no shareholder rights, and no single foreign investor could hold more than 5 percent ownership. U.S. bankers, especially those in the Southwest and Florida, pressured the U.S. government to demand reduced barriers to the establishment of banking facilities in Mexico; the removal of Mexican restrictions on foreign ownership and control; national treatment in cross-border banking; and reciprocity.

/44/ One money center bank has indicated it will focus on expanding commercial lending and establishing a securities business. Another leading bank has indicated it will focus on taking deposits and lending in pesos, and in corporate lending, as well as continuing cross-border lending in dollars. Still a third major bank, based on the East Coast, has suggested it will focus on investment banking, helping Mexican corporations obtain access to foreign capital markets to finance mergers and acquisitions, both domestically and with foreign companies.

/45/ Other conditions on access and use may include requirements to use specified technical interfaces with public networks or services and restrictions on the interconnection of private circuits to provide public networks or services.

/46/ Canadian truck and bus companies are not subject to the existing U.S. moratorium affecting Mexico.

/47/ See "Environmental Regulations and Opportunities," at IX.

/48/ *See* 'Energy and Natural Resources," at II.

/49/ This will include all U.S. imports of products now subject to 22 quotas (such as sugar and peanuts) and orange juice. It will also include Mexican imports of products currently subject to import licenses, such as corn, dried beans, and nonfat dried milk.

/50/ For example, frozen concentrate orange juice will be subject to an inquota tariff rate of 50 percent of the MFN rate; the over-quota rate on frozen orange juice concentrate will start out at the MFN rate and be eliminated over fifteen years, The quota amount of frozen concentrate orange juice will be initially 40 million gallons. It is important to note that the precise in-quota and over-quota tariff rates will vary product by product.

/51/ Examples include Mexican imports of grapes from October 15 to May 31, and *millet. Nearly* half of the U.S.-Mexico bilateral agricultural trade will be duty free when the NAFTA goes into effect. This high proportion of duty-free trade is largely attributable to the fact that many agricultural products are now entering the United States from Mexico under the Generalized System of Preferences *(GSP) preferential tariff* rate of zero percent and will continue to enter at that rate.

/52/ For example, most U.S. imports of Mexican products other than orange juice and those currently subject to 22 quotas will be subject to a simple tariff that will be phased out. These include: dried garlic, dried onions, asparagus, cantaloupes, and other melons. Mexico will subject seven U.S. commodities to a simple tariff that will be phased out, instead of a TRQ.

/53/ Such as Mexican imports of U.S. poultry, eggs, animal fats, barley, and potatoes, and U.S. imports of many seasonal fruits and vegetables, including tomatoes (March I through July 14, and November 15 through the last day of February), onions (January 1 through April 30), eggplant (April I through June 30), chili peppers (October 1 through *July 31),* squash (October I through June 30), and watermelons (May I through September 30).

/54/ The safeguard is likely to be used by the United States for seasonal fruits and vegetables, such as those identified above in footnote 53.

/55/ In the *first year of* the agreement, the *"trigger"* will equal *1.05* multiplied by the highest annual level of imports of those products during the previous three years. The trigger will increase automatically by 3 percent per year in each of the remaining nine years of the safeguard mechanism.

/56/ These assessments are based on independent analyses by U.S. farm groups, state agricultural commissioners, and the federal government. There is disagreement among analysts about how some sectors will be affected. The categories used reflect the general consensus among analysts. Moreover, the conclusions apply to projections over the next fifteen years; after fifteen years, the effects on agricultural sectors may differ significantly from the projections, depending on how quickly Mexican wages rise and whether and to what extent Mexican agricultural plots are aggregated *so as* to permit large-scale agricultural production in Mexico.

/57/ See "Prospects for Completion and Ratification," at X.

/58/ See "Sanitary and Phytosanitary Measures," at VIII.

/59/ 57 Fed. Reg. 20,606.

/60/ 52 Fed. Reg. 47,515.

/61/ TIAS 8249; 27 UST 1087; 993 UNTS 243.

/62/ For example, tariffs on most water filtering and purifying machinery will be phased out in five equal annual stages commencing January 1, 1994, and will be eliminated on January 1, 1998.

/63/ Its effects on some sectors may be different from those projected above if the Uruguay Round of trade negotiations is successfully concluded and implemented.

/64/ This analysis of the NAFTA's rules of origin is based partly on a document issued by the office of the U.S. Trade Representative which has authorized its distribution and republication. See 'Description of the Proposed North American Free Trade Agreement,' August 12, 1992.

/65/ This analysis of the NAFTA's procedures for reviewing antidumping and countervailing duty matters is based partly on a document issued by the office of the U.S. Trade Representative, which has authorized its distribution and republication. See, "Description of the Proposed North American Free Trade Agreement," August 12, 1992.