

# THE NORTH AMERICAN FREE TRADE AGREEMENT IMPLEMENTATION ACT

## STATEMENT OF ADMINISTRATIVE ACTION

This Statement of Administrative Action is submitted to the Congress in compliance with section 1103 of the Omnibus Trade and Competitiveness Act of 1988 ("1988 Act") and accompanies the implementing bill for the North American Free Trade Agreement ("NAFTA" or "Agreement"). The bill approves and makes statutory changes required or appropriate to implement the Agreement, which the President signed on December 17, 1992, on behalf of the United States under the authority of section 1102 of the 1988 Act.

This Statement describes significant administrative actions proposed to implement the NAFTA. In addition, incorporated into this Statement are two other statements required under section 1103: (1) an explanation of how the implementing bill and proposed administrative action will change or affect existing law; and (2) a statement setting forth the reasons why the implementing bill and proposed administrative action are necessary or appropriate to carry out the Agreement.

For ease of reference, this Statement generally follows the organization of the NAFTA, with the exception of grouping the general provisions of the Agreement (*i.e.*, Chapters One, Two and Twenty-Two of the Agreement) at the beginning of the discussion.

For each chapter of the NAFTA, the Statement first briefly summarizes the most important provisions of the Agreement. Next, the Statement describes the pertinent provisions of the implementing bill, explaining how the bill changes or affects existing law and stating why those provisions are required or appropriate to implement the NAFTA. Finally, the Statement describes the administrative action proposed to implement the particular chapter of the NAFTA, explaining how the proposed action changes existing administrative practice and stating why the changes are required or appropriate to implement the Agreement.

The Statement addresses certain provisions of Title V as well as Title VI of the implementing bill -- which make various changes in U.S. law that are appropriate (rather than required) to implement the NAFTA -- following the discussion of NAFTA Chapter Twenty-One.

It should be noted that this Statement does not, for the most part, discuss those many instances in which U.S. law or administrative practice will remain unchanged under the NAFTA.

In many cases, U.S. laws and regulations are already in conformity with the obligations imposed by the Agreement. In other cases, U.S. laws and regulations are "grandfathered" (*i.e.*, exempted) from the obligations of the NAFTA. In addition, some provisions of the NAFTA impose obligations only on Canada or Mexico.

In a few instances where there have been frequent questions from the public or the Congress, the Statement notes examples of specific statutes, regulations or practices that do *not* have to be changed as a result of the Agreement. Because this Statement is designed to describe *changes* in U.S. laws and regulations proposed to implement the NAFTA, however, the Statement concentrates on those changes and generally does not attempt to enumerate instances in which no change in existing law or practice will be required.

Although the implementing bill is voluminous, a careful reading of this Statement makes clear that the NAFTA requires comparatively few significant changes in U.S. law or regulation. Much of the bulk of the legislation is taken up with amendments or additions to U.S. law -- such as Title VI, the "Customs Modernization Act," -- that the Administration, working with the Congress, considered to be desirable, rather than necessary, to implement the NAFTA. Other parts of the bill -- such those establishing NAFTA's "rules of origin" for goods -- set out certain parts of the NAFTA itself. Still other bill provisions, simply extend to Mexico treatment currently enjoyed by Canada under the United States - Canada Free-Trade Agreement Implementation Act of 1988.

Finally, references in this Statement to particular sections of U.S. statutes are based on those statutes in effect as of the date this Statement was submitted to the Congress.

## CHAPTERS ONE, TWO AND TWENTY-TWO: GENERAL PROVISIONS

### A. SUMMARY OF NAFTA PROVISIONS

Chapters One, Two and Twenty-Two set out provisions that, for the most part, have general application to the rest of the Agreement. Chapter One makes clear that the NAFTA establishes a free-trade area in accordance with Article XXIV of the General Agreement on Tariffs and Trade ("GATT"). The chapter also sets out the general objectives of the Agreement, including the liberalization of trade in goods and services, removal of barriers to investment, the protection and enforcement of intellectual property rights, and the establishment of a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of the Agreement.

#### 1. Relationship to Other Agreements

Articles 103 and 104 describe the relationship between the NAFTA and other international agreements.

Article 103 makes clear that the United States, Canada and Mexico retain their respective rights and obligations under the GATT and other preexisting agreements to which all three countries are parties, but that the provisions of the NAFTA prevail over inconsistent provisions of other agreements to the extent of the inconsistency, unless otherwise specified in the NAFTA.

The North American Agreement on Environment Cooperation and the North American Agreement on Labor Cooperation, signed on September 14, 1993, are not covered by Article 103 because they were concluded after the NAFTA and will enter into effect immediately after the NAFTA. The Administration does not consider that there are any inconsistencies between the supplemental labor and environmental agreements and the NAFTA.

It should be noted that nothing in the NAFTA will affect native American treaty rights.

Article 104 states that the trade obligations of certain international environmental agreements prevail over the NAFTA's provisions to the extent of any inconsistency between them. Article 104 lists three multilateral environmental agreements with trade provisions -- the Washington convention on trade in endangered species, the Montreal protocol on ozone-depleting substances and the Basel convention on the transborder movement of hazardous waste.

In addition, Annex 104.1 lists two bilateral agreements with trade provisions to which the United States is a party. These are an agreement with Canada on cross-border movement of hazardous waste and the La Paz agreement with Mexico on protecting the environment in the border area, which includes an annex on cross-border movement of hazardous waste. The Administration does not consider that agreements listed in Article 104, or Annex 104.1, are

necessarily inconsistent with the NAFTA in whole or in part, but listing these agreements removes doubt in the unlikely event that an inconsistency were found.

The NAFTA governments may agree in writing to add to the list of agreements included in Article 104 or to include amendments of the three multilateral agreements listed above. The Administration views this modification procedure as an ongoing process to respond to changes in international environmental and conservation law and to provide greater clarity regarding the NAFTA's relationship to other environmental and conservation agreements. To this end, the Administration has obtained commitments from Mexico and Canada to add to the list of agreements specified in Article 104, when the NAFTA enters into effect, the *Convention Between the United States of America and the United Mexican States for the Protection of Migratory Birds and Game Mammals* and the U.S.-Canada *Convention on the Protection of Migratory Birds*. The Administration intends to pursue further discussions with Mexico and Canada concerning the addition of other agreements.

By virtue of Article 2005(3), in any dispute between NAFTA countries concerning a governmental action that the defending government claims is subject to Article 104, that government may insist that the dispute be resolved exclusively under the NAFTA, in which case the complaining government will not have recourse to dispute settlement procedures under the GATT. The Administration does not foresee any conflict between the requirements of the NAFTA and the trade obligations imposed by the environmental agreements mentioned above or other agreements that are not currently included in Article 104.

## **2. Application to States and Provinces**

NAFTA Article 105 is virtually identical to Article 103 of the United States - Canada Free-Trade Agreement ("CFTA") and builds on language in GATT Article XXIV:12. It makes clear that state, provincial and local governments must, as a general rule, conform to the same obligations as those applicable to the three countries' federal governments, subject to the same exceptions.

Some provisions of the NAFTA, however, either do not apply to states or localities or impose reduced levels of obligation for state and local measures. For example, Article 902 requires the three governments only to "seek, through appropriate measures," state and provincial government observance of NAFTA's rules regarding standards-related activities. Chapter Ten, which covers government purchases, imposes no obligations on state, provincial or local governments. Articles 1108, 1206 and 1409 exempt all existing measures at the local level in respect of certain investment and services provisions of the NAFTA and provide a mechanism for "grandfathering" state and provincial laws.

Article 105 does not address the application of the NAFTA under the *domestic* law of the three countries. That is a matter for each country to decide. Rather, Article 105 makes clear what obligations the three countries have to each other under *international* law in respect of state and provincial measures. In this regard, Article 105 simply says that no country can avoid its

commitments under the Agreement by claiming that the measure in question is a matter of state or provincial jurisdiction.

It is important to note that neither Article 105 nor any other provision of the NAFTA imposes any obligation on states, provinces or municipalities to adopt or conform with federal government standards or to refrain from setting higher levels of protection for human, animal or plant health or the environment than those imposed under federal law or to refrain from modifying their health or labor standards.

### **3. Definitions and Final Provisions**

Chapter Two defines certain terms that appear frequently in various chapters of the Agreement.

Chapter Twenty-Two sets out a number of provisions of general applicability. Article 2201 makes clear that the NAFTA's annexes are to be considered part of the Agreement itself. Article 2202 provides for amendments to the Agreement. Under Article 2203, the NAFTA is to enter into force on January 1, 1994, as between those governments certifying in an exchange of diplomatic notes that they have completed domestic legal procedures. Article 2204 provides for the accession to the NAFTA by other countries, subject to the agreement of each NAFTA government and after necessary legal steps in each country. In the United States, accession would require Congressional approval and implementing legislation. Any government may withdraw from the NAFTA upon six months' notice, but the Agreement will remain in force for the remaining countries.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

#### **a. Congressional Approval**

Section 101(a) of the bill provides Congressional approval for the NAFTA and this Statement. Section 108(a) makes clear that in approving the application of the NAFTA to Canada and Mexico, the Congress reserves the right to review, and to approve or reject, accession by any other country to the Agreement.

#### **b. Entry into Force**

Article 2203 of the Agreement requires the three governments to exchange notes certifying that they have each completed necessary legal procedures as a final condition of entry into force of the NAFTA. Section 101(b)(1) of the bill establishes as a condition of entry into

force of the Agreement with respect to Canada and Mexico that the President first determine, and report to the Congress, that such country has taken measures necessary to comply with the obligations of the Agreement, including with regard to uniform regulations implementing NAFTA's rules of origin.

The goal of this provision is to ensure full implementation of the Agreement. The Administration will not exchange notes permitting entry into force of the NAFTA for either Mexico or Canada unless and until the President is satisfied that such country has brought its laws and regulations into conformity with the obligations of the Agreement.

The Administration has already begun the process of scrutinizing Canadian and Mexican implementing measures, and will be seeking advice from the Congress and the private sector with regard to problems in implementation of which they may be aware. It is expected that this process of scrutiny and public exposure would uncover any significant problem with the terms of Canadian or Mexican implementing measures (or the absence of Canadian or Mexican action on existing measures that require amendment to conform with the Agreement).

The Administration understands that Canada and Mexico intend similarly to assure themselves that the United States has taken necessary implementing measures. None of the three countries anticipates that significant problems will arise, but all three are sensitive to the need to assure that the balance of benefits in the Agreement is not impaired by inadequate implementation.

The President's determination will not in any sense waive U.S. rights to challenge Canadian or Mexican measures under the dispute settlement provisions of the Agreement. Much will depend on the application of laws and regulations, and even the most careful process of scrutiny might not reveal problems until after the Agreement is actually in force. Further, although section 101(b)(1)(A) will be implemented to assure that the balance of benefits negotiated exists from the outset of the Agreement, some issues on both sides may be better dealt with through dispute settlement than by delaying entry into force.

Section 101(b)(1)(B) requires the President, before the entry into force of the Agreement, to report to the Congress his determination as to whether Canada and Mexico have taken the measures necessary to comply with the Agreement. The report is to include a description of the specific steps that Mexico has taken to bring its law into conformity with Chapter Nineteen of the NAFTA. Chapter Nineteen creates a system of binational panel review for antidumping and countervailing duty determinations. Mexico undertook a number of specific commitments in that chapter to introduce greater transparency and procedural fairness into its trade laws. The Administration intends to ensure that those changes are made before applying the NAFTA to Mexico.

Section 101(b)(2) of the bill provides authority for the President to bring the NAFTA into force for the United States at such time as the supplemental agreements on labor and environmental cooperation, which the three governments signed on September 14, 1993, go

into effect. The Administration views those agreements as critical components of the overall NAFTA package. Consequently, the President will not commit the United States under the NAFTA with respect to Mexico or Canada unless the obligations of the supplemental agreements will also apply as between the United States and that country.

The NAFTA, and each of the supplemental agreements, allows any signatory government to withdraw, but requires that six months notice be given to the other governments prior to the effective date of such withdrawal. Accordingly, the United States will have ample warning of any withdrawal by Canada or Mexico from any of the three agreements.

The Administration, after thorough consultation with the Congress, would provide notice of withdrawal under the NAFTA, and cease to apply that Agreement, to Mexico or Canada if either country withdraws from a supplemental agreement. The preceding would not apply in any instance in which the withdrawal by another government is consensual in nature -- for example, where that government and the United States withdraw from a supplemental agreement in order to enter into a superseding agreement in the labor or environmental area.

### **c. U.S.- Canada Free-Trade Agreement**

The NAFTA incorporates or otherwise carries forward most of the provisions of the CFTA. For example, under the NAFTA the tariff phase-out schedules for automobiles and other goods traded between the United States and Canada will remain the same, but the NAFTA rules of origin, rather than the CFTA origin rules, will be applied to those goods. For automobiles, the new origin rules require increased North American content in order for automobiles to be eligible for NAFTA's preferential tariff rates.

In many cases, the NAFTA simply restates as obligations for the three governments, in the same or somewhat different words, the bilateral obligations created by the CFTA. In other cases, the three governments decided on a new approach to a particular subject area. For example, the NAFTA creates new protections for intellectual property. In still other cases, where the three governments agreed that certain CFTA provisions should continue to apply solely between the United States and Canada, those provisions have been incorporated by reference into the NAFTA in appropriate annexes or have been carried forward by separate agreement.

The United States and Canada will suspend the operation of the CFTA upon the entry into force of NAFTA for the two countries. The suspension will remain in effect for such time as the two governments are parties to the NAFTA. Where the United States - Canada Free-Trade Implementation Act of 1988 ("CFTA Implementation Act") carries out U.S. obligations under the CFTA that will continue in effect through the NAFTA, those statutory provisions will either remain in place or are amended in the NAFTA implementing bill. The suspension agreement between the two governments will establish transitional arrangements for certain provisions of the CFTA, including the continuation of binational panel reviews in progress under CFTA Chapter Nineteen at the time the NAFTA enters into effect. Section 107

of the implementing bill amends section 501(c) of the CFTA Implementation Act to provide for the suspension of certain provisions of that Act in the event that the United States and Canada suspend the CFTA.

**d. Relationship to Federal Law**

Section 102 establishes the relationship between the NAFTA and U.S. law. The implementing bill, including the authority granted to federal agencies to promulgate implementing regulations, is intended to bring U.S. law fully into compliance with U.S. obligations under the Agreement. The bill accomplishes that objective with respect to federal legislation by amending existing federal statutes that would otherwise be inconsistent with the NAFTA and, in certain instances, by creating entirely new provisions of law.

As section 102(a)(2) of the bill makes clear, those provisions of U.S. law that are not addressed by the bill are left unchanged. In particular, neither the NAFTA nor the implementing bill amend section 301 of the Trade Act of 1974. Section 301 authorizes the U.S. Trade Representative to take action, subject to the direction of the President, against acts, policies or practices that are inconsistent with, or deny benefits under, trade agreements *or* that are unreasonable, unjustifiable or discriminatory and burden or restrict U.S. commerce. Section 301 will remain fully available in the event that another NAFTA country engages in practices that deny internationally recognized worker rights and that burden or restrict U.S. commerce.

An illustrative list of federal environmental and health safety laws that are not amended by the bill is set out at the end of this part of the Statement.

Section 102(a)(1) clarifies that no provision of the NAFTA will be given effect under domestic law if it is inconsistent with federal law, including provisions of federal law enacted or amended by the bill. Section 102(a)(1) will not prevent implementation of federal statutes consistently with the NAFTA, where permissible under the terms of such statutes. Rather, the section reflects the Congressional view that necessary changes in federal statutes should be specifically enacted rather than provided for in a blanket preemption of federal statutes by the NAFTA.

The Administration has made every effort to include all laws in the implementing bill and identify all administrative actions in this Statement that must be changed in order to conform with the new U.S. rights and obligations arising from the NAFTA. Those include both regulations resulting from statutory changes in the bill itself and changes in laws, regulations and rules or orders that can be implemented without change in the underlying U.S. statute.

Accordingly, at this time it is the expectation of the Administration that no changes in existing federal law, rules, regulations, or orders other than those specifically indicated in the implementing bill and this Statement will be required to implement the new international obligations that will be assumed by the United States under the NAFTA. Should it

prove otherwise, the Administration would need to seek new legislation from Congress or, if a change in regulation is required, follow normal agency procedures for amending regulations.

**e. Relationship to State Law**

As noted above, the NAFTA's rules generally cover state and local laws and regulations, as well as those at the federal level. There are a number of exceptions to, or limitations on, this general rule, however, particularly in the areas of standards, government procurement, investment and trade in services.

The NAFTA does not automatically "preempt" or invalidate state laws that do not conform to NAFTA's rules -- even if a NAFTA dispute settlement panel were to find a state measure inconsistent with the NAFTA. (See discussion of panel reports under Chapter Twenty.) Each country is free under the NAFTA to determine how it will conform with NAFTA's rules at the federal and non-federal level. The Administration is committed to carrying out U.S. obligations under the NAFTA, as they apply to the states, through the greatest possible degree of state-federal consultation and cooperation, in conformity with the consultative framework established under section 102(b)(1) of the bill.

Under that section, the President will consult in accordance with section 306(c)(2)(A) of the Trade and Tariff Act of 1984 (19 U.S.C. 2114(c)(2)(A)) through an intergovernmental policy advisory committee established under that section with state governments in order to assist states in conforming their laws and practices with the Agreement. These consultations will begin immediately upon enactment of the implementing bill.

In addition, the United States Trade Representative ("the USTR") will establish an expanded consultative process with individual states to:

- assist them in identifying those state laws and regulations that may be inconsistent with NAFTA Chapter Eleven (Investment), Twelve (Cross-Border Trade in Services) or Fourteen (Financial Services) for the purpose of "grandfathering" those measures under the NAFTA;
- provide for the reciprocal exchange of information and advice between the states and the Executive Branch regarding any matter under the NAFTA that may have a direct effect on state interests; and
- involve them to the greatest extent possible in developing U.S. positions in connection with the work of relevant committees established under the NAFTA and in respect of any dispute settlement proceedings involving state measures.

To coordinate these expanded consultative procedures, the USTR will designate in the Office of the United States Trade Representative ("USTR") a "NAFTA Coordinator for

State Matters." The coordinator will carry out the functions established by the bill for transmittal of information and advice from the states to USTR and for informing the states on an ongoing basis of NAFTA-related trade matters that directly relate to or that may have a direct effect on them. The coordinator will also serve as a liaison point in the Executive Branch for state governments and federal agencies, working with relevant agencies, to transmit information to interested states and relaying advice and information from the states on NAFTA-related trade matters of this kind.

These matters will include:

- implementation of the NAFTA (including committee, subcommittee and working group activities) in any area -- including sanitary, phytosanitary and standards-related measures -- in which the states exercise concurrent or exclusive legislative, regulatory or enforcement authority;
- dispute settlement proceedings challenging state measures;
- negotiations under the NAFTA on state government procurement;
- identification of state measures that may be "grandfathered" under the NAFTA; and
- inquiries from other NAFTA countries concerning state measures.

In establishing a statutory framework for federal-state consultations, the Administration and the Congress seek to minimize the administrative burden imposed on USTR. Accordingly, it is the understanding of the Administration and the Congress that:

- the Governor's office in each state will designate a single point of contact for the state responsible for the transmittal of information to USTR and the dissemination to relevant state offices of information received from USTR; and
- whenever possible, the Governors will jointly designate one or two Governors as the principal point(s) of contact with USTR on particular matters affecting state interests, other than for dispute settlement proceedings.

In the case of dispute settlement proceedings initiated under the NAFTA in respect of state laws, USTR, in addition to exchanging pertinent information through the contact point designated by the Governor, will consult directly with the office of the attorney general in the state concerned.

The Administration is committed to take into account the views of state governments in implementing the NAFTA with respect to any matter that may directly affect their interests.

The Administration is particularly cognizant of the importance of coordination and consultation with state governments in areas of special importance or sensitivity to them, including with regard to state laws protecting human, animal or plant health or the environment.

To this end, the Administration will involve the states to the greatest extent possible in the development of U.S. positions with respect to issues subject to state jurisdiction that are addressed by the various committees and working groups established by the NAFTA. The Administration will seek advice from the states and take such advice into account in formulating U.S. positions in the work of such bodies, including by permitting state representatives to assist in relevant federal agency preparations for such work. Where the Administration determines that it is feasible and appropriate, it will invite state representatives to attend as observers at meetings held by such bodies, including meetings of the Land Transportation Standards Subcommittee held to consider common motor carrier safety rules.

Furthermore, where a dispute settlement proceeding is initiated under the NAFTA in respect of a state measure, USTR will seek to involve relevant state officials to the greatest extent possible at every stage of the proceeding. USTR will provide the state concerned with the opportunity (consistent with any applicable timetables specified in the NAFTA or by statute) to advise and assist USTR in the preparation of factual information and argumentation concerning the state measures at issue for use in any written or oral presentations by the United States in consultations or panel proceedings held under the dispute settlement provisions of the NAFTA.

In addition, where a state measure is at issue, USTR will invite state representatives to attend panel hearings and, where appropriate, to make presentations to the panel on the state measure concerned. In the event that a proceeding involves measures of several states, it may be necessary to limit the number of state representatives, in which case it is the Administration's expectation that the states concerned would select appropriate joint representatives. Should a panel determine that a state measure is inconsistent with the NAFTA, USTR will work cooperatively with the state concerned to fashion a mutually agreeable settlement of the dispute in conformity with U.S. obligations under the Agreement.

The consultative process established under the bill, as elaborated above, is consistent with Administration practice under existing trade agreements. The history of federal government efforts to secure state conformity with the GATT and the CFTA, for example, suggest that the federal-state relations in implementing the NAFTA are likely to be entirely cooperative in nature.

The Administration has traditionally worked very closely with the states involved in any dispute settlement proceedings, both before and after any panel consideration, in a cooperative effort to determine the best course of action. Although ultimately the federal government, through its Constitutional authority and the implementing bill, retains the authority

to overrule inconsistent state law through legislation or civil suit, use of this authority has not been necessary in the nearly half-century history of the GATT or the five years that the CFTA has been in effect.

Section 102(b)(2) makes clear that only the United States is entitled to bring an action in court in the event that there is an unresolved conflict between a state law, or the application of a state law, and the NAFTA. The authority conferred on the United States under this paragraph is intended to be used only as a "last resort," in the unlikely event that efforts to achieve consistency through the cooperative approach discussed above have not succeeded.

In determining whether to exercise the authority of this paragraph, the Attorney General will consider the advice of the USTR as to whether the Canadian or Mexican Government had objected to the state measure in question and the extent to which Canada or Mexico, as the case may be, was taking necessary measures to assure conformity of Canadian provincial or Mexican state measures with the NAFTA. The Attorney General will be particularly careful in considering recourse to this authority where the state measure involved is aimed at the protection of human, animal or plant health or of the environment. In such a case, the Attorney General would entertain use of this authority only if consultations between the President and the Governor of the state concerned failed to yield an appropriate alternative.

If an action is instituted under section 102(b)(2), the United States will not seek to introduce into evidence in federal court any panel report issued under Chapter Twenty of the NAFTA with regard to the state measure at issue. The United States would base any such proceeding on the provisions of the NAFTA itself -- not a panel report -- and the court would thus consider the matter *de novo*, reaching its own interpretation of the relevant NAFTA provisions in the light of the Agreement's negotiating and legislative history, including this Statement. Although a court could take judicial notice of the panel report and consider the views of the panel, panel reports are not binding on federal or state courts. In view of the authority provided under section 102(b)(2), it was unnecessary to include in the implementing bill an additional provision comparable to section 102(b)(1) of the CFTA Implementation Act.

The reference in section 102(b)(3) to the business of insurance is required by virtue of section 2 of the McCarran-Ferguson Act (15 U.S.C. 1012). That section states that no federal statute shall be construed to supersede any state law regulating or taxing the business of insurance unless the federal statute "specifically relates to the business of insurance." Certain provisions of the NAFTA (for example, Chapter Fourteen, relating to financial services) do apply to state measures regulating the insurance business, although "grandfathering" provisions in Chapter Fourteen allow states to exempt existing inconsistent measures.

Given the provision of the McCarran-Ferguson Act, the implementing act must make specific reference to the business of insurance in order for the NAFTA's provisions covering the insurance business to be given effect with respect to state insurance law. Insurance is otherwise treated in the same manner under the NAFTA and the implementing bill as other financial services under the Agreement.

**f. Private Lawsuits**

Section 102(c) of the implementing bill precludes any private right of action or remedy against a federal, state or local government, or against a private party, based on the provisions of the NAFTA or of the labor or environmental supplemental agreements. A private party thus could not sue (or defend a suit against) the United States, a state or a private party on grounds of consistency (or inconsistency) with the NAFTA. The provision also precludes a private right of action attempting to require, preclude or modify federal or state action on grounds such as an allegation that the government is required to exercise discretionary authority or general "public interest" authority under other provisions of law in conformity with the NAFTA.

With respect to the states, section 102(c) represents a determination by the Congress and the Administration that private lawsuits are not an appropriate means for ensuring state compliance with the NAFTA or the two supplemental agreements. Suits of this nature may interfere with the Administration's conduct of trade and foreign relations and with suitable resolution of disagreements or disputes under those agreements.

The prohibition of a private right of action based on the NAFTA, or on Congressional approval of the Agreement in section 101(a), does not preclude the exercise of the right to challenge certain provisions of the implementing bill provided for in section 516A(g)(4) of the Tariff Act of 1930 pursuant to section 414(6) of the implementing bill. Furthermore, section 102(c) does not preclude a private party from seeking to enforce an award against the United States issued pursuant to the investor-state arbitration provisions of Chapter Eleven (Investment) of the Agreement. The provision also would not preclude any agency of government from considering, or entertaining argument on, whether its action or proposed action is consistent with the NAFTA, although any change in agency action would have to be authorized by domestic law.

**g. Implementing Regulations**

Section 104(b) of the bill requires that, to the extent possible, all federal regulations included in this Statement as necessary or appropriate to implement immediately applicable U.S. obligations under the NAFTA are to be developed and promulgated within one year of the Agreement's entry into force. The regulations implementing NAFTA's rules of origin are to be issued no later than the date of entry into force of the Agreement. In practice, the Administration intends, wherever possible, to amend or issue the other regulations required to implement U.S. obligations under the Agreement at the time the NAFTA enters into force. Section 104(a) of the bill provides the authority for such new or amended regulations to be issued, and for the President to proclaim actions implementing the provisions of the Agreement, on the date the NAFTA enters into force.

**h. Accession**

Section 108(a) of the bill provides that Congressional approval of the NAFTA may not be construed as conferring Congressional approval of entry into force of the NAFTA with respect to countries other than Canada and Mexico.

Under section 108(b) of the bill, by May 1, 1994, and again by May 1, 1997, USTR must submit to the President and the Ways and Means and Finance Committees a report listing those countries that either: (1) currently provide fair and equitable market access to U.S. exports, or (2) have made significant progress in opening their markets to U.S. exports, and the further opening of whose markets has the greatest potential to increase U.S. exports. On the basis of these reports, the President, by July 1, 1994 and July 1, 1997, is required to report to the two committees on the countries with which the United States should seek to negotiate free trade agreements, and the objectives for such negotiations.

**i. Effective Dates**

Section 109 of the bill provides that Title I goes into effect when the bill is enacted into law, except for section 107, which provides for the suspension of the CFTA Act and which goes into effect when the NAFTA enters into force between Canada and the United States. Other effective dates are set out in various other sections of the bill.

**2. Administrative Action**

The Administration does not anticipate that regulatory changes will be necessary to implement Chapters One, Two or Twenty-Two.

**a. U.S. Sovereignty**

Under the NAFTA, as well as the supplemental agreements on the environment and labor, U.S. sovereignty and that of the states is fully protected. U.S. laws and regulations will continue to be enacted, administered, enforced and amended solely by appropriate U.S. entities and authorities. All domestic legislative, judicial or administrative prerogatives are fully maintained under the three agreements. Each agreement creates a procedure for resolving disputes under that agreement between the NAFTA governments. In no case does a recommendation by a panel established under those procedures have the force of law in the United States. The appropriate federal and state executive and legislative authorities will decide how to respond under domestic law to any adverse panel recommendation.

Together, the three agreements call for each government to provide high levels of protection for the environment and high labor standards. Each government remains free under the agreements to establish its own laws and regulations and to modify them in order to protect the health and safety of its citizens.

**b. Price Controls**

The Administration recognizes that price controls in foreign markets can adversely affect U.S. exports of consumer products. The Administration will give due consideration to the question of foreign government price controls in future free- trade negotiations.

## Federal Environmental and Health Measures

Among the federal environmental and health-related statutes that are not amended or modified by the bill are,

- the Federal Water Pollution Control Act (33 U.S.C. 251 *et seq.*);
- title XIV of the Public Health Service Act (popularly known as the Safe Drinking Water Act) (42 U.S.C. 300f *et seq.*);
- the Clean Air Act (42 U.S.C. 7401 *et seq.*);
- the Pollution Prevention Act of 1990 (42 U.S.C. 13101 *et seq.*);
- the Toxic Substances Control Act (15 U.S.C. 2601 *et seq.*);
- the Federal Insecticide, Fungicide, and Rodenticide Act (7 U.S.C. 136 *et seq.*);
- the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321 *et seq.*);
- the Motor Vehicle Information and Cost Savings Act (15 U.S.C. 1901 *et seq.*);
- the Federal Hazardous Substances Act (15 U.S.C. 1261 *et seq.*);
- the Atomic Energy Act of 1954 (42 U.S.C. 2011 *et seq.*);
- the Noise Control Act of 1972 (42 U.S.C. 4901 *et seq.*);
- the Solid Waste Disposal Act (42 U.S.C. 6901 *et seq.*);
- the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601 *et seq.*);
- the Superfund Amendments and Reauthorization Act of 1986 (Public Law 99-499; 100 Stat. 1613);
- title I of the Marine Protection Research and Sanctuary Act of 1972 (popularly known as the "Ocean Dumping Act") (33 U.S.C. 1411 *et seq.*);
- the Environmental Research, Development, and Demonstration Authorization Act (Public Law 96-569; 94 Stat. 3335);
- the Pollution Prosecution Act of 1990 (42 U.S.C. 4321 note);

- the Federal Facilities Compliance Act of 1992 (Public Law 102-386; 106 Stat. 1505);
- sections 9 to 20 of the Act of March 3, 1899 (popularly known as the "Refuse Act") (33 U.S.C. 2701 *et seq.*);
- the Oil Pollution Act of 1990 (33 U.S.C. 2701 *et seq.*); and
- the Act to Prevent Pollution from Ships (33 U.S.C. 1901 *et seq.*).

## **CHAPTER THREE: NATIONAL TREATMENT AND MARKET ACCESS FOR GOODS**

### **A. SUMMARY OF NAFTA PROVISIONS**

The NAFTA's principal rules governing trade in goods are set out in Chapter Three. Chapter Three requires the NAFTA countries to treat products from other NAFTA countries in a non-discriminatory manner, provides for the phase-out of tariffs on North American-produced goods traded between the three countries, and requires the elimination of a wide variety of non-tariff trade barriers that restrict or distort trade flows.

#### **1. National Treatment**

Article 301 establishes a general rule of non-discrimination with respect to trade in goods. Paragraph one achieves this result by making the GATT's "national treatment" obligation a substantive obligation under the NAFTA. Under the NAFTA, Canada, Mexico and the United States will thus be required to treat goods from another NAFTA country in a manner that is no less favorable than that accorded like products of domestic origin. The incorporation in the NAFTA of the GATT "national treatment" obligation will ensure that actions by Mexico or Canada that are inconsistent with this basic trade rule will be actionable under the NAFTA's enhanced dispute settlement mechanism.

State and provincial governments must also accord national treatment to goods from another NAFTA country. Under the terms of paragraph two, this means that a state or provincial government must accord such products treatment no less favorable than the most favorable treatment it accords to any domestic products, including goods produced in that state or province. For example, if a Canadian province were to give preferential treatment to goods produced in that province as compared to goods produced in other provinces, the province would be required to accord such preferential treatment to like U.S. products as well.

Annex 301.3 establishes a limited number of exceptions to the national treatment obligation of Article 301, as well as to the rules governing import and export restrictions set out in Article 309 (described below). In general, the United States and Canada will be subject to the same exceptions under the NAFTA as those that apply under the GATT and the CFTA for trade in goods. By contrast, far fewer Mexican measures will be exempted from the NAFTA than are exempted from the GATT. Among the exceptions set out in Annex 301.3 are maritime cabotage restrictions, export controls on logs, and for a period of ten years, Mexican import restrictions on used goods listed in the Annex.

#### **2. Tariff Elimination**

Article 302 provides for the phased elimination of U.S., Canadian and Mexican tariffs on goods traded between the United States, Canada and Mexico that qualify under the rules of origin set out in Chapter Four of the Agreement ("originating goods"). The phase-out of tariffs between the United States and Mexico will eliminate a long-standing disparity in the degree of trade protection that Mexico has enjoyed in its trade with the United States. Currently, Mexico's average duty rate is two and one-half times greater than that of the United States, and Mexico is free under existing international trading rules to raise its duties even higher.

For originating goods traded between the United States and Mexico, as well as those traded between Canada and Mexico, dutiable products in the Harmonized Tariff System ("HTS") will be assigned to one of several phase-out (or "staging") categories, including:

- immediate elimination of duties (which, for many products, means the continuation of current duty-free status, including for GSP-eligible products from Mexico);
- five equal, annual cuts (20 percent per year);
- ten equal, annual cuts (10 percent per year); and
- in the case of the most import-sensitive products, fifteen equal, annual cuts (6.67 percent per year).

There are some exceptions to the above categories, for example a phase-out period of twelve years for certain sensitive products.

The relevant staging category for a particular product is identified in each country's tariff schedule (published with the NAFTA in separate volumes). Tariffs on originating goods traded between Canada and the United States will be eliminated by January 1, 1998, in accordance with the schedule set out in the CFTA.

### **3. Restrictions on Drawback**

Article 303 restricts the amount of duty drawback, and duty waivers and reductions under a foreign trade zone, bonded warehouse or maquiladora program, that may be claimed on goods from outside North America ("non-originating goods") that are traded between the three NAFTA countries. The inclusion of this provision in the NAFTA is critical to ensure that none of the NAFTA countries can become an "export platform" for materials produced in other regions of the world.

The restrictions go into effect on U.S. exports to and imports from Canada on January 1, 1996, and on U.S. exports to and imports from Mexico on January 1, 2001. Beginning on those dates, drawback and deferrals will be permitted only up to an amount that is the lesser of:

- the total amount of customs duties paid or owed on the good initially imported or
- the total amount of customs duties paid to another NAFTA government on the good, or the product into which the good is incorporated, when it is subsequently exported.

For example, if a Mexican manufacturer imports an engine component from Germany on which it pays \$50 in duties, and that manufacturer uses the component in an engine that is exported to the United States and on which the U.S. importer pays the equivalent of \$10 in duties to the United States, the Mexican importer may, upon presentation of proof of the U.S. importer's payment, recover only the \$10, less any administrative charge that may be due. By contrast, under current practice, the Mexican importer in this example may recover the full amount of duties paid on the German component.

The NAFTA restrictions on duty drawback, and on waivers or reductions under a duty deferral program, are subject to some exceptions. For example, they do not apply to goods exported in the same condition as when they were imported ("same condition drawback"). The restrictions also do not apply to originating goods exported from one NAFTA country to another. It should be noted that the exception for originating goods will not have any practical effect once duties on such goods are phased out under the NAFTA. In addition, the United States may maintain full drawback on imported sugar used in refined sugar exported to Mexico or Canada, and the United States and Canada may maintain drawback on imported citrus products and certain textile and apparel goods.

Article 303 also prohibits, beginning on the dates set out above, certain specified types of duty refunds and waivers, including the refund of antidumping or countervailing duties on export of a good to another NAFTA country and the refund of fees applied under section 22 of the Agricultural Adjustment Act. In addition, Article 303 eliminates, as of the date of entry into force of the Agreement, same condition substitution drawback on exports of goods to another NAFTA country.

#### **4. Duty Waiver Programs**

Article 304 limits the extent to which a NAFTA country may grant duty waivers that are linked to performance requirements. This article represents a major step in ensuring that NAFTA governments will not offer waivers of otherwise applicable duties in return for commitments from firms in their territories to export their products to other NAFTA countries or to use locally-produced components. The article carries forward the obligations of the United States and Canada under the CFTA and calls for the eventual elimination of Mexican duty waiver programs.

Article 304(1), together with Annex 304.1, prohibits the United States and Canada from adopting new duty waiver programs linked to performance requirements, extending existing programs to new participants, and expanding current programs for the firms now participating in

them. The Annex also places significant limitations on Mexico's capacity to extend or expand its existing duty waiver programs.

Under paragraph two of the article, all such duty waiver programs must be eliminated according to the schedule set out in Annex 304.2. For the United States and Canada, all such programs must be ended by January 1, 1998, consistent with the terms of the CFTA. Mexico must eliminate its duty waiver programs no later than January 1, 2001.

Article 304 also provides that if duty waivers granted to a particular firm for commercial purposes, regardless of whether the waivers are linked to performance requirements, have an adverse impact on the commercial interests of another NAFTA country, or a firm from that country, the government granting the waiver must either cease to grant the waiver or make it available to all importers.

## **5. Temporary Admission of Goods**

Article 305 requires each government to grant temporary, duty-free admission of the following goods, regardless of origin when imported from another NAFTA country:

- professional equipment ("tools of the trade") imported by a business person from a NAFTA country;
- equipment for the print, film or broadcasting media;
- goods intended for sports purposes and goods intended for display or demonstration; and
- commercial samples and advertising films.

Article 305 allows the three governments to place certain conditions on such admissions, including a bonding requirement on non-originating goods and a requirement that the goods not be sold or leased while in the territory of the country granting the temporary admission.

Article 305 also prohibits a NAFTA country from making duty-free temporary admission conditional on the unavailability of like or similar goods in that country and the imposition of a bond on originating goods. In addition, Article 305 limits the types of routing restrictions that a NAFTA government may place on the vehicles or containers used in international traffic that enter its territory temporarily.

Article 305 maintains current U.S. practice on temporary admission of goods under Chapter 98 of the HTS.

## **6. Duty-Free Entry of Commercial Samples and Advertising Materials**

Article 306 guarantees duty-free entry of commercial samples of negligible value (*i.e.*, commercial samples valued at not more than one U.S. dollar or marked or otherwise treated so that they are unsuitable for commercial use except as a sample) and printed advertising material classifiable in Chapter 49 of the HTS that is imported from another NAFTA country. This provision will ensure that other NAFTA governments offer the same treatment to these types of goods that has traditionally been afforded by the United States.

## **7. Goods Re-Entered after Repair or Alteration**

Article 307 provides that no government may impose customs duties on a good imported temporarily from another NAFTA country for purposes of repair or alteration, regardless of its origin, and that no government may impose customs duties on a good when it is re-imported after having been repaired or altered in another NAFTA country. This provision does not prevent the three governments from charging duties upon the re-entry of goods that have been exported to another NAFTA country and further processed in the normal course of manufacturing.

Annex 307.1 provides exceptions to the general rule prohibiting the imposition of duties on goods re-entered after repair or alteration. Annex 307.1 generally preserves the treatment of repaired or altered goods under the CFTA for trade between Canada and the United States, and describes the treatment to be accorded such goods traded between Mexico and the United States. Annex 307.1 provides special rules for duties on the repair of vessels.

Annex 307.3 commits the United States to provide written clarification of certain U.S. Customs and Coast Guard practices regarding the treatment of vessel repairs, and to begin a process to define the terms "repairs" and "rebuilding" under U.S. maritime laws.

## **8. Most-Favored-Nation Rates of Duty**

Article 308 obligates each NAFTA country to reduce its most-favored-nation ("MFN") rate of duty on certain automatic data processing goods and parts in accordance with Table 308.1.1 of Annex 308.1 and on certain semiconductor products in accordance with Table 308.1.2.

Under Annex 308.1, the three governments will phase in over ten years a common external tariff for the automatic data processing goods and their parts listed in Table 308.1.1. Under this arrangement, when an MFN rate of duty applicable to the products listed in Table 308.1.1 reaches the level agreed to by all three governments under paragraph one of Annex 308.1, those products will be deemed to be originating goods upon importation into any of the NAFTA countries, notwithstanding the origin rules set out in Chapter Four of the Agreement.

Annex 308.1 also provides for a reduction by the three governments of MFN tariffs applicable to certain semiconductor products listed in Table 308.1.2.

Annex 308.2 requires the three governments during the first ten years of the Agreement to consult before reducing any MFN rate of duty on certain color television picture tubes. If one government objects to another's reduction, the objecting government may raise its applicable rate of duty on such goods to a level that would have been in effect if the good had been placed in staging category "C" (which provides for a ten-year phase-out) for purposes of tariff elimination.

Article 308 also requires each government to accord MFN duty-free treatment to "local area network" equipment. Annex 308.3 requires the three countries to consult with regard to tariff classification of such goods to facilitate the operation of this provision. The equipment falling within this category is defined for these purposes in Article 318.

## **9. Import and Export Restrictions**

Article 309 incorporates into the Agreement GATT Article XI rights and obligations with respect to quantitative restrictions on imports and exports, with the exception of those government measures listed in Annex 301.3. Moreover, Article 309 makes explicit that all three NAFTA countries interpret Article XI to prohibit minimum import and export price requirements. As in the case of the incorporation in NAFTA of the GATT "national treatment" obligation, Article 309 will ensure that unfair import or export restrictions imposed by Mexico (or Canada) will be subject to NAFTA's dispute settlement procedures.

In addition, Article 314 imposes a prohibition on export taxes, subject to a Mexican exception for basic foodstuffs.

## **10. Customs Processing Fees**

Article 310 prohibits the adoption of customs merchandise processing fees on originating goods. Canada currently does not impose customs processing fees. Annex 310.1 prohibits Mexico from increasing its current customs processing fee and prohibits the United States from increasing its merchandise processing fee on imports of originating goods.

The Annex requires Mexico to eliminate its customs processing fee on originating goods by June 30, 1999. In addition, the United States is required to eliminate its merchandise processing fee on Mexican products by the same date. The Annex also reaffirms a requirement imposed by the CFTA for the United States to eliminate its merchandise processing fee with respect to Canadian goods on January 1, 1994.

## **11. Country of Origin Marking**

Annex 311 creates a series of obligations with respect to country of origin marking of goods to prevent a government from using marking requirements as a disguised barrier to trade. For example, a NAFTA country may not require country of origin marking if the expense of marking is prohibitive or if the cost of marking is substantial in relation to its customs value. Each government will also ensure that marking is conspicuous, legible and sufficiently permanent. The Annex also requires the three governments to establish by January 1, 1994, rules for determining the origin of goods for marking purposes, and for such other purposes as the parties may agree.

## **12. Alcoholic Beverages**

Article 312 reapplies CFTA rules regarding the treatment of wine and distilled spirits in U.S.-Canadian trade, and extends those rules to Canadian-Mexican trade. U.S.-Mexican trade in alcoholic beverages will be governed by the general NAFTA trade in goods provisions. Article 313 requires the three countries to accord distinctive product status to certain alcoholic beverages, such as Bourbon Whiskey, Tennessee Whiskey, Canadian Whisky, Tequila and Mezcal.

## **13. Other Export Measures**

Article 315 reimposes the CFTA rule that when the United States or Canada restricts exports to the other to conserve resources or to deal with a short supply situation or domestic price control program, it may not:

- reduce the proportion of total supply historically available to the other country;
- impose a higher price on exports than for comparable domestic sales; or
- disrupt the normal channels of supply or mix of products.

Article 315 does not apply as between Mexico and the other NAFTA countries.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT NAFTA**

### **1. Implementing Bill**

#### **a. Proclamation Authority**

Section 201 of the bill grants the President authority to implement by proclamation U.S. rights and obligations under Chapters Three and Seven (Agriculture) through the application or elimination of tariffs and tariff rate quotas. Section 201(a) authorizes the President to:

- modify or continue any duty,
- keep in place duty-free or excise treatment; or
- impose any duty

that the President determines to be necessary or appropriate to carry out or apply Articles 302, 305, 307, 308, and 703 and Annexes 302.2, 307.1, 308.1, 308.2, 300-B, 703.2 and 703.3. Puerto Rico's duty on coffee imports will not be affected by the NAFTA or this proclamation authority.

The proclamation authority granted to the President with respect to Annex 302.2 of the Schedule of the United States also authorizes the President to extend the bonding exception in Article 305 that is currently provided for in Chapter 98 of the HTS for originating goods imported temporarily from Canada pursuant to the CFTA to goods imported temporarily from Mexico.

The proclamation authority with respect to Article 302 permits the President to provide for the phase-out and elimination of tariffs on imports from Mexico that meet NAFTA's rules of origin. Duties on Canadian goods are currently being phased out under a Presidential proclamation issued pursuant to the CFTA Act. That duty staging will remain unchanged, but the NAFTA rules of origin, rather than the CFTA origin rules, will be applied to those goods.

Existing U.S. law is consistent with NAFTA Article 306, regarding the treatment of commercial samples and advertising materials.

The President will implement Article 307(1) by using the proclamation authority to remove duties on imports of products repaired or altered in Mexico or Canada. Currently, under HTS item 9802.00.40, articles returned to the United States after having been exported to Canada for repair or alteration under warranty are exempt from duty. Under HTS item 9802.00.50, if the repairs or alterations are done in Canada but not pursuant to warranty, a duty will be imposed (as it is currently) on the value of repairs or alterations and the duty rate will equal the duty rate applied under the CFTA to the repaired or altered article, regardless of

whether the article is an originating good. Duties will be eliminated immediately on articles altered or repaired in Mexico, with the exception of a phase-out of duties on the value of repairs on certain vessels.

Consistent with Article 307(2), under HTS item 9813.00.05 articles admitted temporarily from another NAFTA country for repair or alteration in the United States will continue to be exempt from duty, regardless of their origin.

The proclamation authority also will be used to implement Article 307 as it applies with respect to drawback. The proclamation will amend U.S. Note (1)(c) to Subchapter XIII of HTS Chapter 98 (which concerns eligibility for drawback) to ensure that goods entered temporarily into the United States from other NAFTA countries for repairs or alterations are subject to NAFTA drawback restrictions. The proclamation will also modify U.S. Note 1 to Subchapter II of HTS Chapter 98, which concerns, among other things, restrictions on the tariff treatment of articles repaired or altered in another country, to carry out the terms of Article 303 with respect to drawback.

The President will use the proclamation authority with respect to Annex 307.1 to continue, at the rate prescribed in the CFTA, the staged elimination of the duty on the value of Canadian repairs or alterations of U.S.-flag vessels documented to engage in foreign or coastwise trade. The President will also provide for the staged elimination of the 50 percent duty on the value of Mexican repairs or alterations of such vessels.

The President will implement Article 308 and Annexes 308.1 and 308.2 by proclaiming the agreed MFN treatment for imported local area network equipment and modifications to the duty treatment of the automatic data processing goods and their parts, semiconductor products and color television tubes listed in those provisions.

Section 201(a)(2) requires the President to withdraw beneficiary status under the GSP program from Mexico effective on the date the President issues a proclamation to carry out the schedule of duty reductions with Mexico.

Section 201(b)(1) of the implementing bill authorizes the President, subject to the consultation and lay-over requirements of section 103(a) of the bill, to:

- modify the staging of duty elimination pursuant to any agreement reached with the other NAFTA countries under Annex 302.2;
- modify or continue any duty;
- continue duty-free or excise treatment; or
- impose additional duties

by proclamation whenever the President determines it to be necessary or appropriate to maintain the level of reciprocal benefits under the NAFTA.

Section 201(b)(2) prohibits the President from considering a new request for tariff acceleration of a product for which the tariff phase-out is more than ten years if a previous request was denied in any of the preceding three calendar years. Section 201(c) provides for the conversion of existing specific or compound rates of duty for textile and apparel products to *ad valorem* rates for purposes of implementing NAFTA tariff reductions.

Section 103(a) sets forth consultation and layover provisions, which must be followed prior to the implementation of any action by the President by proclamation. The President must first: (1) obtain the advice of the private sector (pursuant to section 135 of the Trade Act of 1974) and the International Trade Commission; (2) report the action proposed, the reasons therefore and the advice received to the Committees on Ways and Means and on Finance; and (3) consult with those committees during a period of a least 60 days. This process may commence upon enactment of the implementing bill, but any modifying proclamation cannot take effect until the NAFTA enters into effect. These procedural requirements also apply to other Presidential proclamation authority provided in the bill subject to consultation and layover, such as modification of the scheduled staging of tariff reductions.

#### **b. Drawback**

Section 203 of the implementing bill makes a number of amendments to current law to implement NAFTA's drawback provisions, set out in Article 303. These amendments go into effect, pursuant to section 213 of the bill, for exports to Canada on January 1, 1996, and for exports to Mexico on January 1, 2001. This timetable is consistent with the schedule set out in Annex 303.7.

Section 203(a) states that all goods imported into the United States are subject to NAFTA drawback restrictions except for those categories of goods specifically mentioned in that section. The categories track those listed in paragraph six of Article 303.

The term "NAFTA drawback," as used in the bill, refers to the formula used to calculate the amount of the refund, waiver or remission that will be allowed for duties owed or paid to the Customs Service. The formula, which is drawn from NAFTA Article 303(1), limits the amount by which the Customs Service may refund, waive or reduce a duty paid or owed to the lesser of:

- the amount of duty paid or owed on the good on importation into the United States; or
- the amount of duty paid to the NAFTA country to which the good, or the product into which it is incorporated, is subsequently exported.

The formula will be applied to drawback claims for duties paid on imported goods that are subsequently exported, as well as duties the payment of which has been deferred because of their introduction into a foreign-trade zone or other duty deferral program.

Section 203(b) amends the applicable provisions of the Tariff Act of 1930 and the Foreign Trade Zones Act to authorize the Customs Service to apply NAFTA drawback to goods subject to NAFTA drawback that are covered in those provisions. Specifically, with regard to "manufacturing" drawback, section 203(b) amends section 311 of the Tariff Act of 1930 (19 U.S.C. 1311) relating to bonded manufacturing warehouses and section 312 (19 U.S.C. 1312) relating to bonded smelting and refining warehouses. With regard to "substitution" drawback, section 203(b) amends section 313 of the Tariff Act (19 U.S.C. 1313) relating to drawback and refunds to apply NAFTA drawback restrictions to goods subject to NAFTA drawback. With regard to "same condition" drawback, section 203(b) amends section 562 of the Tariff Act (19 U.S.C. 1562) relating to manipulation in bonded warehouse to apply NAFTA drawback to goods subject to NAFTA drawback. With regard to duty deferrals allowed under the Foreign Trade Zones Act, section 203(b) amends the Foreign Trade Zones Act to apply the NAFTA drawback restriction to goods exported from a foreign trade zone (FTZ).

Section 203(c) eliminates, effective upon entry into force of the Agreement, "same condition substitution drawback" by amending section 313(j)(2) (19 U.S.C. 1313(j)(2)), thus eliminating the right to a refund on the duties paid on a dutiable good upon shipment to Canada or Mexico of a substitute good, except for goods described in paragraphs one through eight of section 203(a).

Section 203(d) of the bill implements Article 303(2)(c) by eliminating drawback for fees applied pursuant to section 22 of the Agricultural Adjustment Act (7 U.S.C. 624), effective for goods subject to NAFTA drawback that are exported to Canada after December 31, 1995, and for such goods exported to Mexico after December 31, 2000.

Section 203(e) of the bill makes clear that no amendment contained in section 203 authorizes the refund, waiver or reduction of countervailing or antidumping duties imposed on a good imported into the United States. This provision is consistent with NAFTA Article 303(2)(a), which provides that drawback shall not apply to such duties. Current U.S. law (19 U.S.C. 1677h) does not provide drawback on antidumping or countervailing duties.

Pursuant to NAFTA Article 502(3), importers may claim preferential duty treatment for originating goods up to one year after importation. If an importer in another NAFTA country exercises this right after a U.S. exporter has claimed and received NAFTA drawback for the goods in question, the drawback amount may have to be adjusted. Section 205(a) of the implementing bill amends section 508(b) of the Tariff Act of 1930 (19 U.S.C. 1508(b)) to require persons who claim NAFTA drawback to disclose to the Customs Service whether any person has prepared or intends to prepare a NAFTA certificate of origin for the article for which drawback is claimed. The amendment authorizes the Customs Service to adjust the drawback payment as warranted.

Section 210 implements Article 303(8), which prohibits, upon entry into force of the Agreement, drawback of customs duties on 14-inch or larger color picture tubes manufactured in a NAFTA country for use in standard or high definition televisions exported to another NAFTA country.

Section 211 provides that for five years after the NAFTA takes effect, the Customs Service will monitor the volume of 14-inch or larger color televisions imported from other NAFTA countries and exercise all U.S. rights under Chapter Five (Customs Procedures), including conducting verifications, to ensure full compliance with NAFTA's rules of origin and to ensure full implementation of NAFTA duty drawback commitments. If, based on information generated by such monitoring, the President considers that 14-inch or larger color picture tubes intended for consumption in the United States are entering another NAFTA country in a manner inconsistent with the Agreement or are being undervalued so as to raise concerns under U.S. trade laws, section 211 provides that the President will promptly take such actions as are appropriate under the NAFTA, including under Article 317 and Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures), and applicable U.S. trade statutes.

**c. Merchandise Processing Fee**

Section 204 of the bill implements U.S. commitments under NAFTA Article 310, regarding customs user fees on originating goods, by amending section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c). The amendment provides for the immediate elimination of the merchandise processing fee for Canadian goods, consistent with U.S. obligations under the CFTA. In addition, section 204 provides for the elimination by June 30, 1999, of the merchandise processing fee on imports of Mexican goods.

The Secretary of the Treasury will reimburse the Customs Service for the costs of customs user services in respect of Mexican and Canadian imports out of the General Fund, subject to the availability of appropriations. This procedure avoids charging fees in excess of services rendered with respect to importations from non-NAFTA countries, which would be inconsistent with U.S. obligations under the GATT.

**d. Country of Origin Marking**

Section 207(a) of the bill implements Article 311 and Annex 311 by making certain limited amendments to section 304 of the Tariff Act of 1930 in respect of the marking of Mexican and Canadian products imported into the United States. Section 207(a) also amends section 304 to provide that certain pipes and fittings may be marked by means of continuous paint stencilling in addition to the methods provided in section 304(c)(1) of the Tariff Act of 1930 and that certain manhole rings or frames may be marked with "an equally permanent method of marking" in addition to the methods provided in section 304(e) of the Tariff Act of 1930. The section also makes conforming changes to section 304(c)(2) of that Act.

Section 207(b) exempts such products from Treasury Department marking regulations promulgated under section 1907(c) of the Omnibus Trade and Competitiveness Act of 1988.

**e. Discriminatory Taxes**

Section 511 of the bill states the sense of the Congress that the discriminatory enforcement of sales or other taxes by a state, province or other governmental entity of a NAFTA country is inconsistent with the NAFTA. Section 511 provides that the U.S. Trade Representative should pursue appropriate remedies to remove such discrimination.

**2. Administrative Action**

**a. Implementation by the Customs Service**

The Customs Service intends to issue regulations to implement the amendments to the drawback laws and to implement the changes required by Articles 305 and 307, which cover the temporary admission of goods and goods entered after repair or alteration, respectively. The Customs Service also intends to promulgate, not later than the date of entry into force of the NAFTA, marking regulations for purposes of Annex 311.

In implementing section 203(b)(5) of the bill, which applies NAFTA drawback to goods manufactured or changed in condition in an FTZ, the Customs Service intends to wait 60 days from the date of withdrawal of the merchandise from an FTZ before collecting any duty. If, within the 60 day period, the person who withdrew the goods from the FTZ presents satisfactory evidence of the amount of duties paid to another NAFTA government on the goods, the amount of duty to be paid to the United States will be reduced by the amount paid to the other NAFTA country. Thus, it is possible that such persons will only have to engage in one transaction, rather than having to pay the full duties first and later request a refund. This procedure should reduce administrative costs imposed on U.S. businesses as well as the Customs Service.

**b. Distinctive Products**

Article 313 and Annex 313 require the United States to recognize Canadian whisky as a distinctive product of Canada and to recognize Tequila and Mezcal as distinctive products of Mexico. Current Treasury Department regulations restrict the designations of Canadian whisky and Tequila to products of Canada and Mexico, respectively. The Treasury Department will amend its distilled spirits regulations (27 C.F.R. 5.22) to restrict the use of the designation "Mezcal" to products manufactured in Mexico in accordance with Mexican law and regulations.

**c. Acceleration of Tariff Reductions**

In exercising the authority provided under section 201(b) to accelerate the staging of tariff reductions, the Administration will, as a matter of priority, consider requests from interested private sector groups. The Administration will give special priority to negotiating the acceleration of tariff reductions for products where the Canadian or Mexican duty is substantially higher than the U.S. tariff, such as dry beans, bedding components, cream cheese, flat glass, major household appliances, potatoes and wine. The Administration would expect to use essentially the same procedures for tariff acceleration as those that have been used under the CFTA. In addition, with respect to an item for which the phase-out schedule exceeds ten years, the Administration would consider a request for acceleration of the phase-out schedule only if such acceleration is not opposed by U.S. producers of the item, and only if a request had not been denied within the preceding three calendar years.

**d. Broomcorn Brooms**

The Administration will carefully monitor U.S. imports of broomcorn brooms from Mexico ("Mexican brooms") once the Agreement enters into force. If the elimination of tariffs under the Agreement results in increased imports of Mexican brooms and causes or threatens to cause serious injury to U.S. producers of such brooms, the Executive Branch will take action consistent with the Agreement and U.S. law to rectify the situation. Moreover, the Executive Branch will consult with the Congress concerning any developments with respect to imports of Mexican brooms to ensure the continuing health and survival of the U.S. broomcorn broom industry.

**e. Native American Jewelry**

The Administration intends to work with the Governments of Canada and Mexico to protect authentic products of the unique cultural industries of Native Americans in all three countries. In support of this objective, the Customs Service will strictly enforce country of origin marking requirements of 19 U.S.C. 1304 as prescribed in 19 C.F.R. 134.43 with respect to Native American-style jewelry and handicrafts to ensure that the country of origin is marked conspicuously, legibly and with sufficient permanence to ensure that the marking remains on the goods until they reach the ultimate purchasers. The Customs Service will also assess penalties

against any person who, with the intent to conceal the country of origin required by 19 U.S.C. 1304, removes or obscures country of origin marking on Native American-style jewelry and handicrafts.

## **ANNEX 300-A: TRADE AND INVESTMENT IN THE AUTOMOTIVE SECTOR**

### **A. SUMMARY OF NAFTA PROVISIONS**

NAFTA's automotive provisions, set out in Annex 300-A, will create a major opening of the Mexican market for automobiles, trucks and components. These provisions will immediately provide significant new export opportunities for the U.S. automotive industry. The Annex provides for the elimination of all Mexican barriers to automotive imports from the United States and Canada over a ten-year transition period.

#### **1. General Obligations**

Annex 300-A sets out a number of general obligations applicable to all three NAFTA governments as well as specific obligations assumed by each country.

Each government is required to extend to all existing producers of vehicles (including automobiles, trucks, buses and special purpose vehicles other than motorcycles) in its territory treatment "no less favorable" than it accords to any new producers of vehicles in its territory. This obligation ensures that producers operating under current laws and restrictions will not be disadvantaged by competition from new entrants that might otherwise be exempted from those measures. However, where a government has committed in Annex 300-A to apply different treatment to existing producers during a transition period, such different treatment is permitted.

The three governments will review, no later than December 31, 2003, the status of the North American automotive sector and the effectiveness of the measures in Annex 300-A to determine actions that could be taken to strengthen the global competitiveness of the sector. This commitment creates no obligation other than to discuss these issues by the date specified. Any recommendations by the three governments that might emerge as a result of the review would be subject to applicable legislative and rulemaking requirements in the United States.

#### **2. Canadian Obligations**

As provided in Appendix 300-A.1, the NAFTA continues open automotive trade between the United States and Canada. The NAFTA permits the United States and Canada to maintain the *1965 Agreement Concerning Automotive Products between the Government of Canada and the Government of the United States* ("Auto Pact"), although there is no requirement that the Auto Pact be maintained. Nor does the NAFTA limit the ability of the United States to terminate the Auto Pact pursuant to its terms.

The NAFTA also preserves U.S. rights under the GATT and other agreements to challenge Canada's duty remission programs, including duty remissions under the Auto Pact.

Canada's obligations under the CFTA regarding such programs are carried forward into the NAFTA.

NAFTA also carries forward those CFTA provisions that limit the eligible recipients of Canada's export-based and production-based duty waivers and require their elimination by January 1, 1998, for exports to countries other than the United States and January 1, 1996, for production-based duty waivers. Canada terminated export-based duty waivers for exports to the United States on January 1, 1989. Canada's continued use of duty waivers will remain subject to the full range of disciplines contained in Chapter Ten of the CFTA. After January 1, 1996, duties refunded on automotive products entering Canada under its duty-waiver programs will be limited to the duty paid on the finished goods incorporating that component if it subsequently enters the United States or Mexico.

Appendix 300-A.1 also requires Canada to eliminate over a ten year period, beginning January 1, 2009, its embargo on the importation of used motor vehicles from Mexico that meet the NAFTA rules of origin. Canada's embargo on importation of used motor vehicles from the United States ended on January 1, 1993.

Finally, it should be noted that the NAFTA's stricter rules of origin for automotive products trade (62.5 percent for cars, light trucks and their engines and transmissions; 60 percent for heavy trucks and most other parts) will supersede the CFTA's less stringent rules of origin for these products.

### **3. Mexican Obligations**

Mexico's obligations in the automotive sector are set out in Appendix 300-A.2. It establishes a ten-year transition period for the elimination of Mexican automotive trade and investment restrictions. Most of Mexico's restrictions are contained in its 1989 Auto Decree and implementing regulations, which cover cars and light trucks, and its 1989 Autotransportation Decree and implementing regulations, which apply to large commercial vehicles.

#### **a. Mexican Auto Decree**

- **Local Content Requirement**

The NAFTA will phase out Mexico's requirement that a company assembling passenger cars and light trucks in Mexico must purchase a specified level of parts from Mexican suppliers. The elimination of this longstanding Mexican local content ("national value added") requirement will provide greater access to the Mexican market for U.S. and Canadian parts manufacturers over the ten-year transition period and reduce pressure on those manufacturers to invest in Mexico in order to supply automotive assemblers.

The local content requirement will decline immediately from its current level of 36 percent to 34 percent for the first five model years, declining one percentage point per

year thereafter until it is eliminated entirely after ten years. An existing assembler (one which began production in Mexico prior to model year 1992) may choose the percentage level of local purchases it actually achieved in model year 1992, which will be constant throughout the transition period until the percentage achieved by the assembler falls below the reduction schedule referred to above. After that point, the assembler will apply the percentage specified in the Agreement for each remaining year during the transition period.

Further modifications permit even greater use of U.S. and Canadian parts exports in Mexican assembly operations. Existing assemblers will only be required to meet local content requirements on a declining portion of growth in the Mexican market. Mexico will also adopt a broader definition of firms eligible to supply Mexican content, further easing the burden of the local content requirement on U.S.-owned assemblers.

#### (1) Trade Balancing Requirement

Under the NAFTA, Mexico must phase out its "trade balancing" rules in the auto sector. Mexico requires automotive assemblers to offset every dollar of parts and component imports with one dollar of vehicle, parts or component exports. If an assembler also imports finished vehicles, it must generate a sufficient trade surplus to compensate for imports at the rate of \$2.00 (\$1.75 in model year 1994) in exports for every dollar of imports. The NAFTA will modify the trade balancing requirement to permit assemblers immediately to increase their level of imports relative to exports.

Upon its entry into force, NAFTA eliminates the stricter (\$2.00 to \$1) trade surplus requirement for vehicle imports and immediately reduces the overall trade balancing requirement. The requirement to balance 100 percent of parts and components imports against exports (\$1 to \$1) will be immediately reduced to 80 percent (\$0.80 to \$1) and will decline steadily to 55 percent (\$0.55 to \$1) in the tenth year after implementation. At the end of the tenth year the trade balancing requirement will be eliminated.

The elimination of Mexico's trade balancing rules will mean that U.S. auto companies will be able to export to Mexico cars and trucks manufactured in the United States free of any compulsion to import Mexican-produced vehicles into the United States. It will also allow U.S. assemblers in Mexico to import parts and components freely from the United States, creating export opportunities for parts manufacturers in the United States.

(2) Other Auto Decree Restrictions

Mexico will eliminate at the end of the transition period its requirement that only assemblers in Mexico may import vehicles, permitting for the first time in many decades exports to Mexico of vehicles manufactured in the United States by assemblers not established in Mexico. In addition, immediately after the NAFTA takes effect, Mexico will eliminate its limitation on vehicle imports based on a percentage of assemblers' sales in Mexico.

**b. Mexican Truck Decree**

Mexico's Autotransportation Decree, covering semi-trucks, heavy trucks and buses, will be eliminated immediately upon implementation of the Agreement. In its place, the NAFTA permits Mexico to establish a five-year transitional quota for imports of North American origin semi-trucks, heavy trucks and buses into Mexico.

For a firm with assembly operations in Mexico, the quota will be 50 percent of its production of each type of vehicle produced in Mexico. For other firms, the combined quota will be 15 percent of total Mexican production of each type of vehicle (semi-trucks, heavy trucks and buses) for the first two years, 20 percent for the next year and 30 percent for the last two years. The quota for non-assemblers will be auctioned on a non-discriminatory basis.

**c. Used Vehicles**

Finally, Appendix 300-A.2 phases out over ten years the Mexican embargo of imports into Mexico of used "originating" motor vehicles, beginning fifteen years after the NAFTA goes into effect.

**4. U.S. Obligations**

Under Appendix 300-A.3, the United States will include content added in Mexico as "domestic" content for purposes of the definition of a "domestically manufactured" automobile under the Corporate Average Fuel Economy (CAFE) standards. Canadian content has been treated as "domestic" since the enactment of the CAFE requirements in 1975.

Manufacturers that began the production of automobiles in Mexico prior to model year 1992 may choose when, beginning three years after implementation, to begin counting Mexican content as "domestic" content for purposes of CAFE and *must* apply the new definition ten years after the NAFTA enters into force. Beginning on the date the NAFTA takes effect, the Mexican content of vehicles manufactured by companies that began assembly in Mexico after model year 1991 must be counted as domestic content for purposes of the CAFE requirements.

The seven-year grace period for an election by long-term manufacturers in Mexico is intended to provide flexibility to producers that may have structured their sourcing patterns in accordance with current law. The CAFE definition of "domestic" content has no bearing on the

NAFTA rules of origin for automotive products, Mexico's local content requirement, or other U.S. laws with automotive content definitions.

## **5. Relevant Provisions in Other Chapters**

### **a. Tariffs**

All tariffs on North American origin automotive goods will be eliminated within ten years. Mexico will reduce its 20 percent tariffs on passenger cars and light trucks to 10 percent immediately on implementation of the NAFTA and will phase out the remaining ten percent over five years for light trucks and ten years for passenger automobiles. Mexico will eliminate in five years its ten to 15 percent tariffs on 75 percent of U.S. automotive parts exports. Less than 25 per cent by value of Mexico's automotive parts tariffs will be phased out over ten years.

The United States will eliminate its tariffs on most Mexican-produced parts either upon implementation or over five years. Tariffs on a few parts will be phased out over ten years. The current U.S. passenger automobile tariff of 2.5 percent will be eliminated immediately and the light truck tariff will be reduced to ten percent immediately upon implementation and phased out over five years.

Mexico will phase out its current tariffs on buses, semi-trucks, specialty vehicles, and medium and heavy trucks over ten years. The United States will phase out its current tariffs on semi-trucks and medium and heavy trucks over the same period.

### **b. Standards**

The NAFTA countries will create a North American Automotive Standards Council to seek harmonization, on a voluntary basis, of federal government technical regulations in the safety and emissions areas. Standards in these important areas will not be weakened as a result of the NAFTA. The Council will provide an excellent opportunity to work toward compatible technical regulations throughout North America with major benefits for automotive safety and the environment.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

#### **a. CAFE**

Section 371 of the implementing bill adds Mexico to the United States and Canada in the Corporate Average Fuel Economy definition of "domestically manufactured" (15 U.S.C. 2003(b)(2)(G)). The existing CAFE definition of "automobiles," which includes both passenger automobiles and light trucks, is not affected by the proposed implementing bill or regulatory changes. The schedule for implementing the new definition for the different categories of manufacturers is set forth in Appendix 300-A.3 of the Agreement.

Manufacturers that began production of automobiles in Mexico before model year 1992 may make a one-time election at any time between January 1, 1997, and January 1, 2004, to apply the new definition beginning with the next model year after such election. For those not making such election, the new definition will apply beginning with the next model year after January 1, 2004.

For manufacturers that began or begin production of automobiles in Mexico after model year 1991, the new definition will apply beginning with the next model year after January 1, 1994, or the date that the manufacturer begins production of automobiles in Mexico, whichever is later.

Manufacturers that produce automobiles in Canada or the United States but not in Mexico (and that may procure inputs from Mexico) may make a one-time election at any time between January 1, 1997, and January 1, 2004, to apply the new definition beginning with the next model year after such election. For those not making such election, the new definition will apply beginning with the next model year after January 1, 2004.

For manufactures that do not produce automobiles in any NAFTA country (but that may procure inputs from Mexico), the new definition will apply beginning with the next model year after January 1, 1994.

The United States is required by Appendix 300-A.3 to "ensure that any measure it adopts pertaining to the definition of domestic production in the CAFE Act or its implementing regulations shall apply equally to value added in Canada or Mexico." This obligation is prospective in nature and pertains only to the definition of domestic production in the CAFE legislation and implementing regulations. It affects no other features of the CAFE legislation or regulations. The Appendix explicitly preserves the ability of the United States to make future changes in its fuel economy requirements for automobiles.

The CAFE provisions will apply to all automobiles produced by any manufacturer and sold in the United States, wherever produced and irrespective of car line or truck line. If an

enterprise subject to the CAFE requirements makes an election, that election will apply to all the car and truck lines produced by that manufacturer regardless of where the car or truck line is produced.

**b. Report on Motor Vehicle Exports**

Section 514 of the bill requires the U.S. Trade Representative to report annually for five years beginning July 1995 to the Congress on the effectiveness of the NAFTA's automotive trade provisions. These reports will include information on current bilateral automotive trade levels; remaining barriers; the amount U.S. exports have increased over the previous year; whether such increases meet anticipated levels of new exports; and if not, what actions the Trade Representative is prepared to take to realize those benefits, including, but not limited to, possible future negotiations with Mexico.

**2. Administrative Action**

The Environmental Protection Agency will amend its CAFE regulations, 40 C.F.R. Part 600, to reflect requirements of Appendix 300-A.3. Section 511 of Part 600 describes the methodology for determining "domestic" production. Vehicles are determined to be either domestically produced or not domestically produced (*i.e.*, imported) on the basis of the value added in either the United States or Canada. To be domestically produced, the U.S. and Canadian value added must be 75 percent or greater. The source of specific components or subassemblies used in each car line must be considered in determining the domestic content of the car line. Components are considered imported, unless they are wholly the growth, product or manufacture of the United States or Canada or are substantially transformed into a new or different article of commerce.

EPA will publish in the *Federal Register* amended CAFE regulations no later than the date of entry into force of the NAFTA, to provide that value added in Mexico will be considered as domestic for purposes of determining whether vehicles are domestically produced for manufacturers to whom the new definition applies.

In addition, the Secretary of Transportation will publish in the *Federal Register* by January 1, 1995, procedures to be used by manufacturers in electing when their value-added in Mexico will begin to be considered as domestic. The EPA Administrator will continue to be responsible for implementing all other aspects of the CAFE domestic content requirements.

## **ANNEX 300-B: TEXTILE AND APPAREL GOODS**

### **A. SUMMARY OF NAFTA PROVISIONS**

The NAFTA establishes special rules that apply to trade in textiles and apparel between the NAFTA countries. Those rules are set out in Chapter Three's Annex 300-B and in the rules of origin applying to those products in Annex 401.

#### **1. Tariff Elimination**

Section 2 and Appendix 2.1 of Annex 300-B provide for a ten-year phase-out of all tariffs on trade between the United States and Mexico in textile and apparel goods that meet the special NAFTA rules of origin for such products. Mexican tariffs on over 20 percent, or \$250 million, of current U.S. exports of such key products as denim, underwear, thread and many household furnishings will be eliminated immediately. Mexican tariffs on 95 percent of U.S. yarn exports, 89 percent of U.S. fabric exports, 97 percent of U.S. apparel exports and 60 percent of U.S. exports of made-up textile products other than carpet will be eliminated after five years.

Tariffs on NAFTA-origin textile and apparel products traded between the United States and Canada will continue to be progressively eliminated in accordance with the provisions of the CFTA, with such tariffs reduced to zero by January 1, 1998.

#### **2. Elimination of Import Restrictions and Consultation Levels**

Section 3 and Appendix 3.1(B) of Annex 300-B provide for the immediate elimination of quantitative restrictions (and so-called "consultation levels") on the importation into the United States of Mexican "originating" textile and apparel goods. Restrictions on the importation of "non-originating" Mexican products will be eliminated under one of three schedules, depending on the product: (1) immediate elimination, (2) elimination after seven years, or (3) elimination after ten years. Section 3 and Appendix 3.1(B) provide for the elimination of restrictions on goods in the "Special Regime Program" that are assembled in Mexico from fabric cut and formed in the United States.

#### **3. Bilateral Emergency Actions (Safeguards)**

Section 4 of the Annex provides that a NAFTA government may invoke a special "safeguards" provision at any time during the tariff phase-out period if a NAFTA-origin good covered by the Annex is being imported in such increased quantities and under such conditions as to cause "serious damage, or actual threat thereof," to a domestic industry producing a like or directly competitive good. A government taking an action under this provision may either suspend further duty reduction or increase the rate of duty to the Most-Favored-Nation applied rate, for up to three years. In any such case, the government must provide equivalent trade liberalizing compensation to the exporting country.

Section 5 provides for a "quantitative restriction" safeguard, which the United States and Mexico each may invoke against "non-originating" textile or apparel goods from the other country, using the same standard of "serious damage, or actual threat thereof" applied under Section 4. As provided in Appendix 5.1, Section 5 does not apply to trade between the United States and Canada.

#### **4. Rules of Origin**

The rules of origin for textiles and apparel are set out in Section XI of Annex 401, which appears in Volume II of the 1993 *Government Printing Office* edition of the NAFTA, and Appendix 6A of Annex 300-B. These rules are among the most important features of the textile and apparel provisions of the Agreement.

The general NAFTA rule of origin for most textile and apparel products can be described as a "yarn forward" rule, which requires North American content from the yarn manufacturing stage to the end product before a particular product is eligible for preferential treatment with regard to duties and quantitative restrictions. For example, in order for a garment to meet NAFTA's rule of origin:

- it must be cut and sewn in a NAFTA country;
- the fabric for the garment must have been manufactured in a NAFTA country; and
- the yarn used to produce the fabric must have been made in a NAFTA country.

There are a number of specific departures in the agreement from the "yarn forward" rule. Certain products are required to meet a stricter "fiber forward" rule of origin, certain others are subject to a "fabric forward" rule, and yet other products, such as apparel made from fabrics not generally produced in North America, are subject to a less rigid "single substantial transformation" rule of origin. Section 7 of Annex 300-B provides for consultation and review by the three governments of the rules of origin no later than five years after the NAFTA enters into force or, under Section 7.2, on the request of any government to address issues of availability of fibers, yarns or fabrics in the NAFTA countries.

#### **5. Tariff Preference Levels**

Appendix 6(B) of Annex 300-B provides for a limited exception to the general NAFTA rules of origin for textile and apparel goods. The exception takes the form of Tariff Preference Levels (TPLs), under which specific quantities of goods from each NAFTA country that do not meet the rules of origin will nonetheless be accorded NAFTA's preferential duty rates. Imports of such goods that exceed these quantities will be subject to the country's Most-Favored-Nation rate of duty.

TPLs are available between the United States, Canada and Mexico for cotton and man-made fiber apparel, wool apparel, cotton and man-made fiber fabric and made-up products, and cotton and man-made fiber spun yarn. In recognition that certain fibers, yarns and fabrics are in abundant supply in North America, TPLs between the United States and Mexico cannot be used for man-made fiber sweaters, any apparel made from oxford cloth or blue denim, and t-shirts and men's and women's underwear made from cotton or man-made fiber circular knit fabric under 100 metric count.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT NAFTA**

### **1. Implementing Bill**

Section 201(a) of the implementing bill grants the President authority to proclaim modifications to the HTS regarding textiles and apparel products in order to put into effect NAFTA's textile and apparel provisions, including the progressive reductions of tariffs, tariff safeguard actions, and TPLs. Existing section 204 of the Agricultural Act of 1956 provides the President with authority to impose quantitative restrictions on textile and apparel products under the NAFTA, including the elimination or staged reduction of such restrictions and the imposition of temporary restrictions under the NAFTA safeguard provisions.

Section 202(q)(1) of the implementing bill gives the President the authority to proclaim the rules of origin for textile and apparel goods that are contained in Section XI of Annex 401 and Appendix 6A of Annex 300-B. Section 202(q)(2) provides that the President may proclaim subsequent modifications to these rules of origin for textile and apparel goods only in two specific circumstances. First, within one year of enactment of the implementing legislation, the President may proclaim technical corrections to the rules of origin. Second, consistent with Section 7.2 of Annex 300-B, the President may proclaim changes to the rules of origin for textile or apparel goods that the President determines to be warranted in light of a change in the availability in North America of a particular fabric, yarn or fiber.

In either instance, such a proclamation would be subject to the Congressional consultation and lay-over provisions of section 103(a) of the implementing bill. Other changes to the rules of origin for textile and apparel goods would require Congressional action.

Under Section 201(b) of the implementing bill, the President may proclaim, subject to consultation and layover procedures of section 103(a), subsequent modifications to tariffs on textile or apparel goods to which the relevant NAFTA government agrees, including modifications to TPLs made in light of a change in availability in North America of a particular fiber, yarn, or fabric, consistent with Appendix 6B.8(a) to Annex 300-B.

As described in Section 2, below, a proclamation modifying a rule of origin or a TPL in light of a change in availability in North America of a particular fiber, yarn, or fabric will be

based on an agreement with the relevant NAFTA government and a recommendation from the interagency Committee for the Implementation of Textile Agreements (CITA).

For imports of textiles and apparel goods from Mexico, section 201(c) of the implementing bill grants the President authority to use *ad valorem* rates of duty, at levels that are equivalent to existing compound rates (*e.g.*, \$X/kg + Y% *ad valorem*), as the starting "base rates" for purposes of the staged reduction of duties under the NAFTA. Use of *ad valorem* rates, agreed to by the United States and Mexico in the course of the NAFTA negotiations, is not intended to increase or decrease any existing rates.

## **2. Administrative Action**

Under authority delegated by Executive Order 11651, CITA presently supervises the implementation of U.S. bilateral textile and apparel agreements, including making determinations of market disruption due to textile and apparel imports and issuing directions to the Customs Service regarding quantitative limitations on such products.

The Executive Order delegates to CITA the authority necessary to take action with respect to textiles and apparel under the NAFTA's safeguards and quantitative restrictions provisions for those products. Thus, for example, CITA will, as appropriate, issue instructions to the Customs Service regarding adjustments to quantitative restrictions in conformity with Annex 300-B, make determinations under the textile and apparel safeguards provisions regarding the existence of "serious damage, or actual threat thereof" to a domestic industry, and take action in cases in which such injury or threat is found.

Consistent with Section 7.2 of Annex 300-B, any interested person may submit to CITA a request for a modification to a particular rule of origin based on a change in the availability in North America of a particular fiber, yarn or fabric. The requesting party will bear the burden of demonstrating that a change is warranted. If, on the basis of this consideration, CITA recommends a change to a rule of origin for a textile or apparel good, and the NAFTA government concerned has agreed to the change, the President may proclaim the change under section 202(q)(2) of the implementing bill, subject to the Congressional consultation and lay-over provisions contained in section 103(a). The same procedure will apply to modifications to TPLs made on the basis of changes in availability in North America of a particular fiber, yarn or fabric.

## CHAPTER FOUR: RULES OF ORIGIN

### A. SUMMARY OF NAFTA PROVISIONS

#### 1. Overview

Chapter Four of the NAFTA establishes rules of origin for identifying goods that are to be treated as "originating in the territories of the NAFTA parties" and thereby eligible for preferential treatment accorded to originating goods under the NAFTA, including reduced duties. The purpose of the rules is to ensure that the special lower NAFTA tariff benefits accrue primarily to firms and individuals that produce or manufacture goods in North America.

#### 2. "Originating" Goods

Chapter Four, together with the chapter's annexes, establish rules for determining whether particular goods have a sufficient nexus to North America -- whether the goods "originate" in the free-trade area -- to qualify for special reduced tariff rates established under NAFTA Article 302. These origin rules also apply for purposes of determining tariff or quota treatment under Annex 300-A (automotive trade), Annex 300-B (textiles), Annex 310 (customs user fees) and Article 801 and Annex 801.1 (bilateral safeguards).

Chapter Four provides that goods wholly produced or obtained in the territory of one or more NAFTA party (for example, crops grown in the soil of a country, minerals taken from its mines) are "originating goods" and thus eligible for preferential treatment. It should be noted, however, that under paragraphs ten and eleven of Annex 703.2 (governing market access for agricultural products), the United States and Mexico may treat certain agricultural goods traded between them as "non-originating" even where they meet Chapter Four's origin rules. (See discussion of this point in connection with Section A of Chapter Seven.)

Goods produced in whole or in part from non-originating (non-NAFTA) materials can become originating goods if the non-originating materials undergo, in one or more of the NAFTA parties, processing or assembly sufficient to result in a designated change in tariff classification under the Harmonized Tariff System, as specified in Annex 401. The change in tariff classification ensures that the processing or assembly within the NAFTA territories results in changes in the product that are physically and commercially significant.

In some product sectors, most notably the automotive and chemicals sectors, the change in tariff classification requirement is supplemented or replaced by a requirement that a specified percentage of either the value of the goods or their net cost be attributable to labor performed and materials produced in the territories of the NAFTA parties.

#### 3. Transshipment

Article 411 provides that originating goods shipped outside the NAFTA territories for further processing lose their "originating" status. For example, if originating materials are shipped to a non-NAFTA country for further processing or assembly, the finished product is considered to be wholly non-originating if it is returned to the territory of NAFTA country. A similar provision was included in the CFTA.

#### **4. Non-qualifying Processes**

A special anti-circumvention provision, Article 412, prevents a good from becoming an originating good by virtue of mere dilution with water or another substance that does not alter the characteristics of the good, or by virtue of any production or pricing practice in respect of which the preponderance of the evidence shows that the object was to circumvent the rules of Chapter Four.

#### **5. Value-Content Requirements**

As mentioned above, some NAFTA origin rules require that a specified percentage of either the value or net cost of a good be attributable to NAFTA materials and labor. By comparison with the CFTA, NAFTA significantly decreases the number of goods for which a value-content calculation is required. Through discussions with domestic industries, U.S. negotiators were able in many cases to find formulas expressed in terms of changes in tariff classification that were at least as rigorous as, or more rigorous than, the CFTA value-added rules, yet easier to apply and administer.

For most products where the rules of origin provide for a regional value-content calculation, the calculation is an alternative to a tariff classification change rule that requires a greater amount of processing. A regional value-content test is *mandatory* only for automotive products, footwear, and for the limited number of cases where the final product and its components are classified under the same tariff subheading or under an undivided tariff heading.

Chapter Four provides two new methods for calculating regional value content of a good -- the "transaction value" method, which is based on the price paid for a good, and the "net cost" method, which is based on the total cost of the good, less sales promotion, royalties, shipping and certain other costs. Generally, the importer has the option to use either method. However, the net cost method is required for automotive products, for footwear, and for goods for which a transaction value cannot be reliably determined, for example, in the case of sales between related parties and consignment sales.

##### **a. Transaction value method**

The "transaction value" method requires that the value of non-originating (non-NAFTA) materials used to produce a good be subtracted from the "transaction value" (*i.e.*, the price actually paid or payable for the good). The remainder is then divided by the transaction value to obtain the regional content.

$$\frac{x-y}{x} = z$$

x = transaction value  
 y = value of non-NAFTA materials  
 z = regional (NAFTA) value content

In most cases where a regional value-content calculation is required or provided as an option, the regional content derived under the transaction value method must be not less than 60 percent for a good to qualify as "originating."

**b. Net cost method**

The net cost method requires that specified ineligible costs (*e.g.*, royalties, sales promotion, shipping, interest costs in excess of allowed levels) be subtracted from the total cost of producing the good. The difference is called the "net cost." The value of non-NAFTA materials is then subtracted from the net cost, and the difference divided by the net cost, to obtain the regional value content.

$$\frac{(a-b) - y}{(a-b)} = z$$

a = total cost  
 b = ineligible cost  
 y = value of non-NAFTA materials  
 z = regional (NAFTA) value content

Interest costs are not allowed in calculating net cost to the extent that the interest cost incurred by a producer exceeds 700 basis points above the applicable federal government rate in the country of the producer, to be identified in uniform regulations, for debt of comparable maturities.

Producers may use one of three specified methods to allocate costs to the goods at issue using generally accepted accounting principles.

In most cases where a regional value-content calculation is required or provided as an option, the regional content derived under the net cost method must be not less than 50 percent in order for a good to be consider as "originating." In a few cases, notably automotive products, the percentage is higher.

## **6. Accumulation**

Article 404 clarifies that where more than one producer is involved in the production of a good, either in one NAFTA party or in more than one, the processing by the different producers may be accumulated when determining whether a good meets a required tariff classification change or regional value content.

## **7. De Minimis Rule**

Article 405 provides a *de minimis* rule that allows goods to qualify as "originating" where a small portion of the material (generally less than seven percent of the transaction value or total cost of the good) fails to undergo a required change in tariff classification. Thus, a good that is otherwise required to meet a regional value-content requirement (for example, where failure of materials to undergo a required change in tariff classification triggers a requirement for a minimum regional value-content) will be exempted from that requirement if the value of all "non-originating" materials is less than seven percent of the transaction value or total cost of the good.

The *de minimis* rule is not applicable to certain agricultural products and home appliances listed in paragraph three of Article 405.

## **8. Automotive Products**

Pursuant to Article 403(5), automotive products are subject to special regional content requirements. The regional content for such products must be calculated using the net cost method. In the case of passenger motor vehicles (other than those capable of transporting more than 15 persons), light trucks (under five tons g.v.w.), and their engines and transmissions, the required amount of regional content will increase in stages from 50 percent for the first four years after the NAFTA is implemented to 56 percent for the second four years to 62.5 percent thereafter. Other motor vehicles and automotive parts are subject to a 50 percent regional content requirement for the first four years, 55 percent for the second four years, and 60 percent thereafter.

In order to improve the accuracy of the regional content calculation for automotive products, the value of certain non-NAFTA parts and components must be traced back through each step in the production process. The value of such parts is traced by requiring all producers of automobiles and light trucks (both vehicle builders and their suppliers) to report the value of their non-North American imports of a broad range of specified motor vehicle parts to manufacturers at the next stage of component or vehicle production. For example, if an item on the tracing list in Annex 403.1, such as a water pump, is imported and ultimately incorporated into an automobile, the auto manufacturer will be obliged to count the water pump as a non-NAFTA ("nonoriginating") material, whether or not the auto manufacturer imported the pump directly. If the pump was imported by an engine manufacturer who used it as a part in an engine to be sold to an auto manufacturer, the engine manufacturer would inform the auto

manufacturer that the pump was a nonoriginating material, and the auto manufacturer would be obliged to count it as a nonoriginating material in its regional value calculation.

Article 403(3) and Article 403(4) permit the averaging of regional content in certain circumstances in order to provide flexibility to automotive parts producers and assemblers. Averaging is permitted over the same model line of motor vehicles in a single class produced in the same plant, over the same class of motor vehicles produced in the same plant (regardless of whether they are of the same model line), or over the same model line (regardless of whether they are of the same class or produced in the same plant). Averaging is permitted only for vehicles produced in the territory of a single NAFTA party. Under certain conditions, vehicles produced by General Motors of Canada may be averaged with vehicles produced by GM's CAMI joint venture.

Article 403(6) sets the amount of regional content required at 50 percent, for a five-year period, for investors establishing new plants to produce vehicles not previously made by that producer in the region, and for a two-year period following refit of an existing plant to produce a new vehicle. A "new vehicle" is one of a different class, marque, or size category and underbody. At the end of these periods, vehicles produced in such plants must meet the regional content requirement in effect at that time.

As part of an overall resolution of the automotive rules of origin, including a stronger and clearer set of rules, the United States and Canada also decided to resolve certain problems encountered in applying the regional content provisions of the CFTA to automotive trade. To this end, the United States and Canada have agreed that the NAFTA regional content formula, with appropriate modifications to the tracing requirements, will be applied upon the election of the importer to entries of automotive products under the CFTA that have not been finally liquidated by the U.S. Customs Service at the time the NAFTA enters in effect.

## **9. Modification of Rules of Origin**

Article 414 provides for the three NAFTA governments to consult regularly to ensure that the rules of origin are properly and consistently administered, and to discuss any appropriate modifications. Each government must agree to any amendment of the rules of origin.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

#### **a. General**

Section 202 of the implementing bill provides for legislative enactment of Articles 401 through 415, with some technical drafting amendments. Those amendments do not change the substance of the Chapter Four rules. In addition, section 202 implements paragraph 10 of section A of Annex 703.2, which establishes additional rules for certain agricultural products.

#### **b. Proclamation Authority**

Section 202(q) authorizes the President to proclaim the specific rules of origin in Annex 401 and NAFTA's other product-specific origin rules and definitions. In addition, section 202(q) gives authority to the President to modify NAFTA's specific rules and definitions -- other than those regarding textile and apparel goods -- by proclamation, if the three governments agree to such a change, subject to the consultation and layover provisions of section 103 of the bill.

The rules proclaimed by the President for textile and apparel goods could be modified by subsequent proclamation in only two circumstances. First, within one year of enactment of the implementing legislation, the President may proclaim technical corrections to the rules of origin for specific textile or apparel goods. Second, the President may proclaim a change to the rules of origin for a textile or apparel good that the President determines to be warranted in light of a change in the availability in North America of a particular fabric, yarn or fiber. Proclamations in either case would be subject to the consultation and layover requirements of section 103(a).

Section 202(q) also provides the President with authority to modify the rule of origin definitions, set out in section 202(p) of the bill, during the first year in which the NAFTA is in effect to reflect any agreement by the three governments to change the definitions in NAFTA Article 415.

Under section 103, before proclaiming a modification to the rules of origin the President must: (1) obtain the advice of the private sector (pursuant to section 135 of the Trade Act of 1974) and the International Trade Commission; (2) report to the House Ways and Means Committee and the Senate Finance Committee the action proposed, the reasons therefore, and the advice received; and (3) consult with those committees during a period of at least 60 days.

#### **c. Interim Implementing Regulations**

Section 104 of the bill requires the Customs Service to promulgate interim regulations implementing NAFTA's rules of origin by no later than the date of entry into force of the NAFTA.

**2. Administrative Action**

**a. Purpose of Rules of Origin**

The rules of origin of Chapter Four are intended to direct the benefits of tariff reduction under the NAFTA principally to firms producing or manufacturing goods in North America. For this reason, the rules are designed to ensure that any goods that are not wholly produced or obtained in one or more of the Parties undergo substantial processing and substantial change in one or more of the Parties in order to be eligible for NAFTA benefits. Under Article 412, each Party must deny benefits to goods that have been processed or priced merely to circumvent the purpose of the rules of origin.

Article 412 will be applied in the same manner as the anti-circumvention provisions of other U.S. tariff preference programs. It is expected that Article 412(b) will be applied in a manner such that the legitimate practice of configuring merchandise to fall within the scope of a particular tariff provision will not be impaired.

**b. Cuban Sanctions Program**

The NAFTA rules of origin will not in any way diminish the Cuban sanctions program. Pursuant to an Executive Order issued in 1963 under authority of the Trading With the Enemy Act, the United States imposes a complete economic embargo and boycott on trade with Cuba. Regulations issued by the Treasury Department (31 C.F.R. Part 515) make it unlawful to import merchandise of Cuban origin or merchandise that is made or derived in whole or in part by any article that is the growth, product, or manufacture of Cuba.

Nothing in the NAFTA would operate to override this prohibition. Article 309(3) permits the United States to ensure that Cuban products or goods made from Cuban materials are not imported into the United States from Mexico or Canada and that U.S. products are not exported to Cuba through those countries. Furthermore, Article 2102 provides, *inter alia*, that nothing in the NAFTA shall be construed to prevent any government from taking any actions that it considers necessary for the protection of its essential security interest taken in time of war or other emergency in international relations. In the negotiation of this provision, the United States made clear that it would be invoked, if necessary, to prevent any circumvention of the Cuban sanctions program.

## CHAPTER FIVE: CUSTOMS PROCEDURES

### A. SUMMARY OF NAFTA PROVISIONS

Chapter Five establishes procedures for each government's customs administration to follow in its treatment of goods traded between the three countries. The procedures are designed to provide uniform, effective and efficient application of NAFTA's marking and origin rules, thus ensuring that the benefits of trilateral tariff reduction accrue to goods produced in North America and facilitating the flow of trade across national boundaries.

#### 1. Certificates of Origin

Article 501 calls for the three governments to create a uniform "certificate of origin" for claims that particular goods "originate" in the NAFTA region and thus qualify for the special tariff treatment provided under the Agreement. In order to obtain preferential NAFTA tariff treatment, an importer must possess, at the time a claim for preferential treatment is made, a valid certificate of origin completed by the exporter of the goods. The importer may then declare to the customs administration of the importing country, on the basis of that certificate, that the goods are "originating" goods and thus qualify for special NAFTA tariff rates.

If the exporter is not the producer of the goods the exporter may base the certification upon:

- the exporter's knowledge that the goods qualify as "originating" (for example, a U.S. dairy operator who exports to Canada could certify his goods as "originating" on the basis of his knowledge that all milk used in his products is collected from dairy farms in the vicinity of his plant);
- the exporter's reasonable reliance upon the producer's written representation that the goods are of North American origin; or
- a completed and signed certificate provided by the producer.

Certificates may cover a single importation or multiple importations of identical merchandise during any period of up to one year specified in the certificate. Certificates will remain valid for four years from the date of signature. The importing country may require the importer to translate the certificate if it has been completed in a language other than that required by the importing country's law.

Nothing in the NAFTA compels a producer to provide a certificate of origin to an exporter or requires an exporter to furnish such a certificate to an importer. However, there is also nothing in the NAFTA that would prevent producers, exporters and importers from contracting with each other to do so.

Chapter Five provides that the three governments must impose specified obligations on, and grant rights to, persons who complete a certificate of origin. Article 505 requires each government to require those persons to keep records associated with the certificate. Under Article 510, such persons will be entitled to appeal decisions by a customs administration in another NAFTA country regarding the origin of the goods they certify as "originating."

## **2. Obligations Regarding Importations**

Article 502 provides that in order to claim NAFTA preferential tariff treatment, importers must:

- make a written declaration, based on a valid certificate of origin, that the goods for which preferential treatment is sought qualify as "originating" goods;
- possess the certificate when the declaration is made;
- provide a copy of the certificate to the customs administration of the importing country upon request; and
- promptly make a corrected declaration and pay any duties owing if the importer has reason to believe that a certificate upon which a declaration was based contains incorrect information.

An importer will not be subject to penalties for making an incorrect declaration if the importer promptly and voluntarily makes a corrected declaration, except in the event of fraudulent misrepresentation or as the circumstances may otherwise warrant. Importers may make "post-importation" claims for NAFTA preferential tariff treatment up to a year after the goods are imported. In making a post-importation claim the importer may apply for a refund of excess duties paid on presentation of a written declaration that the good qualified as an "originating" good, a copy of the certificate of origin, and such other documentation as the customs administration may require.

An importer's exercise of the right to make a post-importation claim may affect the amount of refund, waiver or remission of customs duties granted to a claimant upon the exportation of such goods, in accordance with NAFTA Article 303 (regarding drawback). That amount may be adjusted by the customs service of the exporting country.

## **3. Exceptions**

Article 503 provides that certificates of origin are not required for certain low-value commercial and non-commercial importations or importations for which a NAFTA government has waived the certificate of origin requirement. However, the rule does not apply if the

importations are undertaken or arranged in order to avoid the certification requirements; that is, if an exporter and importer arrange for a series of low-value shipments in order to avoid the requirement to execute a certificate of origin.

#### **4. Obligations Regarding Exportations**

Article 504 provides that upon request, exporters or producers who have completed certificates of origin must provide a copy of a certificate of origin to the customs administration in the country in which they are located. Exporters or producers who have completed certificates of origin and who have reason to believe that the certificates contain incorrect information must promptly notify in writing all persons to whom the exporter or producer gave the certificates of any change that could affect their accuracy or validity.

Exporters or producers who make false statements in a certificate of origin will be subject to the same penalties under the law of the exporting country as importers who make false statements in connection with an importation. However, exporters or producers will not be subject to penalties -- except in the event of fraudulent misrepresentation or as otherwise warranted -- for making an incorrect certification if they promptly and voluntarily provide written notification to all persons to whom they gave the certificate of any change that could affect its accuracy or validity. Material false statements in a NAFTA certificate of origin will be subject to penalties under section 592(a) of the Tariff Act of 1930.

#### **5. Recordkeeping Requirements**

Article 505 provides that persons who execute NAFTA certificates of origin must maintain for five years from the date on which a certificate is signed all records relating to the origin of a good for which preferential tariff treatment was claimed. In addition, importers claiming preferential tariff treatment for particular goods must maintain for at least five years from the date of importation records required by the customs authorities relating to the importation of the goods, including the certificate of origin.

#### **6. Origin Verifications**

Article 506 provides that in order to determine whether an imported good qualifies as an "originating good," the customs administration of the importing country may verify the origin claim by:

- issuing questionnaires;
- visiting the premises of a foreign exporter or producer to review applicable records and observe its production facilities; or
- using such other procedures as the three governments may agree.

Before conducting a verification visit in another NAFTA country, the customs administration must deliver an advance written notification of its intention to the firm whose premises are to be visited, to the customs administration in that country and, if requested, to that country's embassy in the territory of the verifying country. The notification must include certain specified information.

Before conducting such a verification visit, the customs administration must also obtain the written consent of the person whose premises are to be visited. If the exporter or producer does not consent to the visit within 30 days of receipt of notification, however, the importing country may deny preferential tariff treatment to the goods in question.

The customs administration of the country where the verification visit is to be conducted (the exporting country) may, within 15 days of receipt of the notification, postpone the proposed verification visit for up to 60 days, or for such longer period as the two governments may agree. The purpose of the postponement is to allow the customs administration of the exporting country to complete an ongoing investigation or audit relating to the exporter or producer. The importing country may not deny preferential tariff treatment solely on the basis of such a postponement.

The firm whose goods are the subject of a verification visit may designate two observers to be present during the visit. The customs authorities are not required to postpone a verification visit if the firm in question fails to designate observers.

When customs authorities conduct a verification visit in another NAFTA country, they must use the "generally accepted accounting principles" applied in that country in determining whether the NAFTA's regional value-content requirements have been met. The accounting principles applied in the three NAFTA countries are generally similar.

The customs administration must provide the firm whose goods are the subject of the verification a written determination of whether the goods qualify as "originating" goods, including findings of fact and the legal basis for the determination. If the customs administration establishes through two or more verifications a pattern of false or unsupported representations by an exporter or producer that particular goods meet NAFTA's rules of origin, it may withhold preferential tariff treatment for future importations of identical goods until the exporter or producer establishes compliance with the rules of origin.

A determination by the customs authorities of the importing country that particular goods do not meet NAFTA's rules of origin, based on a classification or value of materials used in the production of the goods that differs from that applied by the exporting country, does not become effective until those authorities notify in writing both the importer and the person that completed the certificate of origin. In certain cases, the importer may have been entitled to rely, in making the claim for preferential tariff treatment, on an "advance ruling" or on consistent treatment by the customs administration of the exporting country concerning the classification or value in

question. In such a case, the importing country may not apply its determination to goods imported before the effective date of the determination.

In addition, if either the importer or person who signed the certificate can show that it relied to its detriment on the classification or value applied by the exporting country, the effective date of the importing country's determination will be delayed for up to 90 days. These provisions mean, for example, that U.S. exporters who sign certificates of origin based in part on reliance on a tariff classification of materials applied by the U.S. Customs Service will be given advance notice if the customs administration of another NAFTA country disagrees with that designation. The advance notice will enable U.S. exporters to make adjustments to avoid unnecessary business losses.

## **7. Confidentiality**

Article 507 requires the customs administration in each country to maintain the confidentiality of proprietary business information collected pursuant to Chapter Five. Such information may only be disclosed to those authorities responsible for the administration and enforcement of determinations of origin, and of customs and revenue matters.

## **8. Penalties**

Article 508 requires each government to maintain criminal, civil or administrative penalties for violations of its customs laws and regulations. Furthermore, Article 508 makes clear that each government retains the right to apply any penalties or other enforcement measures that the circumstances may warrant.

## **9. Advance Rulings**

Article 509 provides that each country's customs administration must issue binding and expeditious "advance rulings" to importers in its territory and to exporters and producers in other NAFTA countries. This provision will provide greater certainty to U.S. exporters in their dealings with Mexican and Canadian customs authorities concerning the tariff treatment that will be applied to their goods. Neither Mexico nor Canada currently provides advance rulings.

Under Article 509, advance rulings will be provided concerning:

- whether materials imported from a non-NAFTA country undergo an applicable change in tariff classification, due to production in one or more NAFTA countries, and thus qualify as "originating" materials;
- whether a good satisfies a regional value-content requirement under either of the methods set out in Chapter Four;

- the appropriate basis or method for calculating the "transaction value" of a good or of the materials used in the production of a good;
- the appropriate basis or method for reasonably allocating costs, for calculating the net cost of a good, or for calculating the value of an intermediate material;
- whether a good qualifies as an "originating" good;
- whether a good that reenters that country after the good has been exported to another NAFTA country for repair or alteration qualifies for duty-free treatment under Article 307;
- whether the proposed or actual marking of a good satisfies NAFTA country-of-origin marking requirements;
- whether an "originating" good qualifies as a good of a particular NAFTA country under Annex 300-B (Textile and Apparel Goods), Annex 302.2 (Tariff Elimination) or Chapter Seven (Agriculture and Sanitary and Phytosanitary Measures);
- whether a good is a "qualifying" good under Chapter Seven; or
- such other matters as the NAFTA countries may agree.

Each country is required to adopt or maintain procedures for the issuance of advance rulings, including methods of requesting supplemental information from firms that request such rulings. Adverse advance rulings must be accompanied by an explanation.

Article 509 requires that advance rulings apply prospectively, either from the date of issuance or any later date specified in the ruling. If the facts and circumstances are identical in all material respects, the customs authorities must provide to any firm requesting an advance ruling the same treatment they have provided to any other firm to which they have previously issued an advance ruling.

Under certain circumstances the issuing customs administration may modify or revoke an advance ruling. Modifications or revocations must take effect prospectively unless the firm to whom the advance ruling was issued has not acted in accordance with its terms and conditions. However, the customs administration must postpone the effective date of such modification or revocation for a period not exceeding 90 days where the firm demonstrates detrimental reliance on a ruling issued to it.

If, on examining the regional value content of particular goods for which it has issued an advance ruling, the customs administration determines that:

- the exporter or producer has not complied with the advance ruling;

- the exporter's or producer's operations are inconsistent with material facts or circumstances on which the ruling was based; or
- the information used in applying the method for calculating the value or allocating the cost was materially incorrect;

the customs administration may modify or revoke the ruling.

If the customs administration determines that an advance ruling was based on incorrect information but the person to which the advance ruling was issued demonstrates that it used reasonable care and good faith in presenting the facts and circumstances on which the ruling was based, the person may not be penalized. If, on the other hand, a person misrepresents or omits material facts or circumstances on which the ruling is based, or fails to act in accordance with the terms and conditions of the ruling, the customs authorities may take action warranted by the circumstances.

## **10. Review and Appeal**

Under the terms of Article 510, each NAFTA government must give exporters and producers in the other two countries substantially the same rights of review and appeal of marking determinations, country of origin determinations and advance rulings as it provides to its own importers. This provision will make it possible, for the first time, for U.S. exporters and producers to appeal adverse determinations by Mexican and Canadian authorities.

Exporters and producers will be given these rights where:

- they have completed a certificate of origin for a good that has been the subject of a determination of origin;
- their goods have been the subject of a NAFTA country of origin marking determination; or
- they have received an advance ruling.

Such rights of review and appeal must include access to at least one level of independent administrative review, and judicial or quasi-judicial review of the determination or decision taken at the final level of administrative review.

## **11. Uniform Regulations**

Article 511 requires the three governments to adopt common ground rules for the interpretation, application and administration of Chapter Four and Chapter Five and other matters that may be agreed. This provision is designed to foster the greatest possible degree of

uniformity in the implementation of NAFTA's origin and marking rules. If the three governments decide to change any joint interpretations or rules under Article 511 after the Agreement enters into force, they will implement the changes promptly.

## **12. Cooperation**

Under Article 512 the three governments must notify each other when they take certain actions that could raise concerns in another NAFTA country over the application of the Agreement's origin or marking rules. For example, a government must give notice when it makes a determination of origin based on an on-site verification in another country.

The three governments have also pledged to cooperate in customs enforcement matters. For example, in order to detect and prevent unlawful transshipment of textiles and apparel from non-NAFTA countries, the three governments will collaborate in the enforcement of import prohibitions or quantitative restrictions. The three countries also intend to cooperate in the area of data exchange and documentation.

## **13. Working Group and Customs Subgroup**

An inter-governmental Working Group on Rules of Origin will meet at least four times each year for such purposes as monitoring the implementation and administration of NAFTA's drawback and marking rules as well as of Chapters Four and Five, and any agreed sets of rules for applying those chapters. The Working Group may also consider any differences between the NAFTA governments over the customs provisions of the agreement.

A Customs Subgroup, operating under the direction of the Working Group, will be used to address potential disagreements between the customs administrations of the three governments and to consider ways of facilitating the flow of trade through customs in the three countries.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

#### **a. Recordkeeping Requirements**

Section 205(a) of the bill implements Article 501(3)(a) and Article 505 by amending section 508 of the Tariff Act of 1930 (19 U.S.C. 1508) to require U.S. exporters and producers who execute NAFTA certificates of origin to maintain records relating to those certifications for five years. A penalty of \$10,000 or such general recordkeeping penalties as may apply under the customs laws, whichever is higher, will apply for failure to maintain such records.

#### **b. Summons Authority**

Section 205(b) amends section 509 of the Tariff Act of 1930 (19 U.S.C. 1509) to extend Customs Service summons authority to persons who export merchandise, or knowingly cause merchandise to be exported, to a NAFTA country.

**c. Prior Disclosure**

Section 205(cb) of the bill implements Articles 502 and 504. Generally, importers who make false declarations of NAFTA origin to the Customs Service, and persons who make false statements in NAFTA certificates of origin, will be liable for penalties under section 592 of the Tariff Act (19 U.S.C. 1592) for fraud, gross negligence or negligence, as appropriate. Section 205(c) of the bill amends section 592 of the Tariff Act to exempt from penalty U.S. exporters or producers who make false certifications if they voluntarily and promptly notify in writing all persons to whom the person provided the certificate of origin of its falsity.

In addition, exporters or producers who make certifications that are correct at the time made but are rendered incorrect due to a change in circumstances, are exempt from penalty if they voluntarily and promptly notify in writing all persons to whom they provided the certificate of the change. Finally, under section 205(c), U.S. importers who make false declarations of NAFTA origin based on incorrect certificates of origin can avoid penalties if they voluntarily and promptly correct their declarations and pay any duties owing.

**d. Reliquidation of Entries for NAFTA Origin Claims**

Section 206 of the bill implements Article 502 by amending section 520 of the Tariff Act (19 U.S.C. 1520) to authorize the Customs Service to reliquidate an entry and provide NAFTA tariff treatment to the entry if the importer, within one year after the date of importation, files a NAFTA claim in accordance with the implementing regulations, including specified documents.

**e. Review and Appeal**

Sections 207(a)(2) and 208 of the bill implement Article 510, which gives Mexican and Canadian exporters and producers substantially the same rights of appeal under U.S. law as those available to importers for marking determinations and, where such producers or exporters have signed a certificate of origin, for NAFTA origin determinations.

Section 207(a)(2) of the bill amends section 304 of the Tariff Act of 1930 (19 U.S.C. 1304) to provide Mexican and Canadian exporters and producers -- or their agents -- a right of review and appeal of adverse NAFTA marking determinations. Under the amendment, the Customs Service will, upon request, provide Canadian and Mexican exporters and producers with a statement of the basis for any such determination.

If the importer of the merchandise protests the determination, the exporter or producer may intervene in that protest (subject to Customs regulations). In such a case, the rights of the exporter or producer will be subordinate to the importer's rights. Consequently, if the importer decides to withdraw or settle the protest, the exporter or producer will have no right to continue the protest. If the importer does not file a protest, the exporter or producer may petition the Customs Service for review. The decision on review, if contrary to the initial decision of the Customs Service, will become effective 30 days after the date the notice of the determination is published in the *Federal Register*.

Section 208 of the bill amends section 514 of the Tariff Act of 1930 (19 U.S.C. 1514) by providing Canadian and Mexican exporters and producers who have completed NAFTA certificates of origin the right to protest adverse determinations of NAFTA origin. The amendment also provides for the consolidation of such protests. In addition, section 208 provides that if the Customs Service finds a pattern of false or unsupported representations regarding NAFTA origin by an exporter or producer, preferential tariff treatment may be denied to, or withheld from, the goods in question without the issuance of any further notice until the Customs Service is satisfied that compliance has been established.

#### **f. Exchange of Information**

Section 209 of the bill provides for the exchange of information contemplated under NAFTA Article 512. It amends section 628 of the Tariff Act (19 U.S.C. 1628) to authorize the Secretary to share customs information with another NAFTA country if the Secretary reasonably believes the exchange is necessary to implement Chapters Three, Four or Five of the NAFTA, provided that the Secretary receives satisfactory assurances from the other NAFTA country that the information will be held in confidence and used for governmental purposes. This amendment is intended to facilitate the implementation of various NAFTA customs provisions, such as the NAFTA drawback rules, which depend upon the prompt exchange of accurate customs data. It is not intended to lessen the breadth of Customs Service authority to share information under current law.

### **2. Administrative Action**

Under Article 511, the three governments will negotiate uniform standards for the application of Chapter Five. The Customs Service will promulgate regulations based on these standards. The Customs Service intends to issue the regulations as soon as possible after the enactment of the implementing bill. The regulations will address the following subjects, among others.

#### **a. Advance Rulings**

Since the provisions in the NAFTA for advance rulings were modeled after the U.S. ruling regime, Customs Service regulations for NAFTA advance rulings will parallel in most respects the current regulations in Part 177 of the Customs Regulations for obtaining

advance rulings. For example, a ruling will represent the official position of the Customs Service and may be relied on provided that the facts and circumstances represented in the ruling are complete and do not change. The regulations will make provision for modifications and revocations as well as for delaying the effective date of a modification where the firm in question has relied on an existing ruling.

The subjects for which an advance ruling may be requested are set forth in Article 509(1) of the Agreement, and they include, in addition to rulings on the eligibility of goods for preferential tariff treatment, rulings on whether a good meets the country of origin marking requirements of Article 311 or whether a good is a "qualifying" good under Chapter Seven (Agriculture) of the Agreement. NAFTA advance rulings will be issued within 120 days of receipt of all information reasonably required to process the application for the ruling.

**b. Post-Importation Claims**

Consistent with Article 502, the regulations will establish procedures for filing claims for NAFTA tariff benefits for goods up to one year after their importation. In addition to providing the Customs Service a copy of the certificate of origin, the claimant will be required to indicate whether drawback has been claimed in connection with the good. This latter requirement will be imposed to prevent firms from claiming both NAFTA drawback and tariff benefits. Under the NAFTA, goods for which NAFTA tariff benefits are claimed are subject to the drawback limitations set forth in Article 303.

**c. Filing and Administration of Protests**

The regulations will also elaborate on the protest and appeals rights conferred by sections 207(a) and 208 of the implementing bill on Mexican and Canadian exporters and producers in connection with goods for which NAFTA tariff benefits are claimed. These rights will be substantially similar to the rights that U.S. importers will enjoy in connection with such goods. The regulations will establish a procedure for notifying these parties of the results of an origin determination. In addition, they will set out the notification procedure regarding the opportunity to protest an origin determination within a period of 90 days following the liquidation of the entry transaction.

Regulations will also specify how appeals by importers, producers and exporters are to be filed, including procedures for consolidation of actions and the protection of confidential business information.

**d. Origin Verifications**

The Customs Service will issue regulations describing the procedures that it will follow in using questionnaires, letters or visits to conduct an origin verification of a Canadian or Mexican exporter or producer. In addition, the regulations will establish procedures for notifying the appropriate parties of a Customs Service determination of origin and for applying

that determination to current and future importations of identical goods. The Customs Service will also use the procedures described in Article 506 to verify the applicable rate of customs duty for an "originating good" in accordance with the rules set out in Annex 302.2 and to determine whether a good is a "qualifying good" for purposes of Annex 703.2.

**e. Trilateral Cooperation**

The regulations will also set out procedures under which the Customs Service will exchange rulings, determinations of origin and other information with Mexican and Canadian customs authorities pursuant to Article 512. In addition, the regulations will establish procedures to be used in connection with the activities of the Rules of Origin Working Group and Customs Subgroup established under Article 513, and address the creation of Working Groups that will meet regularly to discuss differences between NAFTA governments concerning the administration of the Agreement and proposals for changes to the Uniform Regulations.

**f. Cooperation between EPA and Customs Service**

The Customs Service and the Environmental Protection Agency (EPA) recognize the importance of ensuring that regulations pertaining to the importation of hazardous materials, including waste, are properly enforced. To further this goal, the EPA requires prompt and accurate information on this type of imports, particularly from Mexico. For this reason, both the Customs Service and the EPA will cooperate in the area of exchange of information and will study the feasibility of developing an automated interface system between the two agencies to monitor in a more effective manner imports subject to EPA requirements for enforcement and statistical purposes. In addition, the EPA and the Customs Service will continue to explore ways to improve the collection of data relating to certain transboundary shipments to and from Mexico.

## **CHAPTER SIX: ENERGY AND BASIC PETROCHEMICALS**

### **A. SUMMARY OF NAFTA PROVISIONS**

Chapter Six establishes specific rules in respect of trade in energy products and petrochemicals. It also spells out certain Mexican Government exceptions ("reservations") in connection with NAFTA's rules governing national treatment of investments and trade in services related to energy products and petrochemicals.

The chapter should be read in conjunction with the other relevant provisions of the NAFTA, including Chapter Three (National Treatment and Market Access for Goods), Chapter Eleven (Investment), Chapter Twelve (Cross-Border Trade in Services) and Chapter Fifteen (Competition Policy, Monopolies and State Enterprises). The chapter also carries forward and supersedes each of the key provisions of the CFTA energy chapter.

#### **1. Scope and Coverage**

Chapter Six covers "energy and basic petrochemical goods." Article 602 defines this term to mean those products listed under specified portions of the Harmonized Commodity Description and Coding System. The list includes such energy products as petroleum, natural gas, coal, electricity and uranium and other nuclear fuels. The chapter also covers pentane, carbon black feedstocks, hexanes, heptanes and ethane, which all three countries consider to be basic petrochemicals. In addition, Chapter Six applies to naphtha, butanes and propane, which are treated either as energy products or as basic petrochemicals in the three countries.

#### **2. Import and Export Restrictions; Export Taxes**

Articles 603 through 605 and Article 607 track closely major provisions of the CFTA energy chapter.

Article 603 incorporates by reference GATT rules concerning import and export restrictions, making clear that those provisions apply to North American trade in energy and basic petrochemical goods. Article 603 also explicitly states that all three NAFTA countries interpret the relevant GATT provisions to prohibit minimum or maximum export-price and import-price requirements.

Unlike the CFTA, however, the relevant GATT provisions are made part of the NAFTA without any of the limitations and exceptions that governments can invoke under the GATT. In practical effect, this means that Mexico may not use the limitations and exceptions included in its GATT accession or cite its status as a developing country as a basis for failing to comply with the GATT rules incorporated in the NAFTA.

In addition, Article 603 affirms each government's right to maintain a system for licensing imports and exports of energy and basic petrochemical goods. However, any such

system must comply with all of the relevant requirements of the NAFTA, including the GATT rules on import and export restrictions incorporated into Article 603 and the obligations governing the behavior of government-owned energy firms set out in Chapter Fifteen.

Article 604 extends GATT disciplines to cover export taxes on energy products and petrochemicals, requiring the three governments to refrain from imposing such taxes unless they are also imposed on domestic consumption of the good in question.

### **3. Other Export Measures**

Article 605 carries forward for energy trade between Canada and the United States CFTA Article 904. It limits the circumstances under which the United States and Canada may restrict exports to the other country when conserving resources to address a domestic shortage or protect a domestic price control program. Under Article 605, the two governments may not impose such restrictions if:

- the restrictions reduce the proportion of total supply historically available to the other country;
- the government imposes a higher price on exports than for comparable domestic sales; or
- the restrictions disrupt the normal channels of supply or mix of energy or basic petrochemical products supplied to the other country.

By virtue of Annex 605, this article does not apply to energy trade with Mexico.

### **4. Energy Regulatory Measures**

Article 606 reiterates that the three governments' energy regulatory measures at the federal and sub-federal level are subject to NAFTA's rules regarding national treatment, import and export restrictions, and export taxes. In recognition of the complexity of energy regulatory programs and their potential effects on energy trade, the article also reflects the agreement of the three governments that the implementation of regulatory measures should be undertaken in a manner that promotes a stable commercial environment.

### **5. National Security Measures**

Article 607 carries forward CFTA Article 907. It sets out the national security exception applicable to trade in energy and basic petrochemical goods between the United States and Canada. The permissible grounds for invoking the national security exception in Article 607 are narrower than those permitted by GATT Article XXI or NAFTA's general national security provision.

Specifically, Canada and the United States may invoke the exception in respect of their energy trade only where an import or export restriction is necessary to permit the supply of a military establishment, to fulfill critical defense contracts, to respond to armed conflict, to assure nuclear weapons non-proliferation, or to respond to direct threats of disruption in the supply of nuclear materials for defense purposes.

For energy trade with Mexico, each NAFTA country has reserved its right to use NAFTA's general national security exception, Article 2102.

## **6. Miscellaneous Provisions**

Article 608(1) follows closely CFTA Article 906. It recognizes the importance of government incentives for oil and gas resource development in view of the contribution of such incentives to the overall energy supply security of the NAFTA countries. Moreover, nothing in the NAFTA precludes a government from adopting policies to promote increased energy efficiency such as those in the Energy Policy Act of 1992. Article 608(1) does not prohibit the imposition of antidumping or countervailing duties, however, if subsidies granted by a NAFTA country result in exports that injure another NAFTA country's domestic industry.

Paragraph one of Annex 608.2 incorporates by reference Annexes 902.5 and 905.2 of the CFTA solely for trade between the United States and Canada. In those Annexes, Canada and the United States agreed to make changes in certain laws and regulations.

Paragraph two of the Annex tracks the language of CFTA Article 908. It makes clear that the United States and Canada intend no inconsistency between their respective obligations in Chapter Six and the obligations the two governments have under the *Agreement on an International Energy Program* (T.I.A.S. No. 8278), which entered into force in 1976.

## **7. Mexican Reservations**

Annex 602.3 sets out certain Mexican reservations in respect of trade, services and investment in connection with energy and basic petrochemical goods. The Annex contains important qualifications on those reservations, however, pertaining to trade in natural gas and basic petrochemicals, performance clauses in service contracts of state enterprises, and investment in electricity generation facilities in Mexico. Mexico's reservations reflect the fact that virtually all of the activities in the sectors that Mexico has reserved are carried out exclusively by Mexican government-owned monopolies.

Paragraph one of the Annex reserves to the Mexican Government certain activities in the petroleum, natural gas, basic petrochemicals, nuclear energy and electricity sectors. The activities encompassed by this reservation include foreign trade in the products specified and investment and services in connection with such goods.

The list of petrochemicals to which the reservation applies is limited, and reflects the elimination of fourteen "reserved" products included in the list at the outset of the NAFTA negotiations. The shortened list will substantially increase trade and investment opportunities for U.S. firms in Mexico's petrochemicals sector.

Mexico's reservation in respect of foreign trade in the energy and basic petrochemical goods listed in the Annex is qualified by paragraph three. It requires Mexico to permit suppliers and end-users of natural gas and basic petrochemical goods to negotiate supply contracts for cross-border trade in such goods in conjunction with the Mexican Government petroleum monopoly, PEMEX.

Paragraph four represents another qualification of the Mexican reservation. It obliges Mexico to permit PEMEX, and Mexico's electricity monopoly, CFE, to negotiate performance clauses in their service contracts. This provision makes clear that PEMEX and CFE may allocate commercial risk between themselves and their service contractors by negotiating the level and means of rewarding contractors for their performance.

Mexico's reservation regarding the supply of electricity as a public service is qualified by paragraph five. It requires Mexico to allow U.S. and Canadian investors to acquire, establish, and operate electric generating plants in Mexico for self-generation, co-generation and independent power production. In addition, Mexico must permit these independent power producers, together with CFE, to negotiate power purchase and sale contracts with electric utilities in the United States and Canada.

It should be noted that the reservations set out in Annex 602.3 do not permit Mexico to impose export or import restrictions inconsistent with the GATT rules incorporated in Article 603. Moreover, to the extent that Mexican Government enterprises are given responsibility for carrying out activities in the reserved sectors, those state enterprises are subject to the disciplines of Chapter Fifteen (Competition Policy, Monopolies and State Enterprises).

Chapter Fifteen provides several benefits to U.S. and Canadian investors in the Mexican energy sector. It requires, for example, that PEMEX and CFE act in a non-discriminatory manner in their sales of goods and services to U.S.- or Canadian-owned businesses in Mexico. In addition, when buying or selling a monopoly good or service, PEMEX and CFE must follow commercial considerations, consistent with the terms of their government mandates, and must not discriminate against U.S. or Canadian goods or businesses. Chapter Fifteen also requires Mexico to ensure that these monopolies do not use their monopoly positions to engage in anticompetitive practices in non-monopoly markets in Mexico, such as discriminatory provision of the monopoly good or service, cross-subsidization or predatory conduct.

Finally, Mexico's reservations in Annex 602.3 also are subject to certain qualifications that appear elsewhere in the NAFTA. Note 40, appended to Annex 602.3 and Article 1101(2), provides that once Mexico permits investments in otherwise reserved activities, such investments will be entitled to the protections of Chapter Eleven. (NAFTA's endnotes appear following Chapter 22.) These protections include the right to make transfers, safeguards against

unjustifiable expropriations, and investor-state arbitration procedures. In addition, Article 1108(1), together with Section B(2) of Annex III, make clear that Mexican measures pertaining to investment in reserved activities may not be made more restrictive in the future and, once liberalized, may not subsequently be made more restrictive.

**B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

No change in statute and no administrative action will be required to implement the provisions of Chapter Six. Because the NAFTA essentially duplicates the principal provisions of CFTA Chapter Nine for U.S.-Canada energy trade, there is no need to amend section 305 of the CFTA Implementing Act or to change implementing regulations for the CFTA.

## **CHAPTER SEVEN: AGRICULTURE AND SANITARY AND PHYTOSANITARY MEASURES**

### **SECTION A -- AGRICULTURE**

Chapter Seven consists of two sections. Section A covers agricultural trade and Section B covers sanitary and phytosanitary measures.

#### **A. SUMMARY OF NAFTA PROVISIONS**

To a large extent, Section A amounts to three bilateral agreements rather than a trilateral accord. As between the United States and Canada, the NAFTA incorporates most of the agricultural market access provisions of Chapter Seven of the CFTA. The NAFTA also sets out separate agricultural market access agreements between Mexico and the United States and between Mexico and Canada. In addition, Section A includes a few obligations common to all three countries.

Section A should be read in conjunction with the other relevant provisions of the NAFTA, including the tariff schedules of the respective NAFTA countries, Chapter Three (National Treatment and Market Access for Goods), Chapter Four (Rules of Origin), Chapter Eight (Emergency Action), Chapter Nine (Standards-Related Measures) and Chapter Seventeen (Intellectual Property).

##### **1. International Obligations**

Article 702 sets out commitments by the NAFTA countries regarding other international agreements or obligations. Paragraph one incorporates by reference (through Annex 702.1) Articles 701, 702, 704, 705, 706, 707, 710, and 711 of the CFTA for purposes of agricultural trade between the United States and Canada. Accordingly, these provisions of the CFTA, and the provisions of the CFTA Implementation Act and regulations implementing these provisions will remain in force. These CFTA provisions relate to agricultural export subsidies, temporary duties on fresh fruits and vegetables under specified circumstances, quantitative import restrictions on meat, import restrictions on grains and grain products, Canadian import restrictions on poultry and eggs, U.S. import restrictions on goods containing ten percent or less sugar by dry weight, the rights of the NAFTA countries under the GATT and definitions.

The NAFTA's dispute settlement procedures rather than those of the CFTA will apply to matters arising under the incorporated CFTA provisions. In addition, the NAFTA clarifies that the rights of the United States and Canada under the GATT preserved in CFTA Article 710 include certain exemptions and waivers under the GATT, which includes the waiver granted to the United States under the GATT for measures to implement section 22 of the Agricultural Adjustment Act (7 U.S.C. 624).

In addition, through a separate agreement, the United States and Canada have agreed to maintain in force between them the provisions of Article 708 of the CFTA.

Paragraph two of Article 702 imposes an obligation on each NAFTA country to consult with the other NAFTA countries before adopting any measures pursuant to an international commodity agreement that may affect trade in an agricultural good between the NAFTA countries. The consultations are to be held with a view to avoiding nullification or impairment of a NAFTA tariff concession granted by the country proposing to adopt the measure. NAFTA's dispute settlement procedures would also be available to address nullification or impairment of benefits of the agricultural market access commitments under the NAFTA.

Paragraph three of Article 702 and Annex 702.3 apply only to Canada and Mexico. Neither Canada nor Mexico is permitted to adopt or maintain a measure, pursuant to an intergovernmental coffee agreement, that restricts trade in coffee between them.

## **2. Market Access for Agriculture**

Article 703 includes commitments by the NAFTA countries regarding market access for agricultural goods. Article 703(1) is the same as Article 703 of the CFTA, and provides a "best efforts" obligation on the NAFTA countries to work together to improve access to their respective markets.

Annex 703(2) contains specific, bilateral commitments by the NAFTA countries with respect to customs duties, quantitative restrictions and grading and marketing standards for agricultural trade. Section A of Annex 703.2 applies only between the United States and Mexico, and Section B of Annex 703.2 applies only between Canada and Mexico. As mentioned above, specific market access provisions of the CFTA continue to apply to agricultural trade between Canada and the United States.

### **a. United States and Mexico**

#### **(1) Qualifying Goods**

The United States - Mexico agricultural market access provisions in Section A of Annex 703.2 generally apply to goods that are "qualifying goods." A "qualifying good" is an agricultural good that meets the NAFTA rules of origin based on its U.S. and Mexican content alone; Canadian content is treated as if it were non-NAFTA content. The purpose of this definition is to ensure that the benefits of the U.S. - Mexico agricultural market access provisions of Annex 703.2 accrue only to United States and Mexican products.

(2) Elimination of Non-Tariff Barriers; "Tariffication"

NAFTA is the first free trade agreement entered into by the United States that employs the concept of "tariffication" of agricultural quantitative restrictions. Under this concept, a country replaces each of its non-tariff barriers with a "tariff equivalent," which is a tariff rate set at a level that will provide protection for a product equivalent to the non-tariff barrier that the tariff replaces.

In the case of several agricultural goods listed in the tariff schedules of each NAFTA country, the NAFTA countries will convert quantitative restrictions to tariffs or tariff rate quotas. Under a tariff rate quota, a tariff is applied at a lower rate (the "in-quota" rate) to a certain volume of imports (the "in-quota" quantity). Any imports above the in-quota quantity are assessed a higher rate of tariff (the "over-quota" rate).

Under the NAFTA, Mexico has agreed to convert to tariff rate quotas its import licensing requirements for imports from the United States of corn, dry beans, milk powder, poultry, barley and malting barley, animal fats, potatoes and eggs. Mexico has also agreed to convert its import license requirements for wheat, grapes imported from June 1 through October 14, tobacco, cheese, evaporated milk and day-old chicks to simple tariffs (not tariff rate quotas) that will be phased out over 10 years. Furthermore, Mexico agreed to eliminate both its import licensing requirement and all tariffs on millet and on grapes imported from October 15 through May 31.

For its part, the United States agreed to convert to tariff rate quotas its import quotas under section 22 of the Agricultural Adjustment Act for imports from Mexico of dairy products, cotton, sugar-containing products and peanuts.

For both Mexican and U.S. agricultural products, in-quota imports will enter duty-free. The in-quota quantity will increase over time, and the over-quota tariff rate will be eliminated in either ten or 15 years.

The decision by the United States and Mexico to convert to tariffication led to the inclusion of several other provisions in Section A of Annex 703.2.

Tariffication requires that countries not institute new non-tariff barriers. It would be futile to reach agreement with a country to convert its non-tariff barrier to a tariff rate quota only to have the country then impose a new non-tariff barrier on the good.

Accordingly, in paragraph three of Section A of Annex 703.2, the United States and Mexico have waived their rights with respect to each other under Article XI:2(c) of the GATT and those rights as incorporated into the NAFTA under Article 309 regarding the importation of "qualifying goods." This GATT provision preserves the rights of GATT parties to maintain quantitative restrictions on imported agricultural goods under certain circumstances, such as to support domestic supply management and surplus removal programs. By waiving

their rights under this GATT Article, the United States and Mexico will be bound by the general prohibition in the GATT and the NAFTA against quantitative restrictions. Neither country will apply to qualifying goods any quantitative restrictions otherwise permissible under GATT Article XI:2(c). However, such restrictions still may be applied to non-qualifying goods.

Paragraph four of Section A of Annex 703.2 addresses the cases in which over-quota tariff rates permitted under the NAFTA exceed the tariff rates bound under the GATT. For example, this would occur when, as part of tariffication for a product, the NAFTA over-quota tariff rate exceeds the tariff rate for that product currently "bound" under the GATT. Under the GATT, countries bind themselves not to apply to imports of a particular good a rate of duty higher than a specified amount. This maximum amount is referred to as the "bound" rate of duty.

Paragraph four makes clear that in such situations the over-quota rate may be applied between the United States and Mexico even though it exceeds the GATT-bound tariff rate. However, not all the tariff rate quotas under the NAFTA are the result of tariffication. Some of them result from creating a tariff rate quota under a simple tariff. In that case, the over-quota tariff rate would not exceed the GATT "bound" rate, and there is no need for the United States or Mexico to waive their GATT rights with respect to that over-quota tariff rate. The agricultural products for which this is the case are listed in Annex 703.3 and Appendix 703.2.A.4.

Negotiations are currently being conducted pursuant to the Uruguay Round of multilateral trade negotiations under the auspices of the GATT. The United States and other countries have advocated the use of tariffication in those negotiations as well. Accordingly, those negotiations could result in over-quota tariff rates lower than the corresponding NAFTA over-quota tariff rates. Under paragraph five of Section A the over-quota rate applied by the United States or Mexico may not exceed the lower of: (1) the over-quota rate in an agreement resulting from multilateral trade negotiations under the GATT involving agriculture or (2) the over-quota rate agreed to in the NAFTA.

Paragraph six of Section A provides that the United States and Mexico may count the in-quota quantity of qualifying goods under the NAFTA toward the in-quota quantity for such products under tariff rate quotas agreed or to be agreed to under the GATT. Under paragraph seven, however, any agricultural good admitted or entered into a maquiladora or foreign-trade zone and re-exported may not count as part of the in-quota quantity under a NAFTA tariff-rate quota.

As noted above, the United States agreed, as part of tariffication, to convert to tariff rate quotas its import restrictions under section 22 of the Agricultural Adjustment Act on imports of qualifying goods from Mexico. Accordingly, under paragraph eight of Section A, the United States may not apply to qualifying goods any fee under section 22 of the Agricultural Adjustment Act. In addition, as a result of paragraph two of Section A and Article 309 of the NAFTA, the United States will not apply to qualifying goods any quantitative

restrictions under section 22. Similarly, Mexico is obligated to dismantle its highly restrictive import licensing regime with respect to qualifying goods and will not be able to impose any new licensing requirements on these goods, except in accordance with the NAFTA.

Similarly, as a result of tariffication the United States will not apply to qualifying goods from Mexico quantitative restrictions under the Meat Import Act of 1979. In addition, under paragraph nine of Section A of Annex 703.2, neither the United States nor Mexico may seek a voluntary restraint agreement from the other with respect to the export of meat that is a qualifying good.

Because the reciprocal elimination of quantitative restrictions and fees applies only to qualifying goods, the United States and Mexico retain the right to apply such quantitative restrictions and fees to non-qualifying goods. For example, the United States may continue to apply section 22 quotas and fees with respect to goods from Mexico with insufficient Mexican or United States content to be considered qualifying goods.

(3) Certain Special Rules for Preferential Treatment of Peanuts, Peanut Products, and Sugar-Containing Products

Paragraphs ten and eleven of Section A of Annex 703.2 are reciprocal special rules concerning eligibility of certain peanuts, peanut products and sugar-containing products for preferential treatment under the NAFTA. The provisions impose stricter rules of origin than otherwise would be applicable under other NAFTA rules. Under these paragraphs, in order to qualify for NAFTA benefits peanuts exported to the United States must be harvested in Mexico, peanut butter and other products under subheading 2008.11 of the Harmonized Tariff Schedule of the United States (HTS) must be made from peanuts harvested in Mexico, and the sugar used in the sugar-containing products under HTS subheadings 1806.42 and 2106.90.12 must have been harvested in Mexico.

(4) Restriction on Same-Condition Substitution Duty Drawback

Paragraph twelve of Section A provides that duty drawback will not be available with respect to an imported agricultural good that is substituted by an identical or similar good subsequently exported to the other NAFTA country.

(5) Trade in Sugar and Syrup Goods

Paragraphs thirteen through twenty-two of Section A of Annex 703.2 address trade in sugar and syrup goods between the United States and Mexico. During each of the first fourteen years of the NAFTA, Mexico and the United States will jointly determine whether either has been or is projected to be a net surplus producer of sugar in a given October-to-September marketing year.

The United States and Mexico each will allow duty free imports of sugar up to the greater of (1) 7,258 metric tons raw value, (2) the quota allocated by the United States for a non-NAFTA country in the category "other specified countries and areas" under the U.S. sugar quota regime, or (3) if the other country is projected to have a net production surplus for the marketing year: for each of the first six marketing years, the amount of the net production surplus up to a maximum of 25,000 metric tons; and for years seven through fourteen, the amount of the net production surplus up to a ceiling amount set out in a schedule. For imports into the United States from Mexico, the duty-free amount under the NAFTA replaces the amount of the in-quota quantity currently allocated to Mexico under the existing U.S. sugar tariff rate quota.

The United States and Mexico have reached a subsequent understanding as a result of which the calculations related to net surplus production will include an adjustment for consumption of high fructose corn syrup production. Also, the ceiling for imports of sugar during the seventh through fourteenth marketing years will be the amount of the net production surplus up to a ceiling of 250,000 metric tons.

Paragraphs seventeen through twenty provide that beginning not later than six years after the NAFTA enters into force, Mexico will implement a tariff-rate quota regime for sugar that conforms with the regime of the United States. Mexico will apply a tariff rate quota on an MFN basis at tariff rates no less than the lower of prevailing MFN rates of the United States or the United States' MFN rates when Mexico commences to apply the tariff rate quota. Mexico may not, however, apply to sugar that is a qualifying good a tariff rate higher than that applied by the United States to such good. If the United States eliminates its tariff-rate quota regime with respect to sugar, Mexico may then elect to receive, with respect to sugar that is a qualifying good, either MFN treatment or treatment dependent on net production surplus under the terms described above.

With respect to re-export sugar, Mexico is not required to apply NAFTA tariff treatment to qualifying sugar or a sugar-containing product if the United States has granted or will grant benefits under a re-export program in connection with such good. The United States is required to notify Mexico of the export of goods for which such benefits have been or will be claimed by the exporter. Each of the two NAFTA countries is required, however, to accord duty-free treatment for raw sugar imported from the other that is refined in the importing NAFTA country and re-exported to the producing NAFTA country, as well as to qualifying refined sugar produced from raw sugar originally exported from the importing NAFTA country. These goods are not included in the quantities counted under a tariff rate quota.

(6) Agricultural Grading and Marketing Standards

Paragraph 23 provides that if a NAFTA country applies a measure with respect to classification, grading or marketing of a domestic agricultural good, the measure must treat an imported qualifying good destined for processing no less favorably than a like domestic good destined for processing. The importing NAFTA country can adopt measures to ensure that

the imported good is processed. Paragraph 23 does not prejudice GATT or NAFTA national treatment rights.

## **B. CANADA AND MEXICO**

Section B of Annex 703.2 sets forth agricultural market access commitments between Canada and Mexico.

### **1. Special Safeguard Provisions**

Paragraph three of Article 703 permits the NAFTA countries to apply a special safeguard, in the form of a tariff-rate quota, to the goods listed in Annex 703.3. The over-quota tariff rate may not exceed the lower of the prevailing most-favored-nation (MFN) rate or the applicable MFN rate as of July 1, 1991.

The purpose of this safeguard mechanism is to allow tariffs to be increased on certain agricultural products in the event of import surges exceeding the in-quota volume, which may result, for example, from seasonal supply changes. Although the United States and Mexico will gradually lower their tariffs on the qualifying goods listed in their respective sections of Annex 703.3, the tariffs may be raised back to higher levels under the conditions of the tariff rate quota.

Providing import surge protection in the form of a tariff rate quota affords transparency and predictability to importers and exporters, since the import volume triggering protection, and the level of the tariff to be applied for protection, are dictated by the tariff rate quota. Although this safeguard mechanism will apply to trade between the United States and Mexico in the specified agricultural goods, the "snapback" provisions of CFTA Article 702 will continue to apply to trade between the United States and Canada.

The limitation of the over-quota tariff rate to the lesser of the prevailing MFN rate or the MFN rate as of July 1, 1991, is simply to ensure that the NAFTA countries receive treatment no less favorable than other MFN trading partners, and no less favorable than that applicable on July 1, 1991, when NAFTA tariff negotiations were proceeding.

A NAFTA country may not simultaneously apply, with respect to the same good and the same country, a special safeguard under this provision and an emergency action under Chapter Eight.

### **2. Domestic Support**

The NAFTA countries recognize in Article 704 both the importance, and potential trade distorting or production effects, of domestic support measures in the agricultural sector. The NAFTA governments also recognize that commitments to reduce domestic support in the agricultural sector may be undertaken in multilateral trade negotiations. Accordingly, Article 704 encourages the NAFTA countries to work toward domestic support measures in the agricultural sector that minimize or cause no trade distorting or production effects, and that do not conflict with any applicable commitments to reduce domestic support measures that may be

negotiated under the GATT. Article 704 also recognizes that a NAFTA country may change its domestic support measures at its discretion, subject to GATT rights and obligations.

### **3. Export Subsidies**

The NAFTA incorporates, as between the United States and Canada, the CFTA Article 701 prohibition on introducing or maintaining export subsidies on agricultural goods exported between these two countries. NAFTA Article 705 does not extend this prohibition to agricultural trade with Mexico, but instead affirms that export subsidies on agricultural goods exported to another NAFTA country are inappropriate where there are no other subsidized imports of that good into that NAFTA country. In addition, Article 705(4) requires an exporting NAFTA country to give the importing NAFTA country advance written notice before adopting an export subsidy for export of an agricultural good to that importing NAFTA country. Article 705(4) also provides for consultations between the importing and exporting NAFTA countries with a view to eliminating the export subsidy or minimizing or countering any adverse impact of the subsidy on the market of the importing NAFTA country for the agricultural good.

The NAFTA countries will establish a working group to work toward the elimination of all export subsidies affecting agricultural trade between them.

Article 705(7) explicitly affirms that if the exporting and importing NAFTA country agree to an export subsidy for an agricultural good, the exporting NAFTA country may maintain the subsidy, notwithstanding any other provision of Article 705. This provision was added for clarity, since if the countries involved agree to a subsidy, there would be no inconsistency with the NAFTA. Article 705(7) also preserves the rights of each NAFTA government to apply countervailing duties.

### **4. Committees**

Article 706 establishes a committee on agricultural trade, which under Article 707 is to establish an advisory committee on private commercial disputes regarding agricultural goods.

## **C. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

#### **a. Meat Import Act of 1979**

Section 321(a) of the implementing bill amends the Meat Import Act of 1979 to delete Mexican meat articles from the calculation of the quantity of meat articles that may be imported without triggering an import quota under the Act. It also removes Mexico from the supplying countries to which any allocated meat import quota would apply. This section also provides that the rules of origin applicable to determining whether meat originates from Canada or Mexico for purposes of the Meat Import Act of 1979 will be the same as for tariff treatment purposes. This section does not affect the provision of the Meat Import Act of 1979 authorizing the imposition under certain circumstances of import restrictions on Canadian meat articles.

#### **b. Section 22 of the Agricultural Adjustment Act**

Section 321(b) of the implementing bill authorizes the President, pursuant to Article 309 and Annex 703.2 of the NAFTA, to exempt any "qualifying good" from any quantitative limitation or fee imposed pursuant to section 22 of the Agricultural Adjustment Act (7 U.S.C. 624), for so long as Mexico is a NAFTA country.

#### **c. Tariff Rate Quotas**

As discussed above, the United States has agreed to convert to tariff rate quotas its import quotas under section 22 of the Agricultural Adjustment Act for imports from Mexico of dairy products, cotton, sugar-containing products and peanuts. Article 302(4) of the NAFTA permits the allocation of the in-quota quantity under these tariff rate quotas, provided that such measures do not have trade restrictive effects on imports additional to those caused by the imposition of the tariff rate quota.

Section 321(c) of the bill directs the President to take such action as may be necessary to ensure that imports of goods subject to tariff rate quotas do not disrupt the orderly marketing of commodities in the United States. This provision will be implemented consistent with NAFTA Article 302(4). Any agency action pursuant to this provision will be taken in accordance with regulations promulgated after providing notice and opportunity for public comment.

#### **d. Peanuts**

Section 321(d) of the bill affirms that nothing in the NAFTA or the implementing legislation affects the penalty applicable to an importer if any additional peanuts exported by a handler are reentered into the United States in commercial quantities. It also requires peanut

importers to maintain such records and documents as the Secretary of Agriculture may require to ensure compliance with the provision concerning reentry of exported additional peanuts.

This section also sets forth the sense of Congress that the United States should request consultations pursuant to the import surge supplemental agreement if imports of peanuts are entering at amounts in excess of the in-quota quantity established in the U.S. NAFTA Tariff Schedule for Mexican peanuts. The consultations would concern the question of injury to the domestic peanut industry and whether recourse to emergency action under either the NAFTA or GATT safeguard provisions is appropriate.

**e. Information Regarding Fresh Fruits, Vegetables, Citrus and Cut Flowers**

Section 321(e) requires the Secretary of Agriculture to collect and compile certain information, if reasonably available, from United States and Mexican governmental agencies on fresh fruits and vegetables, processed citrus products and cut flowers. The Secretary is also to designate an office to maintain and disseminate this information.

**f. End-Use Certificates**

Section 321(f) of the bill is a free-standing provision that establishes an end-use certificate requirement for the following: (1) wheat imported into the United States from any foreign country or instrumentality that requires, as of the effective date of the subsection, end-use certificates on wheat produced in the United States; and (2) barley imported into the United States from any foreign country or instrumentality that requires, as of the effective date of the subsection, end-use certificates on barley produced in the United States. The effective date of this subsection is 120 days after the date of enactment of the implementing bill.

The purpose of the U.S. end-use certificate requirement is to ensure that foreign agricultural commodities do not benefit from U.S. export programs.

The Secretary of Agriculture is directed to issue regulations regarding the information to be provided in end-use certificates. Such information could include the class, quantity and country of origin of the covered commodity; importer of the commodity; and the end-use of the commodity, if known at the time of importation of the commodity.

In order to protect U.S. agricultural producers, the Secretary may, after consulting with them and reporting to the Congress, suspend end-use certificate requirements if the requirements have directly resulted in: (1) the reduction of income to U.S. producers of agricultural commodities; or (2) the reduction of competitiveness of U.S. agricultural commodities in world export markets.

If a foreign country or instrumentality that requires end-use certificates for imports of U.S.-produced wheat as of the effective date of the subsection, eliminates this

requirement, the Secretary is to suspend the U.S. end-use certificate requirement on wheat, effective 30 calendar days after the suspension by the foreign country or instrumentality. If a foreign country or instrumentality that requires end-use certificates for imports of U.S.-produced barley as of the effective date of the subsection, eliminates this requirement, the Secretary is to suspend the U.S. end-use certificate requirement on barley, effective 30 calendar days after the suspension by the foreign country or instrumentality.

**g. Agricultural Fellowship Program**

Section 321(g) of the bill authorizes a new fellowship program under which the Secretary of Agriculture will provide fellowships to individuals from other NAFTA countries to study agriculture in the United States and to individuals in the United States to study agriculture in other NAFTA countries.

**h. Assistance for Affected Farm Workers**

Section 321(h) of the bill authorizes the Secretary of Agriculture, subject to appropriation, to make available up to \$20 million per fiscal year in grants to tax-exempt entities that have experience in providing emergency services to low-income migrant or seasonal farm workers. The Secretary must first determine, however, that the NAFTA has caused such workers to lose income.

**i. Biennial Report on Effects of NAFTA**

Section 321(i) of the bill requires the Secretary of Agriculture to submit a report every two years on the effects of NAFTA on U.S. agricultural producers and rural communities, beginning March 1, 1997. The requirement expires with the report due on March 1, 2011. The bill requires the report to assess the effects of the NAFTA on: (1) a commodity-by-commodity basis; (2) agricultural investments; (3) rural communities; and (4) agricultural employment. The Secretary may also include other appropriate information and data.

**j. Special Rules of Origin for Peanuts and Sugar**

Section 202(o) of the bill implements the special rules of origin provided for in paragraph 10 of Section A of Annex 703.2.

**k. Special Tariff Provision for Canadian Fresh Fruits and Vegetables**

Section 308 of the bill amends section 301 of the CFTA Act, which implemented the tariff "snapback" provided for in Article 702 of the CFTA. Section 301(a) of the CFTA Act is amended to provide that the President may impose a temporary duty on imports of a listed Canadian fresh fruit or vegetable if:

(1) The Secretary of Agriculture determines that both of the conditions in the statute (relating to the import price of the fresh fruit or vegetable and the planted U.S. acreage for the like product) exist, and notice of such determination is published in the *Federal Register*;

(2) the Secretary, no later than six days after such publication, decides to recommend to the President the imposition of a temporary duty; and

(3) not later than seven days after receiving that recommendation, the President determines to impose the temporary duty.

The Commissioner of Customs and Director of the Census Bureau are to provide the Secretary with timely information concerning the importation of Canadian fresh fruits and vegetables, and importers are to report such information as the Commissioner of Customs requires.

#### **l. Frozen Concentrated Orange Juice**

Section 309 of the bill establishes a price-based tariff snapback for imports of frozen concentrated orange juice into the United States from Mexico. In other words, the tariff on imports of Mexican frozen concentrated orange juice in excess of the threshold quantity will "snapback" or revert to the lesser of the prevailing most-favored nation rate of duty or that in effect as of July 1, 1991 if the futures price for frozen concentrated orange juice in the United States falls below a historical average price for five consecutive days.

The temporary duty ceases to apply if the futures price is above the historical price for five consecutive days. For 1994 through 2002, the "snapback" duty would apply to imports above 264,978,000 liters, or 70 million gallons, single strength equivalent. For 2003 through 2007, the threshold level is 340,560,000, or 90 million gallons, single strength equivalent.

The tariff snapback is automatically triggered and removed upon the determination by the Secretary of Agriculture that the conditions have been met. The Secretary's determinations are to be published in the *Federal Register*.

This provision results in a potential three-tier tariff rate quota for frozen concentrated orange juice. The first tier is the in-quota rate for the first 40 million gallons, as provided in the NAFTA. The second tier is the NAFTA over-quota tariff rate applicable to quantities entering above 40 million gallons. The potential third tier is the quantity above the 70 or 90 million gallons threshold, which may be subject to the snapback duty, if the price conditions are met.

This provision implements an understanding reached between the United States and Mexico providing for the potential third tier.

#### **m. Tomatoes, Peppers and Citrus Products**

Section 315 makes citrus products eligible for provisional relief under section 202(d) of the Trade Act of 1974. That section currently provides for expedited investigation and determination by the International Trade Commission with respect to perishable agricultural products. The citrus products that will explicitly be eligible as a result of section 315 are processed oranges, processed grapefruit, and orange and grapefruit juice, including concentrate.

Section 316 requires the International Trade Commission to monitor imports of tomatoes and peppers for ten years. The purpose of this provision is to provide an expedited determination concerning import relief for these commodities. The Department of Agriculture and the Customs Service will work with the Commission and help ensure that the type of information needed for the monitoring is available to the Commission, including gathering the necessary information as appropriate.

## **2. Presidential Action**

The President will proclaim changes to the U.S. sugar import regime to implement the provisions of Annex 703.2.A(22).

The President will also exempt Mexico from the quantitative limitations and fees imposed under section 22 of the Agricultural Adjustment Act and consequently will remove Mexico from the allocation of the import quota under section 22 of the Agricultural Adjustment Act with respect to cotton goods under subheading 9904.30.10 of the Harmonized Tariff Schedule of the United States.

## **3. Administrative Action**

No changes in administrative regulations, practices or procedures, other than those specifically provided for in the implementing bill or discussed below, are contemplated.

### **a. Meat Imports**

Article 704 of the CFTA is incorporated by reference into the NAFTA pursuant to Article 702(1) and Annex 702.1(1) and therefore remains in effect. Accordingly, the United States will continue to apply the terms of Article 704 of the CFTA. For purposes of determining whether imports of meat articles from Canada are frustrating actions taken against meat imports from third countries, the President will consider, for example, whether imports of meat goods originating in Canada increased significantly as a result of displacement of those goods within the Canadian market by an increase of imports into Canada of third country meat goods.

### **b. Trade in Sugar and Syrup Goods**

The Department of Agriculture will issue regulations to implement the provisions of Annex 703.2.A(21) and (22) to provide the required two-day notice and to provide for licensing of duty free imports of qualifying raw and refined sugar.

**c. Tariff rate Quotas**

While the Agreement authorizes high over-quota rates, there will be times when Mexico will want to import a greater quantity of agricultural goods than provided for under the in-quota quantity of the tariff rate quota. In these cases, the high over-quota tariff rate could work to the detriment of U.S. exports and to the advantage of non-NAFTA country exports. In particular, this outcome could hurt U.S. exports of those goods subject to tariffication -- milk powder, dry edible beans, potatoes, barley and barley malt, poultry products, corn, eggs and animal fats and oils.

In view of this possibility, immediately after entry into force of the NAFTA the Administration will enter into consultations with the Mexican government to ensure that over-quota amounts of these U.S. agricultural commodities receive access to Mexico on terms at least as favorable as access provided to such goods from other countries. The consultations will be aimed at clarifying how Mexico will notify Mexican buyers and U.S. producers in advance of allowing more than the duty-free access for U.S. agricultural goods in any year.

**d. Export Subsidies**

Agricultural export subsidy programs have provided an important tool to maintain and expand exports of U.S. agricultural commodities. Currently, there are export subsidy programs to promote exports to Mexico of many U.S. agricultural commodities, including the export enhancement program, the dairy export incentive program and the cottonseed oil and sunflower seed oil assistance programs.

The Secretary of Agriculture will aggressively use the agricultural export subsidy programs with respect to exports to Mexico as appropriate to help U.S. producers compete against subsidized products from other countries, such as dairy products, vegetable oil, and wheat and to maintain U.S. markets in the face of subsidized imports from other countries.

**e. Agricultural Grading and Marketing Standards**

The Department of Agriculture will issue regulations to implement the provisions of Annex 703.2.A(23) to exempt certain imported fruits and vegetables destined for processing from regulations implementing Section 8e of the Agricultural Marketing Agreement Act of 1937 and to identify control procedures to ensure that such imported commodities are processed after entering the United States.

**f. Committee on Agricultural Trade**

The U.S. representatives to the Committee on Agricultural Trade will request that the Committee establish subcommittees or working groups with respect to wheat, sugar, fruits and vegetables, dairy, livestock and other appropriate commodities. The functions of these subcommittees or working groups would include, with respect to the particular commodity, monitoring and promoting cooperation on the implementation and administration of Section A of Chapter Seven and providing a forum for the NAFTA countries to consult on related issues.

**NOTE:** As a convenience to the reader, set out below are provisions of the U.S. - Canada Free-Trade Agreement that have been incorporated into the NAFTA

**ATTACHMENT TO SECTION A OF CHAPTER 7**

**UNITED STATES - CANADA FREE-TRADE AGREEMENT**

**ARTICLE 701: AGRICULTURAL SUBSIDIES**

1. The Parties agree that their primary goal with respect to agricultural subsidies is to achieve, on a global basis, the elimination of all subsidies which distort agricultural trade, and the Parties agree to work together to achieve this goal, including through multilateral trade negotiations such as the Uruguay Round.
2. Neither Party shall introduce or maintain any export subsidy on any agricultural goods originating in, or shipped from, its territory that are exported directly or indirectly to the territory of the other Party.
3. Neither Party, including any public entity that it establishes or maintains, shall sell agricultural goods for export to the territory of the other Party at a price below the acquisition price of the goods plus any storage, handling or other costs incurred by it with respect to those goods.
4. Each Party shall take into account the export interests of the other Party in the use of any export subsidy on any agricultural good exported to third countries, recognizing that such subsidies may have prejudicial effects on the export interests of the other Party.
5. Canada shall exclude from the transport rates established under the Western Grain Transportation Act agricultural goods originating in Canada and shipped via west coast ports for consumption in the United States of America.

**ARTICLE 702: SPECIAL PROVISIONS FOR FRESH FRUITS AND VEGETABLES**

1. a) Notwithstanding Article 401, for a period of 20 years from the entry into force of this Agreement, each Party reserves the right to apply a temporary duty on fresh fruits or vegetables originating in the territory of the other Party and imported into its territory, when:
    - (1) for each of five consecutive working days the import price of such fruit or vegetable for each such day is below 90 percent of the average monthly import price, for the month in which that day falls, over the preceding five years, excluding the years with the highest and lowest average monthly import price; and
    - (2) the planted acreage in the importing Party for the particular fruit or vegetable is no higher than the average acreage over the preceding five years, excluding the years with the highest and lowest acreage.
  - b) The temporary duty referred to in subparagraph (a) may be applied on a regional or national basis, and the import prices and planted acreage will then be determined on a regional or national basis, as appropriate.
  - c) For purposes of calculating the planted acreage referred to in subparagraph (a)(ii), any acreage increase attributed directly to a reduction in wine grape planted acreage existing on October 4, 1987 shall be excluded.
2. Any temporary duty applied under this Article together with any other duty in effect for the particular fresh fruit or vegetable shall not exceed the lesser of:

- a) the applicable most-favoured-nation (MFN) rate of duty that was in effect for the particular fresh fruit or vegetable prior to the date of entry into force of this Agreement determined with reference to the same season in which the temporary duty is applied; or
- b) the MFN rate of duty in effect for imports of that particular fresh fruit or vegetable at the time the temporary duty is applied.

3. Any temporary duty shall only be applied either once per twelve-month period per good nationally or once per twelve-month period per good in each region. If a temporary duty is initially applied in one or more regions, any later application in a different region during that twelve-month period shall be based on a later five consecutive working day period under subparagraph 19(a)(i). No temporary duty shall apply to goods in transit at the time the duty is applied.

4. Such a temporary duty shall be removed when, for a period of five consecutive working days, the representative F.O.B. point of shipment price in the exporting Party exceeds 90 percent of the average monthly import price referred to in subparagraph 1(a)(i), adjusted to an F.O.B. point of shipment price, if necessary, and in any event shall be removed after 180 days.

5. Prior to the application of the temporary duty, the importing Party shall provide to the exporting Party two working days notice and an opportunity to consult during those two working days.

6. No Party may introduce or maintain any action under this Article on a particular good during such time as an action is maintained under Chapter Eleven (Emergency Action) on the same good.

7. For purposes of this Article, fresh fruit or vegetable shall mean any good classified within the following tariff headings of the Harmonized System (HS):

| <b><u>HS Tariff Heading</u></b> | <b><u>Description</u></b>   |
|---------------------------------|---|
| 07.01                           | potatoes, fresh or chilled  |
| 07.02                           | tomatoes, fresh or chilled  |
| 07.03                           | onions, shallots, garlic, leeks and other alliaceous vegetables, fresh or chilled   |
| 07.04                           | cabbages, cauliflowers, kohlrabi, kale and similar edible brassicas, fresh or chilled   |
| 07.05                           | lettuce ( <i>lactuca sativa</i> ) and chicory ( <i>cichorium</i> spp.), fresh or chilled                                      |
| 07.06                           | carrots, salads beets or beetroot, salsify, celeriac, radishes and similar edible roots (excluding turnips), fresh or chilled |
| 07.07                           | cucumbers and gherkins, fresh or chilled  |
| 07.08                           | leguminous vegetables, shelled or unshelled, fresh or chilled   |
| 07.09                           | other vegetables (excluding truffles), fresh or chilled   |
| 08.06.10                        | grapes, fresh   |
| 08.08.20                        | pears and quinces, fresh  |
| 08.09                           | apricots, cherries, peaches (including nectarines), plums and sloes, fresh  |

08.10

other fruit (excluding cranberries and blueberries), fresh.

8. The Parties shall, upon the request of either Party, consult concerning removal of any temporary duty applied under paragraph 1.

9. For purposes of this Article, a region in Canada means:

- a) British Columbia, Alberta, Saskatchewan, Manitoba, and that part of Ontario west of 89 19' longitude (Thunder Bay);
- b) Quebec and that part of Ontario east of 89 19' longitude (Thunder Bay); or
- c) New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland.

#### **ARTICLE 704: MARKET ACCESS FOR MEAT**

1. Neither Party shall introduce, maintain or seek any quantitative import restriction or any other measure having equivalent effect on meat goods originating in the territory of the other Party except as otherwise provided in this Agreement.

2. If a Party imposes any quantitative import restriction on meat goods from all third countries, or negotiates agreements limiting exports from third countries, and if the other Party does not take equivalent action, then the first Party may impose quantitative import restrictions on meat goods originating in the territory of the other Party only to the extent and only for such period of time as is sufficient to prevent frustration of the action taken on imports of the meat goods from third countries. The Party contemplating the action shall notify the other Party and provide an opportunity to consult prior to taking action pursuant to this paragraph.

#### **ARTICLE 705: MARKET ACCESS FOR GRAIN AND GRAIN PRODUCTS**

1. Commencing at such time as the level of government support for any of the grains wheat, oats, or barley in the United States of America becomes equal to or less than the level of government support for that grain in Canada, Canada shall eliminate any import permit requirements for wheat and wheat products, oats and oat products, or barley and barley products, as the case may be, originating in the territory of the United States of America, except that Canada may require that the grain be:

- a) accompanied by an end-use certificate which has been completed by the importer of record declaring that it is imported for consumption in Canada and is consigned directly to a milling, manufacturing, brewing, distilling or other processing facility for consumption at that facility;
- b) denatured if for feed use; or
- c) accompanied by a certificate issued by Agriculture Canada, or its successors, if for seed use.

2. The Canadian Grain Commission, or its successors, shall be responsible for monitoring compliance with subparagraphs 1(a) and (b) and shall freely provide the end-use certificate required in subparagraph 1(a).

3. For purposes of paragraph 1, wheat, oat and barley products shall be defined as processed or manufactured substances which contain alone or in combination more than 25 percent by weight of such grain or grains. Any grain for which import permit requirements have been eliminated in accordance with paragraph 1 shall be excluded from this definition.

4. The method for calculating the level of government support referred to in paragraph 1 is set out in Annex 705.4.

5. Each Party shall, for purposes of restricting the importation of a grain or of a grain product due to its content of that grain, retain the right, to the extent consistent with other provisions of this Agreement, to introduce or, where they have been eliminated, reintroduce quantitative import restriction or import fees on imports of such grain or grain products originating in the territory of the other Party if such imports increase significantly as a result of a substantial change in either Party's support programs for that grain. For purposes of this paragraph, grain means wheat, oats, barley, rye, corn, triticale and sorghum.

#### **ARTICLE 706: MARKET ACCESS FOR POULTRY AND EGGS**

If Canada maintains or introduces quantitative import restrictions on any of the following goods, Canada shall permit the importation of such goods as follows:

- a) the level of global import quota on chicken and chicken products, as defined in Annex 706, for any given year shall be no less than 7.5 percent of the previous year's domestic production of chicken in Canada;
- b) the level of global import quota on turkey and turkey products, as defined in Annex 706 for any given year shall be no less than 3.5 percent of that year's Canadian domestic turkey production quota; and
- c) the level of global import quotas on eggs and egg products for any given year shall be no less than the following percentages of the previous year's Canadian domestic shell egg production:
  - 1.647 percent for shell eggs;
  - 0.714 percent for frozen, liquid and further processed eggs; and
  - 0.627 percent for powdered eggs.

#### **ARTICLE 707: MARKET ACCESS FOR SUGAR-CONTAINING PRODUCTS**

The United States of America shall not introduce or maintain any quantitative import restriction or import fee on any good originating in Canada containing ten percent or less sugar by dry weight for purposes of restricting the sugar content of such good.

## **ARTICLE 710: INTERNATIONAL OBLIGATIONS**

Unless otherwise specifically provided in this Chapter, the Parties retain their rights and obligations with respect to agricultural, food, beverage and certain related goods under the General Agreement on Tariffs and Trade (GATT) and agreements negotiated under the GATT, including their rights and obligations under GATT Article XI.

## **ARTICLE 711: DEFINITIONS**

For purposes of this Chapter:

***agricultural goods*** means all goods classified within chapters 1, 2, 4, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 17, 18, 19, 20, 21 and 24 of the Harmonized System and all goods classified within the following specific tariff headings of the Harmonized System:

05.02 to 05.11.10 inclusive  
05.11.99  
16.01  
16.02  
16.03 (extracts and juices of meats only)  
22.01  
22.02  
22.09  
23.01.10  
23.02 to 23.09 inclusive  
33.01  
33.02  
35.01 to 35.05 inclusive  
40.01  
41.01 to 41.03 inclusive  
43.01  
51.01 to 51.05 inclusive  
52.01 to 52.03 inclusive  
53.01 to 53.05 inclusive;

***agricultural, food, beverage and certain related goods*** means all agricultural goods, all goods classified within chapter 3 of the Harmonized System, and all goods classified within the following specific tariff headings of the Harmonized System:

16.03 (other than extracts and juices of meat)  
16.04 to 16.05 inclusive  
22.03 to 22.08 inclusive  
23.01.20  
29.36  
29.37  
29.40 to 29.42 inclusive  
30.01 to 30.04 inclusive  
31.01 to 31.05 inclusive  
32.03  
32.04 (food, drug or cosmetic dyes and preparations only)  
38.08  
39.17.10  
44.01 to 44.18 inclusive;

***animal*** means any living being other than a human or a plant;

***equivalent*** means having the same effect;

***export subsidy*** means a subsidy that is conditional upon the exportation of agricultural goods. An illustrative list of such export subsidies is found in paragraphs (a) to (1) of the Annex to the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade;

***harmonization*** means making identical;

***import fee*** means a fee on imports, including a fee applied pursuant to Section 22 of the United States Agricultural Adjustment Act of 1933, as amended, but excluding a customs duty as defined in Chapter Four (Border Measures);

***import price*** means the value for imports into a Party determined for customs purposes by the customs authorities in that Party, except that, in the case of imports sold on a consignment basis, a Party may use the price reported for such sales adjusted to the same pricing basis as the value determined for customs purposes;

***meat goods*** means meat of cattle (including veal), goats and sheep (except lambs), whether fresh, chilled or frozen;

***standard*** means a technical specification approved by a recognized standardizing body for repeated or continuous application, with which compliance is not mandatory;

***sugar*** means sugar derived from sugar cane or sugar beets;

***technical regulation*** means a technical specification, including the applicable administrative provisions, with which compliance is mandatory; and

***technical specification*** means a specification contained in a document that lays down characteristics of a good such as levels of quality, performance, safety or dimensions. It may include, or deal exclusively with, terminology, symbols, testing and test methods, packaging, marking or labelling requirements as they apply to a good.

## **CHAPTER SEVEN: AGRICULTURE AND SANITARY AND PHYTOSANITARY MEASURES**

### **SECTION B -- SANITARY AND PHYTOSANITARY MEASURES**

#### **A. SUMMARY OF NAFTA PROVISIONS**

##### **1. Overview**

Sanitary and phytosanitary ("S&P") measures generally deal with protecting human, animal and plant life and health from risks of plant- and animal-borne pests and diseases, and additives and contaminants in foods and feedstuffs.

The NAFTA does not establish or deal with any particular sanitary or phytosanitary measure as such. Instead, the NAFTA establishes a number of general requirements and procedures to ensure that a sanitary or phytosanitary measure is in fact intended to protect against the risk asserted.

The NAFTA explicitly recognizes that countries have a legitimate need for regulations to protect human, animal and plant life and health. The NAFTA provisions are designed to preserve the ability of governments, which include state and local governments, to act in this area while guarding against the unjustified use of these types of measures as a way to protect domestic industry. The NAFTA sets up requirements and procedures that will help to distinguish legitimate and protectionist measures. The NAFTA also will facilitate making these measures compatible among the three NAFTA countries, where appropriate. At the same time, the NAFTA safeguards the ability of governments to protect human, animal and plant life and health, including inspecting imported goods to determine they are safe.

The NAFTA's provisions on S&P measures differ fundamentally from the NAFTA's rules regarding standards-related measures, set out in Chapter Nine, in the means used to determine whether a measure is protectionist in nature. Chapter Nine relies on a non-discrimination test. Section B of Chapter Seven relies on whether the measure has a basis in science and is based on a risk assessment. A strict requirement for non-discriminatory treatment is not possible for S&P measures, since they frequently discriminate against imported goods or goods from a particular foreign country because those goods pose a different risk of a plant or animal pest or disease. Under Section B of Chapter Seven, discrimination is allowed as long as it is not arbitrary or unjustifiable.

## **2. Background**

Section B represents the first comprehensive agreement on S&P measures concluded by the United States. Before the NAFTA, rules on S&P measures had not been fully elaborated, although they are covered by the GATT and some particular obligations are set out in Chapter Seven of the CFTA.

Prior to the NAFTA negotiations, a text on S&P measures had been proposed in the context of the Uruguay Round of multilateral trade negotiations under the auspices of the GATT. The Uruguay Round proposed text had been the subject of multilateral negotiations, with over 100 countries participating, although final agreement in the Uruguay Round had not been reached when the NAFTA was concluded. The NAFTA provisions on S&P measures drew from the Uruguay Round draft text, as well as from other GATT texts and the CFTA.

Because the NAFTA negotiations involved only three countries rather than over 100, the three NAFTA governments were able to tailor the NAFTA provisions to their particular needs.

## **3. Unjustified S&P Measures**

Governments routinely take S&P measures in order to protect the life and health of humans, animals and plants. For example, a country may require that imports of a particular imported plant product that poses a risk of introducing into the country a plant pest or disease be treated in a manner that will eliminate the pest or disease. For example, many countries require that imported vegetables be fumigated.

Governments sometimes impose trade restrictions, in the guise of S&P measures, in order to protect a domestic industry. For example, a country may prohibit imports of a particular agricultural product in order to protect domestic producers of that product, citing an unfounded risk of a pest or disease.

U.S. exports have frequently been subject to such unjustified S&P measures. These measures have served as significant barriers to U.S. exports, injuring U.S. farmers and rural communities.

Experience has shown that unjustified S&P measures are frequently employed when other barriers to trade are reduced or removed, such as tariffs and non-tariff import restrictions. The United States has more than once negotiated the elimination of high tariffs or import quotas for a product only to be confronted with an unfounded sanitary or phytosanitary measure that negates the benefit of the earlier negotiation.

Under the NAFTA, agricultural trade between the United States and Mexico will be significantly liberalized. In fact, the United States and Mexico will generally eliminate non-tariff barriers to agricultural trade between them (with certain key exceptions such as the

ability to maintain S&P measures) upon entry into force of the agreement, and to eliminate all tariffs on agricultural trade between them over time.

The NAFTA provisions on S&P measures provide each NAFTA government with an assurance that the benefits of this agricultural trade liberalization will be realized and that S&P measures will not be used as disguised barriers to trade.

#### **4. Basic Concepts**

Any understanding of the provisions of Section B depends on an understanding of certain basic concepts, discussed below.

##### **a. Sanitary or Phytosanitary Measure**

Only "sanitary and phytosanitary measures" are subject to the provisions of Section B. Other measures are not covered. Under Article 724, a sanitary or phytosanitary measure is any measure to:

- protect animal or plant life or health in its territory from risks arising from the introduction, establishment or spread of a pest or disease,
- protect human or animal life or health in its territory from risks arising from the presence of an additive, contaminant, toxin or disease-causing organism in a food, beverage or feedstuff,
- protect human life or health in its territory from risks arising from a disease-causing organism or pest carried by an animal or plant, or a product thereof, or
- prevent or limit other damage in its territory arising from the introduction, establishment or spread of a pest,

including end product criteria; a product-related processing or production method; a testing, inspection, certification or approval procedure; a relevant statistical method; a sampling procedure; a method of risk assessment; a packaging and labelling requirement directly related to food safety; and a quarantine treatment, such as a relevant requirement associated with the transportation of animals or plants or with material necessary for their survival during transportation.

Accordingly, whether a measure is a sanitary or phytosanitary measure is determined by the *intent* of the measure. If it is not intended to protect against one of the enumerated risks, the measure is not a sanitary or phytosanitary measure.

##### **b. Appropriate Level of Protection**

In taking S&P measures to protect against risks, an important question is how much protection the government seeks against a particular risk. Under the NAFTA, each government decides what is the "appropriate level of protection," defined in Article 724 as "the level of protection of human, animal or plant life or health in the territory of a Party that the Party considers appropriate."

Article 712(2) explicitly affirms the right of NAFTA governments to choose their levels of protection. A government may establish its levels of protection by any means available under its law, including by referendum. In the end, the choice of the appropriate level of protection is a societal value judgement. The NAFTA imposes no requirement to establish a scientific basis for the chosen level of protection because the choice is not a scientific judgment.

## **5. Scope and Coverage**

Article 709 establishes the scope and coverage of Section B -- it applies only to S&P measures by a NAFTA government that may, directly or indirectly, affect trade between the NAFTA countries. If a measure has no trade effect, Section B does not apply to it.

## **6. Relation to Other Chapters**

Article 710 clarifies the relationship between Section B and the rest of the NAFTA. It provides that Article 301 (National Treatment) and Article 309 (Import and Export Restrictions) do not apply to any sanitary or phytosanitary measure. These articles do not apply since S&P measures may treat imports less favorably than domestic goods, or may constitute import restrictions or prohibitions, in order to protect against the risk of pests or diseases associated with imported goods that are not associated with domestic goods. For example, if an imported plant product originates in a region where there is a plant pest that does not exist in the United States, it may be necessary to treat imports of that plant product less favorably than the same plant product produced in the United States, or to prohibit its importation, in order to prevent the introduction of that plant pest into the United States.

Similarly, Article 710 provides that Article XX(b) of the GATT, as incorporated into Article 2101 of the NAFTA, does not apply to sanitary or phytosanitary measures. Article XX(b) grants to S&P measures, among others, a general exception to the GATT rules, particularly the GATT rules on national treatment (GATT Article III) and import and export restrictions (GATT Article XI). However, an exception for these rules is not needed for S&P measures since Articles 301 and 309 of the NAFTA, which incorporate the GATT rules on national treatment and import and export restrictions, do not apply to S&P measures. Furthermore, the conditions on the exception to GATT Article XX, set out in its introductory language, are included in Section B.

## **7. Reliance on Non-Governmental Entities**

Article 711 requires each NAFTA government to ensure that any non-governmental entity on which it relies in applying a sanitary or phytosanitary measure acts in a manner consistent with Section B. While only governments are subject to the disciplines of Section B, governments in some cases may rely on non-governmental entities in applying a sanitary or phytosanitary measure, such as relying on a private laboratory to conduct a control or inspection procedure to ensure that a particular product complies with a sanitary or phytosanitary measure. For example, a government could rely on a private laboratory to test a product to ensure it contains no pesticide residues in excess of the permitted level. Article 711 ensures that a government could not evade its obligations under Article 717, for example, by relying on a non-governmental entity that fails to act consistently with Section B.

## **8. Basic Rights and Obligations**

### **a. Right to Take Sanitary and Phytosanitary Measures**

Article 712(1) explicitly recognizes the right of NAFTA governments, which as noted above include state and local governments, to adopt, maintain or apply S&P measures, including measures more stringent than an international standard. (See discussion regarding Article 712(5) with respect to the term "necessary.")

### **b. Right to Establish Level of Protection**

Article 712(2) makes explicit that each government may establish those levels of protection for human, animal or plant life or health that the government considers to be appropriate. A government's choice of the level of protection concerning food additives or other products need not be based on a scientific rationale or on a "risk assessment." The NAFTA implicitly recognizes that such choices are based on societal, not scientific, values.

### **c. Scientific Principles**

Article 712(3) sets out three fundamental tests for S&P measures used to achieve the levels of protection a government considers appropriate. First, it requires that all S&P measures be based on scientific principles. Second, it requires that S&P measures not be maintained where there is no longer a scientific basis for them. Third, it requires that S&P measures be based on a risk assessment,<sup>1</sup> as appropriate to the circumstances, to assess whether a particular product, including a process or production method, or substance in fact poses any risk.

The term "scientific" is not separately defined in the text. Accordingly, under general principles of international law (including those reflected in the Vienna Convention on the Law of Treaties), the term "scientific" is to be interpreted in good faith, using its ordinary meaning in context and in the light of the object and purpose of the NAFTA.

The ordinary meaning of "scientific," as provided by dictionary definitions, includes "of, relating to, or used in science,"<sup>2</sup> "broadly, having or appearing to have an exact,

objective, factual, systematic or methodological basis,"<sup>3</sup> "of, relating to, or exhibiting the methods or principles of science"<sup>4</sup> and "of, pertaining to, using, or based on the methodology of science."<sup>5</sup> Dictionary definitions of "science" include "the observation, identification, description, experimental investigation, and theoretical explanation of natural phenomena,"<sup>6</sup> "any methodological activity, discipline, or study,"<sup>7</sup> and "knowledge attained through study or practice."<sup>8</sup>

It is clear that under the NAFTA, the requirement that measures be based on "scientific principles" and not be maintained "where there is no longer a scientific basis" do *not* involve a situation where a dispute settlement panel may substitute its scientific judgment for that of the government maintaining the sanitary or phytosanitary measure. The question under the NAFTA in this regard is whether the government maintaining the sanitary or phytosanitary measure has "a scientific basis" for the measure. "Scientific basis" is defined as "a reason based on data or information derived using scientific methods."

The question is also *not* whether the measure was based on the "best" science or the "preponderance" of science or whether there was conflicting science. The question is only whether the government maintaining the measure has *a* scientific basis for it. This is because section B is based on a recognition that there is seldom, if ever, scientific certainty and consequently any scientific determination may require a judgment among differing scientific opinions. The NAFTA preserves the ability of *governments* to continue to make those judgments.

With respect to Article 712(3), which requires that S&P measures be based on "a risk assessment, as appropriate to the circumstances," the discussion above of the differences between the basic concepts of the level of protection that a government chooses and the measure that the government uses to achieve that level of protection is particularly relevant. One potential example that may be useful to illustrate this distinction in U.S. law is the "Delaney clauses," which prohibit the addition of food additives, color additives and animal drugs to foods or feeds if the substance is found to induce cancer in humans or animals. (See, *e.g.*, 21 U.S.C. 348(c)(3)(A) and 376(b)(5)(B).)

The NAFTA was carefully drafted, with the Delaney clauses and other provisions of U.S. law firmly in mind, to safeguard the ability of governments to ensure food safety.

As noted above, Article 712(2) makes explicit that each government may establish those levels of protection for human, animal or plant life or health that the government considers to be appropriate. The Delaney clauses, in the first instance, establish a level of protection. They reflect a decision by the Congress that there should be no risk of cancer to humans from the substances those clauses cover. That decision is fully protected under the NAFTA.

A determination that a particular food additive poses a health risk is made on *scientific* grounds. Similarly, legitimate food additive regulations are based on "risk

assessments" of the type required in the NAFTA -- that is, an evaluation of the potential for adverse effects on human life or health arising from the presence of an additive, contaminant, toxin or disease-causing organism in a food, beverage, or feedstuff. Importantly, "risk assessment" as used in the NAFTA is not limited to quantitative risk assessment, which is a particular type of risk assessment used to evaluate the potential for carcinogenesis.

The Delaney clauses are entirely consistent with the NAFTA's requirements in this regard. The determination that a particular substance poses a risk of cancer is a scientific determination, based on an evaluation of the potential for a substance to induce cancer. Based on scientific principles, the United States has determined that if a substance induces cancer in animals, it poses some risk of human carcinogenesis. And since the level of protection under Delaney requires that there be *zero* risk of carcinogenesis, the United States prohibits the substance.

**d. Non-Discriminatory Treatment, Unnecessary Obstacles and Disguised Restrictions**

Article 712 also includes a number of provisions designed to assure that sanitary or phytosanitary measures are not "padded" with extra obstacles to trade. These are found in paragraphs four, five and six.

(1) Non-Discriminatory Treatment

Article 712(4) requires each NAFTA government to ensure that none of its S&P measures arbitrarily or unjustifiably discriminates between its goods and like goods from another NAFTA country or between goods from another NAFTA country and like goods of any other country, where similar conditions prevail.

(2) Unnecessary Obstacles

Article 712(5) requires that any sanitary or phytosanitary measure that a NAFTA government adopts or maintains is applied only to the extent necessary to achieve that country's appropriate level of protection, taking into account technical and economic feasibility.

It is important to understand how the term "necessary" is used and is *not* used in Article 712(5) -- in particular that it does not mean "least trade restrictive."<sup>9</sup> That is, the use of the term "necessary" in Article 712(5)<sup>10</sup> does not mean that a government's S&P measures must be the "least trade restrictive" possible. To argue that the use of the term "necessary" in this context carries with it the meaning "least trade restrictive" is as much a *non sequitur* as a claim that under Article 717(3) the assistance provided must be the least trade restrictive possible since that article also uses the term "necessary." The question whether there should be a "least trade restrictive" obligation in Section B was specifically discussed during the negotiations concerning Chapter Seven and it was specifically agreed by the three NAFTA governments that this obligation would not be included.

In fact, Article 712(5) has a different purpose and meaning. The article addresses the question of how a health law or regulation that is in place is *applied*. It does not address the validity of the underlying health law or regulation itself, or the level of protection afforded by those laws. Article 712(5) is meant to ensure that governments do not enforce or apply their health laws or regulations in a way calculated to provide a special advantage to domestic producers.

Article 712(5) does not require governments to avoid taking any action that has trade restrictive effects. And it recognizes that governments may legitimately take economic and technical factors into account in the manner in which they apply their health regulations to imported goods. Finally, the provision is drafted so that a government will always be able to apply its S&P measures in a manner that fully achieves the country's chosen level of protection.

As is the case with the term "scientific," the word "necessary" in this context is to be given its ordinary meaning in light of the context.

### (3) Disguised Restrictions

Article 712(6) prohibits governments from adopting, maintaining or applying any sanitary or phytosanitary measure with a view to, or with the effect of, creating a disguised restriction on trade between NAFTA countries.

## **9. Use of International Standards**

Recognizing that the S&P measures of the three NAFTA countries are often different, Article 713 provides for the use of relevant international standards, without reducing the level of protection of human, animal or plant life or health, as a basis for each NAFTA government's own S&P measures. The objective in using international standards is to make the NAFTA governments' measures equivalent or, where appropriate, identical, in order to facilitate trade. At the same time, the NAFTA explicitly affirms the right of each government to maintain or adopt sanitary or phytosanitary measures more stringent than the relevant international standard, as long as the sanitary or phytosanitary measure is consistent with the other provisions of Section B.

The NAFTA provisions on S&P measures were specifically negotiated to be clear that there would be no "downward harmonization" of S&P measures. While governments are required to use international standards as "a basis" (but by no means necessarily the only basis) for their S&P measures, Article 713(1) explicitly states that this is to be done "*without* reducing the level of protection of human, animal or plant life or health." (Emphasis added.) Article 713(3) also explicitly provides that *nothing* in this requirement "shall be construed to prevent a Party from adopting, maintaining or applying, in accordance with the other provisions of this Section [for example, the provision prohibiting arbitrary discriminating between domestic goods

and like goods from another NAFTA country], a sanitary or phytosanitary measure that is more stringent than the relevant international standard, guideline or recommendation."

International standards, guidelines or recommendations are defined under Article 724 by the subject matter and international organization involved. The international organizations in the article are the *Codex Alimentarius Commission*, under the aegis of the United Nations' Food and Agriculture Organization, the *International Office of Epizootics*, and the *Secretariat of the International Plant Protection Convention*. The NAFTA governments can also agree to designate additional international organizations.

Article 713(5) requires each NAFTA government, to the fullest extent practicable, to participate in these organizations. Full participation by the NAFTA governments should help ensure the quality of the standards, guidelines and recommendations of those organizations.

Under Article 713(2), if a sanitary or phytosanitary measure conforms to a relevant international standard, guideline or recommendation, it is presumed to be consistent with the basic obligations in Article 712. Accordingly, any NAFTA government challenging such a measure would have the burden of rebutting that presumption, as noted in Article 723(6). However, the fact that a sanitary or phytosanitary measure differs from a relevant international standard, guideline or recommendation does not, for that reason alone, create any adverse presumption about the sanitary or phytosanitary measure.

Under Article 713(4), a NAFTA government can request another NAFTA government to provide in writing the reasons for any measure not based on a relevant international standard, guideline or recommendation, if the requesting government has reason to believe that the sanitary or phytosanitary measure is adversely affecting, or may affect, its exports.

## **10. Equivalence**

Because there may often be a range of S&P measures available to achieve the same level of protection, S&P measures employed in the three NAFTA countries may differ even where they are designed to achieve the same level of protection. Differences in measures may restrict trade without providing any additional protection of human, animal or plant life or health. Accordingly, Article 714 establishes a number of ways to help reduce adverse trade effects while preserving full S&P protection.

Article 714 does not require the United States to change any particular sanitary or phytosanitary measure. Instead, Section B creates a process by which the three NAFTA governments can try to reach greater compatibility of S&P measures among the three countries without requiring any country to agree to a particular change.

Under Article 714(1), the NAFTA governments will pursue equivalence of their respective S&P measures to the greatest extent practicable and without reducing the level of protection of human, animal or plant life or health. In addition to the use of international

standards under Article 713 to help achieve equivalence, the NAFTA governments also have agreed under Article 714(4) that they should consider actual or proposed S&P measures of the other NAFTA governments in developing their own S&P measures. This provision encourages each NAFTA government to at least identify and consider the measures of the other NAFTA governments so that S&P measures do not differ between countries simply due to a lack of awareness of the S&P measures used by other NAFTA governments. The inquiry points required of each country under Article 719 can be used for this purpose.

Article 714(1) establishes a cooperative approach to making S&P measures equivalent, where practicable and without reducing the level of protection of human, animal or plant life or health. This work will generally be done through the Committee on Sanitary and Phytosanitary Measures established under Article 722 and technical working groups or subcommittees under that committee. Any recommendations by those groups could only be implemented in the United States through the normal domestic legal processes -- either through legislation or rulemaking consistent with U.S. law.

Article 714(2) deals with particular cases. Under that article, each importing government is to treat a sanitary or phytosanitary measure of an exporting NAFTA government as equivalent to its own where the sanitary or phytosanitary measure of the exporting government achieves the importing government's appropriate level of protection. In order to avail itself of this opportunity, the exporting government, in cooperation with the importing government, is required to provide to the importing government scientific evidence or other information, in accordance with risk assessment methodologies agreed on by those NAFTA governments, to demonstrate objectively that the exporting government's measure achieves the importing government's appropriate level of protection. However, the importing government may reject the arguments submitted by the exporting government if the importing government provides a scientific basis for its rejection.

Exporting governments are to take such reasonable measures as may be available to them to facilitate access in their territory for inspection, testing and other relevant procedures for purposes of establishing equivalence.

## **11. Risk Assessment and Appropriate Level of Protection**

The NAFTA does not specify any particular method for conducting, or any particular type of, a risk assessment pursuant to Article 712(3)(c). Instead, Article 724 provides a general definition of "risk assessment." However, Articles 715(1) and (2) do set forth a number of factors for each government to take into account when it conducts a risk assessment, where relevant. These include such factors as relevant scientific evidence, inspection and environmental conditions. The factors in Article 715(2) apply only with respect to S&P measures to protect animal or plant life or health.

Furthermore, if the government conducting a risk assessment determines that available scientific evidence or other information is insufficient to complete the assessment, the

government is free under Article 715(4) to adopt a provisional sanitary or phytosanitary measure on the basis of available relevant information. However, within a reasonable period after information sufficient to complete the assessment is presented to it, the government is obligated to complete its assessment, review and, where appropriate, revise the provisional measure in light of the completed assessment.

While each government is free to choose the level of protection it considers appropriate, Article 715(3) does provide the minimal disciplines, in establishing levels of protection, of encouraging each government to take into account the objective of minimizing negative trade effects and requiring governments to avoid arbitrary or unjustifiable distinctions in the levels of protection in different circumstances if such distinctions result in arbitrary or unjustifiable discrimination against a good from another NAFTA country or constitute a disguised restriction on trade between NAFTA countries. In addition, the factors in Article 715(2) are also to be taken into account, where relevant, in establishing appropriate levels of protection for animal and plant life or health.

Article 715(5) allows for sanitary or phytosanitary measures to be phased in, or for specified exceptions to be granted for a limited time from a sanitary or phytosanitary measure on request of another NAFTA government as long as the government can still achieve its appropriate level of protection.

## **12. Adaptation to Regional Conditions**

Article 716 addresses issues arising from the fact that animal and plant pests and diseases are not necessarily distributed according to national boundaries. A region of a country could have a plant pest or disease that is either not found, or occurs only in low prevalence, in another region of the same country. As a result, it may not be necessary for an importing country to apply a measure needed to protect against an animal or plant pest or disease to all the relevant goods originating in another country, or to apply the measure in the same way to all the relevant goods originating in that country. Similarly, an animal or plant pest or disease may not pose the same risk when imported to different regions of a country, since for example the pest or disease may not be able to survive in certain regions.

Consequently, Article 716(1) provides for each government to adapt its S&P measures relating to the introduction, establishment or spread of an animal or plant pest or disease to the sanitary or phytosanitary characteristics of the area where the good subject to the measure is produced and the area in its territory to which the good is destined. However, Article 716(1) also recognizes that other conditions may be relevant such as transportation and handling conditions. For example, a plant product from a pest-free area could be exposed during transit to plant products from other areas where the pest occurs, and thus pose a risk of transmitting the pest.

Article 716(2) lists the types of factors to be used in determining whether an area is pest-free or disease-free or an area of low pest or disease prevalence. These are such factors as

geography, ecosystems, epidemiological surveillance and the effectiveness of sanitary or phytosanitary controls in the area.

Article 716(3) provides for each NAFTA government to recognize that an area in the territory of an exporting NAFTA country is, and is likely to remain, a pest-free or disease-free or an area of low pest or disease prevalence where the government of the exporting country so demonstrates to the satisfaction of the government of the importing NAFTA country.

The three NAFTA governments recognize in Article 716(4) that there may be a difference between the risk assessment procedures for, and the disposition of goods produced in, a pest-free or disease-free area as compared to those for goods produced in an area of low pest or disease prevalence.

Article 716(5) prohibits discrimination against a good produced in a pest-free or disease-free area or an area of low pest or disease prevalence in a NAFTA country compared to a good posing the same level of risk produced in such an area in a non-NAFTA country, and requires the use of equivalent risk assessment techniques for such areas and the surrounding areas.

Article 716(6) provides for the NAFTA governments to pursue agreements on the specific requirements that, when fulfilled, would allow goods produced in areas of low pest or disease prevalence in a NAFTA country to be imported into another NAFTA country.

### **13. Control, Inspection and Approval Procedures**

Control and inspection procedures are defined in Article 724. Control and inspection procedures are generally similar to conformity assessment procedures under Chapter Nine, but there are specific differences in the definitions due to the particular nature of S&P measures. Approval procedures are separately defined in Article 724. Approval procedures require government approval for an additive, or government establishment of a tolerance (maximum permissible level) for a contaminant, before the additive or contaminant can be used or before a food, beverage or feedstuff containing the additive or contaminant can be marketed. In this sense, an approval procedure establishes a "default zero" for the level of the additive or contaminant -- the permitted level is automatically zero unless and until the government has approved the use of the additive or established a tolerance.

Article 717(4) explicitly recognizes the right of governments maintaining approval procedures to prohibit access to their domestic markets for foods, beverages or feedstuffs containing an additive or contaminant until they have approved the additive or established a tolerance for the contaminant. However, a government maintaining an approval procedure is obligated to consider the use of a relevant international standard, guideline or recommendation as the basis for granting access to its domestic market until it completes its approval procedure. This does not require either the use of international standards or that access be offered to imports prior to approval.

Article 717(1) details a number of specific obligations for governments regarding control and inspection procedures. These obligations closely parallel those in Article 908, allowing for the particular nature of S&P measures. Article 717(2) applies these same requirements to approval procedures, except for the requirements in Articles 717(1)(j) and (k). The requirement in 717(1)(j) is not applicable since sampling is used to determine that a good meets an established measure. Similarly, Article 717(1)(k) assumes that a government has *already* established a measure for a good to satisfy. Consequently, these requirements would not work for an approval procedure. As noted above, an approval procedure applies *before* a government establishes a measure regarding a particular substance for a good to satisfy.

If the sanitary or phytosanitary measure of an importing NAFTA government requires the conduct of a control or inspection procedure at the level of production, under Article 717(3) an exporting NAFTA government is to take such reasonable measures as may be available to it to facilitate access in its territory and to provide assistance necessary to facilitate the conduct of the importing NAFTA government's control or inspection procedure.

#### **14. Transparency**

Article 718 requires advance public notice and opportunity to comment on proposed S&P measures or modifications to S&P measures. In the case of federal measures, the NAFTA requires at least 60 days advance notice. Under Article 718(2), each NAFTA country is to seek through appropriate measures to ensure that similar notice is provided for S&P measures proposed by state and provincial governments, including local governments. The requirement that there be a minimum of 60 days notice of S&P measures does not apply to state, provincial or local governments.

Article 718(4) requires a delay between publication of the final sanitary or phytosanitary measure and its effective date. However, there is an exception from these requirements where necessary to address an urgent problem relating to sanitary or phytosanitary protection. These requirements are consistent with requirements already in force for federal agencies under the Administrative Procedure Act and other statutes.

Advance notice and publication of S&P measures are part of what is often referred to as procedural "transparency." Transparent procedures are those designed to allow interested persons to know what requirements apply and to be able to adapt their production or other activity to the requirements. Advance notice and comment should also help to avoid unnecessary problems and provide an opportunity to determine whether proposed S&P measures conform to the NAFTA disciplines.

Article 719 provides additional transparency requirements. It requires each NAFTA government to maintain an inquiry point that can answer reasonable questions from other NAFTA governments and interested persons, and to provide relevant documents, regarding the NAFTA country's S&P measures. Article 719(2) prohibits discrimination in setting the price of

documents for domestic purchase as compared to purchase by another NAFTA government or other interested persons.

Article 721 permits each government to publish information concerning its S&P measures only in its an official language and clarifies that publication requirements do not apply if disclosure would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises.

## **15. Cooperation**

Article 720 provides for technical cooperation between the NAFTA governments. Article 722 establishes a Committee on Sanitary and Phytosanitary Measures whose functions include facilitating the enhancement of food safety and the improvement of S&P conditions in the three NAFTA countries and facilitating technical cooperation between NAFTA governments in the area of S&P measures.

Article 723 provides for technical consultations between NAFTA governments on matters covered by Section B. Consultations under Article 723(3) may serve as the consultations under Article 2006 if the NAFTA governments involved so agree.

## **16. Burden of Proof**

Article 723(6) makes clear that a NAFTA government asserting that a sanitary or phytosanitary measure of another government is inconsistent with Section B has the burden of establishing the inconsistency. This is consistent with current practice under the CFTA and under the GATT.

## **17. Application to State and Local Governments**

From the beginning of the NAFTA negotiations, a fundamental objective of U.S. policy was to ensure that the NAFTA did not result in the lowering of S&P protections, including state and local S&P measures. The NAFTA secured that objective.

The provisions of Section B apply to state, provincial and local S&P measures in most respects.<sup>11</sup> Nothing in the NAFTA, however, requires that state or local governments adopt, or comply with *federal* SPS measures. The NAFTA simply requires that state and local S&P measures comply with the rules set out in Section B. Just as the federal government will be free to maintain or change its laws, subject to NAFTA rules, so will state and local governments.

The NAFTA is drafted as a set of prohibitions. Unless the NAFTA prohibits a certain type of measure or practice, a NAFTA country is free to maintain or impose it. Since nothing in the NAFTA precludes states from maintaining or adopting S&P measures that are higher than federal S&P measures, they will continue to have the right to do so.

The NAFTA negotiators specifically used the plural "levels" in Article 712(2), which talks in terms of each NAFTA government's right to set the levels of protection that it sees fit, in part to account for the fact that each NAFTA country may have a multiplicity of levels due to differences among the states and between the states and federal government.

Article 105 requires each country to take "all necessary measures" to ensure that state and provincial governments observe those provisions of the agreement that apply to them. This language is drawn directly from the CFTA, which has been in effect since 1989. It simply reflects an understanding among the three countries that they intend to apply the agreement equally at the federal and state and local level, with exceptions to that general rule in certain areas. This language is not meant to suggest -- and has not been interpreted under the CFTA to mean -- that state or provincial regulation must conform with federal standards. Article 105 of the NAFTA provides that: "The Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments."

This language clearly does not interfere with the ability of state and local governments to maintain measures to protect human, animal or plant life or health. Article 105, and any measures taken thereunder to secure observance by state and local governments of provisions of the NAFTA, will in no way diminish or impair the constitutional and legal rights of state and local governments to adopt, maintain, or apply measures to protect public health and the environment.

Furthermore, nothing in the NAFTA requires the federal government to take legal action against state measures that NAFTA dispute settlement panels may determine to be inconsistent with trade obligations. Under the NAFTA, panel opinions are advisory only. If the defending country loses, it is not required to remove or change the offending measure. It may offer trade compensation instead or simply permit the other country to take retaliatory action of equivalent effect.

As has been the case under the GATT, in those rare instances where state rules may be successfully challenged under the NAFTA, the federal government will work cooperatively with the states -- as set out more fully in this Statement in connection with Chapter One -- to seek a satisfactory resolution of the matter. Under the NAFTA, each country will retain full discretion, under its own political and legal system, to determine how to satisfy its trade obligations.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

#### **a. General Provisions**

Section 351 of the implementing bill amends Title IV of the Trade Agreements Act of 1979 to add a new subtitle concerning standards and measures under the NAFTA. Chapter 1 of the new subtitle contains provisions to implement Section B of NAFTA Chapter Seven.

Title IV of the Trade Agreements Act of 1979 was enacted to implement the Tokyo Round Standards Code. Federal agencies have been subject to the requirements of Title IV since 1980. These existing provisions continue apply to standards activities of federal agencies, which includes some of the standards-related measures under the NAFTA. However, the definitions and coverage of Chapter Seven differ from the definitions and coverage of the Standards Code, so it was necessary to provide separate legislative provisions in the Trade Agreements Act of 1979 to implement Chapter Seven.

Section 461 of the new subtitle contains general provisions. Section 462 of the new subtitle assigns to the standards information center established under section 414 of the Trade Agreements Act of 1979 the additional duties prescribed under Chapter Seven. The National Institute of Standards and Technology (NIST) under the Department of Commerce currently serves as the standards information center.

Section 463 of the new subtitle provides definitions of the terms used in chapter 2 of the new subtitle. These definitions are drawn from the definitions in the NAFTA. The definitions of "standard" and "technical regulation" are taken from the notes to Article 724 agreed to by the NAFTA countries set out after Chapter Twenty-Two of the NAFTA.

#### **b. Technical and Conforming Changes**

##### **(1) Importation of Animals**

Section 361(b) of the bill amends section 6 of the Act of August 30, 1890, to authorize the Secretary of Agriculture, in accordance with such regulations as the Secretary may promulgate, to permit the importation of cattle, sheep, and other ruminants and swine, which are diseased or infected with any disease, or which have been exposed to such infection within 60 days prior to their exportation to the United States. This provision does not require the Secretary to permit the importation of such animals. The law had prohibited the entry of such animals, with a few limited exceptions, but a prohibition on importation from Mexico and Canada may not be needed for animal health purposes in all instances, nor may animal health concerns necessitate limiting imports from Mexico of certain cattle only to the state of Texas.

Accordingly, the bill permits the Secretary to specify those circumstances in which such animals may be imported.

(2) Inspection of Animals

Section 361(c) of the bill amends section 10 of the same act to authorize the Secretary to promulgate regulations to permit the Secretary to waive certain requirements regarding shipments of ruminants and swine between the United States and Canada or Mexico.

(3) Disease-free Countries or Regions

Section 361(d)(1) of the bill amends section 306 of the Tariff Act of 1930 to implement NAFTA Article 716 regarding adaptation to regional conditions. The bill authorizes the Secretary to permit, subject to such terms and conditions as the Secretary determines appropriate, the importation of ruminants and swine and the fresh, chilled and frozen meat of such animals from regions of countries that are, and are likely to remain, free of foot-and-mouth disease and rinderpest. This provision does not obligate the Secretary to permit the entry of such goods but merely authorizes the Secretary to determine the appropriate terms and conditions for such entry.

Section 361(d)(2) of the bill amends the Honeybee Act, also to implement NAFTA Article 716. This provision permits the importation of honeybees and honeybee semen from regions of Canada and Mexico that are free of diseases or parasites harmful to honeybees and undesirable species or subspecies of honeybees.

(4) Meat and Poultry Inspection

Sections 361(e) and (f) of the bill amend, respectively, section 17(d) of the Poultry Products Inspection Act and section 20(e) of the Federal Meat Inspection Act to implement NAFTA Article 714(2) on equivalence. With respect to poultry and poultry parts and products, these provisions permit the importation from Canada or Mexico of such goods capable of use as human food if they are processed in facilities and under conditions that meet standards that are equivalent to U.S. standards. With respect to meat, carcasses and meat products, the bill would permit the importation from Canada or Mexico of such goods upon certification by the Secretary that plants in Canada or Mexico have complied with requirements equivalent to the applicable U.S. requirements.

The bill specifically authorizes the Secretary to treat an applicable standard of Canada or Mexico as equivalent to a U.S. standard or requirement if the exporting country provides the Secretary with scientific evidence or other information, in accordance with mutually agreed risk assessment methodologies, to demonstrate that the foreign standard achieves the level of protection that the Secretary deems appropriate. The Secretary remains free to determine, on a scientific basis, that the foreign standard does not achieve that level of protection.

(5) Peanut Butter and Peanut Paste

Section 361(g) establishes requirements for peanut butter and peanut paste in the domestic market. Peanut butter and peanut paste must be processed from peanuts meeting the standards of Marketing Agreement No. 146, except that imported peanut butter and peanut paste may, as an alternative, comply with sanitary measures that provide at least the same level of sanitary protection as is achieved by peanut butter or peanut paste processed from peanuts meeting the standards of Marketing Agreement No. 146. This provision is included to provide additional protection from risks associated with aflatoxin.

(6) Animal Health Biocontainment Facility

Section 361(h) of the bill authorizes the Secretary of Agriculture, subject to appropriation, to make a grant to a land grant college or university, located in a state adjacent to Mexico, that the Secretary determines has an established program in animal health research and education and a collaborative relationship with a Mexican university or veterinary school. The grant is for the construction of the "Southwest Regional Animal Health Biocontainment Facility," to conduct research in animal health and certain other biocontainment matters. In light of the increased U.S. - Mexico trade expected under the NAFTA, this facility will help to ensure the protection of animal and plant life and health in the border area.

(7) Inspection Reports

Section 361(i) of the bill mandates an annual report by the Secretary of Agriculture, in addition to the biennial report required pursuant to section 321(i), on the impact of NAFTA with respect to inspection of commercially significant quantities of imported meat, poultry, other foods, animals and plants into the United States. These reports are required beginning January 31, 1995, through 2004. The Secretary will consult with other appropriate agencies in preparation of the annual report.

**2. Presidential Action**

Article 718 requires, in general, publication of a notice and notification in writing to the other NAFTA countries of proposed S&P measures at least 60 days prior to their adoption. This obligation is consistent with Executive Order No. 12662 (54 *Fed. Reg.* 785), which requires federal agencies to publish or serve notice of proposed standards-related measures not less than 75 days before comments are due. The appropriate conforming changes will be made in that or a similar executive order to reflect U.S. obligations under Section B.

**3. Administrative Action**

No changes in administrative regulations, practices, or procedures, other than those specifically provided for in the implementing bill or discussed below, are contemplated.

As noted above, federal agencies are presently subject to the provisions of Title IV of the Trade Agreements Act of 1979 (19 U.S.C. 2531-2573)(the "1979 Act"), which implements U.S. obligations under the Standards Code. Continued compliance by federal agencies with those provisions will satisfy many of the requirements set out in Section B.

Article 713 provides for the use of relevant international standards, without reducing the level of protection of human, animal or plant life or health, as a basis for each NAFTA government's own S&P measures. Section 402(2) of the 1979 Act (19 U.S.C. 2532) already requires federal agencies, when developing standards, to take international standards into consideration and use the international standards as a basis if appropriate.

Federal agencies currently participate in international standardizing organizations, such as the *Codex Alimentarius Commission*. They will continue to participate in these organizations pursuant to the commitment in Article 713(5) to participate to the greatest extent practicable with a view to promoting the development and periodic review of international standards, guidelines and recommendations.

Under the coordination of the U.S. Trade Representative, appropriate federal agencies will work with representatives from the other NAFTA countries to pursue equivalence of the respective S&P measures of the NAFTA countries in accordance with Article 714(1), without reducing the level of protection of human, animal or plant life or health.

Pursuant to section 414 of the 1979 Act, the National Institute of Standards and Technology (NIST) currently serves as the U.S. repository of standards-related information under the Standards Code. NIST will also serve as the U.S. inquiry point required by Article 719 and will be responsible for information exchange in accordance with Section B of Chapter Seven, including providing its Canadian and Mexican counterparts with copies of proposed federal and state S&P measures, except that it will refer inquiries regarding agricultural products to the Department of Agriculture. Providing information on S&P measures proposed or adopted by state governments will entail an expansion of NIST's current responsibilities because NIST presently does not notify regulations that may significantly affect trade proposed by state agencies under the Standards Code. NIST will also disseminate information to interested persons in the United States on Mexican and Canadian federal, state and provincial S&P measures.

Article 722 establishes a trilateral Committee on Sanitary and Phytosanitary Measures. Under the coordination of the U.S. Trade Representative, federal agencies will participate, as appropriate, in the Committee's functions, including facilitating:

- the enhancement of food safety and improvement of S&P conditions in the territories of the NAFTA countries;
- technical cooperation between the NAFTA countries; and

- consultations on specific matters relating to sanitary and phytosanitary measures.

The relevant federal agencies will participate, as appropriate, in the functions of any working groups established by the Committee.

The U.S. representatives to the Committee will request that the Committee establish a high-level Subcommittee on Pesticides to address pesticide issues among the NAFTA countries, including issues regarding pesticide tolerances. The United States would appoint appropriate high-level representatives to the Subcommittee.

### ENDNOTES

1. Section B defines a risk assessment as "an evaluation of:
  - "(a) the potential for the introduction, establishment or spread of a pest or disease and associated biological and economic consequences; or
  - "(b) the potential for adverse effects on human or animal life or health arising from the presence of an additive, contaminant, toxin or disease-causing organism in a food, beverage or feedstuff."

Article 712(3) does not specify that the government adopting, maintaining or applying the measure must conduct the risk assessment itself. For example, a state government could rely on a risk assessment conducted by the federal government, another state government, or a competent international organization. Presumably the government would do so in light of the factors specified in Articles 715(1) and (2).
2. *The American Heritage Dictionary (1976).*
3. *Id.*
4. *Webster's New Collegiate Dictionary (1980).*
5. *Webster's II New Riverside Dictionary (1988).*
6. *The American Heritage Dictionary (1976).* See also *Webster's II New Riverside Dictionary.*
7. *The American Heritage Dictionary (1976).*
8. *Webster's New Collegiate Dictionary (1980).*
9. The question arises because some persons have incorrectly claimed that the term "necessary" in a trade agreement must always, wherever it is used, mean "least trade restrictive"

based on the inaccurate belief that under Article XX of the GATT, the term "necessary" means "least trade restrictive."

10. Article 712(5) reads: "Each Party shall ensure that any sanitary or phytosanitary measure that it adopts, maintains or applies is applied only to the extent necessary to achieve its appropriate level of protection, taking into account technical and economic feasibility."

11. Some provisions of Section B do not apply to state or local governments, in particular Article 718(1).

## **CHAPTER EIGHT: EMERGENCY ACTION**

### **A. SUMMARY OF NAFTA PROVISIONS**

Chapter Eight sets out the procedures and remedies available to domestic industries that have sustained, or are threatened by, serious economic injury due to increased imports. Special safeguards provisions, which apply to textile and agricultural products, are provided for elsewhere in the NAFTA.

The Administration does not anticipate that the NAFTA will result in injurious increases in imports from either Mexico or Canada. Nevertheless, the safeguards provisions of the NAFTA, which have been supplemented by a written understanding between the three governments on "import surges," will assure that relief is available where needed.

Chapter Eight covers two different situations -- actions that can be taken against increased imports from a NAFTA country or countries due to injury caused by the phase-out of tariffs under the NAFTA ("bilateral" actions) and those that can be taken against imports from all sources ("global" actions). In several respects, the chapter tracks the emergency action provisions of Chapter Eleven of the CFTA for both bilateral and global actions, while adding Mexico to, and making certain changes in, the CFTA rules.

Chapter Eight goes beyond the CFTA, however, in significant respects. The chapter establishes procedural rules similar to those in current U.S. law and practice that each government will be required to follow in conducting investigations leading to bilateral and global safeguard actions against goods from other NAFTA countries. These rules require the publication of notice of an investigation and its scope, the holding of a public hearing, and publication of findings and the basis for those findings.

Chapter Eight also permits the United States and Mexico to take bilateral safeguard actions against each other's imports when increased imports cause or threaten serious injury -- that is, before serious injury occurs. Under the CFTA bilateral safeguards rules, which are carried forward into the NAFTA for U.S.-Canada trade, the United States and Canada may take safeguards actions against imports from the other country only where there is a finding of actual injury.

#### **1. Bilateral Actions**

Article 801, together with Annex 801.1, permits each party to take bilateral safeguard actions during specified "transition periods" -- that is, during the period in which duties on NAFTA-origin goods are being phased out. Article 801 applies solely with respect to goods traded with Mexico; the bilateral safeguard provisions of the CFTA are incorporated into the NAFTA through Annex 801.1 and thus will continue to apply between the United States and

Canada during the transition period for the phase-out of duties between the United States and Canada.

More specifically, Article 801 permits the United States (or Mexico, in the case of U.S. goods) to take a bilateral action against goods from Mexico during the transition period if, as a result of the reduction or elimination of a duty under the Agreement, a good originating in Mexico is being imported into the United States in such increased quantities, in absolute terms, and under such conditions as to constitute a substantial cause of serious injury, or threat thereof, to a domestic industry. If injury or threat is found, the United States may suspend any further reduction in duties on that good, or may increase the rate of duty on the good to a level not to exceed the lesser of the current most-favored-nation (MFN) rate of duty or the MFN-applied rate of duty in effect immediately preceding the entry into force of the Agreement.

In addition to allowing for safeguards actions based on a "threat" of serious injury in the case of imports from Mexico, Article 801 establishes a longer period of relief than that under the CFTA. It permits an additional, fourth year of relief action in the case of those import-sensitive goods from Mexico falling into the NAFTA "C+" tariff elimination category. It also allows for greater flexibility in the phase-out of duties on goods subject to a bilateral action during the portion of the transition period that remains after the action is terminated.

As is the case under the CFTA, a government taking action under the NAFTA bilateral safeguards mechanism may reimpose tariffs up to the MFN rate of duty for the product in question. The NAFTA also continues the CFTA rule allowing a government adversely affected by a safeguard action to impose offsetting tariff increases of its own in the absence of agreement between the two governments on trade compensation.

## **2. Global Safeguards**

As is the case under the CFTA, the NAFTA global safeguards provision maintains each country's right to take remedial action against imports from all sources under the GATT Article XIX escape clause, including those from free-trade partners. At the same time, the NAFTA provides that imports from other NAFTA countries are to be excluded when they are not a significant part of the problem. (GATT Article XIX allows a GATT contracting party to take emergency action and "escape" from its obligations with respect to a product when the party finds that a product is being imported into its territory in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers of a like or directly competitive product.)

Article 802 provides that where a NAFTA country takes a global safeguard action -- that is, an emergency action directed at goods from all countries -- the country must exclude goods from other NAFTA countries unless:

- imports from a NAFTA country, considered individually, account for a substantial share of total imports, and

- imports from a NAFTA country, considered individually or, in exceptional circumstances, imports from NAFTA countries considered collectively, contribute importantly to the serious injury or threat of such injury.

Article 802 provides guidance as to when imports from a NAFTA country account for a "substantial share" of total imports and when imports from a NAFTA country or countries "contribute importantly" to serious injury or the threat of such injury. Under Article 802(2)(a), a country "normally" will not be considered to account for a substantial share of total imports if it was not among the top five suppliers of the subject good.

Similarly, under Article 802(2)(b), imports from a NAFTA country or countries "normally" will not be deemed to contribute importantly to serious injury, or threat, if the growth rate of imports from the country or countries during the period in which the injurious increase in imports occurred is appreciably lower than the growth rate of total imports from all sources over the same period. The use of the word "normally" recognizes the need for some flexibility in exercising this rule. There may be instances in which a country not meeting one of these guidelines should be included in the safeguards action, or the reverse.

### **3. Procedural Requirements**

Article 803 and Annex 803.3 set forth obligations regarding the administration of emergency action proceedings. Each country is required to maintain equitable, timely, transparent and effective procedures for emergency action proceedings. These obligations provide for a level of administrative transparency and fairness in bilateral and global safeguard investigations similar to that under current U.S. law and practice. In addition, a September 14, 1993, understanding between the three NAFTA governments concerning emergency action establishes a Working Group on Emergency Action and provides for additional consultative procedures.

Each NAFTA country must entrust determinations of serious injury or threat to a "competent investigating authority." In the case of the United States, this body will continue to be the United States International Trade Commission (ITC). The competent investigating authority must give detailed notice of its investigation, hold a public hearing, and gather and consider information relating to certain economic factors relevant to the question of injury and causation. Once its investigation is completed, the authority must publish a report setting forth its findings and conclusions on all pertinent issues of law and fact.

Entities filing petitions for relief must furnish specified information (or best estimates) in their petitions.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

Chapter Eight's bilateral and global action provisions largely track the current U.S. global safeguard law, set forth in sections 201-204 of the Trade Act of 1974, 19 U.S.C. 2251-2254. Changes in existing legislation are required primarily to adapt the existing CFTA safeguards framework for use in respect of both Canadian and Mexican imports, consistent with the terms of Chapter Eight.

#### **a. Relief from NAFTA-Origin Imports**

Sections 301 through 307 of the bill implement the bilateral safeguard action provisions of Article 801 and Annex 801.1. These provisions of the bill authorize the President, after an investigation and affirmative determination by the ITC, to take a safeguard action against "originating" goods from Canada or Mexico when, as a result of the reduction or elimination of a duty under the Agreement, a Canadian or Mexican article is being imported into the United States in such increased quantities and under such conditions as to be a substantial cause of serious injury or, in the case of Mexico, threat of serious injury to the domestic industry.

The standards and procedures set out in these provisions closely follow those of section 302(a) of the CFTA Implementation Act. These standards and procedures in turn parallel the procedures set forth in sections 201-204 of the Trade Act of 1974.

Section 301 defines the terms "Canadian article" and "Mexican article" for purposes of the safeguard provisions.

Section 302 provides for the filing of petitions with the ITC and for investigations and determinations by the ITC. Section 302(a) provides that a petition requesting a bilateral safeguard action may be filed with the ITC by an entity that is "representative of an industry." As under section 202(a)(1) of the Trade Act of 1974, the term "entity" is defined to include a trade association, firm, certified or recognized union, or a group of workers.

In addition, section 302(a) permits a petitioning entity to request that provisional relief be provided as if the petition had been filed under section 202(a) of the Trade Act of 1974. This provision will ensure that agricultural producers can apply for expedited relief from surges of imports of perishable products from Mexico and Canada after the ITC monitors imports of such products for a minimum of 90 days. If a petition is filed after the monitoring period, the ITC has 21 days to determine whether imports are a substantial cause of serious injury and the President has seven additional days to provide any relief he determines necessary. Similar authority exists in current law for imports from all countries.

Section 302(a) also provides that producers of products other than perishable agricultural products who claim injury and critical circumstances with respect to a surge of

imports from Mexico or Canada may apply for accelerated relief (within 120 days), if a petition is filed within 90 days after the ITC has begun an investigation. Similar authority exists in current law for imports from all countries.

Section 302(b) sets out the standard to be used by the ITC in undertaking an investigation and making a determination, including that the ITC is to make an affirmative determination if it finds a threat of serious injury from Mexican imports. The "threat" standard does not apply to imports from Canada since, as noted above, the NAFTA incorporates the CFTA bilateral safeguards provision, which does not provide for emergency actions between the United States and Canada based on a threat of serious injury.

Section 302(c) makes applicable by reference several provisions of the Trade Act of 1974. These are the definition of "substantial cause" in section 202(b)(1)(B), the factors applied in making determinations listed in section 202(c), the provisional relief provisions in sections 202(b)(3) and 202(d), and the hearing requirement of section 202(b)(4).

Section 302(d) exempts from investigation under this section, articles that have been accorded relief previously under this section as well as certain textile and apparel articles.

Section 303 establishes deadlines for ITC determinations and reports and provides for ITC findings and recommendations to the President. As under the CFTA Implementation Act, the ITC must make its injury determination within 120 days of the date on which an investigation is initiated. If it makes an affirmative determination under section 302(b), the ITC must find and recommend to the President the amount of import relief that is necessary to remedy or, for Mexican goods, prevent or remedy serious injury. The relief that may be recommended by the ITC is limited to that authorized in section 304(c).

Under section 303(c), the ITC is required to transmit its report to the President not later than 30 days after making its injury determination. The ITC's report must include a statement of the basis for the ITC's determination, any dissenting views, and any finding regarding import relief. Section 303(d) requires the ITC to publish its report promptly.

Section 303(e) makes applicable the provisions of section 330(d) of the Tariff Act of 1930, which will apply when the ITC Commissioners are equally divided on the question of injury or remedy.

Section 304 sets forth the nature of the relief that the President may provide, the period of relief, and special provisions relating to the rate on Mexican articles after termination of relief. The President may take action in the form of:

- a suspension of further reductions in the rate of duties to be applied to the Mexican or Canadian goods in question; or

- an increase in the rate of duty on the article to a level that does not exceed the lesser of the existing MFN rate or the MFN rate of duty imposed at the time the Agreement entered into force.

In the case of a duty applied on a seasonal basis, the President may increase the rate of duty on the article to a level that does not exceed the MFN rate of duty imposed for the immediately prior corresponding season. In the event that he takes action with respect to an agricultural good subject to a tariff rate quota under Article 703(3), the NAFTA's agricultural safeguard provision, the President will suspend the tariff rate quota for the period that relief is in effect.

The President is directed to take action not later than 30 days after receiving a report from the ITC containing an affirmative determination. The President must provide relief with respect to the imports to the extent that he determines is necessary to remedy or, in the case of Mexican goods, prevent or remedy the injury found by the ITC. The President is not required to provide import relief, however, if he determines that the relief will not provide greater economic and social benefits than costs. This exception generally tracks the exception in current section 203(a)(1)(A) of the Trade Act of 1974.

The general three-year limitation on the duration of a bilateral safeguard action set out in section 304(d) is the same as that in the CFTA Implementation Act. After obtaining advice from the ITC, however, the President may extend the period of a safeguard action for up to one year in the case of certain import-sensitive articles.

Section 304(c) also specifies the duty rate to be applied to Mexican goods after termination of a bilateral safeguard action. Section 304(e) provides greater flexibility than the CFTA Implementation Act in addressing how NAFTA duty phase-out is to be resumed once import relief imposed under a bilateral safeguard action against Mexican products is terminated. Upon the termination of relief, the rate of duty for the remainder of the year is to be the rate that would have been in effect one year after the initiation of the action. For the rest of the duty phase-out period, the President may set the duty:

- at the rate called for under the U.S. tariff phase-out schedule; or
- in a manner that eliminates the tariff in equal annual stages ending on the date set out in that schedule.

Section 305 provides that the President's authority to take action under the bilateral safeguards provision expires at the end of the appropriate "transition period," which in the case of a Canadian good is December 31, 1998, and in the case of a Mexican product, is ten years after the date on which the Agreement enters into force, and 15 years in the case of articles whose duty phase-out exceeds ten years. The President may take action under the bilateral safeguards provision after the expiration of the transition period, but only if the Government of Canada or Mexico, as the case may be, consents to such action.

Section 306 allows the President to provide trade compensation to the exporting country, as required under Chapter Eight, when the United States imposes relief through a bilateral safeguard action. Section 306 provides that for purposes of section 123 of the Trade Act of 1974, which allows the President to provide compensation, any relief provided under section 304 will be treated as an action taken under the global safeguard action provisions of U.S. law (sections 201-204 of the Trade Act of 1974).

Section 307 provides for the submission of bilateral and global safeguard action petitions to the ITC separately or at the same time. Where bilateral and global petitions are submitted together, the ITC is to consider the petitions jointly.

Section 308 amends section 301(a) of the CFTA Implementation Act, which authorizes the President to impose temporary duties on Canadian fresh fruits and vegetables after a determination by the Secretary of Agriculture. The section makes this provision more effective by imposing deadlines on the Secretary for making his or her determination, and by making certain improvements in the information and data available to the Secretary.

#### **b. Relief from Imports from All Countries**

Sections 311 and 312 of the bill implement the global action provisions of Article 802. They authorize the President, in the case of a global action under sections 201-204 of the Trade Act of 1974, to exclude imports of a Canadian or Mexican good when certain conditions are present. The standards and procedures in this part generally parallel those set forth in section 302(b) of the CFTA Implementation Act, but they provide more flexibility and take into account the fact that the NAFTA is trilateral, rather than bilateral in nature.

Section 311 requires the ITC to make special findings with respect to imports from a NAFTA country if the ITC makes an affirmative determination in a global safeguard action investigation under section 202(b) of the Trade Act of 1974. The ITC must find whether:

- imports of the article from a NAFTA country, considered individually, account for a "substantial share" of total imports; and
- imports of the article from a NAFTA country, considered individually or, in exceptional circumstances, imports from NAFTA countries considered collectively, "contribute importantly" to the serious injury, or threat thereof, caused by imports.

The term "contribute importantly" is defined to mean "an important cause, but not necessarily the most important cause." It has the same meaning as in the CFTA Implementation Act.

The ITC normally will not consider imports from a NAFTA country to constitute a "substantial share" of total imports if that country is not among the top five suppliers of the product subject to investigation, measured in terms of import share during the most recent three-year period. Nor will imports from a NAFTA country or countries normally be

considered to contribute importantly to serious injury or the threat of serious injury if the growth rate of imports from such country or countries during the period in which the injurious increase in imports occurred is appreciably lower than the growth rate of total imports from all sources over the same period. In determining whether imports from a NAFTA country or countries "contribute importantly" to the serious injury or threat, the ITC is to consider such factors as the change in the import shares of the NAFTA country or countries, and the level and change in the level of imports of such country or countries.

As the use of the modifier "normally" makes clear, there will likely be instances when it is appropriate for the ITC to find that a NAFTA country accounts for a substantial share of total imports even though the country is not one of the top five suppliers. For example, when there is little difference between the share of a fifth-place supplier and those that fall below fifth place, or there are many suppliers, each accounting for a substantial share, the sixth- or seventh-place supplier may nevertheless account for a substantial share of total imports. Similarly, a growth rate in imports from a NAFTA country or countries that is appreciably lower than the growth rate from all sources would not necessarily be determinative of whether imports from such country or countries contribute importantly to the serious injury or threat of such injury. In addition, the ITC is likely to consider imports from NAFTA countries collectively when imports from individual NAFTA countries are each small in terms of import penetration, but collectively are found to contribute importantly to the serious injury or threat of injury.

Under section 312, the President must exclude NAFTA imports from a global safeguard action if he makes a negative determination that imports from a NAFTA country account for a substantial share of total imports or imports from a NAFTA country or countries contribute importantly to the serious injury or threat of serious injury. Section 312 includes a "surge" provision similar to that in the CFTA Implementation Act, however, that allows the President to include the previously excluded imports in the action if he later determines that a surge in imports of the product from the excluded country or countries is undermining the effectiveness of the action. As under the CFTA Implementation Act, the domestic industry may request the ITC to conduct an investigation to determine whether a surge in imports is undermining the effectiveness of the action; the ITC must submit its findings on that subject to the President no later than 30 days after the request is received.

### **c. Other Safeguard Provisions**

Section 315 makes citrus products eligible for provisional relief under section 202(d) of the Trade Act of 1974. That section currently provides for expedited investigation and determination by the International Trade Commission with respect to perishable agricultural products. The citrus products that will explicitly be eligible as a result of section 315 are processed oranges, processed grapefruit, and orange and grapefruit juice, including concentrate.

Section 316 requires the International Trade Commission to monitor imports of tomatoes and peppers for ten years. The purpose of this provision is to provide an expedited determination concerning import relief for these commodities. The Department of Agriculture

and the Customs Service will work with the Commission and help ensure that the type of information needed for the monitoring is available to the Commission, including gathering the necessary information as appropriate.

Section 317 directs the ITC to adopt such procedures, rules and regulations as are necessary to bring its procedures into conformity with Chapter Eight of the Agreement. With certain minor exceptions, such as the requirement that a petitioner include in a petition information on the extent to which NAFTA country imports are contributing importantly to the serious injury or threat of injury, current ITC procedures, rules, and regulations relating to the conduct of investigations already conform with the requirements of Chapter Eight.

Section 317 also amends section 202(a) of the Trade Act of 1974 to provide that the procedures in section 332(g) of the Tariff Act of 1930 with respect to the release of confidential business information are to apply in the case of Commission global action investigations under Chapter 1 of Title II of the Trade Act of 1974 as well as bilateral action investigations under Part 1 of Subtitle A of Title III of the implementing bill.

Section 318 provides that the safeguard provisions of Subtitle A of Title III are to take effect on the date the NAFTA enters into force, with the exception of section 308(a), which will take effect upon enactment.

## **2. Administrative Action**

No changes in administrative regulations, practices or procedures, other than those mandated specifically by the implementing bill, are contemplated to implement Chapter Eight.

### **a. Tariff Rate Quotas**

For purposes of determining whether a reduction in duty has occurred, the Commission will consider the expansion of a quota under a tariff-rate quota to be a reduction in a duty.

### **b. Import Trends**

In determining whether increased imports are a substantial cause of serious injury or the threat thereof to the domestic industry, the Commission will examine trends in imports and changes in the marketplace over the most recent years. Particularly in the case of imports of an agricultural good, the fact that imports may have been higher in a year prior to the most recent year due to natural disasters (such as floods, droughts, pest problems) would not be dispositive of the question of whether imports are increasing or whether increased imports are a substantial cause of serious injury or the threat thereof to the domestic industry.

### **c. Major Household Appliances**

The following applies to safeguard actions regarding these major household appliances:

| <u>HTS number</u> | <u>Product</u>                                      |
|-------------------|---|
| 7321.11.30        | Gas cooking stoves or ranges (other than portables) |
| 8418.10.00        |   |
| 8418.21.00        | Refrigerators and combined refrigerator/ freezers   |
| 8418.22.00        |   |
| 8418.29.00        |   |
| 8418.30.00        | Freezers, chest and upright                         |
| 8418.40.00        |   |
| 8422.11.00        | Dishwashing machines (household type)               |
| 8450.11.00        |   |
| 8450.12.00        | Clothes washing machines (household laundry type)   |
| 8450.19.00        |   |
| 8450.20.00        |   |
| 8451.21.00        | Clothes drying machines (household type)            |
| 8451.29.00        |   |
| 8516.60.40        | Electric stoves or ranges                           |

In making its determination as to whether an article is being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or threat thereof, the ITC will take into account all economic factors that it considers relevant, including (but not limited to) those set out at 19 U.S.C. 2252(c)(1)(A) (with respect to serious injury) or 19 U.S.C. 2252(c)(1)(B) (with respect to threat of serious injury).

As provided in Article 801.1 of the NAFTA, in the case of any bilateral action, the reference to "the reduction or elimination of a duty provided for in this Agreement" includes the reduction of MFN duty rates to zero, including, in the case of GSP-eligible products, by not applying the MFN duty rate above the competitive need limit.

In assessing whether a petition is filed by an entity that is "representative of an industry," the ITC will take into account whether firms not included among the petitioners are related to exporters or importers or are themselves importers of the like or directly competitive article and thus may not have been petitioners for reasons unrelated to their U.S. production.

In considering whether a domestic industry has suffered serious injury or threat thereof, the ITC will bear in mind that the purpose of these provisions is to consider the condition of the industry producing products in the United States. Accordingly, the ITC will take into account, among other things, whether firms that are related to exporters or importers or are themselves importers of the like or directly competitive article have been shielded or are benefiting from the presence in the U.S. market of increased quantities of imports.

The ITC may, in its discretion, also apply the above provisions in investigations involving products other than the appliance products listed above.

With respect to injury as a result of imports from NAFTA countries, any trade remedy provided will be reinstatement of MFN rates as provided for in Article 801.

If the ITC has made an affirmative determination of injury in a global investigation, it will recommend to the President the relief that will be most effective in facilitating the efforts of the petitioners to make a positive adjustment to import competition. The ITC will carefully consider the relief proposed by the petitioner.

If the President determines to provide import relief in conformity with Article 802 with respect to imports from Canada or Mexico, the remedy with respect to Canada or Mexico will be the MFN rate of duty in effect on the day immediately preceding the date of enactment unless in consultation with the industry the President determines that another form of import relief would be more effective in fully offsetting the injury.

## **CHAPTER NINE: STANDARDS-RELATED MEASURES**

### **A. SUMMARY OF NAFTA PROVISIONS**

#### **1. Overview**

Standards-related measures ("SRMs") deal with voluntary and mandatory product or service standards and the procedures used to determine whether a particular product or service meets the standard.

The NAFTA explicitly recognizes that countries have a legitimate need for product and service standards. The NAFTA provisions are designed to preserve the ability of governments to act in this area while guarding against the unjustified use of these types of measures to protect a domestic industry. The NAFTA establishes requirements and procedures that will help to distinguish legitimate measures from protectionist measures. The NAFTA also will facilitate making these measures compatible among the three NAFTA countries, where appropriate, without reducing the level of safety or of protection of human, animal or plant life or health, the environment or consumers.

The NAFTA does not deal with specific product or service standards as such. Instead, Chapter Nine established several general procedural and other requirements to be observed when adopting or maintaining SRMs. These requirements are intended to ensure that product standards do not create unnecessary obstacles to trade.

While there are many similarities between the NAFTA SRMs chapter and the NAFTA provisions regarding sanitary and phytosanitary ("S&P") measures, set out in Section B of Chapter Seven, the two texts differ fundamentally in the means used to determine whether a measure is protectionist in nature. The SRMs text relies on a discrimination test. The S&P text prohibits arbitrary or unjustifiable discrimination and relies primarily on a test of scientific basis and risk assessment.

#### **2. Background**

Since 1980, the United States has been a party to the Agreement on Technical Barriers to Trade ("Standards Code") negotiated in the Tokyo Round of multilateral trade negotiations under the auspices of the GATT. The Standards Code was approved by the Congress in the Trade Agreements Act of 1979, and was implemented in the United States through Title IV of that Act.

Prior to the NAFTA negotiations, a draft text to update the Standards Code had been negotiated in the context of the Uruguay Round trade negotiations to update the existing Tokyo Round Standards Code. The proposed Uruguay Round text was the result of negotiations that

included over 100 countries. The NAFTA provisions on SRMs drew both from this text and from the CFTA, in particular Chapter Six.

Because the NAFTA negotiations involved only three countries, the NAFTA governments were able to tailor the provisions of Chapter Nine to their particular needs.

### **3. Background**

Product standards are commonplace in an industrialized society. Product standards may be voluntary industry standards, such as the size of lead to put in mechanical pencils. Or product standards may take the form of governmental standards, such as requirements for automobile brake lights. The NAFTA recognizes the need for, and appropriateness of, adopting and applying product standards.

At the same time, product standards have been used in other countries to exclude U.S. goods or to disadvantage U.S. exports by comparison to goods produced in the importing country. Abuse of SRMs for protectionist purposes often increases as tariff and non-tariff trade barriers are reduced through negotiation. The NAFTA provisions on SRMs are designed to ensure that standards are not used to create unnecessary obstacles to trade.

### **4. Basic Concepts**

A thorough understanding of Chapter Nine requires familiarity with certain basic concepts.

#### **a. Standards-Related Measure**

The term "standards-related measure" or "SRM" actually consists of three separate types of measures:

- "standards,"
- "technical regulations" and
- "conformity assessment procedures."

Each of these terms is defined in turn in the NAFTA. However, the key distinctions are that "standard" refers to *voluntary* product standards, "technical regulation" refers to *mandatory* product standards, and "conformity assessment procedure" is the method used to determine that a product satisfies a standard or technical regulation.

#### **b. Standard**

The term "standard" in common usage is much broader than the term as it is used in the NAFTA. In the NAFTA, a "standard" means:

- (1) characteristics for a good or a service,
- (2) characteristics, rules or guidelines for:
  - processes or production methods relating to such good, or
  - operating methods relating to such service, and
- (3) provisions specifying terminology, symbols, packaging, marking or labelling for:
  - a good or its related process or production method, or
  - a service or its related operating method,

for common and repeated use, including explanatory and other related provisions, set out in a document approved by a standardizing body, with which compliance is not mandatory. Standards can be either government standards, or more commonly they are private standards developed by private standardizing bodies.

**c. Technical Regulation**

The term "technical regulation" refers to mandatory (and therefore governmental) product standards. Under the NAFTA, a technical regulation means:

- (1) characteristics or their related processes and production methods for a good,
- (2) characteristics for a service or its related operating methods, or
- (3) provisions specifying terminology, symbols, packaging, marking, or labelling for:
  - a good or its related process or production method, or
  - a service or its related operating method,

set out in a document, including applicable administrative, explanatory and other related provisions, with which compliance is mandatory.

#### **d. Conformity Assessment Procedure**

Under the NAFTA, a "conformity assessment procedure" is any procedure used, directly or indirectly, to determine that a technical regulation or standard is fulfilled, including sampling, testing, inspection, evaluation, verification, monitoring, auditing, assurance of conformity, accreditation, registration or approval used for such a purpose, but does not mean an approval procedure. Thus, for example, registration of a pesticide or approval of a pharmaceutical would not be a conformity assessment procedure.

Some provisions of Chapter Nine apply only to one or two of these types of measures. For example, Article 906(4) on equivalence applies only to technical regulations. It does not apply to standards or conformity assessment procedures, while Article 906(6) applies only to conformity assessment procedures.

#### **5. Scope and Coverage**

Chapter Nine applies only to SRMs that may directly or indirectly affect trade in goods or services between the NAFTA countries and to measures taken by NAFTA countries relating to those SRMs. If a measure has no trade effect, Chapter Nine does not apply to it. Furthermore, Chapter Nine explicitly does not apply to S&P measures or to technical specifications prepared by governmental bodies for production or consumption requirements of those bodies.

While some S&P measures would otherwise fall within the definition of SRMs, S&P measures are covered by Section B of Chapter Seven. Similarly, as noted in Article 901(2), technical specifications prepared by governmental bodies are covered exclusively by Chapter Ten (Government Procurement).

Currently, the only services covered by Chapter Nine are land transportation services and telecommunications services. Chapter Nine could be extended to other services upon agreement of the NAFTA governments.

#### **6. Extent of Obligations**

Article 902(1) provides that Article 105 does not apply to Chapter Nine. Article 105 requires in part that the federal government of each NAFTA country ensure that all necessary measures are taken in order to give effect to the NAFTA by state or provincial governments and by local governments. Under Article 902(2), however, each NAFTA country has simply agreed "to seek, through appropriate measures, to ensure the observance" of Articles 904 through 908 by state or provincial governments, by local governments, and by non-governmental standardizing bodies in its territory. This lesser degree of obligation is appropriate in light of the voluntary nature of standards (as opposed to technical regulations) and in light of the involvement of non-governmental bodies in standards.

The language in Article 902(2) to "seek, through appropriate measures, to ensure observance" was deliberately drafted to differ from the language of GATT Article XXIV:12, prompted by dissatisfaction with recent interpretations of that GATT Article.<sup>1</sup> The Article 902(2) is intended to reflect a lesser level of obligation than that found in GATT Article XXIV:12, as it has been recently interpreted.

## **7. Affirmation of GATT Standards Code and Other Agreements**

In Article 903, the NAFTA countries affirm their existing rights and obligations under the Standards Code as well as other international agreements, including environmental and conservation agreements, to which the NAFTA countries are party. Affirmation of these agreements does not incorporate their provisions into the NAFTA.

## **8. Basic Rights and Obligations**

Article 904 sets out the basic rights and obligations of the NAFTA countries regarding standards-related measures. Article 904(1) explicitly affirms the right of each country to adopt, maintain and apply standards-related measures, including any SRM relating to safety, the protection of human, animal or plant life or health, the environment or consumers. It also explicitly affirms the right of each country to adopt, maintain and apply any measure to ensure the enforcement or implementation of standards-related measures. Moreover, Article 904(1) explicitly affirms each country's right to adopt, maintain or apply measures to prohibit the importation of a good of another NAFTA country, or the provision of a service by a service provider of another NAFTA country that fails to comply with the applicable requirements of the NAFTA country's SRMs or to complete the NAFTA country's approval procedures.

Article 904(2) explicitly affirms the right of each NAFTA country, in pursuing its legitimate objectives of safety or the protection of human, animal or plant life or health, the environment or consumers, to establish the levels of protection that it considers appropriate.<sup>1</sup> As in the case of sanitary and phytosanitary measures, the NAFTA implicitly recognizes that such choices are based on societal, not scientific, values.

Article 904(3) requires each NAFTA country to refrain from using its standards-related measures in a discriminatory manner. In other words, each NAFTA country must treat goods and services from the other NAFTA countries no less favorably than like goods or services of national origin and like goods or services from any other country.

In addition, under Article 904(4), no NAFTA country may adopt, maintain or apply a standards-related measure that would create an "unnecessary obstacle to trade between the Parties." Article 904 also specifically provides that measures whose demonstrable purpose is to achieve a legitimate objective, and that do not operate to exclude goods of another NAFTA country that meet that objective, do not create unnecessary obstacles to trade under the terms of Chapter Nine. This clarification of the term "unnecessary obstacle to trade" is drawn from

Article 603 of the CFTA and section 401 of the Trade Agreements Act of 1979 (19 U.S.C. 2531).

## **9. Use of International Standards**

Article 905 requires each NAFTA country to use relevant international standards as a basis for its standards-related measures except where those standards would be an ineffective and inappropriate means to fulfill its legitimate objectives.<sup>3</sup> However, under that article, each NAFTA country retains the right to adopt, apply and enforce standards-related measures that result in a higher level of protection than would be achieved by measures based on international standards.

The provisions of Chapter Nine were specifically negotiated to be clear that there would be no "downward harmonization" of standards-related measures. That is, SRMs are not required to be "harmonized down" to the least stringent standards-related measure. While governments are required to use international standards as "a basis" -- but by no means necessarily the only basis -- for their standards-related measures, Article 905(1) explicitly states that this is to be done only where the international standard would be an effective and appropriate means to fulfill the government's legitimate objectives. Article 905(3) also explicitly provides that *nothing* in this requirement "shall be construed to prevent a government, in pursuing its legitimate objectives, from adopting, maintaining or applying any standards-related measure that results in a higher level of protection than would be achieved if the measure were based on the relevant international standard."

## **10. Compatibility and Equivalence**

Recognizing the crucial role of SRMs in achieving legitimate objectives, the NAFTA governments have committed under Article 906(1) to work jointly to enhance the level of safety and of protection of human, animal and plant life and health, the environment and consumers.

Article 906 does not require that the United States change any particular standards-related measure. Instead, Chapter Nine creates a process by which the three NAFTA governments can try to reach greater compatibility of standards-related measures among the three countries, but that does not require any country to agree to change its U.S. standards-related measures.

Article 906(2) establishes a cooperative approach to making standards-related measures compatible. Under Article 906(2) the NAFTA countries commit to make their respective standards-related measures more compatible, to the greatest extent practicable, taking into account international standard-setting activities, so as to facilitate trade in the free trade area. However, Article 906(2) also makes it explicit that the NAFTA countries' SRMs are to be made compatible "[w]ithout reducing the level of safety or of protection of human, animal or plant life or health, the environment or consumers."

In this regard, it should be noted that nothing in the NAFTA reduces safety standards in the United States or precludes any NAFTA country from issuing new regulations as needed. For example, Mexican and Canadian motor carriers operating in the United States must continue to conform to all federal and relevant state operating standards for vehicles and drivers.

It is anticipated that the work of making standards compatible will generally be done through the Committee on Standards-Related Measures established under Article 913 and technical working groups or subcommittees under that committee. Any recommendations of those groups could be implemented in the United States only through the normal domestic legal processes -- either through legislation or rulemaking consistent with U.S. law.

Article 906(3) provides a means to facilitate compatibility of a standard or conformity assessment procedure in particular instances, including those of state or local governments or non-governmental standardizing bodies.

Article 906(4) obligates each importing NAFTA country to treat an exporting NAFTA country's technical regulation as equivalent to its own, where the exporting NAFTA country demonstrates to the importing country's satisfaction that its technical regulation adequately fulfills the importing country's legitimate objectives. If the importing country does not treat the exporting country's technical regulation as equivalent, it is obligated under Article 906(5) to provide its reasons in writing to the exporting country on request.

Article 906(6) provides an obligation for conformity assessment procedures parallel to that of Article 906(4) for technical regulations.

## **11. Assessment of Risk**

While there is no obligation under Chapter Nine that a NAFTA country conduct an assessment of risk or that SRMs be based on an assessment of risk, Article 907 affirms the right of a NAFTA country in pursuing its legitimate objectives to conduct an assessment of risk and the right to take into account factors that include available scientific evidence or technical information, intended end uses, processes or production, operating, inspection, sampling or testing methods or environmental conditions. Under Article 907(2), if a NAFTA country establishes a level of protection that it considers appropriate and conducts an assessment of risk, it should avoid arbitrary or unjustifiable distinctions between similar goods or services in the level of protection it considers appropriate, where the distinctions result in arbitrary or unjustifiable discrimination against goods or service providers of a NAFTA country, a disguised restriction on trade between NAFTA countries, or discrimination between similar goods or services for the same use under the same conditions that pose the same level of risk and provide similar benefits.

Article 907(3) affirms the right of each NAFTA country to adopt provisional technical regulations, on the basis of available relevant information, where it determines that available scientific evidence or other information is insufficient to complete an assessment of risk.

However, the NAFTA country is to complete the assessment of risk within a reasonable period after information sufficient to complete the assessment is presented to it, and it is to review and, where appropriate, revise the provisional technical regulation in light of the completed assessment.

## **12. Conformity Assessment**

Article 908(1) requires the NAFTA countries to make compatible, to the greatest extent practicable, their conformity assessment procedures. As noted above under "Basic Concepts," these procedures are used to determine whether the requirements set out in technical regulations or standards are fulfilled. Under Article 908(2), each NAFTA country is required to accredit, approve, license or otherwise recognize conformity assessment bodies (for example, testing laboratories) in the territories of other NAFTA countries on terms no less favorable than those accorded to such bodies in its own territory.

In Annex 908.2, Mexico has taken a temporary, four-year reservation from Article 908(2) with respect to conformity assessment bodies other than governmental conformity assessment bodies. Accordingly, other than with respect to governmental conformity assessment bodies, the United States owes no obligation to Mexico, and Mexico is not obligated to the United States, under Article 908(2) for a four-year period after entry into force of the NAFTA.

Article 908(3) sets out a detailed list of rules governing conformity assessment procedures to ensure that they do not create unnecessary obstacles to trade between the NAFTA countries. For example, a NAFTA country may not adopt, maintain or apply a conformity assessment procedure that is stricter than necessary to give confidence that a good or service conforms with a technical regulation or standard. Under Article 908(4), the relevant rules of Article 908(3) would also apply, with the necessary modifications, to the approval procedures of any NAFTA country. Approval procedures are defined separately in Article 915. Approval procedures require government approval for a good or service before it can be produced, marketed or used for a stated purpose or under stated conditions.

Conformity assessment procedures may frequently require inspection or testing or other procedures with respect to a product or service at a stage prior to importation or providing the service. Accordingly, under Article 908(5), each NAFTA country is to take such reasonable measures as may be available to it to facilitate access in its territory for conformity assessment activities. The language "such reasonable measures as may be available" was deliberately selected to be distinct from the "seek, through appropriate measures" language used elsewhere in Chapter Nine since Article 908(5) is referring to measures within the control of the federal government.

## **13. Transparency**

Article 909 requires advance public notice and opportunity to comment on proposed technical regulations or modifications to technical regulations. In the case of federal measures,

the NAFTA requires at least 60 days advance notice. Under Article 909(3), each NAFTA country is to seek through appropriate measures to ensure that similar notice is provided for technical regulations proposed by state and provincial governments, but not for local governments. The requirement that there be a minimum of 60 days notice of technical regulations does not apply to state or provincial governments.

Advance notice and comment is also required for standards-related measures other than technical regulations (Article 909(2)), but only where the standard or conformity assessment procedure is not substantially the same as an international standard (or there is no relevant international standard) and the measure may have a significant effect on the trade of the other NAFTA countries.

Article 909(5) requires a delay between publication of the final SRM and its effective date. However, there is an exception from these requirements where necessary to address an urgent problem relating to safety or to protection of human, animal or plant life or health, the environment or consumers. These requirements are consistent with requirements already in force for federal agencies under the Administrative Procedure Act and other statutes, and with requirements in force for state government agencies under state laws requiring notice and comment.

Advance notice and publication of SRMs are part of what is often referred to as procedural "transparency." Transparent procedures are those that enable interested persons to know what requirements they must meet and to adapt their production or other activity to those requirements. Transparency, therefore, can be important to U.S. exporters. Advance notice and comment should also help to avoid issues that might arise if the public could not participate and should provide an opportunity to verify that proposed SRMs conform to the NAFTA disciplines.

Article 910 provides additional transparency. It requires each NAFTA government to maintain an inquiry point that can answer reasonable inquiries from other NAFTA governments and interested persons, and to provide relevant documents, regarding the NAFTA country's standards-related measures. Article 910(4) prohibits discrimination in the price of documents between those made available for domestic purchase and those sold to another NAFTA government or other interested persons.

Article 909(6) ensures that non-governmental persons from other NAFTA countries have a right to be present during the development of SRMs if the NAFTA country allows non-governmental persons in its own territory to be present. This provision is designed to prevent a situation in which local firms or individuals have an advantage over persons from other NAFTA countries because they alone were able to be present during the development of the SRM and thus were able to influence the SRM to their advantage or had a head start in adapting to the SRM.

Article 912 makes clear that governments do not need to publish information regarding SRMs other than in an official language and clarifies that transparency requirements do not apply where a disclosure would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises.

#### **14. Cooperation**

Article 911 provides for technical cooperation between the NAFTA governments. Article 913 establishes a Committee on Standards-Related Measures whose functions include facilitating the process by which the NAFTA countries make compatible their standards-related measures and enhancing cooperation on the development, application and enforcement of standards-related measures.

Subcommittees and working groups will be created to address specific topics of interest, including land transportation, telecommunications, automotive standards and textile and apparel goods. The Agreement provides that these subcommittees and working groups may invite the participation of scientists, technical experts and representatives of interested non-governmental organizations from the three countries. Furthermore, Article 913(6) also contemplates participation in the activities of the Committee by representatives of state or provincial governments, where and as appropriate. The activities of the Committee would include the working groups and subcommittees.

Article 914 provides for technical consultations between NAFTA governments on matters covered by Chapter Nine. Consultations under Article 914 may serve as the consultations under Article 2006 if the NAFTA governments involved so agree.

#### **15. Burden of Proof**

Article 914(4) makes clear that where a NAFTA government asserts that a standards-related measure of another government is inconsistent with Chapter Nine, the government making the assertion has the burden of establishing the inconsistency. This rule is consistent with current practice under the CFTA and under the GATT.

#### **16. Impact on State and Local Governments**

From the beginning of the NAFTA negotiations, a fundamental objective of U.S. policy was to ensure that the NAFTA did not result in lowering health, safety or environmental standards, including state and local measures. The NAFTA secured that objective.

Under the NAFTA, the federal government has generally agreed to take all necessary measures to ensure that state and local governments also observe the provisions of the NAFTA, except as otherwise provided in the NAFTA. However, as noted above, this obligation does not apply to Chapter Nine. Furthermore, under Chapter Nine, as under the S&P provisions of Chapter Seven, there is no requirement that states adopt federal standards or compliance with federal law.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

Section 351 of the implementing bill amends Title IV of the Trade Agreements Act of 1979 to add a new subtitle concerning standards-related measures under the NAFTA. Chapter 2 of the new subtitle contains provisions to implement NAFTA Chapter Nine.

Title IV of the Trade Agreements Act of 1979 was enacted to implement the Standards Code. Federal agencies have been subject to the requirements of Title IV since 1980. These requirements continue apply to standards activities of federal agencies, which include many of the standards-related measures under the NAFTA. However, the definitions and coverage of Chapter Nine differ from the definitions and coverage of the Standards Code, so it is necessary to provide separate legislative provisions in the Trade Agreements Act of 1979 to implement Chapter Nine.

Section 471 of the new subtitle contains general provisions. Section 472 of the new subtitle assigns to the standards information center established under section 414 of the Trade Agreements Act of 1979 the additional duties prescribed under Chapter Nine. The National Institute of Standards and Technology (NIST) under the Department of Commerce currently serves as the standards information center.

Section 473 of the new subtitle provides definitions of the terms used in chapter 2 of the new subtitle. These definitions are drawn directly from the definitions in the NAFTA. The definitions of "standard" and "technical regulation" are taken from the notes to Article 915 agreed to by the NAFTA countries. Those notes are set out following Chapter Twenty-Two of the NAFTA.

Section 352 of the bill provides that any regulations issued by the Secretary of Transportation implementing a recommendation of the Land Transportation Standards Subcommittee established under Article 913(5)(a)(i) may not take effect before 90 days after issuance.

Section 361(a) of the bill provides a conforming change to amend the Federal Seed Act to remove the staining requirement for alfalfa and clover seed imported from Mexico. The CFTA Implementing Act made a similar conforming change to implement the CFTA.

## **2. Presidential Action**

Article 909 requires, in general, publication of a notice and notification in writing to the other NAFTA countries of proposed technical regulations at least 60 days prior to their adoption.

This requirement is consistent with Executive Order No. 12662 (54 *Fed. Reg.* 785) which requires federal agencies to publish or serve notice of proposed standards-related measures not less than 75 days before comments are due. The appropriate conforming changes will be made in that or a similar executive order to reflect the U.S. obligations under Chapter Nine of the NAFTA.

## **3. Administrative Action**

No changes in administrative regulations, practices or procedures, other than those specifically provided for in the implementing bill or discussed below, are contemplated.

As noted above, federal agencies are presently subject to the provisions of Title IV of the Trade Agreements Act of 1979 (19 U.S.C. 2531-2573)(the "1979 Act"), which implements U.S. obligations under the Standards Code. Continued compliance by federal agencies with those provisions will satisfy the majority of the requirements set out in Chapter Nine.

Section 402 of the 1979 Act (19 U.S.C. 2532) prohibits federal agencies from engaging in standards-related activities that create unnecessary obstacles to the foreign commerce of the United States. Section 402 also requires federal agencies to ensure that imported products are treated no less favorably than like domestic or imported products with respect to standards-related activities, a provision analogous to Article 904's non-discrimination requirement.

Article 905 provides that each NAFTA country will use relevant international standards as a basis for its standards-related measures, except where the international standards would be inappropriate. Section 402(2) of the 1979 Act (19 U.S.C. 2532) already requires federal agencies, when developing standards, to take international standards into consideration and use the international standards as a basis if appropriate. The work currently performed by federal agencies in international standardizing bodies should prove beneficial in this regard.

Under the coordination of the U.S. Trade Representative, appropriate federal agencies will work with representatives from the other NAFTA countries to enhance the level of safety and protection of human, animal and plant life and health, the environment and consumers, in accordance with Article 906. Federal agencies will also participate in the process for making compatible the respective standards-related measures, including conformity assessment procedures, of the NAFTA countries under Articles 906 and 908.

Pursuant to section 414 of the 1979 Act, NIST currently serves as the U.S. repository of standards-related information under the Standards Code. NIST will also serve as the U.S. inquiry point required by Article 910 and will be responsible for information exchange in

accordance with Chapter Nine, including providing its Canadian and Mexican counterparts with copies of proposed federal and state standards-related measures, except that it will refer inquiries regarding agricultural products to the Department of Agriculture. Providing information on standards proposed or adopted by state governments will entail an expansion of NIST's current responsibilities because NIST presently does not notify regulations that may significantly affect trade proposed by state agencies under the Standards Code. NIST will also disseminate information to U.S. businesses on Mexican and Canadian federal, state and provincial standards-related activities.

Article 913 establishes a trilateral Committee on Standards-Related Measures. Under the coordination of the U.S. Trade Representative, federal agencies will participate, as appropriate, in the Committee's functions, including:

- monitoring the implementation and administration of Chapter Nine;
- facilitating the process for making compatible the standards-related measures of the NAFTA countries under Articles 906 and 908; and
- providing a forum for the NAFTA countries to consult on issues relating to standards-related measures, including the provision of technical advice and recommendations under Article 914.

The relevant federal agencies will participate, as appropriate, in the functions of the subcommittees mandated by Article 913 to address land transportation standards, telecommunications standards, automotive standards, labelling of textile and apparel goods, and any other topics the Committee considers to be appropriate.

The Department of Transportation ("DOT") will consult with interested persons in the private sector, relevant Congressional committees and, where they have sole or concurrent jurisdiction over the matter, state governments, at all stages of the work of the Land Transportation Standards Subcommittee in considering common motor carrier safety rules or other common standards for bus and truck operations. DOT will promptly notify the pertinent Congressional committees of any recommendation that the Committee adopts on these subjects. In addition, DOT will provide notice to those committees of any proposed or final DOT regulations implementing such a recommendation.

## ENDNOTES

1. GATT Article XXIV:12 reads: "Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory."
2. Of course, state and local governments also retain their rights to establish levels of safety and of protection of human, animal or plant life or health, the environment or consumers that they determine to be appropriate.
3. There is no comprehensive definition of "legitimate objective." Article 915 provides as an illustrative list of such objectives: safety, protection of human, animal or plant life or health, the environment or consumers, and sustainable development. Article 915 also makes explicit that the protection of domestic production is not a legitimate objective, drawing on language from GATT Article III:1.

## **CHAPTER TEN: GOVERNMENT PROCUREMENT**

### **A. SUMMARY OF NAFTA PROVISIONS**

Chapter Ten requires the three NAFTA countries to eliminate "buy national" restrictions on the majority of non-defense related purchases by their federal governments of goods and services provided by firms in North America. For the United States and Canada, this represents a further elimination of barriers to participation in each other's government procurement markets, building on the GATT Agreement on Government Procurement ("GATT Code") and the CFTA.

Under the NAFTA, Mexico -- which is not a party to the GATT Code -- has committed for the first time to eliminate discriminatory government procurement practices. Mexico has made this undertaking solely in respect of U.S. and Canadian firms, goods and services. European, Asian and other competitors do not benefit from Mexico's procurement commitment under the NAFTA.

#### **1. Scope and Coverage**

Chapter Ten covers virtually all federal government agencies in the three countries, as well as a significant number of federal government enterprises, often referred to as "parastatals" in this context. The agreement applies not only to procurement of goods, but also, for the first time in an international trade agreement, to procurement of services, including construction services. The entities, goods and services covered by the chapter are specified in Annex 1001. Article 1022 provides that changes in the coverage specified by each Party are permitted only under exceptional circumstances.

##### **a. Covered Entities**

Chapter Ten will for the first time give U.S. products and services guaranteed access to procurement by Mexican Government agencies. Chapter Ten also goes beyond the CFTA by extending coverage for goods to additional U.S. and Canadian federal agencies, and to services and construction services purchased at the federal level. Unlike the CFTA, NAFTA will also cover purchases by government-controlled enterprises, including those by Mexican parastatals, whose purchases account for a large percentage of total Mexican government procurement.

As set forth in Annex 1001.2a, the Mexican Government will provide U.S. and Canadian suppliers growing access to purchase contracts by PEMEX, the state-owned petroleum company, and CFE, the Mexican Government's electrical utility. When the NAFTA enters into force, Mexico will immediately open 50 percent of PEMEX and CFE procurement to U.S. and Canadian goods and services, with progressive annual increases through 2002. Thereafter, Mexico's government procurement market in the energy sector will be completely open, subject to limited PEMEX and CFE procurement "set-asides" for Mexican suppliers.

**b. Thresholds**

Chapter Ten applies to purchases by specified federal government agencies and federal government-controlled enterprises in each NAFTA country above certain U.S. dollar thresholds:

- purchases of goods over \$25,000 by federal agencies in the United States from Canadian suppliers or by Canadian federal agencies from U.S. suppliers;
- for other procurements by federal government agencies in the three countries, purchases of goods and services over \$50,000 and purchases of construction services over \$6.5 million; and
- for federal government-owned enterprises, purchases of goods and services over \$250,000 and purchases of construction services over \$8 million.

The \$25,000 threshold for U.S.-Canada procurements of goods effectively carries forward the threshold in use under the CFTA.

**c. Exclusions**

The rules of Chapter Ten do not apply to certain kinds of purchases by the U.S. Government, among them:

- purchases under small or minority business set-aside programs;
- procurements for national security purposes and certain items purchased by the Department of Defense, including those subject to "Berry Amendment"-type restrictions;
- purchases by the Department of Agriculture for farm support programs and human feeding programs;
- purchases by the Agency for International Development for the purpose of providing foreign assistance (purchases not for the direct benefit or use of AID); and
- procurements by state and local governments, including procurements funded by federal grants, such as those made pursuant to the Federal Transit Act (49 U.S.C. App. 1601 *et seq.*) and the Federal Aid Highway Act (23 U.S.C. 101 *et seq.*).

The Schedule of the United States contained in the General Notes, Annex 1001.2b specifically excludes from Chapter Ten's coverage set-asides on behalf of small and minority businesses. This exclusion exempts from Chapter Ten's rules U.S. Government procurement programs such as those which give preference to small businesses, business concerns and private and voluntary organizations owned or controlled by women or socially and economically disadvantaged individuals, historically black colleges and universities, and colleges and universities with substantial Hispanic or Native American enrollment. The exclusion is identical to that taken by the U.S. Government under the GATT Code. It means that the President does not have the authority to waive existing or future laws, regulations, procedures or practices under these programs to allow procurements by Mexican or Canadian businesses.

## **2. General Disciplines**

The general rule of Chapter Ten, set out in Article 1003, is that the three governments must treat goods and services from another NAFTA country -- and suppliers of such goods and services -- "no less favorably" than domestic goods, services and suppliers with respect to purchases by covered government entities. In addition, under Article 1006, each government is required to ensure that its entities do not consider, seek or impose "offsets" in the evaluation of bids or the award of contracts. "Offsets" are contract conditions that encourage local development or improve the country's balance-of-payments accounts by requiring, for example, local content, the licensing of technology, local investment or countertrade. Article 1007 provides that the purpose and effect of technical specifications should not be to impose unnecessary obstacles to trade.

## **3. Procurement Procedures**

Articles 1008 to 1016 set out a series of rules designed to ensure that procurement practices in all three countries are fair, transparent and predictable.

The basic rule, established by Article 1008, is that of non-discrimination in procurement procedures. The NAFTA also requires covered entities to follow procedures similar to those required under the GATT Code, with respect to qualification of suppliers, time limits, documentation, award of contracts and other aspects of the procurement process. The United States and Canada already adhere to these procedures. Mexico will be adopting them for the first time under the NAFTA. They will result in significant changes in the way Mexico conducts its procurements.

Article 1014, for example, requires a minimum degree of fairness and competition in the process used to negotiate a procurement, while Article 1015 requires contract awards to be made in accordance with criteria set out in advance. Article 1016 recognizes that each government will sometimes need to deviate from the rule of open competition. But the article requires that "limited tendering" be as competitive as possible and be used only in limited circumstances.

In order to promote fair and open procurement procedures, Article 1017 requires each government to maintain a "bid challenge" mechanism enabling individual suppliers to have the entire bidding process reviewed. Suppliers from other NAFTA countries will have the right to challenge both bid procedures and contract awards, and will be assured that an independent body in each country will review such challenges and recommend action to correct any discrepancies.

#### **4. Cooperation and Further Negotiations**

Pursuant to Articles 1019 and 1020, the three governments will exchange information regarding their procurement systems to assist their suppliers in taking advantage of the opportunities created by Chapter Ten. Article 1021 establishes a special mechanism for joint efforts by the three countries to promote government procurement opportunities for small businesses.

The NAFTA governments will initiate further negotiations on remaining procurement issues, pursuant to Article 1024, no later than the end of 1998, including whether to extend the coverage of Chapter Ten to procurement by state and provincial governments. Each government will consult with its state or provincial governments before that date with a view to obtaining voluntary and reciprocal commitments to open their procurement markets to the other NAFTA countries. The timetable for negotiations on expanded coverage will be accelerated if a new GATT Code is adopted at an earlier date.

### **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

#### **1. Implementing Bill**

Section 361(a) of the bill amends Title III of the Trade Agreements Act of 1979 (19 U.S.C. 2511(b)) to authorize the President to waive discriminatory purchasing requirements, including the Buy American Act (41 U.S.C. 10a), with respect to procurements that are covered by Chapter Ten. The section makes it explicit that the President's waiver authority does not extend to the waiver of any small business or minority preferences.

Section 361(a) also authorizes the President to direct certain federally-owned utilities and other entities to comply with the procurement procedures set forth in Chapter Ten. This provision is necessary in order to ensure that these entities comply with the procurement procedures set forth in Chapter Ten. In fact, these entities currently follow procurement procedures that are similar to those employed by federal government agencies. As a result, exercise by the President of this authority will not require any change in existing procurement practices by these bodies.

Section 361(b) of the bill makes a conforming technical change to Title III of the Trade Agreements Act of 1979 (19 U.S.C. 2512(a)) in order to maintain the *status quo*. Section 2512(a) of Title 19 presently prohibits, with respect to purchases covered by the GATT Code,

procurement from countries that are not signatories to the Code and have not otherwise assumed the obligations of the Code. In the absence of the conforming change, the section could be read to refer to purchases covered by NAFTA, as well as the GATT Code.

Similarly, section 361(c) of the bill makes a technical change to Title III of the Trade Agreements Act of 1979 (19 U.S.C. 2518(4)(A)). It amends the definition of "eligible product" to make it clear that it includes products covered by the GATT Code and NAFTA.

Section 361(d) of the bill amends the Rural Electrification Act of 1938 (7 U.S.C. 93 note) to waive the application of buy national requirements imposed as conditions of funding by the Rural Electrification Administration.

## **2. Administrative Action**

Under the authority of section 361(a) of the bill, the President will waive application of the Buy American Act for purchases subject to Chapter Ten. Part 25 of the Federal Acquisition Regulations (FAR) will be changed to reflect the issuance of the waiver. The President will also issue instructions to the federally-owned utilities and other entities covered by section 361(b) to comply with the procurement procedures contained in Chapter Ten.

The waiver authority provided under section 361(a) is strictly limited to purchases covered by Chapter Ten. It cannot be used to waive Buy American requirements on purchases not covered by the chapter. In implementing Chapter Ten, federal agencies will not accord Canadian or Mexican goods a price preference over other foreign goods in the case where no bidder is supplying U.S. goods.

Presently, many purchases by federal government agencies are subject to the requirement for nondiscriminatory treatment and the procedural rules contained in the GATT Code and CFTA. The rules set out in Chapter Ten are very much similar to those of the Code and CFTA. As a result, for most agencies the NAFTA will not require any change in procurement procedures.

Chapter Ten applies to four government agencies that currently are not subject to the GATT Code -- the Departments of Energy and Transportation, the Army Corps of Engineers (Department of Defense) and the Bureau of Reclamation (Department of the Interior). Procurement by these agencies is already subject to the FAR and thus Chapter Ten will not cause them to alter their procurement practices.

Chapter Ten also applies to several government-controlled enterprises not subject to the GATT Code -- the Tennessee Valley Authority, the St. Lawrence Seaway Development Corporation and the five power marketing administrations of the Department of Energy. These entities currently follow procedures similar to those in the FAR and thus will not need to change current procurement procedures.

Within thirty days of passage by the Congress of the NAFTA implementing bill, the Administration will provide to each state a status report of USTR efforts to include state governments in a new GATT Code. This report will include an assessment of the reciprocal concessions the United States will obtain from other countries in such an agreement and the likely schedule for concluding the agreement.

The Administration will also provide states with the names and phone numbers of the particular U.S. Government officials with expertise on the obligations of the GATT Code and NAFTA Chapter Ten. These officials will be available to answer questions regarding implementation by state governments of a GATT agreement and initiation of consultations regarding state participation in a future expansion of the coverage of Chapter Ten.

## CHAPTER ELEVEN: INVESTMENT

### A. SUMMARY OF NAFTA PROVISIONS

Chapter Eleven comprises two parts. Part A sets out each government's obligations with respect to investors from other NAFTA countries and their investments in its territory. Part B affords investors the right to seek compensation through international arbitration for a violation of the provisions of Part A or of certain provisions of Chapter Fifteen, governing the behavior of government monopolies and state enterprises.

#### 1. Section A - Investment

##### a. Scope and Coverage

Part A provides four basic protections to "investors of other Parties": non-discriminatory treatment; freedom from "performance requirements;" free transfer of funds related to an investment; and expropriation only in conformity with international law.

"Investment" is broadly defined in Article 1139, and both existing and future investments are covered. "Investor of a Party" is defined to encompass both firms (including branches) established in a NAFTA country, without distinction as to nationality of ownership, and NAFTA-country nationals. The chapter applies where such firms or nationals make or seek to make investments in another NAFTA country.

The chapter applies to all governmental measures relating to investment, with the exception of measures governing financial services, which are treated in Chapter Fourteen. Under Article 1112, in the event of any inconsistency between Chapter Eleven and another chapter, the other chapter will prevail.

##### b. Non-discrimination and Minimum Treatment Standards

Articles 1102 and 1103 set out the basic non-discrimination rules of "national treatment" and "most-favored-nation treatment." These rules require, respectively, each government to treat NAFTA investors and their investments:

- no less favorably than its own investors and their investments, and
- no less favorably than investors of other countries and their investments.

Article 1102 makes clear that the "national treatment" rule prohibits governments from imposing local equity requirements or requiring an investor from another NAFTA country, by reason of its nationality, to sell an investment. Furthermore, Article 1102 provides that the treatment provided by state and provincial governments to investors from other NAFTA

countries and their investments must be no less favorable than the most favorable treatment they provide to domestic investors and their investments.

Article 1104 specifies that investors and their investments are to be accorded the better of national or most-favored-nation treatment. Article 1105 provides that each country must also accord NAFTA investors treatment in accordance with international law.

**c. Performance Requirements**

Article 1106 imposes disciplines on seven types of "performance requirements." Under Article 1106, a government may not, as a condition for the establishment or operation of an investment, require a firm to:

- limit its sales in the domestic market by conditioning such sales on exports or foreign exchange earnings;
- buy or use components from a local supplier or accord a preference to domestic goods or services;
- achieve a minimum level of "domestic content;"
- limit its imports to a certain percentage of exports or foreign exchange inflows associated with the investment;
- transfer technology to any domestic entity, except to remedy an alleged violation of competition law;
- export a specified level of goods or services; or
- supply designated regional or world markets solely from its local production.

A government generally may not use the first four of the requirements listed above as a condition for receiving an advantage, such as a tax holiday. NAFTA's treatment of taxation measures is addressed in Article 2103.

The rules prohibiting performance requirements apply with respect to all investments, whether by non-NAFTA investors, domestic investors, or investors from another NAFTA country. For example, under Article 1106, the Mexican Government may not require a Japanese-owned (or Mexican-owned) firm in its territory to export to the United States.

By virtue of Article 1108(8), NAFTA's disciplines on the second, third and sixth type of performance requirement listed above do not apply to a NAFTA government's export promotion programs or foreign aid activities. In addition, the prohibition against the second,

third, fifth and seventh type of performance requirement does not apply in connection with government procurement. Finally, under Article 1106(6), the disciplines on the second and third category of performance requirements do not affect a government's ability to apply nondiscriminatory environmental measures.

**d. Management**

Article 1107 prohibits NAFTA governments from requiring local firms owned by investors from other NAFTA countries to fill senior management positions with local nationals. A government may require a simple majority of the board of directors to be local nationals, however, as long as the requirement does not materially impair the investor's control over its investment.

**e. Reservations and Exceptions**

Article 1108 creates a system of limited "reservations" and "grandfathering" to exempt certain laws and regulations that are not in conformity with the non-discrimination, performance requirement and senior management obligations described above.

The NAFTA governments have recorded in their schedules to Annexes I, II, and III a specific "reservation" for all federal-level measures inconsistent with those obligations that they wish to maintain. (These annexes appear in Volume II of the 1993 *Government Printing Office* reprint.)

(1) Reservations for Existing Measures

Annex I sets out each government's reservations for existing, inconsistent measures at the federal government level. Existing non-conforming measures at the state or provincial level are automatically "grandfathered" for two years. By the end of that period, any such measure must have been listed as a "reservation" in Annex I in order for the exemption to remain in effect. The two-year period was negotiated in order to allow time for the states and the federal government to identify all such measures and to include them in the Annex, if desired.

Existing measures at the local level that are inconsistent with Chapter Eleven rules are automatically "grandfathered" on a permanent basis.

Laws and regulations that are "grandfathered" or listed as a reservation in Annex I are exempt from challenge under the NAFTA, even if they are amended or renewed, so long as they are not made more inconsistent with the Agreement. If a measure is liberalized, however, any such liberalization may not be reversed by a subsequent amendment.

Canada took various reservations in Annex I based on its exceptions under the CFTA. Such reservations include the right to review direct acquisitions of C\$150 million or

more, restrictions in the oil and gas sectors, and limitations in connection with the ownership and privatization of certain state enterprises.

Mexico retained the right under Annex I to review large acquisitions. The initial threshold for review, \$25 million, will increase to \$150 million in the tenth year after entry into force of the Agreement. The \$150 million threshold will be adjusted annually for inflation and later for economic growth as well, but the amount can never be higher than the Canadian threshold. Other principal Mexican exceptions in Annex I are reservations on the ownership of land, for cable television, air and land transportation, and retail sales of certain petrochemical products. Outside of previously state-monopolized sectors, the privatization of Mexican state enterprises will generally be open to U.S. bidders.

For its part, the United States took reservations for existing, non-conforming legislation in respect of such matters as nuclear power, broadcasting, mining, customs brokers and air transportation.

In addition to "grandfathering" specified government measures, some Annex I reservations set forth schedules for liberalizing investment restrictions, such as the phase-out of Mexican performance requirements and equity limitations in the mining, construction and auto parts sectors.

#### (2) Reservations for Future Measures

The three governments have also recorded a limited number of broader exemptions for measures falling into certain sectors, such as basic telecommunications, broadcasting, and maritime trade. Those exemptions, listed as reservations in Annex II, allow a government to maintain existing and adopt new laws and regulations that vary from Chapter Eleven's rules regarding non-discrimination, performance requirements and senior management.

#### (3) Mexican Exception for Reserved Sectors

Annex III sets out several Mexican reservations reflecting Mexican constitutional provisions making certain commercial activities the exclusive domain of the Mexican Government. These include satellite and telegraphic communications, railroad transportation, nuclear power generation, the production and distribution of electricity as a public service, and activities related to the production, distribution and sale of energy products and primary petrochemicals.

As with Annex I, Annex III measures cannot be changed in the future to be made more inconsistent with the chapter's rules, and if liberalized in the future cannot be subsequently be made more restrictive. Further, any investments (including service contracts) that Mexico permits in these sectors must be accorded the post-establishment protections of Chapter Eleven. (NAFTA Note 40, which is appended to Annex 602.3 and Article 1101(2), confirms these post-establishment protections.) Finally, although Annex III permits Mexico to restrict to Mexican nationals any sale of government assets in the sectors listed in the Annex,

government assets in recently de-monopolized sectors must be opened to purchase by U.S. bidders within three years of their initial sale.

(4) Transfers

Article 1109 requires each NAFTA government to permit transfers relating to an investment covered by Chapter Eleven to be made freely and without delay, including transfers of profits, royalties, sales proceeds and other remittances relating to an investment. Further, no government may require its own investors to repatriate profits generated by their investments in another NAFTA country. Exceptions permit a government to prevent transfers under certain laws of general application, such as bankruptcy laws. Article 2104, which is applicable to trade and investment, permits the establishment of multiple exchange rates in narrowly-defined circumstances, under IMF discipline, to address balance-of-payments difficulties.

(5) Expropriation and Compensation

Under Article 1110, a NAFTA government may not expropriate an investment made by an investor from other NAFTA countries other than for a public purpose, on a non-discriminatory basis and in accordance with due process of law. Compensation must be paid without delay at the fair market value of the expropriated investment, plus any applicable interest, and must be freely realizable and transferable.

(6) Special Formalities

Article 1111 permits a NAFTA government to adopt or maintain "special formalities" in connection with the establishment of an investment, so long as such requirements do not materially impair the substance of any right accorded by Chapter Eleven. Special formalities include requirements such as typical state incorporation requirements. Article 1111 also permits a government to seek routine information and data from investments covered by the chapter.

(7) Denial of Benefits

Article 1113 describes those circumstances under which a NAFTA government may refuse to apply the protection of Chapter Eleven to firms, or their investments, that otherwise qualify for coverage under the chapter, where the firms are owned or controlled by investors from a non-NAFTA country.

The article preserves the foreign policy prerogative of each government to deny benefits to firms owned or controlled by nationals of a non-NAFTA country with which it does not have diplomatic relations or to which it is applying economic sanctions.

It also permits each government to deny benefits to such firms if they have no substantial business activities in the NAFTA country where they are established. Thus shell companies could be denied benefits but not, for example, firms that maintain their central administration or principal place of business in the territory of, or have a real and continuous link with, the country where they are established. This provision requires the denying government to give prior notification, and to consult, in accordance with Articles 1803 and 2006.

#### (8) Environmental Measures

Article 1114 affirms that Chapter Eleven does not preclude a NAFTA government from adopting, maintaining or enforcing measures otherwise consistent with the chapter to ensure investment is consistent with its environmental protection goals. The article also provides that no government should waive or relax its environmental measures in order to attract or retain an investment. Derogations from this provision are subject to compulsory consultations if requested by a NAFTA government but are not subject to formal dispute settlement under Chapter 20. The Commission on Environmental Cooperation, created by the supplemental agreement on environmental cooperation, may assist in such consultations.

### **2. Section B - Investor - State Dispute Settlement**

Section B of Chapter Eleven provides a mechanism for an investor to pursue a claim against a host government that it has breached its obligations under Section A. This mechanism is patterned after the investor-State dispute settlement mechanism of the standard U.S. bilateral investment treaty and permits an investor to submit its claim to binding arbitration under internationally-accepted rules.

#### **a. Nature of Claims**

Articles 1116 and 1117 set forth the kinds of claims that may be submitted to arbitration: respectively, allegations of direct injury to an investor, and allegations of indirect injury to an investor caused by injury to a firm in the host country that is owned or controlled by the investor. In both cases, investors may bring claims where the injury results from an alleged breach of Section A or of certain provisions governing the behavior of government monopolies in Chapter Fifteen.

All claims must be brought within three years. Article 1117(3) provides that if claims arising out of the same events are brought under both Articles 1116 and 1117, the claims should be heard together by a tribunal under Article 1126.

Article 1138(1) excludes from investor-State dispute settlement decisions to prohibit or limit investment on national security grounds. Read together with Annex 1138(2), Article 1138(2) also excludes from investor-State dispute settlement, and from government-to-government dispute settlement under Chapter Twenty, decisions taken by Canada or Mexico to prohibit or restrict an acquisition under their laws providing for screening of foreign investment.

## **b. Initiation of Dispute Settlement Proceedings**

Article 1118 encourages the settlement of claims through consultation or negotiation. Articles 1119 and 1120 set forth the process leading up to the submission of a dispute to an arbitral panel.

Article 1119 provides that an investor must provide notice of its intention to submit a claim to arbitration at least 90 days before doing so, and specifies the content of such notice. Article 1120 provides that once six months have elapsed from the events giving rise to a claim, the investor may submit the claim for arbitration to:

- the International Centre for the Settlement of Investment Disputes (ICSID), provided both the country of the investor and the host country are parties to the ICSID Convention (neither Canada nor Mexico currently is);
- ICSID's "Additional Facility," in the event one such country is not a party to the Convention; or
- an *ad hoc* arbitral tribunal established under the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL).

Because the NAFTA will give rise to private rights of action under Mexican law, Annex 1120.1 avoids subjecting the Mexican Government to possible "double exposure" by providing that a claim cannot be submitted to Chapter Eleven arbitration where the same claim has been made before a Mexican court or administrative tribunal.

Article 1137(1) describes the actions by which claims are considered to have been submitted to arbitration.

## **c. Jurisdictional Requirements**

Articles 1121 and 1122 set out rules for establishing the requisite mutual consent for arbitration. Article 1121 requires the investor (and, in certain cases, the enterprise that is owned or controlled by the investor) to consent in writing to arbitration, and to waive the right to initiate or continue any actions in local courts or other *fora* relating to the disputed measure, except for actions for injunctive or other extraordinary relief. To ensure that a host country cannot frustrate an arbitration by withholding its own consent, Article 1122 itself constitutes advance consent by the three NAFTA governments to arbitration.

## **d. Appointment of Arbitrators**

Article 1123 provides generally for the establishment of three-member arbitral tribunals, one member to be appointed by each of the disputants, and the presiding arbitrator to be appointed by agreement between the disputants. If, within ninety days of the submission of the claim to arbitration, a disputant fails to appoint an arbitrator, or the two disputants fail to agree on a presiding arbitrator, Article 1124 provides for arbitrators to be named by the ICSID Secretary-General.

The Secretary-General may use his discretion in making appointments. However, with respect to the appointment of the presiding arbitrator, he must choose first from a roster of 45 qualified individuals agreed upon by the three NAFTA governments. The Secretary-General may select from ICSID's standing Panel of Arbitrators only in the event that no person on the roster is available and may choose only non-NAFTA nationals.

Article 1125 is intended to satisfy the rules for appointing a national of a disputing party to an arbitral tribunal established under ICSID or the ICSID Additional Facility.

Article 1126 addresses the possibility that more than one investor might submit to arbitration claims arising out of the same event. It provides for the appointment by the ICSID Secretary-General of a special three-member tribunal to consider whether such multiple claims have questions of fact or law in common, in which case that tribunal may assume jurisdiction over, and decide, all or part of any such claims.

#### **e. Arbitral Proceedings**

Articles 1127 through 1129 enable a NAFTA government that is not involved in the arbitration to be apprised of relevant facts and other information and, if it wishes, to submit views to the tribunal on questions of NAFTA interpretation. To help ensure the enforceability of an award, Article 1130 provides that unless otherwise agreed, the arbitration must take place in a country that is a party to the New York Convention on the Recognition and Enforcement of Arbitral Awards ("New York Convention").

Articles 1131 and 1132 address the substantive law to be applied in arbitral proceedings. Article 1131(1) provides that arbitral tribunals are to decide questions in accordance with the NAFTA and applicable international law rules. Article 1131(2) makes binding on NAFTA arbitration tribunals any interpretation of the Agreement by the Free Trade Commission established under Article 2001.

Under Article 1132, a Party's defense that an alleged breach falls within the scope of a reservation set forth in a NAFTA annex must be referred to the Commission, and any decision it makes on the issue will be binding on the tribunal. If the Commission does not make a decision within sixty days, however, the question is referred back to the tribunal.

Under Article 1133, a tribunal may seek advice from experts on environmental, health, safety or other scientific matters under certain conditions. Article 1137(3) provides that

a country cannot assert, as a defense or set-off, that the investor has been compensated for its losses by insurance or similar means.

Article 1137(2), read together with Annex 1137.2, requires each NAFTA government to designate in its official register the agency to which notices and other arbitration documents are to be delivered. For the United States, this will be the Department of State.

**f. Nature of Relief**

Under Article 1134, a tribunal may order interim protective measures to preserve existing rights of the disputants, including the preservation of evidence. A tribunal cannot, however, order attachment of assets or enjoin the government from applying any measure that is the subject of the dispute.

Article 1135 limits a final award to money damages or restitution, or a combination of both; awards of restitution must offer the alternative of paying damages. No punitive damages may be awarded.

**g. Enforcement of Arbitral Awards**

Article 1136 sets forth rules governing enforcement of final awards. Paragraph one restates the traditional rule that an arbitral award has no precedential effect and is binding only on the particular disputants in the matter. Paragraph two obliges a disputant to abide by and comply with the award. Paragraph three provides a disputant the opportunity to seek revision or annulment of the award before enforcement may be sought.

Paragraph four requires each Party to provide for enforcement of an award in its territory. The Federal Arbitration Act (9 U.S.C. 1 *et seq.*) satisfies the requirement for the enforcement of non-ICSID awards in the United States. The Convention on the Settlement of Investment Disputes Act of 1966 (22 U.S.C. 1650, 1650a) provides for the enforcement of ICSID awards.

In the event that a country does not comply with an award, paragraphs five and six provide that the investor's government may request a government-to-government arbitration panel under Article 2008 to consider the matter. The initiation of such proceedings would not prevent the investor from seeking enforcement of the award.

By declaring that claims submitted to NAFTA arbitration will be considered to arise out of a commercial relationship or transaction, paragraph seven satisfies prerequisites of the New York Convention and the Inter-American Convention on International Commercial Arbitration for the enforcement of awards under those agreements.

**h. Publication of Awards**

Article 1137(4) and Annex 1137(4) govern the publication of awards. For arbitrations involving the United States or Canada, either disputant may make the award public; for arbitral proceedings involving Mexico, the applicable arbitration rules will govern.

**B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

**1. Implementing Bill**

No change in statute will be required to implement the provisions of Chapter Eleven.

**2. Administrative Action**

Article 1108 permits the United States to exempt existing, non-conforming state government measures by including them in Annex I within two years after entry into force of the Agreement.

Under Article 1124, the three NAFTA governments must establish a 45-member roster of potential presiding arbitrators on the date of entry into force of the Agreement. The Administration will begin consulting with Canada and Mexico shortly on the development of the 45-member roster, and anticipates soliciting the advice of groups such as the American Arbitration Association and the International Chamber of Commerce.

## **CHAPTER TWELVE: CROSS-BORDER TRADE IN SERVICES**

### **A. SUMMARY OF PROVISIONS**

Chapter Twelve establishes basic rules that the three governments will observe in regulating the cross-border provision of services. These rules parallel and, in many respects, complement NAFTA's rules for trade in goods. These rules will remove many unnecessary barriers that U.S. service providers now face in supplying their services to Mexico and Canada, while retaining each country's right to set its own, non-discriminatory licensing standards.

#### **1. Scope and Coverage**

Chapter Twelve is ambitiously drafted, using an approach that is designed to state simple rules and make all exemptions readily apparent. Earlier trade agreements dealing with services, such as the CFTA, have typically applied only to selected sectors. Sweeping "grandfather" provisions have tended to limit their application only to laws and regulations adopted after those agreements went into effect.

Article 1201 takes a new approach, bringing all existing and future governmental measures related to cross-border, non-financial services within the scope of the chapter. It thus requires each NAFTA government to state explicitly -- in the Agreement's various annexes -- where it does not intend to conform to the chapter's general rules. This is much the same approach that the three governments have taken in NAFTA Chapter Three, which establishes rules for trade in goods.

#### **a. Types of Measures Covered**

Article 1201 makes clear that the chapter applies to laws and regulations affecting the provision of services across NAFTA borders. Chapter Twelve should be read together with Chapter Eleven (Investment), which establishes rules pertaining to the treatment of service firms that choose to provide their services through a local office or subsidiary, rather than cross-border. Chapter Twelve applies where, for example, a service provider is temporarily present in a NAFTA country and does not operate through a local investment.

The article provides an illustrative list of governmental measures that fall within the scope of Chapter Twelve. They include not only measures affecting the production, distribution, marketing, sale and delivery of a service, but also those related to the consumption of services. The list also includes measures governing how services are distributed or transported. (Chapter Thirteen provides additional rules regarding one such type of measure -- those governing access to and use of public telecommunications networks.)

Finally, the article also makes clear that Chapter Twelve applies to measures requiring service providers to post a bond or other form of financial security in order to provide a service on a cross-border basis. While the application of any such bonding requirement would

be subject to Chapter Twelve, the treatment accorded by a NAFTA government to the bond or security would be subject to the investment provisions of Chapter Eleven.

**b. Exclusions from Coverage**

Paragraph two describes those areas outside the coverage of Chapter Twelve. The chapter does not apply to financial services, which are treated under Chapter Fourteen. Nor does it cover measures related to the cross-border provision of air transportation services, which are the subject of long-standing bilateral aviation agreements between the three governments. Chapter Twelve does apply to specialty air services (such as aerial firefighting and surveying), however, and to those aircraft repair and maintenance services that require the withdrawal of an aircraft from service.

Chapter Twelve also does not cover laws and regulations relating to the purchase of services by NAFTA governments. Those measures are governed by Chapter Ten. Finally, it should be noted that while Chapter Twelve covers federal, state and provincial, and local measures, each such type of measure is given somewhat different treatment under the chapter in respect of how it can be made subject to a "reservation" and thus removed from the obligations imposed by the chapter. This subject is discussed more fully below.

**c. Employment and Government Services**

Article 1201 also makes clear that Chapter Twelve does not require NAFTA governments to provide individuals from other NAFTA countries access to their labor market. The NAFTA treats all employment and temporary entry matters exclusively in Chapter Sixteen. Paragraph three is based on a trilaterally-shared understanding that the mere fact that an individual is employed by a NAFTA firm is not a basis on which to regard such an individual as a "service provider" subject to protection under Chapter Twelve. Finally, the article affirms that each government may provide public services or perform public functions, consistent with the obligations of Chapter Twelve.

**2. Non-Discrimination**

Articles 1202 and 1203 require each government to accord non-discriminatory treatment to firms that provide services from other NAFTA countries.

**a. National Treatment**

This means, under Article 1202, that NAFTA governments may not discriminate in favor of local firms. At the state, provincial and local level, it requires governments to give

service providers from the other NAFTA countries treatment that is "no less favorable" than that they give domestic service firms in similar circumstances.

#### **b. Most-Favored-Nation Treatment**

In addition, Article 1203 requires NAFTA governments to accord "most-favored-nation" treatment to service providers from other NAFTA countries. This means that a government must treat such providers as well as they treat firms from any other country (including non-NAFTA countries) in like circumstances.

#### **c. Standard of Non-Discriminatory Treatment**

Article 1204 makes clear that both Articles 1203 and 1204 apply in any given case and thus a government must provide service providers "the better of" national and MFN treatment.

The "no less favorable" standard applied in Articles 1202 and 1203 does not require that service providers from other NAFTA countries receive the same or even "equal" treatment as that provided to local companies or other foreign firms. Foreign service providers can be treated differently if circumstances warrant. For example, a state may impose special requirements on Canadian and Mexican service providers if necessary to protect consumers to the same degree as they are protected in respect of local firms. NAFTA's non-discrimination provisions prohibit the imposition of laws and regulations designed to skew the terms of competition in favor of local firms; they do not bar legitimate regulatory distinctions between such firms and foreign service providers.

### **3. Local Presence Requirements**

Article 1205 reflects the principle that firms should be free to provide their services on a cross-border basis, without having to incorporate or make any form of local investment. In parallel with that principle, the article also prohibits local residency requirements for service providers who are NAFTA nationals.

### **4. Reservations for Inconsistent Measures**

Article 1206 creates a system of limited "reservations" and "grandfathering" to exempt certain laws and regulations that are not in conformity with the chapter's non-discrimination and local presence rules, described above. Each government has recorded a specific "reservation" in Annex I (which appears in Volume II of the 1993 GPO reprint) for each measure at the federal government level that, pursuant to negotiations with the other two governments, it has exempted from Chapter Twelve obligations.

Furthermore, existing non-federal measures that contravene Chapter Twelve rules are subject to "grandfathering" provisions, which exempt them from Chapter Twelve's

non-discrimination and local presence rules for differing periods. Local measures that are inconsistent with those rules are automatically "grandfathered" on a permanent basis.

Non-conforming measures at the state or provincial level are automatically "grandfathered" for two years. After that period, any such measure must be listed as a "reservation" in Annex I in order for the exemption to remain in effect. The two-year period was negotiated in order to allow time for the states, in cooperation with the federal government, to identify any such measures and, where desired, for the federal government to include them in the Annex.

Laws and regulations that are "grandfathered" or listed as a reservation in Annex I are exempt from challenge under the NAFTA, even if they are amended or renewed, so long as they are not made more inconsistent with the Agreement. If a measure is liberalized, however, any such liberalization may not be reversed by a subsequent amendment.

The three governments have also recorded a limited number of broader exemptions for measures falling into certain sectors, such as basic telecommunications, broadcasting and coastal and ocean maritime trade. Those exemptions, listed as reservations in Annex II, allow a government to maintain existing or adopt new laws and regulations that vary from Chapter Twelve's non-discrimination or local presence rules in the listed sectors.

## **5. Non-Discriminatory Quantitative Restrictions**

Article 1207 is based on the recognition that certain non-discriminatory restrictions imposed by governments to limit competition in various services markets can have adverse trade effects. Such measures, called "quantitative restrictions," typically take the form of limits on the number of firms that can enter a particular sector. Often restrictions of this kind are administered through "economic needs" tests, under which a local licensing authority assesses whether the market is being adequately served before allowing an additional entrant.

Article 1207 calls upon the three governments to list in Annex V, for "transparency" purposes only, any such restrictions they impose at the federal or state or provincial level. The article does not require that they be eliminated, however, or prevent the adoption of such measures in the future. It does require the three governments to endeavor periodically to negotiate the liberalization or removal of such restrictions.

## **6. Commitments to Liberalize Non-Discriminatory Measures**

Article 1208 creates a mechanism, Annex VI, for the three governments to record their commitments to eliminate or phase out non-discriminatory quantitative restrictions and other non-discriminatory laws and regulations that create barriers to cross-border services trade. Of particular note in Annex VI are commitments that the three governments have undertaken to open their legal services markets to "foreign legal consultants."

## **7. Licensing and Certification**

Article 1210 deals with the licensing and certification of nationals from other NAFTA countries. Paragraph one expresses the shared goal of applying fair and impartial licensing procedures for such individuals, designed to ensure their competence and to avoid unnecessary trade barriers. Paragraph two makes clear that the MFN obligation imposed by Article 1203 does not require licensing authorities in any NAFTA country to extend the same degree of recognition to professionals in one NAFTA country as it does to professionals in any other country.

### **a. Professional Services**

#### **(1) Citizenship and Permanent Residency Requirements**

Paragraph three calls for the elimination, within two years after the NAFTA enters into force, of citizenship and permanent residency requirements for the licensing or certification of NAFTA-country professionals. By virtue of Article 1213(2), professional services are those for which the relevant licensing authorities require providers to have a college or other specialized post-secondary education, or its equivalent in training. In this context, permanent residency refers to the special "visa" status held by lawful immigrants, as opposed to merely maintaining a residence within the relevant jurisdiction.

Failure by a NAFTA government to comply with paragraph three does not give rise to recourse under the dispute settlement procedures. Rather, the governments may respond by maintaining or reinstating equivalent residency requirements in the relevant sector.

Paragraph four calls for the three governments to consult to determine the feasibility of removing any citizenship and permanent residency requirements not eliminated under paragraph three.

#### **(2) Professional Services Annex**

Paragraph five calls up Annex 1210.5 on professional services. The Professional Services Annex is divided into three sections that address further licensing and certification matters, foreign legal consultants, and the temporary licensing of engineers, respectively.

##### **(a) Section A: Licensing and Certification**

Paragraph one of this section requires licensing authorities to process expeditiously applications for licensing or certification by nationals from other NAFTA countries. Pursuant to paragraph two, the NAFTA governments intend to encourage relevant licensing authorities and professional groups in their respective territories to develop, on a voluntary basis, mutually acceptable licensing standards and criteria and to make

recommendations regarding mutual recognition of professional credentials. Paragraph three provides an illustrative list of topics that such standards and criteria might cover.

Under paragraph four, the NAFTA Commission will review any recommendations concerning mutual recognition developed by professional groups in the NAFTA countries to determine whether they are consistent with NAFTA principles. If they are, each government will encourage its domestic licensing authorities to implement those recommendations as they deem appropriate.

Paragraph five calls on the three governments to encourage temporary licensing of professionals. Paragraph six requires the Commission to review the implementation of Section A at least every third year.

(b) Sections B and C: Foreign Legal Consultants and Engineers

Section B of the Professional Services Annex sets out commitments undertaken by the three governments to permit lawyers licensed in another NAFTA country to practice as foreign legal consultants in their territories, while Section C addresses the temporary licensing of engineers.

**8. Denial of Benefits**

Article 1211 describes those circumstances under which a NAFTA government may refuse to apply the protections of Chapter Twelve to nationals or enterprises of the other NAFTA countries. The article preserves the foreign policy prerogatives of each government to deny benefits to businesses owned or controlled by nationals of any country with which it does not have diplomatic relations or to which it is applying economic sanctions. Consonant with the goal of fostering economic activity within the free-trade area, a government may also deny benefits to transportation firms where they provide services with equipment that is not registered in a NAFTA country.

Similarly, a NAFTA government may withhold the benefits of Chapter Twelve from "shell" companies that have no substantial business activities in any NAFTA country. This provision requires the denying government to give prior notification, and to consult, in accordance with Articles 1803 and 2006.

**9. Land Transportation Annex**

Annex 1212 addresses certain matters related to cross-border land transportation services. Paragraph one requires each government to designate contact points to assist firms from other NAFTA countries in understanding local laws and regulations related to such services. Paragraph two calls for the Commission to review progress in implementing the trade liberalization commitments made by the three governments in their reservations on bus and truck

transportation recorded in Annex I. Pursuant to paragraph three, the NAFTA governments will consider further liberalization within seven years after the NAFTA goes into effect.

## **10. Definitions**

### **a. Non-Governmental Bodies**

Paragraph one of Article 1213 provides that references to a federal, state or provincial government are deemed to include "any non-governmental body in the exercise of any regulatory, administrative or other governmental authority delegated to it by that government." This clarification is intended to subject private entities to the obligations of Chapter Twelve when they act as proxies for the government by exercising authority to regulate service providers.

### **b. "Cross-Border Trade in Services"**

Paragraph two sets out definitions for terms used in Chapter Twelve. Perhaps most important is the definition of "cross-border provision of a service" and "cross-border trade in services," which encompasses all methods of delivering services cross-border. These include the situation in which a consumer travels from one NAFTA territory to another to receive a service.

### **c. "Enterprise"**

Also of note is the definition of "enterprise." Chapter Twelve departs from the general definition of this term found in Article 201 to include branches. Similarly, the definition of "enterprise of a Party" includes branches located in the country's territory and carrying out business activities there.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT NAFTA**

### **1. In General**

Other than as set out below in connection with motor carrier access, implementation of Chapter Twelve requires no immediate changes to laws, regulations, or other measures now in effect.

All federal measures that do not conform with the national treatment, MFN, or local presence requirements of Chapter Twelve have been exempted by virtue of reservations recorded in the U.S. Schedule to either Annex I or II.

Pursuant to Article 1206(1)(a)(ii), all existing, non-conforming measures at the state level will be exempted from Chapter Twelve obligations for two years after the NAFTA enters into effect. During the two-year "grandfathering" period, the Administration will work closely with the states to identify all non-conforming state measures and to take reservations for those measures. Local government measures are exempted by virtue of the "grandfathering" provisions of Article 1206(1)(a)(iii).

The Administration will work with the states to identify all quantitative restrictions, as defined in Article 1207, maintained at the state level in order to record such measures in the U.S. Schedule to Annex V within one year of the NAFTA's entry into force. No action is required with regard to quantitative restrictions maintained by local governments because such restrictions are not within the scope of Article 1207.

No immediate action is required to comply with Article 1210(3), which calls for the removal of all citizenship and permanent residency requirements for the licensing and certification of professionals. The NAFTA provides a two-year grace period before this provision takes effect.

The Administration intends to negotiate actively in the future to eliminate disadvantages to U.S. service providers that remain in place under reservations taken by Canada and Mexico, and to eliminate other distortions in trade in services. The Administration will pursue these objectives where there are sectors of interest to the United States and when it would be to the benefit of the United States to do so. During any such negotiations, the Administration will consult closely with the Congress and the private sector.

## **2. Professional Licensing**

Nothing in the NAFTA will permit Mexican or Canadian professionals to practice a licensed profession in the United States, even on a temporary basis, without meeting all applicable state licensing criteria and receiving such a license. Nor does the NAFTA require any change in state certification or licensing criteria or procedures other than as may be necessary to eliminate U.S. citizenship or permanent residency requirements.

Annex 1210.5 establishes a process for the licensing authorities in each country to consider whether it is desirable to provide for recognition of each other's certification and licensing criteria. Although the federal government will encourage and facilitate this exercise, where appropriate, discussions will not proceed unless the relevant state licensing authorities agree. The Administration will give particular attention when the NAFTA enters into effect to encouraging mutual recognition and market access efforts in the engineering and foreign legal consultancy fields.

## **3. Land Transportation: Motor Carrier Access**

The timetable for the removal of reciprocal motor carrier barriers reflected in the U.S. land transportation reservations will require administrative action on the part of the President and a change in current Interstate Commerce Commission (ICC) regulations. A moratorium, imposed under the Bus Regulatory Reform Act of 1982, currently prohibits the ICC from issuing new grants of operating authority to Mexican motor carriers. Section 6 of the 1982 Act authorizes the President to remove the moratorium in whole or in part for any country or political subdivision thereof upon determining that such action is in the national interest. Sixty days' advance notice to Congress is required whenever the removal or modification applies to a foreign country or political subdivision thereof which substantially prohibits the granting of motor carrier authority to persons of the United States. In 1982, a Presidential order lifted the moratorium with respect to Canada.

The moratorium with respect to Mexico will be lifted in phases to coincide with the schedule of liberalization in the relevant reservations. The initial modification of the moratorium will be accomplished by memorandum from the President that will be published in the *Federal Register*. Each additional phase of the schedule of liberalization will require an additional modification to the moratorium. The NAFTA schedule of liberalization does not require the removal of all barriers for motor carrier operations in the United States; the moratorium will remain in place for Mexican carriers in the one area that was not liberalized (point-to-point carriage of domestic cargo in the United States).

The schedule of Presidential orders needed to lift the moratorium on new grants of operating authority in accordance with the schedule of liberalization is as follows:

- upon entry into force of the NAFTA, for Mexican charter and tour bus companies;
- three years after signature of the NAFTA (December 17, 1995) for an amended moratorium to allow Mexican trucking companies access into the U.S. border states and to allow the establishment of companies to distribute international cargo within the United States;
- three years after entry into force for Mexican regular route bus companies; and
- six years after entry into force for cross-border provision of trucking services throughout the United States.

The Interstate Commerce Commission will initiate a rulemaking proceeding to permit Mexican international charter and tour bus operators to apply for "certificates of public convenience and necessity" (operating authority) upon the NAFTA's entry into force.

The ICC will institute a similar proceeding three years after signature of the NAFTA to permit Mexican trucking companies to apply for operating authority to engage in point-to-point commerce between Mexico and the U.S. border states. Six years after the NAFTA takes effect,

the ICC will institute another proceeding to establish procedures for granting operating authority to Mexican trucking firms for operations between points in Mexico and points in the United States. The "certificates of public convenience and necessity" that the ICC will issue to Mexican trucking firms will supersede the "certificates of registration" currently granted to Mexican carriers for operations in border commercial zones.

The ICC will maintain a compliance monitoring program with the assistance of the Department of Transportation, the Immigration and Naturalization Service, the Treasury Department, and the states, to ensure that Mexican carriers operate only within U.S. border commercial zones for the first three years after the NAFTA was signed, and thereafter in the border states until the beginning of the sixth year that the NAFTA is in effect.

Under the NAFTA, Mexican and Canadian vehicles and drivers must comply with all applicable federal, state and local laws while operating in the United States.

## **CHAPTER THIRTEEN: TELECOMMUNICATIONS**

### **A. SUMMARY OF NAFTA PROVISIONS**

Chapter Thirteen adds to the commitments set out in Chapters Eleven and Twelve concerning the treatment to be accorded to service providers and investors from other NAFTA countries. It ensures that basic telecommunication services in the three countries will be made available to individuals and firms from other NAFTA countries on reasonable terms and conditions for use in the conduct of their business.

#### **1. Scope and Coverage**

Chapter Thirteen covers measures affecting "access to and use of" public telecommunications networks and services by firms and individuals from other NAFTA countries. The chapter gives special emphasis to protecting firms that operate private communications networks, such as intracorporate phone systems, or that provide "enhanced services," such as credit card validation systems, electronic mail, online databases, or computer services, such as remote data processing, over a country's basic telephone network.

The chapter also applies to "standards-related measures" affecting the attachment of terminal and other equipment to the public network. The chapter does not cover government measures regulating entry into the basic telecommunications market. Such measures are covered by Chapter Eleven, but are subject to Annex II "reservations" for each government.

#### **2. Access Commitments**

Paragraph one of Article 1302 sets out the chapter's fundamental rule of "reasonable and non-discriminatory" access to and use of the public telecommunications transport networks and services. The seven paragraphs that follow are a partial elaboration of this rule. As paragraph eight makes clear, the non-discrimination rule in this context refers to discrimination between different customers or users.

Paragraph two provides that, in their use of basic telecommunications services, firms from other NAFTA countries must be provided the opportunity to purchase, or lease, and attach terminal or other equipment to the public networks; interconnect leased channels for domestic or cross-border use with the public networks or other private networks; perform switching, signalling and processing functions; and use the operating protocols of their choice.

Paragraph three requires the three governments to ensure that any firm operating the public network provides network services at prices reflecting the economic costs directly related to the provision of the services and makes leased circuits available at flat rates, independent of usage. This does not foreclose cross-subsidization between various network services for the purpose of ensuring universal service.

Paragraph four ensures that firms can freely move information over domestic public networks (including leased communications circuits) both domestically and cross-border. This guarantee includes the movement of information over intracorporate networks and access to databases or other information stored in machine-readable form.

Paragraphs five through seven describe various types of regulatory measures that may be taken consistent with the chapter's general rule. Paragraph five makes clear that each government can take appropriate action to ensure the security and confidentiality of messages and to protect subscriber privacy.

Paragraph six provides that the only conditions that may be imposed on access to or use of public networks are those that are necessary to safeguard the "public service responsibilities" of public network operators or to protect network integrity. Paragraph seven sets out a list of the types of conditions that can be imposed where the preceding test is met.

### **3. Conditions for Providing Enhanced Services**

Article 1303 limits the types of requirements that may be imposed on providers of enhanced services. Under paragraph one, licensing procedures must be transparent and non-discriminatory, and applications be processed expeditiously. Furthermore, firms seeking to provide enhanced services may be required only to demonstrate that they are solvent and able to comply with applicable standards and regulations.

Paragraph two prevents enhanced services providers from being required to fulfill common carrier obligations, such as providing services to the public generally or filing tariffs. However, paragraph three allows a government to require an enhanced services provider to file tariffs in order to remedy a particular case of anticompetitive conduct. A tariff may also be required from the enhanced services unit of a monopoly public telecommunications operator subject to Article 1305.

### **4. Standards-Related Measures**

Article 1304 sets out special rules for standards, technical regulations and conformity assessment procedures governing terminal and other equipment attached to the public network. Paragraph one limits such "standards-related measures" to those that are technically required to prevent harm to the network or that protect user safety. Paragraph three requires NAFTA governments to ensure that "network termination points" for the attachment of equipment are reasonably and clearly defined.

Paragraph five requires each government to ensure that its "conformity assessment procedures" (*e.g.*, type approvals) are transparent and non-discriminatory and that applications for the approval of terminal or other equipment to be attached to the public network are processed expeditiously. Where a government requires equipment to be tested for such purpose, it must allow any technically competent entity to conduct the tests, although the government may

review the accuracy and completeness of the results. Furthermore, NAFTA governments may not discriminate in the treatment or selection of agents required to act on behalf of suppliers of equipment undergoing conformity assessment procedures.

Under paragraph six, each NAFTA government has committed, within one year after the NAFTA enters into effect, to adopt provisions in its conformity assessment procedures to recognize the results of testing carried out in other NAFTA countries in conformity with the government's standards and procedures. Paragraph seven calls for the creation of a "Telecommunications Standards Subcommittee," which is to focus initially on harmonizing the three governments' procedures for approving telecommunications equipment.

## **5. Treatment of Monopolies**

Article 1305 obligates the three governments to ensure that monopoly providers of basic telecommunications services do not engage in anticompetitive practices that could injure telecommunications equipment or services firms from other NAFTA countries. Each government is required to adopt competition safeguards, such as accounting or non-discrimination requirements.

## **6. Other Provisions**

Article 1306 is designed to ensure that firms and individuals from other NAFTA countries have ready access to critical information affecting access to and use of public networks and services. Article 1307 gives precedence to Chapter Thirteen provisions over others in the NAFTA that may be inconsistent.

Article 1308 recognizes the importance of international standards for global compatibility and interoperability of telecommunications services and networks. The three governments will promote such standards through the International Telecommunication Union, the International Organization for Standardization, and similar bodies.

Under Article 1309 the three NAFTA countries are pledged to cooperate in the exchange of technical information and the development of government-to-government training programs. In addition, they will consult on the feasibility of further liberalizing trade in telecommunications services, including basic services.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

Chapter Thirteen does not require any change in statute or regulation.

## CHAPTER FOURTEEN: FINANCIAL SERVICES

### A. SUMMARY OF NAFTA PROVISIONS

#### 1. Scope of Chapter

Chapter Fourteen sets out rules governing the treatment each NAFTA government must accord to those financial institutions in its territory that are owned by investors from other NAFTA countries, to the investors who own or seek to own those institutions, and to persons in other NAFTA countries providing financial services into its territory on a cross-border basis. The Chapter applies to federal, state and local government measures in the financial sector and, pursuant to Article 1402, to certain self-regulatory organizations.

Paragraph two of Article 1401 applies certain provisions in NAFTA's investment and cross-border services chapters to financial services. These are:

- the requirement to permit transfers of profits, interest and other payments associated with an investment (Article 1109);
- rules governing the expropriation of an investment (Article 1110);
- procedures for investors to bring a NAFTA government to international arbitration for violations of investment rights (Articles 1115-1138); and
- exceptions allowing a NAFTA government to apply reasonable formalities to foreign investors (Article 1111) or to deny benefits to "shell" corporations or certain other companies (Articles 1113 and 1211).

Paragraph two also applies Article 1114 to financial services. That article makes clear that governments can apply environmental measures consistent with the NAFTA and provides that no NAFTA government should lower its environmental standards to attract investments.

Paragraph three clarifies that the chapter does not prevent a NAFTA government from acting as the sole provider of public retirement benefits, social security or other financial services.

Paragraph four and its accompanying Annex carry forward in the NAFTA two specific commitments made by the United States in the CFTA. These commitments apply only with respect to Canada. One permits foreign and domestic banks in the United States to deal in, purchase and underwrite Canadian government securities under the Glass-Steagall Act. The other guarantees certain "grandfather" rights under the International Banking Act of 1978 for interstate branch offices of Canadian banks. No other provisions of the CFTA have been carried

forward because the NAFTA obligations in all other respects exceed the level of obligation under the CFTA.

## **2. General Provisions**

Chapter Fourteen establishes rules for governmental measures with regard to: (1) the establishment of a financial institution; (2) cross-border financial services; (3) the non-discriminatory treatment of investors, financial institutions and cross-border service providers; (4) new financial services and data processing; (5) senior management and boards of directors; and (6) the "transparency" of financial services laws and regulations.

### **a. Establishment of a Financial Institution**

Under Article 1403, each NAFTA country must permit investors from the other NAFTA countries to establish financial institutions within its territory on a non-discriminatory basis, although institutions may be required to take the form of subsidiaries. The article recognizes, however, that in principle investors should have the right to choose the form of establishment -- branch or subsidiary -- that best meets their particular needs. To this end, the article provides that, in the event that the United States permits nationwide banking, the three governments will undertake negotiations toward ensuring a right to establish branches throughout North America.

### **b. Cross-Border Trade**

Article 1404 provides that each NAFTA country generally cannot enact measures that restrict those cross-border financial services activities presently permitted under its law. The obligation guarantees the continued access of U.S. financial firms to other NAFTA markets on a cross-border basis. However, Canada recorded a "reservation" in Annex VII exempting cross-border trade in securities services with the United States from this general rule, and the United States took a reciprocal reservation in this area. (Annex VII appears at the end of Volume II of the 1993 *Government Printing Office* reprint.) In addition, each government must permit its consumers to purchase financial services on their own initiative in other NAFTA countries. Each government may require registration of firms and financial instruments involved in cross-border transactions to protect investors.

### **c. Non-Discrimination**

Chapter Fourteen sets out national treatment and most-favored-nation treatment rules. The non-discriminatory treatment required under this article will permit U.S. firms to compete in other NAFTA markets as those markets liberalize and grow in the future.

Under Article 1405, each country must provide financial services firms from other NAFTA countries treatment that is "no less favorable" than the treatment it provides domestic firms in like circumstances. This requirement can be met by providing equal

competitive opportunities to domestic and foreign-owned firms. In the case of foreign firms operating in the United States in different states, national treatment will be determined by referring to the most favorable treatment accorded to firms in the foreign firm's state of domicile or, in the case of a commercial bank, its "home state" under the International Banking Act of 1978.

Article 1406 requires most-favored-nation treatment. That means that a NAFTA country must give financial services firms from another NAFTA country treatment that is "no less favorable" than the treatment it provides to financial firms from any other country in like circumstances, including non-NAFTA countries. Paragraphs two through four clarify that the article does not prevent a NAFTA country from applying different treatment where the difference is based on valid regulatory harmonization or recognition of home-country regulation in a particular country.

Where the national treatment required under Article 1405 is a different standard than that required under the most-favored-nation treatment obligation of Article 1406, the better of the two treatments must be accorded.

**d. New Financial Services and Data Processing**

Article 1407 requires each NAFTA government to permit financial institutions from other NAFTA countries to offer new services that are similar to those already permitted under its law. The article also provides that foreign financial firms must be permitted to transfer data from one NAFTA country to another for processing. These two rights will allow U.S. firms to utilize their expertise in financial innovation and back-office operations in other NAFTA countries.

**e. Senior Management and Boards of Directors**

Article 1408 protects the rights of U.S. financial firms to staff and manage their investments in other NAFTA countries with U.S. personnel. The article provides that financial institutions in one NAFTA country owned by persons from other NAFTA countries may hire senior management and other essential personnel regardless of their nationality. In addition, the board of directors of a financial institution owned or controlled by investors of another NAFTA country may not be required to include more than a simple majority of members who are nationals or residents of a particular NAFTA country.

**f. Regulatory "Transparency"**

Under Article 1411, each NAFTA government is generally required to provide its draft financial laws and regulations to interested persons before putting them into effect and to permit those persons to comment on the drafts. In addition, the article commits each government's regulatory authorities to provide information on the status of an application and to act on an application within 120 days, if possible, after a completed application is provided to them. These disciplines will assure transparency in foreign regulation and expeditious processing of applications.

### **3. Exceptions**

Article 1410 sets out general exceptions that apply to the chapter and Agreement. Paragraph one provides that nothing in the chapter or in Part V of the NAFTA (covering services, investment, monopolies, and temporary entry) prevents a government from taking reasonable prudential measures. Paragraph two makes clear that actions by a NAFTA country to carry out non-discriminatory monetary, credit and exchange rate policies are not subject to the chapter or Part V. Paragraph two does not affect the obligations imposed under the NAFTA regarding the imposition of performance requirements in connection with an investment or regarding restrictions on transfers.

Under paragraph three, each NAFTA country is permitted to favor its nationals or firms in the privatization of social security and public retirement plans. Paragraph four specifies that governments may impose non-discriminatory prudential restrictions on transfers to affiliates.

### **4. Institutional Provisions and Dispute Settlement**

Article 1412 creates a Financial Services Committee to oversee the chapter's functioning. The Committee, which is to meet annually, will comprise officials from the finance ministries of each of the three countries as well as officials of the Department of Commerce for insurance issues. Article 1413 also provides for consultations and requests for certain regulatory information.

Section A of Annex 1413.6 requires the three governments to consult on the transitional market share limitations that Mexico may impose on limited scope finance companies under Section B of its schedule to Annex VII. Section B of Annex 1413.6 sets out a special consultation procedure that Mexico can invoke if the combined market share of U.S. and Canadian banks in Mexico reaches 25 percent. Mexico may not impose further market share restrictions unless the other NAFTA countries agree.

Article 1414 assures the availability of adequate financial expertise in any NAFTA dispute settlement panel proceeding involving the application of Chapter Fourteen. The article provides that in any such proceeding each government can ensure that at least two panelists are selected from an agreed roster of financial services experts. The article also prevents disputes in other sectors from affecting the financial sector by prohibiting the complaining government from

directing any suspension of benefits authorized under Article 2019 at financial services activities.

Article 1415 is designed to prevent an investor-state dispute regarding financial services from adversely affecting legitimate regulatory interests by allowing the relevant NAFTA governments an opportunity to resolve a prudential issue before an arbitral panel considers the matter.

## **5. Reservations and Transitional Arrangements**

Article 1409 creates a system of limited "reservations" and "grandfathering" to exempt certain laws and regulations that are inconsistent with the obligations set out in Articles 1403 through 1408. Each government has listed in Section A of its schedule to Annex VII those existing federal-level measures that are exempt. A "ratchet" provision in paragraph 1(c) of the article provides that once a reserved law is liberalized it cannot later be made more restrictive.

The three governments have listed in Section B of their schedules those financial services sectors where they have reserved the right both to maintain existing inconsistent federal measures and adopt new ones. Section C lists certain specific additional commitments that individual NAFTA countries have undertaken.

Each country will also list in Annex VII those inconsistent state and provincial measures that it wishes to preserve, based on the timetable set out in Annex 1409.1. Existing local government measures covering financial services are automatically "grandfathered."

The following describes the principal reservations recorded by each country, including, where relevant, any phase-in schedule under which a government will bring its laws into conformity with the obligations of the chapter.

### **a. Canada**

The Canadian schedule to Annex VII sets out three significant exemptions under federal law. The first restriction is a "retention" requirement for reinsurance services under the Canadian Insurance Companies Act. The second, found in Section B of Canada's schedule, permits Canada to introduce new restrictions on cross-border securities activities.

A third restriction involves the question of whether U.S. and Mexican banks owned by non-NAFTA persons can benefit from the Agreement's rules. The general rule in Chapter Fourteen is that any company resident in a NAFTA country -- regardless of ultimate ownership -- is considered a NAFTA firm. For purposes of access to Canada, however, NAFTA's benefits are limited to firms in Mexico and the United States that are ultimately controlled by U.S. and Mexican persons.

**b. Mexico**

(1) Existing and Future Restrictions

Under Section A of its schedule to Annex VII, Mexico has reserved the right to apply its current investment restrictions. Under these restrictions, foreign investors may hold an aggregate of 30 percent of the voting stock in financial holding companies, securities firms or banks, and up to 49 percent of the voting stock of insurance companies, factoring companies, leasing companies, bonding companies and warehousing companies.

Mexico will also maintain certain existing restrictions on the purchase of cross-border insurance by Mexican residents. The three governments intend to consult under Article 1404(4) regarding the liberalization of restrictions affecting cross-border insurance services.

Paragraph 15 of Section B allows Mexico to require Mexican ownership of two insurance companies that were owned by the government when the NAFTA was signed and are the exclusive providers of insurance services to the government. These ownership restrictions can be applied for a "commercially reasonable" time after privatization in order to encourage bids for the companies.

Paragraph 16 of section B allows Mexico to restrict cross-border peso operations where such operations would impair the conduct of Mexico's monetary and exchange rate policies. This provision is intended to permit Mexico to continue to avoid the establishment of an off-shore peso market. It is not intended to allow Mexico to restrict transactions that are based in pesos but settled in dollars. Thus, a Mexican company would not be restricted from drawing on an off-shore dollar facility even though the amount of the draw was based on a specific peso amount. Also, the purchase outside of Mexico of a peso-denominated instrument for an amount of foreign exchange would not be covered by this exception.

Finally, paragraph 17 of Section B permits Mexico to deny the benefits of Article 1403 and Articles 1405 through 1408 to the direct bank branches of Citibank, N.A., the only foreign bank currently operating through branch offices in Mexico. These branch operations can be converted to a foreign financial affiliate operation under the terms of the Mexican schedule to Annex VII. Once converted, the capital equivalency required by Mexico for these branches on the date of signature of the NAFTA will neither be counted against nor subject to the capital limits established under the transitional arrangements described below.

(2) Investment Liberalization

Under Sections B and C of Mexico's schedule, Mexico has committed to liberalize its investment restrictions for investors qualifying to invest in Mexican "foreign financial affiliates." This liberalization marks the first substantial access by the U.S. financial

services industry into Mexico in several decades. In order to qualify, Mexico may require a U.S. or Canadian investor to be engaged in a similar financial services business in its home country. Further, Mexico may require a foreign financial affiliate to be wholly owned by a NAFTA investor and may prohibit them from establishing offices outside of Mexico. If Mexico waives the application of these restrictions, they cannot later be reimposed. During the transition period, Mexico may also restrict any foreign financial affiliate from issuing certain kinds of subordinated debentures other than to the investor that owns the affiliate.

Foreign banks, securities firms, insurance companies, factoring companies and leasing companies are subject to limits on the aggregate percentage of capital in the Mexican market they are permitted to hold. Foreign bank, securities and insurance affiliates are also subject to individual capital limits during the transition to substantially full liberalization of investment in the Mexican financial market. Other forms of financial firms -- such as mutual fund companies, investment advisers, insurance brokerages or agencies and financial warehouses -- will not be subject to capital restrictions.

### (3) Commercial Banks

For commercial banks, the individual size of both newly established and acquired firms will be limited to no more than 1.5 percent of the total capitalization of the Mexican banking system until January 1, 2000. After that date, acquisitions may be limited to four percent of total capitalization. Internal growth, such as through retained earnings or capital contributions, will be unlimited.

The aggregate capitalization of all Canadian and U.S. bank subsidiaries in Mexico will be subject to a limit of eight percent of the Mexican banking system beginning with the entry into force of the Agreement and rising in equal annual increments until reaching 15 percent on January 1, 1999. After January 1, 2000, the aggregate capital limit will be removed, but Mexico will retain the right to apply a further three-year freeze on aggregate market share if the capitalization of Canadian and U.S. banks reaches one-quarter of the Mexican banking system before the year 2004.

### (4) Securities Firms

U.S. and Canadian securities affiliates will be subject to an aggregate limit of ten percent of the Mexican market when the NAFTA goes into effect, rising in equal annual increments to 20 percent by January 1, 1999. Similar to commercial banks, Mexico may invoke once during the period from January 1, 2000 to January 1, 2004, a temporary safeguard on foreign securities firms if their total capitalization reaches 30 percent of the Mexican securities market. Individual firm size will be limited until January 1, 2000, to four percent of total capitalization. Mexico has also committed to review the general minimum capital requirements for securities firms in Mexico after the NAFTA goes into effect by issuing a report on the introduction of a variable capitalization scheme.

(5) Insurance Firms

Mexico will permit two different approaches to investment by U.S. and Canadian firms in its insurance sector. Foreign insurance affiliates will be subject to individual and aggregate restrictions on capital similar to those in the banking and securities sectors. Individual firm capitalization will be limited to 1.5 percent of the total capitalization of the Mexican insurance market in the property and casualty market, and 1.5 percent in the life and health market. Limits on aggregate capitalization will begin at six percent of the total capitalization of the Mexican insurance industry on January 1, 1994, rise to eight percent a year later, and thereafter increase one percent per year until ending on January 1, 2000.

Each of these capital limits applies separately to life and non-life insurance lines offered in Mexico. For example, an individual foreign financial affiliate could theoretically maintain up to three percent of the total capitalization of the Mexican insurance market and all foreign insurance affiliates could control up to 12 percent of the Mexican market on January 1, 1994.

In addition to entry through foreign insurance affiliates subject to capital limits, a U.S. or Canadian firm may also invest in a Mexican insurance company pursuant to paragraph seven of section B of the Mexican schedule. These Mexican companies will not be subject to size limitations or market share limits, but the Canadian and U.S. investment in such firms will be limited to 30 percent on January 1, 1994. Thereafter, the maximum level of foreign investment will rise five percentage points per year until reaching 45 percent on January 1, 1997. The following year, the limit will rise to 51 percent. Beginning on January 1, 1999, the foreign investment limit will be 75 percent. No further investment limits will be imposed beginning January 1, 2000.

Mexico also has committed under paragraph four of Section C of its schedule to Annex VII to allow any U.S. or Canadian investor with a ten percent or greater ownership share of a Mexican insurance company as of July 1, 1992, to increase that share pursuant to any contract right or option in existence on that date, or acquire a controlling interest of up to 100 percent beginning on the earlier of January 1, 1996, or two years after the entry into force of the Agreement. U.S. and Canadian investors may also choose to maintain their existing levels of investments in Mexican insurers.

(6) Leasing and Factoring Firms

Canadian and U.S. investors can engage in leasing and factoring subject to an aggregate limit of ten percent of the Mexican leasing or factoring industry's capitalization beginning on the entry into force of the Agreement. This limit will increase in equal annual increments until reaching 20 percent on January 1, 1999, at which point the limits will be removed. Mexico has imposed no individual limits on the size of individual leasing and factoring firms.

(7) Consumer and Commercial Lending

In addition to liberalizing investment in existing forms of financial institutions, Mexico has also committed to allow a new form of financial institution pursuant to paragraph two of Section C of its schedule. These limited scope finance companies may be owned by U.S. or Canadian non-bank investors and will offer consumer lending, commercial lending, mortgage lending or credit card services.

Until January 1, 2000, Mexico may restrict the aggregate assets of all foreign limited scope finance institutions to three percent of the aggregate assets of all commercial banks and limited scope finance companies in Mexico, excluding the lending of certain automobile affiliates in Mexico. The NAFTA governments will consult on the asset limit three years after the Agreement goes into effect, as required under Section A of Annex 1413.6.

**c. United States**

The United States has "grandfathered" all current federal measures that may be inconsistent with the obligations of Chapter Fourteen. These are:

- citizenship and residency requirements for membership on the boards of directors of national banks;
- discriminatory aspects of the federal interstate banking laws under the federal banking laws;
- foreign ownership restrictions applicable to Edge Act corporations;
- a prohibition on the domestic retail deposit-taking business of foreign bank branches;
- the prohibition against foreign banks becoming shareholders in the Federal Reserve System;
- the reciprocal national treatment tests applicable to primary dealers in government debt and foreign trustees for certain U.S. bond offerings;
- provisions allowing securities firms in Canada to maintain in banks located in Canada reserves required under U.S. securities laws;
- a prohibition on sale of onion futures and options under the Commodity Exchange Act;
- a prohibition on the provision by foreign insurance companies of surety bonds for government contracts; and

- the requirement that only foreign bank branches must register under the Investment Advisers Act of 1940.

As noted above, the United States has taken a reservation from Article 1404(1), allowing it to prohibit cross-border trade with Canada in securities. This reservation mirrors a similar reservation lodged by Canada with respect to the United States.

Section C of the U.S. schedule to Annex VII sets out a commitment by the United States to provide a five-year transition period during which certain Mexican firms can conform their U.S. activities to the Bank Holding Company Act of 1956.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

Chapter Fourteen does not require any legislative change.

### **2. Administrative Action**

Under Section C of its schedule to Annex VII, the United States has pledged to provide certain Mexican banks and holding companies a five-year exemption from the restrictions on affiliations between commercial banks and investment banking activities under the Bank Holding Company Act of 1956. The Board of Governors of the Federal Reserve System is expected to implement this commitment through its administrative authority under the Act.

The states play an important role in financial regulation in the United States. States are the primary regulators of insurance activities and state-supervised banking operations. States are also active in securities regulation. The appropriate federal government agencies will consult with relevant state regulators regarding issues concerning or affecting state regulatory authority in the financial services sector, including in the identification of inconsistent state measures to be "grandfathered" under the Agreement through reservations and the selection of the members of the roster of financial services experts established under Article 1414.

## **CHAPTER FIFTEEN: COMPETITION POLICY, MONOPOLIES AND STATE ENTERPRISES**

### **A. SUMMARY OF NAFTA PROVISIONS**

The NAFTA includes several provisions regarding business conduct, in recognition that such disciplines will help fulfill the market-opening objectives of the Agreement, particularly those relating to the energy sector.

Article 1501 provides that each NAFTA government will adopt or maintain antitrust measures and cooperate on issues of competition law enforcement policy, including mutual legal assistance, notification, consultation and exchange of relevant information. Both the United States and Canada have long had strong antitrust laws. Mexico adopted a comprehensive antitrust law in mid-1993.

Article 1503 requires all enterprises owned or controlled by a federal, state or provincial or local government to act in a manner consistent with the investment and financial services provisions of the NAFTA whenever they exercise any delegated governmental authority. The article also requires all such enterprises to act in a non-discriminatory manner in their sales of goods or services to businesses in that country owned by investors from other NAFTA countries.

Article 1502, which is based, in part, on CFTA Article 2010, imposes additional disciplines on certain officially-designated monopolies. It covers those entities given the right to be the sole providers or purchasers of a good or service in a particular domestic market. The disciplines imposed by Article 1502 apply to both current and future monopolies that are owned by a NAFTA country's federal government, such as Mexico's state oil and electricity monopolies (PEMEX and CFE). They will also apply to any privately-owned monopolies that a NAFTA country may designate in the future.

Article 1502 requires each government to impose several specific disciplines on its monopolies. First, in exercising any governmental authority delegated to them by a NAFTA government in connection with the monopoly good or service (such as the power to grant import licenses), monopolies must act in a manner consistent with the government's NAFTA obligations. Under Article 1116, this obligation, as it applies to actions affecting investments -- as well as the similar obligation discussed above imposed on state enterprises generally -- may be enforced through NAFTA's investor-State arbitration procedures by any investor from another NAFTA country that is adversely affected.

Furthermore, when buying or selling a monopoly good or service in the monopolized market, these entities must follow commercial considerations, consistent with the terms of their government mandates, and must not discriminate against goods or businesses from other NAFTA countries. In addition, each NAFTA government must ensure that such monopolies do

not use their monopoly positions to engage in anticompetitive practices in non-monopoly markets, such as through the discriminatory provision of the monopoly good or service, cross-subsidization or predatory conduct. (Article 1305 contains a similar discipline on the behavior of public telecommunications transport monopolies.)

Finally, Article 1504 provides that a trilateral working group will report to the three governments within five years on issues concerning the relationship between competition laws and policies and trade in the free trade area.

**B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

No change in statute or regulation is required to implement the provisions of Chapter Fifteen.

No changes in U.S. antitrust laws, including the Export Trading Company Act of 1982 or the Webb-Pomerene Act, will be required to implement U.S. obligations under the NAFTA. These laws have contributed to the export competitiveness of U.S. industries and they remain appropriate in the context of a free trade area. Nothing in the Agreement requires any NAFTA government to take measures that would adversely affect such associations.

## CHAPTER SIXTEEN: TEMPORARY ENTRY FOR BUSINESS PERSONS

### A. SUMMARY OF NAFTA PROVISIONS

#### 1. Overview

Under Chapter Sixteen, each government has agreed to facilitate the temporary entry into its territory of business persons who are citizens of other NAFTA countries. NAFTA's temporary entry provisions are similar to those of the CFTA and fully preserve each country's rights to protect its domestic labor force and permanent employment and implement its own immigration policies.

The NAFTA also recognizes the need to ensure border security. Current U.S. law and practice relating to exclusion and deportation of aliens will apply unchanged to all business persons seeking temporary entry under the provisions of this chapter. Furthermore, the NAFTA fully protects the ability of state governments to require that Canadians and Mexicans practicing a profession in the United States are fully licensed under state law to do so.

#### 2. Persons Covered by the Chapter

As provided in Article 1603 and Annex 1603, each NAFTA country will grant temporary entry to four categories of business persons:

- ***business visitors*** engaged in international business activities related to research and design, growth, manufacture and production, marketing, sales, distribution, after-sales service, and other general services, reflecting the activities in a complete business cycle;
- ***traders*** who carry on substantial trade in goods or services between their home country and the country they wish to enter, as well as ***investors*** seeking to commit a substantial amount of capital in that country, provided that such persons are employed or operate in a supervisory or executive capacity or one that involves essential skills;
- ***intra-company transferees*** employed by a company in a managerial or executive capacity or one that involves specialized knowledge and who are transferred within that company to another NAFTA country; and
- certain categories of ***professionals***, set out in Appendix 1603.D.1, who meet minimum educational requirements or possess alternative credentials and who seek to engage in business activities at a professional level.

### **3. Limitation on Mexican Professionals**

Under Appendix 1603.D.4, the United States is authorized to limit the number of Mexican professionals entering the United States to 5,500 annually. This limit may be increased by agreement between the two countries and will expire 10 years after the NAFTA goes into effect unless the two countries decide to remove the limit earlier. Mexico will not be establishing a similar limit on the temporary entry of professionals from the United States. The provisions allowing for the numerical limit also permit the United States to impose in respect of Mexican professionals certain U.S. procedural requirements applicable generally to the admission of professionals into the United States, thus taking into account changes to U.S. immigration laws enacted in 1989 and 1990.

### **4. Other Provisions**

Chapter Sixteen has several other key provisions. Under Article 1603(1), each business person meeting the above criteria must also be qualified for entry under the country's general requirements relating to public health and safety and national security. Business persons entering under the chapter may be required to comply with existing visa requirements. Further, under Article 1603(2), admission may be refused if the temporary entry of the business person might affect adversely the settlement of a labor dispute or the employment of a person involved in such a dispute.

Pursuant to Article 1604, each NAFTA government will publish explanatory material on its requirements for temporary entry and collect appropriate data on the granting of temporary entry, including data specific to each occupation, profession or activity. The NAFTA countries will consult regularly through a specialized working group on temporary entry matters established under Article 1605.

Under Article 1606, a government may not invoke NAFTA's dispute settlement provisions with respect to a refusal to grant temporary entry unless it can show that the matter arises out of a pattern of repeated practices. Article 1607 makes clear that no provision of any other chapter of the Agreement -- other than certain of NAFTA's institutional and transparency provisions -- applies to immigration measures. Finally, Article 1608 defines key terms such as "business person" and "temporary entry."

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

In general, Chapter Sixteen is consistent with existing provisions of the Immigration and Nationality Act (INA). The four categories of persons eligible for admission under the NAFTA's expedited procedures correspond to existing INA nonimmigrant and related classifications. Key terms defined by current U.S. law and practice, such as "essential skills" (relating to traders and investors) and "specialized knowledge" (relating to intra-company transferees), will continue to apply.

In order to provide for the admission of business visitors and intra-company transferees, no changes in U.S. statutes are required. Limited technical changes are needed to provide for the admission of traders and investors and professionals. Legislation is also required to implement Article 1603(2) regarding labor disputes.

#### **a. Traders and Investors**

Under Annex 1603, Section B, Canadian and Mexican citizens are eligible for temporary entry as traders and investors. This category provides for admission under requirements identical to those governing admission under INA section 101(a)(15)(E) (8 U.S.C. 1101(a)(15)(E)), which permits entry to carry on substantial trade in goods or services and to develop and direct investment operations.

Section 101(a)(15)(E) conditions admission into the United States upon authorization pursuant to a treaty of commerce and navigation. Since the NAFTA is not a treaty of commerce and navigation, and no such treaty exists between the United States and Mexico, legislation is necessary to accord treaty trader and investor status to Mexican citizens qualifying for entry under Section B. Further, while eligible Canadian citizens are accorded treaty trader and investor status under the CFTA, legislative authorization is required to confer similar status on Canadians under the NAFTA.

Section 341(a) of the bill does not amend section 101(a)(15)(E). Instead, it uses a mechanism similar to that provided in section 307(a) of the CFTA Implementation Act, which in turn was based upon the Act of June 18, 1954 (68 Stat. 264, 8 U.S.C. 1184a). That act conferred treaty trader and investor status upon nationals of the Philippines on a basis of reciprocity secured by an agreement entered into by the President of the United States and the President of the Philippines.

#### **b. Professionals**

Section D of Annex 1603 requires the United States to provide for the temporary entry of Canadian and Mexican citizens to engage in business activities at a professional level in a profession set out in Appendix 1603.D.1. Section D establishes streamlined admission

procedures for new professions as well as generally recognized professions. When this category was first introduced, in the CFTA, it was based on provisions of U.S. law that preceded current INA sections 101(a)(15)(H)(i)(a) and (b) (8 U.S.C. 1101(a)(15)(H)(i)(a), (b)). Except for the transition arrangements relating to Mexico, described below, the NAFTA and CFTA provisions pertaining to the entry of professionals are nearly identical.

Section 341(b) of the bill authorizes the Attorney General, after consultation with the Secretaries of State and Labor, to promulgate regulations to implement Section D. Corresponding authorization was contained in the CFTA Implementation Act for Canadian professionals entering under that Agreement. The bill also provides for the entry of spouses and children accompanying or following to join business persons entering under this category. The bill also states that under Section D Canadian and Mexican citizens shall be treated as if seeking classification, or classifiable, as nonimmigrants under INA section 101(a)(15) (8 U.S.C. 1101(a)(15)). Finally, section 341(b) references additional requirements applicable to the entry of professionals from Mexico, and incorporates the definition of the term "citizen" contained in Annex 1608 for business persons from Mexico.

The purpose of the reference in the bill to spouses and children is to provide express authorization for current INS practice, which is to admit such persons, but not allow them to be employed in the United States unless they independently meet all applicable INA requirements. Similarly, the reference to INA section 101(a)(15) is to make it clear that, although this section of the bill creates a separate and distinct category of admission from those set out in section 101(a)(15), persons entering as NAFTA professionals:

- are considered to be seeking nonimmigrant status;
- are subject to general requirements relating to admission of nonimmigrants, including those pertaining to the issuance of entry documents and the presumption set out in INA section 214(b) (8 U.S.C. 1184(b)); and
- will be accorded nonimmigrant status on admission.

This treatment also codifies current practice.

It should be noted that while there are many similarities between this NAFTA category and the categories relating to professionals set out in INA section 101(a)(15), a determination of admissibility under the NAFTA neither forecloses nor establishes eligibility for entry under such other categories. Further, Section D of Annex 1603 does not authorize a professional to establish a business or practice in the United States in which the professional will be self-employed.

**c. Numerical Limitation on Mexican Professionals**

Paragraphs four and five of Section D, Annex 1603, relating to the entry of professionals listed in Appendix 1603.D.1, permit the United States to establish a numerical limit with respect to professionals from Mexico for a transition period of up to ten years and to impose during that period procedural requirements other than those ordinarily applicable to entry under paragraph one of Section D. These provisions of the Agreement were designed to provide access for Mexican citizens on a gradual basis, subject generally to certain requirements applicable to the admission of professionals under INA sections 101(a)(15)(H)(i)(a) and (b). Those sections establish similar INA nonimmigrant categories, and persons entering under the latter section are also subject to a numerical limit.

Accordingly, the bill authorizes the Attorney General to establish the numerical limit and provides for adjustments to or elimination of the limit only after the President has consulted with the appropriate advisory committees established under section 135 of the Trade Act of 1974 (19 U.S.C. 2155) and the House and Senate Judiciary Committees.

The bill also states that professionals from Mexico seeking admission under Section D are subject, in the manner and to the extent prescribed by the Secretary of Labor and the Attorney General, to the attestation requirement of INA section 212(m) (8 U.S.C. 1182(m)), in the case of a registered nurse, or the application requirement of INA section 212(n) (8 U.S.C. 1182(n)), in the case of all other professions set out in Appendix 1603.D.1, and the petition requirement of INA section 214(c) (8 U.S.C. 1184(c)).

**d. Labor Disputes**

Article 1603(2) establishes an important safeguard for the domestic labor force in each NAFTA country. It permits a country to refuse to issue an immigration document authorizing employment where the temporary entry of a business person might affect adversely the settlement of a labor dispute or the employment of a person involved in such dispute. Article 1603(2) thus allows the United States to deny temporary entry to a NAFTA-country executive, manager, high-level technical advisor or professional, whose activities in the United States require employment authorization, if admission might interfere with an ongoing labor dispute. If the United States invokes Article 1603(2), it must inform the business person in writing of the reasons for its action and notify the country whose business person is affected by the denial of entry.

Section 341(c) of the bill amends INA section 214 to provide authority to refuse nonimmigrant classification to a Mexican or Canadian business person if there is a strike or lockout affecting the relevant occupational classification at the place of employment in the United States, unless the person establishes, pursuant to regulations issued by the Attorney General, that the entry will not adversely affect the settlement of the strike or lockout or the employment of any person involved in the strike or lockout. The bill also authorizes the

provision of notice to the business person, and to Mexico or Canada, in the event that the person is denied entry under this section, in accordance with NAFTA Article 1603(3).

Section 341(c) of the bill applies only to requests for temporary entry under Sections B, C, and D of Annex 1603, the categories that require employment authorization under U.S. law. Employment in the U.S. labor market is not permitted under Section A of Annex 1603, which provides for temporary entry on a basis equivalent to that afforded under INA section 101(a)(15)(B) (8 U.S.C. 1101(a)(15)(B)); violations of status under Section A that involve labor disputes are fully redressable under existing law.

This section of the bill is similar to existing INA provisions that prohibit admission in certain circumstances where interference with a labor dispute may result. For example, under INA section 212(n)(1)(B) (8 U.S.C. 1182(n)(1)(B)), the U.S. employer sponsoring an alien for admission must certify that there is no strike or lockout in the occupational classification at the place of employment. Additionally, section 341(c) of the bill will supplement INA section 241(a)(1)(C) (8 U.S.C. 1251(a)(1)(C)) and related INA provisions that now authorize deportation of an alien admitted under a particular nonimmigrant category if the alien ceases to perform the type of work permitted under that category or misrepresented the nature of the work at the time of admission.

## **2. Administrative Action**

The Secretary of State and the Attorney General have principal responsibility for administration and enforcement of the INA, although the Department of Labor has significant responsibilities as well, relating primarily to employment of aliens in the United States. The legislative changes described above will permit the three agencies to implement Chapter Sixteen through appropriate administrative action. In most instances, no significant changes to existing regulations, practices or procedures will be required.

### **a. Business Visitors**

The Immigration and Naturalization Service (INS) and the Department of State will promulgate regulations, paralleling those now governing entry of business visitors under the CFTA, that will incorporate the provisions of Appendix 1603.A.1 and provide for admission under paragraph 1 of Section A of Annex 1603. The business activities set out in Appendix 1603.A.1, which is nearly identical to Schedule 1 of CFTA Annex 1502.1, are permissible business activities under current U.S. law and practice under INA section 101(a)(15)(B) (8 U.S.C. 1101(a)(15)(B)). Entry pursuant to paragraph three of Section A, which covers business activities not listed in Appendix 1603.A.1 but otherwise presently authorized under section 101(a)(15)(B), will require no regulatory changes for implementation.

The labor market test set out in paragraph 1(c) of Section A and further described in paragraph 2, which relates to entry under Appendix 1603.A.1 and is used for ensuring that the proposed business activity is indeed permissible under the NAFTA, is based upon existing INS

requirements for admission under section 101(a)(15)(B). *See, e.g., Matter of Hira*, 11 I.& N. Dec. 824 (1966). Similarly, the after-sales service provision in Appendix 1603.A.1 is consistent with the joint agreement of the parties in *Bricklayers and Allied Craftsmen v. Meese*, 616 F. Supp. 1387 (N.D. Cal. 1985); see 51 *Fed. Reg.* 44266 (1986), 52 *Fed. Reg.* 30329 (1987).

**b. Traders and Investors**

Section B of Annex 1603 requires no changes to existing law and practice under INA section 101(a)(15)(E) (8 U.S.C. 1101(a)(15)(E)), other than to authorize citizens of Canada and Mexico to apply for treaty trader and treaty investor status pursuant to the NAFTA. The only administrative action required for its implementation is to include Canada and Mexico on the list of countries, maintained by the Department of State, whose citizens are eligible for such status under section 101(a)(15)(E).

**c. Intra-Company Transferees**

Section C of Annex 1603 requires no changes to existing law and practice under INA section 101(a)(15)(L) (8 U.S.C. 1101(a)(15)(L)), and no administrative action is required for its implementation.

**d. Professionals**

The INS and the Department of State will promulgate regulations, similar to those now applicable to entry of professionals under the CFTA, incorporating the provisions of Appendix 1603.D.1. and providing for admission under Section D of Annex 1603. The list of professionals set out in Appendix 1603.D.1 tracks the list currently in effect under the CFTA. As is the case under corresponding provisions in the CFTA, a NAFTA professional will be required to have a baccalaureate degree or appropriate alternative credentials demonstrating status as a professional for admission under Section D.

A NAFTA professional must also comply with any applicable state licensing requirements. It is important to note that the minimum education requirements and alternative credentials set out in Appendix 1603.D.1 are *not* substitutes for a professional license to practice in the United States. Rather, they are to be used during the admission process, for purposes of identification and verification of status, as assurance that the NAFTA business person is indeed a professional, based on the agreed criteria. For some categories, a professional license may serve as the test for entry. In all cases, however, where a state license is required to engage in a particular activity in the United States, the appropriate state license must be obtained.

Any changes to Appendix 1603.D.1 developed through the working group process under Article 1605 will be implemented through established rulemaking procedures, after full opportunity for public review and comment. In addition, the Judiciary Committee of both the House and Senate will separately be notified of any proposed rulemaking. Moreover,

those committees will regularly be apprised of the activities of the Temporary Entry Working Group through the consultation process described below.

In order to implement the procedural requirements applicable to Mexican professionals during the transition period, the Secretary of Labor will promulgate regulations specifying the manner in which the provisions of INA sections 212(m) and (n) (8 U.S.C. 1182(m), (n)) apply to temporary entry under the NAFTA. In general, U.S. employers will be required to file an attestation, in the case of registered nurses, and a labor condition application, in the case of all other professions set out in Appendix 1603.D.1, supplying the information mandated under INA sections 212(m) and (n), respectively. Such professionals, however, will establish initial eligibility for entry under the NAFTA and not under INA section 101(a)(15)(H)(i)(a) or (b) (8 U.S.C. 1101(a)(15)(H)(i)(a), (b)).

Similarly, the INS will promulgate regulations specifying the applicability of INA section 214(c) (8 U.S.C. 1184(c)), which governs employer petitions, during the transition period. INS regulations will also establish the annual numerical limit.

#### **e. Labor Disputes**

As noted above, section 341(c) of the bill provides broad authority to refuse nonimmigrant classification to a business person whose entry might affect a labor dispute. In order to ensure effective enforcement, the INS and the Department of State will elicit information during the admission process regarding the existence of a labor dispute at the intended place of employment. The INS and the Department of Labor will also extend existing strike certification procedures to cover entry under the NAFTA. These procedures are used to compile information pertaining to labor disputes and apply, for example, in regard to entry under INA section 101(a)(15)(H) (8 U.S.C. 1101(a)(15)(H)). *See* 8 C.F.R. 214.2(h)(17). Finally, the INS will promulgate regulations setting out the requirements for establishing that a business person's entry will not affect a strike or lockout, as expressly provided for in the bill.

A business person who is refused employment authorization under the labor disputes provision of Chapter Sixteen will be informed in writing of the reason for the action. The United States will also notify Canada or Mexico, as appropriate.

#### **f. Explanatory Materials**

NAFTA Article 1604(1)(b) requires each government to publish explanatory material in a consolidated document regarding its requirements for temporary entry under Chapter Sixteen. Relevant U.S. Executive Branch agencies will participate in the preparation and distribution of this document.

Paragraph two of that article requires each government to collect data respecting the granting of temporary entry under Chapter Sixteen. The availability of reliable information about cross-border business travel is essential to the operation of Chapter Sixteen, not only for

evaluating the effectiveness of its current provisions and responding to any unanticipated problems but also for predicting the impact of any future modifications. Consequently, the INS, the Department of State and the Department of Labor will ensure that appropriate data are collected and made available in accordance with customary procedures. Such data will include information specific to each NAFTA occupation, profession or activity.

**g. Temporary Entry Working Group**

Article 1605 establishes a Temporary Entry Working Group, which will meet at least once each year to consider matters relating to implementation and administration of the chapter and proposed modifications of or additions to the chapter, including those relating to further facilitation of temporary entry on a reciprocal basis and the employment of spouses of certain business persons.

The U. S. members of the Working Group will consult regularly with, and seek the advice of, the appropriate advisory committees established under section 135 of the Trade Act of 1974 and the Judiciary Committees, regarding the issues considered by the Working Group.

## CHAPTER SEVENTEEN: INTELLECTUAL PROPERTY

### A. SUMMARY OF PROVISIONS

Chapter Seventeen establishes comprehensive standards for the protection of intellectual property and the enforcement of intellectual property rights in the three NAFTA countries. It requires each government to apply the substantive provisions of the world's most important intellectual property conventions, supplements those conventions with substantial additional protections, and ensures that critical enforcement procedures will be available in each country to safeguard intellectual property rights. The Agreement requires few changes in U.S. law and regulations and does not affect U.S. law or practice relating to parallel importation of products protected by intellectual property rights.

#### 1. Adherence to Multilateral Conventions

Article 1701 requires each government to give effect to the substantive obligations of several key international agreements providing for the protection of intellectual property. These are the Paris, Berne and Geneva conventions as well as the convention on the protection of plant breeder's rights. The United States is currently a party to each of these conventions. The NAFTA Agreement, however, confers no rights and imposes no obligations on the United States with respect to Article 6<sup>bis</sup> of the Berne Convention or the rights derived from that article. Thus, the U.S. implementation of this provision of the Convention is not subject to dispute settlement under the NAFTA.

#### 2. National Treatment

Article 1703 imposes a broad national treatment obligation on the three governments in respect of intellectual property. It requires each country, subject to limited exceptions, to give "nationals" from other NAFTA countries treatment that is "no less favorable" than that it gives to its own nationals with regard to the protection and enforcement of intellectual property rights. In addition, Article 1703 precludes a NAFTA government from conditioning national treatment with respect to the acquisition of rights in copyright or "neighboring rights" on compliance with formalities or conditions, such as first fixation in that country.

#### 3. Protection for Literary and Artistic Works

Article 1705, governing copyright protection, confirms that all types of computer programs are "literary works" under the Berne Convention, and requires each government to protect them as such. It also requires copyright protection for compilations of data or other material that by reason of the selection or arrangement of the material are original.

Article 1705 also provides that copyright holders must be accorded exclusive rights to authorize or prohibit certain acts in respect of their works, such as importation, communication

to the public, and first public distribution. It also requires each government to permit the transfer of rights in literary or artistic works by contract and provides that persons acquiring or holding such rights by virtue of a contract must be able to exercise those rights in their own names and enjoy their benefits.

In addition, Article 1705 requires a minimum term of protection for copyrighted works, including sound recordings, and sharply circumscribes the imposition of limitations on, or exceptions to, the rights provided for in the article. Finally, under Annex 1705.7, the United States is required to restore copyright protection for those motion pictures produced in Mexico and Canada that lost such protection due to failure to comply with notice requirements in U.S. law during a period prior to U.S. accession to the Berne Convention.

Article 1706 requires NAFTA countries to provide sound recording producers the right to authorize or prohibit the direct or indirect reproduction, importation, commercial rental and first public distribution of their sound recordings.

Article 1707 provides important protection for copyrighted television programming transmitted *via* encrypted satellite signals. It requires each government to make it a crime for persons to manufacture, sell or distribute equipment designed for unauthorized decoding of such signals. It also requires governments to provide civil penalties for the distribution of satellite signals that have been decoded without authorization.

#### **4. Trademark Protection**

Article 1706 sets out certain basic rights that the three governments must grant to the holders of a "trademark," as defined in the article. Among these rights is a requirement that there be a presumption that using signs similar or identical to a trademark will result in a likelihood of confusion, and thus that such use may be prevented.

Article 1706 also requires each country to establish a system for registering trademarks. In addition, each government must apply the provisions of Article 6<sup>bis</sup> of the Paris Convention, concerning the protection of well-known trademarks, to service marks. The article also clarifies the standard for determining whether a trademark is "well-known." This article safeguards the role of a trademark as an indication of the source of the product or service by prohibiting imposition of special requirements, such as use with another trademark, that could impair that function.

Paragraphs two and three of Article 1712 require NAFTA governments to refuse to register marks that are deceptively misdescriptive in respect of geographic origin regardless of whether the mark has acquired distinctiveness.

## **5. Patent Protection**

Article 1709 improves considerably on the level of patent protection required under existing international agreements. Under the NAFTA, each government must make patents available for inventions in all fields of technology, provided that the inventions are new, useful and "non-obvious." Article 1709 allows NAFTA countries to exclude certain limited subject matter from patentability, including some plants and animals that are patentable under U.S. law.

Article 1709 also requires any NAFTA country that did not offer product patent protection for pharmaceutical or agricultural chemical products before the dates specified in the Agreement to provide such protection, upon request, to any such product if it has been patented by another NAFTA government and is being marketed in the country for the first time. The protection must be granted for the unexpired term of any patent granted by the other NAFTA government.

Article 1709 also imposes strict conditions on the granting of compulsory licenses and provides that the importation of a patented product will satisfy any requirement to "work" a patent in that country. In addition, the article requires NAFTA governments to place the burden of proof on the defendant, under certain conditions, in process patent infringement actions. Finally, the NAFTA does not establish, directly or indirectly, any right to engage in parallel importation of patented products among the territories of NAFTA countries.

## **6. Protection for Integrated Circuit Layout Designs**

Article 1710 requires NAFTA countries to provide protection for layout designs of semiconductor integrated circuits at a level consistent with current U.S. law. The article includes protection for products incorporating a protected layout design, requires "innocent infringers" to pay a royalty on stock on hand or on order when they have notice that they are dealing with infringing designs, prohibits compulsory licensing of layout designs and provides for a minimum 10 year term of protection.

## **7. Protection for Trade Secrets**

The NAFTA is the first international agreement to include detailed provisions requiring the protection of trade secrets. Article 1711 defines what must be protected as a trade secret, describes the rights that must be provided and, in defining an "act contrary to honest commercial practices," provides an illustrative list of prohibited acts.

Article 1711 also requires NAFTA countries to protect information that they require companies to submit for purposes of obtaining marketing approval of new pharmaceutical or agricultural chemical products. In most cases, NAFTA governments must prohibit other persons from using such information for five years after its submission, unless the person that developed the information consents to its use.

## **8. Geographical Indications**

Article 1712 requires each government to ensure that interested persons can prevent the use of product descriptions or designations that mislead the public regarding the geographic origin of a good or that constitute "an act of unfair competition" under the Paris Convention. In addition, each government must either refuse to register or invalidate the registration of a trademark containing a geographic indication that falsely represents to the public the geographic origin of the product.

Use of generic terms that include a geographic indication may continue under the NAFTA. In addition, governments are precluded from adopting measures that adversely affect a person's right to use its name in connection with its business or that of its predecessor, unless the name is part of a trademark and there is a likelihood of confusion with that mark or use of the name would mislead the public.

## **9. Industrial Designs**

Chapter Seventeen requires each government to provide protection for independently created industrial designs that are new or original and that meet the other conditions specified in Article 1713. The owner of a protected design must have the right to prevent others from making or selling articles for a commercial purpose that copy or substantially copy the protected design. In addition, each government must provide a term of protection of at least ten years. Protection currently available under U.S. patent and copyright law meets the requirements of this article.

## **10. Enforcement Procedures**

Chapter Seventeen also establishes extensive requirements to ensure that intellectual property rights will be effectively enforced both at and inside each country's borders. Articles 1714 and 1715 require each government to provide fair and transparent enforcement procedures, including access by intellectual property rights holders to effective judicial proceedings for the enforcement of intellectual property rights. If a government provides for administrative enforcement proceedings, Article 1715 requires that they conform in substance to the rules set out in the article for judicial procedures.

Article 1716 requires each government to provide for preliminary and final injunctive relief, measures to preserve evidence, civil damages and other remedies in intellectual property enforcement proceedings. The article also includes safeguards to protect litigants from abuse of litigation procedures. Under Article 1717, NAFTA governments must provide criminal sanctions to address willful copyright piracy and trademark counterfeiting on a commercial scale.

Article 1718 ensures that NAFTA governments will put in place effective procedures allowing trademark and copyright owners to obtain seizures of pirated and counterfeit goods at

the border, subject to certain safeguards. For example, to protect legitimate imports, Article 1718 provides that actions concerning whether goods detained at the border are infringing must be initiated within ten working days in most cases.

The article permits NAFTA governments to establish border enforcement procedures for rights other than trademark and copyright, subject to certain additional safeguards. For example, if a government implements the border enforcement provisions of the NAFTA with respect to patents, integrated circuits, trade secrets or industrial designs, any allegedly infringing products being detained by its customs authorities must be released upon payment of a bond after a specified period of time. The article also permits customs officials to take action on their own initiative to prevent the importation of infringing goods.

#### **11. Cooperation and Technical Assistance**

Article 1719 provides for the sharing of technical assistance between the NAFTA governments on mutually agreed terms. This assistance will include training and other efforts to promote cooperation between the relevant authorities. The article requires the establishment of contact points within each country's federal government and the exchange of information on trade in infringing goods.

#### **12. Protection of Existing Subject Matter**

Article 1720 clarifies the application of the NAFTA to acts and rights arising before the effective date of this Agreement for the United States. In general, the Agreement does not apply to acts that occurred before the date of application of its provisions for a particular country. This general provision is subject to the qualifications in the remainder of the article. For example, in respect of sound recordings and other copyrighted works, the provisions of Article 18 of the Berne Convention governs works that have not fallen into the public domain in their country of origin. The obligation under the NAFTA to provide a rental right in regard to Article 1718 provides that actions concerning whether goods detained at the border are infringing must be initiated within ten working days.

### **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

Although Chapter Seventeen requires high levels of protection for, and enforcement of, intellectual property rights, the United States will have to make changes in statute or regulation in only five limited areas:

- the treatment of inventive activity occurring in other NAFTA countries for purposes of establishing the date of invention under the patent law;
- rental rights in computer programs and sound recordings;
- the registrability of misleading geographic indications under the trademark law;

- copyright protection for certain motion pictures now in the public domain in the United States; and
- compulsory licensing and government use of patents.

Other areas of U.S. intellectual property law are unaffected by Chapter Seventeen. For example, it does not require any change in current U.S. law or practice with respect to parallel importation of goods that are the subject of intellectual property rights. Nor does the chapter affect current U.S. law or regulations relating to use of "semigeneric" geographical indications for wines.

Furthermore, despite somewhat different approaches, Chapter Seventeen and current U.S. patent law are consistent in respect of the protection of industrial designs. For example, in order for industrial designs to be protectable, Article 1713 requires that they be independently created, new or original. Article 1713 declares that a design is not "new or original" if it does not significantly differ from known designs or combinations of known design features. This standard for "new or original" is consistent with the requirement under U.S. law that a design be "non-obvious." Similarly, the exclusion in Article 1703 for the protection of industrial designs that are dictated essentially by technical or functional considerations is consistent with the "ornamentality" requirement in U.S. law.

## **1. Implementing Bill**

### **a. Treatment of Inventive Activity**

Section 331 of the implementing bill amends 35 U.S.C. 104 to make it consistent with the requirements of Article 1709(7), which requires patents to be available without discrimination as to the territory where the invention was made. Under current section 104, evidence of inventive activity outside the United States cannot be introduced in U.S. judicial or administrative proceedings for purposes of establishing the date of invention. Section 331 amends section 104 to provide that evidence of inventive activity in Mexico or Canada may be introduced for such purpose.

The implementing bill guards against the possibility that U.S. firms may be unable to probe and challenge adequately such evidence because they cannot obtain other information from Mexico or Canada relevant to the date of invention. The implementing bill includes a provision that enables a party in such a proceeding to demonstrate that relevant information exists in Mexico or Canada and has been requested, that the information has not been made available under the laws and procedures of such country, and that the information would be "discoverable" in the United States. If the party can make this showing, the decision maker must draw appropriate inferences or take any other permissible action in favor of the party that requested the information in the proceeding. In deciding what inferences are appropriate, the decision maker should take into account all relevant facts, including the importance of the

information that has not been made available, whether the information is within the control of the party seeking to establish a date of invention prior to the filing date, and any other pertinent factor.

Consistent with the Chapter's national treatment provisions, the amendment extends the special provisions for those serving in the U.S. armed services to those serving in the armed services of other NAFTA countries.

**b. Rental Rights in Computer Programs and Sound Recordings**

Articles 1705(2) and 1706(1) require NAFTA governments to provide rental rights to authors of computer programs and producers of sound recordings, respectively. Current U.S. law provides rental rights for such works. Section 332 of the bill eliminates a "sunset" provision now contained in the Record Rental Amendment of 1984 so that producers of sound recordings will have rental rights on a permanent basis.

**c. Nonregistrability of Misleading Geographic Indications**

Under the current version of the Trademark Act of 1946, a mark is not registrable on the principal register if it is "primarily geographically descriptive" or "deceptively misdescriptive" -- unless the mark has become distinctive of the applicant's goods. Marks that are considered "primarily geographically descriptive" or "deceptively misdescriptive" are registrable on the supplemental register. Registration on the supplemental register may, in time, facilitate a showing of "distinctiveness" and, thus, qualify for registrability on the principal register.

Paragraphs two and three of Article 1712 require NAFTA governments to refuse to register marks that are deceptively misdescriptive in respect of geographic origin regardless of whether the mark has acquired distinctiveness. By contrast, the article does not prohibit the registration of primarily geographically descriptive marks.

In light of this difference in treatment, section 333 of the bill creates a distinction in subsection 2(e) of the Trademark Act between geographically "descriptive" and "misdescriptive" marks and amends subsections 2(f) and 23(a) of the Act to preclude registration of "primarily geographically deceptively misdescriptive" marks on the principal and supplemental registers, respectively. The law as it relates to "primarily geographically descriptive" marks would remain unchanged.

**d. Motion Pictures in the Public Domain**

Annex 1705.7 requires the United States, subject to Constitutional and budgetary considerations, to restore copyright protection to certain motion pictures. These are films that fell into the public domain in the United States between January 1, 1978, and March 1, 1989,

because of the failure of the motion picture to display a copyright notice as required under Title 17 of the United States Code as it existed prior to U.S. accession to the Berne Convention.

The obligation applies to all motion pictures produced in Mexico and Canada during that period and is not limited to motion pictures produced by nationals or residents of those countries. However, the commitment extends only to motion pictures -- not to all audiovisual works.

Section 334 of the bill reestablishes copyright protection for such films by adding proposed section 104A to Title 17 of the U.S. Code. The new section covers only motion pictures produced between January 1, 1978, and March 1, 1989, the period during which section 405 provided a limited exception to the required use of the copyright notice to maintain protection.

Because certain related works typically are first published -- and protected under copyright -- along with the motion picture to which they pertain, Annex 1705.7 arguably requires that protection for related works be restored along with the motion pictures covered by the Annex. Accordingly, proposed subsection 104(A) provides copyright protection for such works if they fell into the public domain along with the relevant motion pictures. These works include the original music or dramatic text embodied in the sound track as well as the literary work on which the picture was based.

The proposed implementing language takes into account U.S. Constitutional and budgetary considerations by providing notice to persons who are currently using the works covered by proposed subsection 104A(a) and by giving them a reasonable period in which to use or dispose of their stock. To this end, proposed subsection 104A(b) provides that copyright owners of qualifying works and films must file a statement with the Copyright Office within one year of the effective date of the NAFTA providing notice that their works will no longer be in the U.S. public domain. Shortly following that period, the Copyright Office will announce in the *Federal Register* that those works will be protected pursuant to proposed subsection 104A(a).

In addition, proposed subsection 104A(c) provides that persons who are copying, performing or selling copies of such works may continue such activities for a period of one year following publication of the *Federal Register* notice. This "exhaustion of stock" provision applies only to copies produced or acquired before the effective date of the NAFTA.

## **2. Regulatory Changes**

Paragraph ten of Article 1709 limits the extent to which NAFTA governments may grant "compulsory licenses," that is, permit use of a patented product or other subject matter without the patent owner's permission. The paragraph sets out a number of conditions that a government must meet in granting such a license. U.S. law currently provides for the issuance of compulsory licenses under three statutes -- the Atomic Energy Act, the Clean Air Act, and the Energy Policy Act, which amended the Atomic Energy Act. Because of the nuclear material and other technologies regulated under the Atomic Energy Act and Energy Policy Act, the policy underlying these compulsory licenses has a national security element. Moreover, the statutory standards for grant of a compulsory license under the Clean Air Act indicate a clear concern with addressing anticompetitive behavior. As a practical matter, no compulsory licenses have been issued under any of these provisions, and implementing regulations have not been issued for the Clean Air Act compulsory licensing provisions.

While the Atomic Energy Act and Energy Policy Act, and their implementing regulations, meet most of the conditions imposed by Article 1709 on the grant of compulsory licenses, the Department of Energy and the Environmental Protection Agency will need to amend existing or adopt additional regulations to ensure that each of those conditions is met. The Department of Energy will modify regulations set out at 10 CFR Part 780. The Environmental Protection Agency will issue conforming regulations as part of its regulations implementing section 308 of the Clean Air Act.

In addition, Article 1709(10) requires each government to provide notice to patent owners when it knows or has demonstrable grounds to know, without making a patent search, that it will be using a valid patent without the owner's specific authorization. The President will issue an Executive Order ensuring that all U.S. government agencies that may invoke "government use" provisions provide such notice.

## **CHAPTER EIGHTEEN: PUBLICATION, NOTIFICATION AND ADMINISTRATION OF LAWS**

### **A. SUMMARY OF NAFTA PROVISIONS**

Chapter Eighteen sets out a number of requirements designed to foster openness, transparency and fairness in the adoption and application of the administrative measures covered by the Agreement. It should be noted that various other chapters of the NAFTA, such as Chapters Seven through Ten, Twelve, Thirteen and Nineteen, provide specific, detailed rules in this area.

Article 1801 requires each NAFTA country to designate a "contact point" to facilitate communications between the three governments on subjects covered by the Agreement. Article 1802 tracks closely Article 2102 of the CFTA. It provides that each government must promptly publish all laws, regulations, procedures and administrative rulings concerning subjects covered by the NAFTA, or otherwise make them available to interested persons and other NAFTA governments. Each NAFTA country must, where possible, also publish such measures in advance and provide interested persons a reasonable opportunity to comment on them.

Article 1803 provides that NAFTA governments should notify each other of measures that they believe might affect the operation of the Agreement or each other's interests. Furthermore, a NAFTA government must provide information upon request from another government concerning any action that it has taken or intends to take.

Article 1804 requires each government to accord basic procedural guarantees to firms and individuals from other NAFTA countries in specific types of administrative proceedings that affect matters covered by the Agreement. These guarantees include reasonable notice of proceedings and the opportunity to present arguments.

In addition to those basic guarantees, Chapter Eighteen provides for review and appeal of final administrative actions. Article 1805, similar to GATT Article X.3(b), requires each government to establish or maintain independent administrative or judicial review procedures. These appeal rights must include a reasonable opportunity to present arguments and to obtain a decision based on evidence in the administrative record.

### **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

No legislative or administrative changes will be required to implement Chapter Eighteen.

## **CHAPTER NINETEEN: DISPUTE SETTLEMENT IN ANTIDUMPING AND COUNTERVAILING DUTY CASES**

### **A. SUMMARY OF NAFTA PROVISIONS**

Chapter Nineteen largely duplicates, on a trilateral basis, procedures currently in effect between the United States and Canada under the CFTA for binational panel review of final antidumping ("AD") and countervailing duty ("CVD") determinations and for notification and review of trade law amendments. Except for certain innovations introduced in the NAFTA that are described below, the Statement of Administrative Action accompanying the CFTA Implementing Act, H.Doc. 100-216, 100th Cong., 2d Sess. 258-89 (1988), fully describes the panel system that will be established under the NAFTA. This Statement concentrates on the new elements of the system introduced by the NAFTA and certain elements of the system common to both the CFTA and the NAFTA that warrant emphasis.

#### **1. NAFTA Innovations**

Chapter Nineteen incorporates several innovations, including a preference for judges as panelists, and a new "safeguard" mechanism at Article 1905 to ensure the effective functioning of the panel system. Other new elements include improvements in the standards for extraordinary challenges and requirements that all three countries incorporate predictability, transparency and fairness into both their administrative and judicial processes. The United States and Canada will not need to alter their systems in response to the "due process" requirements in Chapter Nineteen because their existing procedures meet those requirements. By contrast, Mexico will need to make significant changes in its law, regulations and practice -- a process that began with the enactment of a new Mexican trade law in July 1993.

#### **2. Amendments of Domestic Trade Laws**

Articles 1901 and 1902 make clear that each country retains its domestic antidumping and countervailing duty laws and can amend them. Article 1903 provides that a NAFTA country can request a binational panel to review whether an amendment to another NAFTA country's antidumping or countervailing duty statutes is consistent with Chapter Nineteen. These provisions are identical to Articles 1901 through 1903 of the CFTA, except for technical changes necessary to accommodate the addition of a third country.

#### **3. Binational Panel Review**

The centerpiece of Chapter Nineteen of the NAFTA, like Chapter Nineteen of the CFTA, is the procedure described in Article 1904 whereby independent binational panels, composed of judges and experts from the two NAFTA countries involved, will review final AD and CVD determinations made by the relevant administering authorities in one country with respect to products from one of the other two countries. Nothing in Article 1904 or any other provision of

Chapter Nineteen restricts in any way the right of a domestic industry to seek redress from unfair trading practices through national AD and CVD laws.

Article 1904 contains a few significant procedural changes from the comparable CFTA provision. Notably, the panels will continue to be binational in composition. One important improvement is the NAFTA's preference for appointing judges and former judges as panelists. Annex 1901.2 of the NAFTA provides that the roster for binational panels "shall include judges and former judges to the fullest extent practicable."

There are several advantages to having judges and former judges serve as panelists. For example, the participation of panelists with judicial experience would help to ensure that, in accordance with the requirement of Article 1904, panels review determinations of the administering authorities precisely as would a court of the importing country by applying exclusively that country's AD and CVD law and its standard of review. In addition, the involvement of judges in the process would diminish the possibility that panels and courts will develop distinct bodies of U.S. law.

For these reasons, the United States hopes not only to include judges and former judges on the roster to the fullest extent practicable as required by Annex 1901.2, but also to appoint judges and former judges to individual panels and committees whenever they are willing and available to serve. The Administration will encourage Canada and Mexico to move in this same direction.

#### **4. Standard of Review**

One other significant change to Article 1904 in the NAFTA as compared to the predecessor CFTA provision is the extraordinary challenge committee ("ECC") provision at paragraph thirteen clarifying and emphasizing that failure by a binational panel to apply the appropriate standard of review would qualify as a ground for ECC review under Article 1904(13)(a)(iii). In negotiating the NAFTA, the parties decided to make explicit in Article 1904.13(a)(iii) of the NAFTA what was clearly implied in Article 1904.13(a)(iii) of the CFTA, namely that a binational panel that failed to apply the appropriate standard of review would per se be considered to have manifestly exceeded its powers, authority or jurisdiction. This amendment affirms the central importance to the functioning of the binational panel system of strict adherence by panels to the proper application of the judicial standard of review of the importing country.

Strict adherence by binational panels to the requirement in Article 1904(3) that panels apply the judicial standard of review of the importing country is the cornerstone of the binational panel process. Scholars have noted the potential within the system for disuniformity of panel decisions with each other and established U.S. law. *See* A.F. Lowenfeld, *Binational Panel Dispute Settlement Under Chapters 18 and 19 of the Canada-United States Free Trade Agreement: An Interim Appraisal* 81 (December 1990). In order to ensure that such

disuniformity does not develop through panel decisions under the NAFTA, binational panels must take care to apply properly the importing country's law and standard of judicial review.

In light of the central importance of this requirement, any failure by a binational panel to apply the appropriate standard of review, if such failure materially affected the outcome of the panel process and threatened the integrity of the binational panel review process, would be grounds for an ECC to vacate or remand a panel decision.

The decisions of a few binational panels convened under the CFTA have underscored the importance of the NAFTA's emphasis on the proper application of the judicial standard of review. In specific, these decisions have raised the question of whether these panels have correctly applied the standard of review. Where, in the Administration's view, panel decisions have failed to apply the appropriate standard of review or they have otherwise manifestly exceeded their powers, authority or jurisdiction, there could be recourse to the extraordinary challenge procedure under Article 1904(13).

The Administration believes that a panel could manifestly exceed its powers where it failed to apply U.S. law in accordance with Article 1904. In two recent decisions, a panel was called upon to address a determination by the Department of Commerce that a subsidy is provided to a specific industry or group of industries, 19 U.S.C. 1677(5). The Administration argued before these panels that U.S. law, including the decisions of U.S. courts, provides that the Department of Commerce may find that a subsidy is specific based on one or more relevant factors, rather than be required to weigh and consider all possible factors.

One case also involved a question of whether the Department of Commerce must measure the price and output effects of a subsidy before countervailing that subsidy. In this regard, the Administration argued that U.S. law, including the decisions of U.S. courts, provides that once the Department of Commerce has found that a subsidy has been provided, it does not have to show that the subsidy affected the price or output of the product.

In these circumstances, the United States could seek recourse to the extraordinary challenge procedure. If that procedure were not successful in correcting the misapplication of law, Article 1902 describes notification and consultation requirements attendant to each NAFTA party's rights to change or modify its law. The Administration would carefully adhere to these procedures in supporting legislation to correct the problem.

## **5. Extraordinary Challenge Committees**

Two important changes from CFTA procedures for ECCs are found in Annex 1904.13 of the NAFTA. Under the NAFTA, ECCs, if convened, must examine the legal and factual analysis underlying the findings and conclusions of the panel's decision. Annex 1904.13 of the NAFTA also triples the length of time available to the ECC to undertake its review. The United States sought the changes in Annex 1904.13 based on its experience under the CFTA. By expanding the period of review and requiring ECCs to look at the panel's underlying legal and

factual analysis, the changes to Annex 1904 clarify that an ECC's responsibilities do not end with simply ensuring that the panel articulated the correct standard of review. Rather, ECCs are to examine whether the panel analyzed the substantive law and underlying facts.

Like the predecessor CFTA provision, the NAFTA ECC provisions do not permit private parties to invoke the extraordinary challenge procedure -- only the NAFTA countries may do so. However, the Office of the United States Trade Representative ("USTR") encourages private parties to notify USTR when a binational panel has taken action that the private parties believe may warrant ECC review. In connection with such notification, private parties are urged to provide USTR with information and arguments relating to the grounds for invoking an extraordinary challenge procedure set forth in Article 1904.13.

Article 1904(13) requires that allegations related to an extraordinary challenge shall be made "within a reasonable time" after the panel decision is issued. Article 1904(14) provides that the NAFTA countries will adopt rules of procedure. Given that these rules are expected to specify a relatively short time period for invoking the extraordinary challenge procedure, private parties should provide any relevant information to USTR as soon as possible after a panel decision is issued.

The United States will base its decision whether to request an extraordinary challenge committee on the factors set forth in Article 1904(13). USTR will inform the private parties concerned of the basis for its decision.

## **6. Changes to Mexican Law**

Paragraph fifteen of Article 1904, like its CFTA counterpart, requires each NAFTA country to make certain changes to its AD and CVD law and regulations. For Mexico, these changes require a major revision of that country's law and regulations to introduce a degree of openness and predictability that Mexico's AD and CVD procedures and judicial review have not previously offered. U.S. exporters that are subject to AD or CVD proceedings in Mexico will be the primary beneficiaries of these changes.

In Annex 1904.15 Mexico committed to changing its AD and CVD laws in 21 specific ways. These include fundamental steps to ensure due process, such as: written notice to interested parties of the initiation of an investigation; full participation for such parties in the administrative process, as well as the right to administrative appeal and judicial review; written notice of any decisions rendered by the investigating authority; and a detailed statement of the basis for any final decisions made.

Mexico's new "Foreign Trade Law," enacted in July 1993 implements certain of the changes required under Annex 1904.15. The new law represents a substantial step toward meeting Mexico's requirements under the Annex as well as toward bringing transparency and procedural fairness to such proceedings. The Administration intends to monitor Mexico's implementation of these provisions carefully, and will report on this subject to the Congress

before the entry into force of the Agreement. Under section 101(b) of the implementing bill, Mexico's compliance with these undertakings is an essential step before the President will put the NAFTA into force for the United States with respect to Mexico.

## **7. Safeguard Mechanism**

Article 1905 of the NAFTA establishes an entirely new feature to safeguard the panel review system. The safeguard is available to a NAFTA country alleging that another NAFTA country, through the application of its domestic law, has frustrated effective implementation of the binational panel process. This could occur, for example, if the application of a NAFTA country's domestic law prevented a panel from forming, prevented a panel from rendering a final decision, interfered with the implementation of, or denied binding effect to, a panel decision, or did not provide opportunity for effective and meaningful review of a final determination by a panel or a national court.

The first step under the safeguard mechanism is for the NAFTA countries to consult on the matter. If the two governments involved cannot resolve the matter through consultations, the complaining NAFTA country has recourse to a special committee, established in the same manner as an ECC, to consider the allegation. An affirmative finding by a special committee prompts further consultations. Such a finding also allows for the stay of binational panel or ECC review, with certain conditions, and tolls the time for requesting a binational panel or ECC.

If the consultations do not produce a resolution, the complaining country may suspend the operation of the binational panel review system under Article 1904 or, as appropriate, suspend other benefits under the NAFTA. The other NAFTA country may reciprocally suspend the operation of Article 1904 and also may reconvene the special committee to decide whether any suspension of other benefits was excessive or the problem complained of has been corrected.

Suspension of the operation of Article 1904 has two important effects. Any binational panel or ECC proceeding stayed when the special committee reaches its affirmative finding is terminated. The proceeding then may be transferred to the court that otherwise would have had jurisdiction over the challenge to the final determination.

The safeguard system offers a number of advantages over the CFTA regime. Under the CFTA, the only recourse available to a NAFTA country concerned with the other country's effective implementation of Chapter Nineteen is abrogation of the entire CFTA. Article 1905 of the NAFTA permits the government concerned to suspend the operation of Article 1904 with respect to the government that has failed to meet its Chapter Nineteen obligations. Article 1905 thus provides an effective and balanced method for ensuring that Chapter Nineteen continues to operate as the NAFTA countries intend, without jeopardizing the entire NAFTA.

## **8. Antidumping and Countervailing Duty Laws**

Under Article 1907, the three countries will meet annually, or at the request of any government, to consider problems in implementing Chapter Nineteen. In addition to discussing subsidies and devising new approaches to unfair trade, the United States, Canada and Mexico will focus on how to improve the administration of their respective AD and CVD laws in the interests of transparency and due process. Article 1907 lists the elements that the NAFTA countries consider essential to an AD/CVD process that accords transparency and due process to interested parties. The listing in Article 1907 will provide a basis for future consultations to ensure that each NAFTA country establishes and maintains such a system. Each of the listed elements is reflected in current U.S. practice.

## **9. Secretariat**

Article 1908 includes a provision for a section within the Secretariat to handle panel or committee reviews under Chapter Nineteen. The Secretariat will continue to function as it has under the CFTA, making any administrative adjustments necessary to accommodate a third country. This provision is intended to ensure that the Secretariat devotes appropriate and sufficient resources to Chapter Nineteen cases, rather than to dictate how the Secretariat is organized, how its staff is allocated and what specific tasks it performs.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Organizational, Administrative and Procedural Provisions**

Subtitle A of the bill pertains primarily to the process of selecting and appointing individuals to rosters created under Chapter Nineteen to serve on binational panels, ECCs and special committees, and to giving panelists and committee members the authority and protection they need to carry out their duties.

#### **a. Selection of Panelists and Committee Members**

Section 402 establishes the process in the United States of preparing the roster of individuals eligible to serve on panels and committees as provided for in Annexes 1901.2 and 1904.13, and of selecting panelists and committee members for service in actual disputes. Unlike the CFTA, the NAFTA establishes a requirement that the United States include judges and former judges on the Annex 1901.2 roster to the fullest extent practicable. (Under the NAFTA, as under the CFTA, the Annex 1904.13 roster is to be comprised solely of judges and former judges.)

To implement the new Annex 1901.2 obligation most effectively, section 402 establishes two separate procedures: the first for inclusion on the roster and appointment to panels of sitting Article III judges and the second for inclusion on the roster and appointment to panels of retired judges, former judges, and administrative law judges, as well as panelists who do not have judicial experience.

Sections 402(a) and 402(c) set forth procedures for the selection of prospective panelists and committee members other than sitting Article III judges. This selection system will operate substantially as it has under the CFTA. USTR will be required to submit the preliminary and amended candidate lists submitted to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate along with a statement of professional experience for each candidate. The statement will, in general, consist of: a resume or comparable document that includes a list of the candidate's publications, and, in the case of a practicing attorney or consultant, a list of the clients represented by the candidate or the candidate's firm if there could be a conflict or the appearance of a conflict of interest.

The purpose of this requirement is to provide basic background information on the prospective candidates to the appropriate Committees in order to improve the consultative process established in the statute and to avoid conflicts and appearances of conflicts of interest. The requirement is not intended to establish a confirmation procedure or to discourage the participation of potential panelists.

Sections 402(a) and 402(b) establish a new procedure for the inclusion of sitting Article III judges on Chapter Nineteen rosters, notification of the rosters to Congress and appointment of such judges to panels or committees in specific cases. This procedure takes into account the special status of sitting Article III judges as well as other considerations (including their existing caseloads) and makes participation by sitting judges entirely voluntary.

Section 402(b) requires the U.S. Trade Representative to adhere to the following procedures in including sitting Article III judges on rosters and appointing such judges to serve on specific panels or committees. First, the USTR will consult with the Chief Judges of the Federal circuits, or their designees, to discuss Article III judges' interest in and availability for sitting on binational panels, ECCs and special committees. If a Chief Judge determines that it is appropriate for one or more judges within that circuit to be included on a roster, the Chief Judge will submit a list of those judges to the Chief Justice of the United States, who may submit the list to the USTR. It will be the decision of the Chief Justice of the United States whether the names of any judges from a federal court should be submitted to the USTR for inclusion on the roster.

The USTR will include those judges on a roster and provide a copy of the list of such judges to the Senate and House Judiciary Committees as well as the House Ways and Means and Senate Finance Committees at the time USTR submits final candidate lists and final forms of amendment to the appropriate committees. Thereafter, at the time the USTR proposes to include individual sitting Article III judges on a binational panel, ECC or special committee, USTR will consult with those judges to ascertain whether they are available to be appointed to the specific panel or committee.

Consistent with Annex 1901.2 and the procedures established under section 402 of the bill, USTR hopes to name as many sitting Article III and other judges as possible to the

roster. Other judges that may be placed on the roster by virtue of their being included on a final candidate list in accordance with the procedures described at sections 402(a) and 402(c) include: retired federal judges under 28 U.S.C. 371(a); administrative law judges; and former judges. To be eligible for placement on the roster, these judges, like other candidates, must have general familiarity with international trade law, which includes relevant experience in administrative law or international commercial law matters. All judges are presumed to satisfy the other criteria set forth in Annex 1901.2 by virtue of their status as judges.

Section 402(a)(2) of the bill prescribes that the USTR will appoint judges to serve on a particular panel unless, based on the procedures set out above, the USTR ascertains that judges are not available to serve. In requiring the USTR to appoint judges to serve as panelists where they are available, section 402(a)(2) takes into account the existing canons of the Code of Conduct for United States Judges. Under Canon 5G, federal judges may undertake responsibilities outside the scope of their judicial duties if Congress authorizes appointment of judges, so long as service would not, in the view of the judge appointed, interfere with the performance of judicial responsibilities or otherwise impair public confidence in their integrity or impartiality.

Section 402(f) grants panelists and committee members under Chapter Nineteen immunity from suits relating to their official acts except for violations of an administrative protective order issued for purposes of a panel or committee proceeding. Although judges are government employees, judges are not considered to be "affiliated with a Party" within the meaning of Annex 1901.2(1).

Section 402(h) requires USTR to submit a report to the Committees explaining the efforts that USTR has made to secure the participation of judges and former judges in the binational panel, extraordinary challenge committee, and special committee processes. USTR must submit this report by March 31 and September 30 of each year at the same time it submits the final candidate list under subsection (c)(4)(A) and the final forms of amendment under subsection (c)(4)(C)(iv). The report will include a description of the steps USTR took to include candidates with judicial experience on the relevant rosters and to select panelists with judicial experience for individual panels.

**b. Regulations and Rules of Procedure for Binational Panels and Extraordinary Challenge Committees**

The bill provides in section 402(g) that the agencies having responsibilities under Chapter Nineteen may issue regulations governing the implementation of NAFTA. If an agency decides such regulations are needed, it must issue the regulations before NAFTA enters into force. These regulations will provide for continued suspension of liquidation during panel review, notice to NAFTA countries of scope rulings, protection of privileged information, and similar matters within the control of the Department of Commerce or the International Trade Commission. Except for modifications necessary to reflect specific additions or changes

contained in the NAFTA, these regulations will vary little from regulations implementing the agencies' obligations under the CFTA.

Section 403 of the bill, relating to the powers of ECCs to secure testimony and document production, parallels the language of the CFTA Implementation Act. This authority is necessary because Article 1904(13)(a)(i), unchanged from the CFTA, provides in certain circumstances for an ECC if a NAFTA country alleges that a panelist has engaged in gross misconduct, is biased, or has a serious conflict of interest. In such circumstances, an ECC might need to compel production of evidence.

Section 404 establishes procedures for requesting binational panel review of a final determination in an AD or CVD proceeding in Canada or Mexico. These procedures will operate as under the CFTA.

Section 405 of the bill requires the Department of Commerce to publish in the *Federal Register* the rules of procedure for binational panel proceedings under Chapter Nineteen. Article 1904(14) requires the United States, Canada and Mexico to develop these rules by January 1, 1994. The rules prescribe requirements for requesting panel review, filing and serving complaints and other pleadings, and other procedural matters. Annex 1904.13(2) requires the three countries to prepare similar rules of procedure for ECCs -- also by January 1, 1994. The NAFTA binational panel and ECC rules of procedure will closely resemble the rules that the United States and Canada have devised for Chapter Nineteen of the CFTA in light of the two countries' five-year experience with binational panels and ECCs. The three countries will negotiate completely new rules, however, to implement Article 1905 of the NAFTA.

#### **c. Subsidies Negotiations**

Section 406, like section 409(a) of the CFTA Implementation Act, sets forth certain objectives for the United States in any future trade negotiations over subsidies, convened under NAFTA Article 1907, with a NAFTA country. These include the achievement of increased disciplines on domestic subsidies; export subsidies, particularly with respect to agricultural products; and maintenance of effective remedies against subsidized imports, including, where appropriate, countervailing duties.

This section reflects the emphasis in Article 1907(2) on developing more effective rules and disciplines concerning the use of government subsidies and underscores the importance of disciplines in this important area. As provided in section 1101(b)(8) of the Omnibus Trade and Competitiveness Act of 1988, the United States attaches a high priority to improving rules on unfair trade practices, including government subsidies and effective rules and remedies to address unfair transborder pricing practices.

#### **d. Industries Facing Subsidized Imports**

Section 407 provides a process for the identification of domestic industries that are likely to face: (1) increased competition from subsidized imports from Canada or Mexico or other countries with which the United States concludes a trade liberalizing agreement; and (2) a deteriorating competitive position before a more effective discipline on subsidies is developed with respect to the country concerned.

Section 407 allows an identified industry to request the gathering of information pursuant to other laws and authorizes monitoring and review of evidence related to subsidies. The procedures and scope of section 407 are virtually identical to section 409(b) of the CFTA Implementation Act. Section 407 does not create any new trade remedy law nor does it prejudice or substitute for rights, processes and decisions under any existing trade laws, including section 301 of the Trade Act of 1974, or U.S. AD and CVD laws.

Action under section 407 is predicated on the USTR and Secretary of Commerce "identifying" the domestic industry. If, however, USTR determines that there is a reasonable likelihood that the industry may face both subsidization and deterioration of its competitive position but does not identify the industry, the Administration should monitor foreign government actions for potential subsidization (with particular attention to the provision of capital, loans, or loan guarantees on terms inconsistent with commercial considerations). This is consistent with the result in the recent decision on the section 409(b) petition filed by Vista Chemical Company concerning potential imports of linear alkybenzene from Canada. Such monitoring will continue under section 407 of the NAFTA.

**e. Application of Trade Law Amendments**

Section 408 of the bill implements the requirement of Article 1902 that amendments to the AD and CVD laws shall apply to a NAFTA country only if the amendment so states explicitly. In accordance with Article 1902(2), the United States will notify Canada and Mexico of any U.S. AD or CVD legislation that would apply to those countries.

## **2. Amendments to Section 516A of the Tariff Act of 1930**

Subtitle B of the bill provides amendments to section 516A of the Tariff Act of 1930 (19 U.S.C. 1516a), including technical conforming amendments and substantive changes necessitated by Chapter Nineteen of the NAFTA.

### **a. Time Limits for Seeking Judicial Review**

Section 411(1) of the bill amends the time limits for seeking judicial review under section 516A(a)(5) (19 U.S.C. 1516a(a)(5)). This section contains one substantive change in addition to substituting the new term, "Free Trade Area Country," for "Canada." If a binational panel dismisses a panel review for lack of jurisdiction, and an interested party with standing to file a summons and complaint has given timely notice that it intends to seek judicial review, then the time for filing a summons and complaint in the United States Court of International Trade ("CIT") begins to run the day after the panel dismisses the panel review. Under the predecessor CFTA provision, the time for filing began to run on the thirty-first day after dismissal. However, because 30 days elapse between the final determination and the beginning of the review, there is no reason for the additional time.

The one difference is that the court action would be stayed if one of the two governments involved requests an ECC, which could occur within thirty days after the panel issued its final announcement of dismissal. The request for an ECC in this instance would have to be based on the panel's decision to dismiss. If the ECC decides that the panel was wrong, the CIT would dismiss the court action. Other amendments to time limits in section 516A(a)(5), and to the standard of review in section 516A(b)(3), merely accommodate the addition of a third country.

### **b. Definitions**

Section 411(3) of the bill adds definitions to section 516A(f) to take into account the NAFTA and the possibility that the CFTA would be reinstated if the United States or Canada dropped out of the NAFTA or it was otherwise terminated. It includes a new definition for "United States Secretary" and adds a definition for "NAFTA." It also adds the terms "Free Trade Area Country," which means Mexico and Canada under the NAFTA but only Canada under the CFTA; "Relevant FTA Secretary," which means the Secretary of a Free Trade Area Country; and "Relevant FTA Country." The addition of the definition for "Free Trade Area Country" permits the provisions and amendments of subtitle B to apply to Canada either in its status as a NAFTA country or in its status as a CFTA country.

### **c. Safeguard and Jurisdictional Provisions**

Section 411(4) of the bill provides amendments to section 516A(g), which concerns judicial review of AD and CVD final determinations involving merchandise from Mexico or Canada. These amendments provide the basic statutory mechanism for

implementation of the binational panel and extraordinary challenge committee processes of Chapter Nineteen. In addition, they also implement the safeguard procedures and special committee process established under Article 1905 of the NAFTA.

Subsection (g)(3)(A) is amended to provide for judicial review of an AD or CVD final determination if the United States or another NAFTA country has suspended Article 1904 binational panel review pursuant to the safeguards criteria of Article 1905. Subsection (g)(3)(B) tolls the time for requesting judicial review if Article 1904 is suspended so that the time spent in the panel process before the suspension of Article 1904 will not be included in the calculation of time for seeking judicial review.

The bill also allows for the possibility that consultations following an affirmative finding by a special committee might lead to a resolution of the concerns of the complaining NAFTA country, thus eliminating the need to suspend Article 1904 and permitting the resumption of the binational panel review process. The bill provides that the time from the affirmative finding of the special committee (which triggers the stay of binational panel proceedings) to the lifting of the stay of these proceedings following the resolution of the safeguards challenge shall not be included in calculating the time for requesting binational panel review.

Two new paragraphs, (11) and (12), of section 516A(g) implement any suspension of Article 1904 and referral of cases to the CIT. Paragraph eleven gives the USTR authority to suspend the operation of Article 1904 and provides for termination of such suspension in appropriate circumstances. Paragraph twelve prescribes procedures for transferring a case for judicial review.

Under paragraph 12(A), a suspension under Article 1905 by the United States becomes effective when the USTR gives notice to the United States Secretary and the Secretary publishes a notice to that effect in the *Federal Register*. Likewise, the Secretary will publish notice of a suspension termination. Each of the other NAFTA countries must designate an appropriate official or agency authorized to give notice. The three NAFTA countries will agree to the exact process for notification.

Paragraph (12)(B) establishes the process for transferring challenges to final determinations from a binational panel or ECC to the CIT. This language also directs the CIT to devise rules to effectuate the transfer.

Paragraph (12)(C) prescribes the persons who may request transfer to the CIT. If the United States requests formation of a special committee under Article 1905(2), the government of the NAFTA country against which the United States makes the complaint or an interested party to the AD or CVD proceeding may seek referral. If an interested party makes the request, there is a further restriction that the interested party must have participated in the binational panel or ECC review, unless the time for filing notices of appearance in the binational panel review had not yet expired. If another NAFTA country requests establishment of a

special committee under Article 1905(2), that country, or an interested party from that country, may request transfer of the case to the appropriate court. If an interested party makes the request, the interested party must have participated in the binational panel or ECC review, unless the time for filing notices of appearance in the binational panel review has not yet expired. The bill imposes similar requirements when the transfer for CIT review is among the terms of a settlement.

#### **d. Constitutional Challenges**

Section 411(4)(F) amends subsection 516(g)(4)(A) to clarify that the U.S. Court of Appeals for the District of Columbia Circuit has exclusive jurisdiction over constitutional challenges to the binational panel system. Although the CFTA Implementation Act indicated the D.C. Circuit was to hear such challenges, the issue of jurisdiction was raised in *National Council for Industrial Defense v. United States*, Civ. Act. No. 92-1898 (RCL) (1993 USD LEXIS 6789 (OC 5/25/93)). Section 411(4)(F) codifies the ruling of the District Court that the D.C. Circuit has exclusive jurisdiction over such constitutional challenges.

### **3. Other Conforming Amendments to the Tariff Act of 1930**

In addition to amendments to section 516A of the Tariff Act of 1930, conforming amendments to other portions of the Tariff Act are necessary. Thus, sections 412(a) and (b) of the bill amend sections 502(b), 514(b) and section 771 of the Tariff Act, respectively, so as to include a reference to the NAFTA.

Section 412(c) of the bill amends section 777(f) of the Tariff Act, which was added to the statute by the CFTA Implementation Act, to implement appropriate safeguards for disclosure of proprietary information under protective order for purposes of binational panel proceedings. Subsection (c) adds necessary references to the NAFTA and also inserts references to the ECC process that were inadvertently omitted from the 1988 legislation.

Section 412(c)(8) amends section 777(f)(4) of the Tariff Act to exempt Article III judges from civil sanctions for violations of protective orders when serving as panelists or committee members. Judges of the United States are subject to criminal proceedings for disclosure of confidential information under 18 U.S.C. 1905. Accordingly, as required under paragraph eight of Annex 1901.2, appropriate sanctions for potential violations of protective orders exist for all panelists.

### **4. Consequential Amendments to Section 410(a) of the CFTA Implementation**

#### **Act**

Section 410(a) of the CFTA Implementation Act authorizes a working group to discuss subsidies and unfair trade rules with Canadian officials for the period established in Article 1907

of the CFTA -- a maximum of seven years. Section 413 of the NAFTA bill tolls that time period for any time during which the United States applies the NAFTA to Canada.

#### **5. Conforming Amendments to Title 28, United States Code**

The CFTA Implementation Act made several amendments to title 28, United States Code, designed to: (1) ensure that the residual jurisdiction of the CIT could not be used to circumvent the binational panel system; (2) prohibit U.S. courts from ordering declaratory relief in any AD or CVD proceeding involving Canadian merchandise; and (3) provide the CIT with exclusive jurisdiction over civil actions to enforce administrative sanctions levied for violations of protective orders. Section 414(a)-(b) of the bill makes appropriate conforming amendments to title 28 by adding references to the NAFTA.

#### **6. Effect of Termination of NAFTA Country Status**

Section 415 contains several provisions designed to implement the transition from a bilateral to a trilateral free trade agreement. Under section 415(a), if the NAFTA ceases to be in force with respect to a particular signatory to the Agreement, the provisions of title IV of the bill will cease to have effect with respect to that country.

Section 415(b) provides that, if the NAFTA should cease to be in force, any violations of protective orders or undertakings that are under investigation or subject to enforcement proceedings will continue to be subject to the sanctions and procedures provided for under section 777(f) of the Tariff Act of 1930.

Furthermore, if on the date on which the NAFTA ceases to be in force a binational panel review or ECC request is pending, or has been requested, with respect to an AD or CVD determination, such determination will be reviewable under section 516A(a), and the limitation period for commencing an action would begin running on the date on which the NAFTA ceased to be in force.

#### **7. Effective Date**

In all likelihood, binational panel reviews of AD or CVD determinations under the CFTA will be pending on the date on which the NAFTA implementing legislation goes into effect. Such binational panel reviews will continue under the CFTA. To simplify the transition to the new regime, section 416 provides that the provisions of title IV of the implementing legislation take effect on the date the Agreement enters into force with respect to the United States, but will not apply to: final AD and CVD determinations published in the *Federal Register* before that date; a scope determination, notice of which is given to the Government of Canada before that date; or binational panel reviews or extraordinary challenges arising out of such reviews, commenced before that date.

## **CHAPTER TWENTY: INSTITUTIONAL ARRANGEMENTS AND DISPUTE SETTLEMENT PROCEDURES**

### **A. SUMMARY OF NAFTA PROVISIONS**

#### **1. Overview**

Chapter Twenty establishes the institutions responsible for overseeing the implementation of the NAFTA and to assist in the avoidance and resolution of disputes between the NAFTA countries under the Agreement. The central institution of the NAFTA is the Free Trade Commission, comprising ministers or cabinet-level officials designated by each country. The NAFTA also establishes a Secretariat to provide administrative support to the Commission and dispute settlement panels.

Chapter Twenty also sets out detailed procedures for government-to-government dispute resolution under the NAFTA. The procedures established in the chapter are based in large part on Chapter Eighteen of the CFTA, with modifications that should facilitate and expedite the settlement of disputes between the three countries. Chapter Twenty does not apply to disputes arising under Chapter Nineteen, however, which sets out specific mechanisms for dispute resolution in antidumping and countervailing duty cases.

#### **2. The Commission**

Article 2001 establishes the Free Trade Commission. The Commission will supervise the implementation of the NAFTA, including the work of committees and working groups established under it, oversee the elaboration of the Agreement and assist in the resolution of disputes that may arise between the NAFTA countries regarding its interpretation or application. The Commission, which will meet at least once a year, is empowered to develop its own rules and procedures and will make decisions by consensus.

#### **3. Secretariat**

To facilitate the operation of Chapters Nineteen and Twenty and to assist the Commission in its functions, Article 2002 requires each country to establish a permanent national NAFTA Secretariat office or "Section." Each country will be responsible for the operating costs of its Section and for designating a Secretary for its Section. The Secretariat will provide administrative assistance to dispute settlement panels and other subsidiary bodies established under Chapters Nineteen and Twenty.

#### **4. Dispute Settlement Procedures**

Under Article 2004, if disputes arise between two or three NAFTA governments with respect to the interpretation or application of the Agreement, the conflict resolution provisions of

Chapter Twenty apply. Those provisions apply to complaints by any country that another country has taken, or is proposing to take, action that is or would be inconsistent with the Agreement or cause "nullification" or "impairment" of benefits that the complaining government reasonably expected to accrue to it under the Agreement.

Article 2005 provides that disputes arising under both the NAFTA and the GATT generally may be settled in either forum at the discretion of the complaining government. This general rule is subject to two exceptions, however.

Before a country initiates a proceeding under the GATT that could also have been initiated under the NAFTA, it must notify the other two governments. The three governments may agree on the appropriate forum, but if no agreement is reached the matter normally is to be referred to NAFTA dispute settlement. Furthermore, where the responding government claims that the action is subject to an environmental or conservation agreement listed in Article 104, or if the governmental action in dispute relates to the environment, health, safety or conservation, the dispute must be heard solely under the NAFTA.

**a. Consultations**

Article 2006 provides that whenever any matter arises that could affect a government's rights under the NAFTA, it may request consultations and the countries concerned will promptly consult on the matter. The NAFTA places priority on reaching an amicable settlement. The third government may participate or seek its own consultations.

Article 2007(2) deems consultations held by the Working Group on Rules of Origin pursuant to Article 513, the Committee on Sanitary and Phytosanitary Measures pursuant to Article 723 and the Committee on Standards-Related Measures pursuant to Article 914 to be "consultations" for purposes of Chapter Twenty.

**b. Commission Consultations**

Under Article 2007, if the disputing governments cannot resolve a particular matter, normally within 30 days (15 or 45 days in certain cases) after consultations have begun, any country that participated in the consultations may refer the issue to the Commission for resolution. Unless it decides otherwise, the Commission must convene in ten days to consider the matter. To help resolve the dispute, the Commission may employ technical advisers, "good offices," conciliation, mediation or other dispute resolution procedures.

**c. Establishment of a Panel**

Article 2008 provides that if the Commission is unable to resolve a dispute within 30 days or other agreed period, any country that participated in the consultations may convene an arbitral panel. If the third government considers it has a substantial interest in the matter it may join as a complainant. If that government does not join in a panel proceeding, it normally must

refrain from starting a separate proceeding under the NAFTA or the GATT on the same matter. However, it is still entitled under Article 2013 to attend all NAFTA panel hearings, to make written and oral submissions to the panel and to receive written submissions of the disputing governments.

#### **d. Roster and Panel Selection**

Articles 2009 through 2012 set out procedures governing the establishment and operation of arbitral panels. Article 2009 requires the NAFTA governments jointly to establish and maintain a roster of 30 individuals to serve as panelists. Roster members must have expertise or experience in law, international trade, other matters covered by the NAFTA or in dispute resolution. They must be chosen on the basis of objectivity, reliability and sound judgment, be independent of the three governments and comply with a code of conduct.

The panel selection procedure is designed to ensure that the NAFTA governments can select experts in the subject matter of the dispute to sit on particular panels. Thus, for example, in a proceeding involving a measure regarding human, animal or plant health, or the environment, each government could appoint to the panel scientific or other experts in the question at issue. The United States will work with its NAFTA partners to ensure that panel members are drawn from among individuals with the requisite degree of scientific or other specialized expertise in appropriate cases.

Article 2011 provides for five-member arbitral panels chosen by "reverse selection." The chair of the panel will be selected first, either by agreement of the disputing countries or, failing agreement, by lot. Then, each "side" in the dispute will select two panelists from among citizens of the other "side." Normally, panelists will be drawn from the roster. A disputing country may exercise a preemptory challenge against any individual proposed as a panelist who is not on the roster.

#### **e. Panel Procedures**

Pursuant to Article 2012, the Commission will establish Model Rules of Procedure that panels must follow unless the disputing governments decide otherwise. The rules will address such issues as procedures for hearings, written submissions by disputing governments and confidentiality requirements. The Administration expects to extend USTR's current practice of providing for public notice and opportunity for comment to NAFTA dispute proceedings. This would include publishing public notice of the dispute in the *Federal Register*, giving briefings for and accepting submissions regarding facts and arguments from interested individuals and groups and making U.S. panel submissions and final reports of dispute settlement panels publicly available. Article 2012 also provides for the use of standard terms of reference.

The NAFTA provides for the use of experts and scientific review boards to improve the quality of the dispute settlement process, particularly where disputes involve

environmental, health, safety or other scientific matters. Article 2014 provides that a panel, on the request of a disputing country or its own motion, may seek information and technical advice from experts on any subject related to the dispute, provided that the disputing governments so agree. The Commission on Environmental Cooperation, created by the supplemental agreement on environmental cooperation, may assist in identifying appropriate experts for panels.

Article 2015 permits the panel, on request of a disputing party or, unless the disputing governments disagree, on its own initiative to establish a scientific review board to report on any factual issue concerning environmental, health, safety or other scientific matters raised by a NAFTA government in a panel proceeding. The board will be selected from among highly qualified, independent experts in scientific matters. The panel is required to take the board's report, and any comments on it by the participating governments, into account in the preparation of its report.

**f. Initial Panel Report**

Under Article 2016, unless the participating governments decide otherwise, the panel must present its initial report within 90 days of the selection of the last panelist. The initial report must contain findings of fact and a determination on whether the measure at issue is inconsistent with a provision of the NAFTA, or nullifies or impairs benefits that the complaining government could reasonably have anticipated under the Agreement.

In addition, the panel is to include in its initial report any recommendations that it may have to resolve the dispute. If the terms of reference so provide, the report will also contain the panel's findings on the adverse trade effects of any measure that the panel finds to be inconsistent with the NAFTA.

The disputing parties are allowed 14 days to provide written comments to the panel on the initial report. Upon receipt of such comments, the panel may seek the views of any government that participated in the dispute, reconsider its report, or make any further examination that it considers appropriate.

**g. Final Report**

Article 2017 requires the panel to present its final report to the disputing parties within 30 days of the presentation of its initial report, unless those governments agree otherwise. They, in turn, must transmit the final report, including any report of a scientific review board established under Article 2015, to the Commission within a reasonable time for publication, unless all three NAFTA governments decide that the report should not be published.

Under Article 2018, when the disputing parties receive the final report they must attempt to resolve the dispute, normally in conformity with the panel's recommendations. Whenever possible, the parties are to resolve the dispute by agreeing that any measure found to be inconsistent with the Agreement will be removed or, where the dispute involved a proposed

measure, will not be implemented. If that remedy cannot be agreed upon, the parties must, where possible, agree on trade compensation for the complaining party.

#### **h. Suspension of Benefits**

Under Article 2019, if a panel has found that a measure is inconsistent with the NAFTA and no settlement has been reached within 30 days or other agreed period, the complaining party may suspend the application to the other party of NAFTA benefits equivalent in effect to those that the complaining party considers were impaired, or may be impaired, as a result of the disputed measure. The suspension of benefits may remain in effect until the parties have resolved the dispute.

Article 2019 provides guidelines to be used by a government in considering what benefits to suspend. On the request of any disputing party, the Commission will establish a panel to determine whether the level of benefits suspended is "manifestly excessive." A panel hearing such a case normally will present its determination within 60 days.

### **5. Interpretations of the NAFTA in Domestic Proceedings**

Under Article 2020, the three governments will endeavor to formulate a common interpretation of NAFTA provisions that come under scrutiny in domestic court or administrative proceedings in those instances in which a government wishes to make its views known to the court or administrative body, or where that body or court solicits a government's views on the subject. Any agreed interpretation is to be submitted by the government in whose territory the proceedings are being conducted, in accordance with the rules of the relevant forum. If the three governments cannot reach agreement on the appropriate interpretation, any government may submit its separate views to the extent and in the manner prescribed for such interventions by the forum.

### **6. Suits Against Other NAFTA Governments**

Article 2021 prohibits any NAFTA country from providing a right of action in its domestic law to challenge the consistency of another government's actions under the Agreement.

### **7. Settlement of Private Commercial Disputes**

Article 2022 requires the three governments to encourage and facilitate the use of arbitration and other alternative dispute mechanisms to settle international commercial disputes between private parties in North America. Each country must provide procedures to ensure observance of agreements to arbitrate and for recognition and enforcement of arbitral awards, for example by complying with the 1958 *United Nations Convention on the Recognition and*

*Enforcement of Foreign Arbitral Awards* or the 1975 *Inter-American Convention on International Commercial Arbitration*. The NAFTA also requires the establishment of a committee to advise the NAFTA Commission on the use of alternative resolution techniques for such disputes.

## **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

### **1. Implementing Bill**

Section 105 of the bill authorizes the establishment of the U.S. section of the NAFTA Secretariat in any department or agency, consistent with Article 2002. Pursuant to section 105(a), the U.S. Section will be responsible for providing administrative support to the panels, boards and committees established under Chapters Nineteen and Twenty subject to the oversight of the interagency group established under section 402 of the bill. For purposes of Chapter Nineteen panel proceedings, the Section will function as a clerk of the court and will be responsible for formally notifying requests for binational panel review.

A U.S. Secretary will supervise administrative matters within the purview of the U.S. Section. Regulations will provide for the appointment of the employees of, and the physical location of, the U.S. Section. It is anticipated that the Section will be established in the Department of Commerce, where the U.S. section of the CFTA Secretariat has been housed since 1989, and that the Section will have no more than 10 employees.

Pursuant to section 105(a), the Section will not be considered an "agency" within the meaning of 5 U.S.C. 552 and thus will not be subject to the Freedom of Information Act, the Privacy Act or the Government in the Sunshine Act. Since they are international bodies, panels, boards and committees established under Chapter Nineteen or Twenty are not subject to those acts.

Section 105(b) of the bill authorizes the appropriation, to the department or agency in which the Section is located, the lesser of (1) such sums as may be necessary, or (2) \$2 million, to fund the U.S. Section and to cover expenses of dispute resolution under Chapters Nineteen and Twenty. Any Administration funding requests for these functions will be made in accordance with established budget formulation procedures, and may be less than \$2 million.

Section 105(c) of the bill authorizes the U.S. Section to retain funds distributed to it by the Mexican or Canadian sections of the Secretariat in connection with the reimbursement of expenses generated by panel proceedings under Chapter Nineteen or Twenty. Section 105(c) implements Annex 2002.2, which requires the governments involved in the proceedings to share the costs of such proceedings equally. Pursuant to that Annex, the three governments will agree in advance on the nature and amount of expenses that panelists and other experts will be permitted to incur.

Section 106 of the bill requires the U.S. Trade Representative to consult with the Ways and Means and Finance Committees in establishing a roster of panelists under Article 2009. The section also provides that where a dispute under Chapter Twenty involves a challenge to U.S. environmental laws, the United States will encourage, to the maximum extent practicable, the appointment of panelists with appropriate environmental expertise. The section is consistent with Articles 2009 and 2010, which provide that persons appointed to panels must have relevant expertise. Such panelists would be required to meet all other relevant qualifications set out in Article 2009(2).

## **2. Administrative Action**

### **a. Implementation of Panel Reports**

It bears repeating that panel reports presented under Chapter Twenty have no effect under the law of the United States. Neither federal agencies nor state governments are bound by any finding or recommendation included in such reports. In particular, panel reports do not provide legal authority for federal agencies to change their regulations or procedures or refuse to enforce particular laws or regulations, such as those related to human, animal or plant health, or the environment. Furthermore, as noted previously in this Statement, the United States will not seek to introduce a panel report into evidence in any civil suit brought by the United States challenging a state law or regulation on the ground that it is inconsistent with the NAFTA.

In normal circumstances, the United States will agree with its NAFTA partners on a resolution of disputes under Chapter Twenty that is in conformity with panel recommendations. Where the matter involves a law or regulation of a state of the United States, any resolution would be reached in consultation and coordination with the state concerned, as described in this Statement in connection with Chapter One.

The NAFTA recognizes that it may not be possible for a NAFTA government to agree to the removal of a federal or state or provincial measure that a panel has found to be inconsistent with the Agreement. Accordingly, it provides for alternative resolutions, including the provision of trade compensation and other negotiated settlements, or the suspension of benefits. In all cases following a panel report, the NAFTA makes discretionary any change in U.S. law and leaves to the United States the manner in which any such change may be implemented -- whether through the adoption of legislation, a change in regulation, judicial action, or otherwise.

### **b. Enforcement of U.S. Rights**

Legislative authority currently exists for the Executive Branch fully to enforce U.S. rights under Chapter Twenty. Section 301 of the Trade Act of 1974, as amended, authorizes the United States Trade Representative ("USTR") to take specific action, subject to

the President's direction, and to take all "appropriate and feasible action" in the President's power that the President directs the USTR to take to enforce U.S. rights under trade agreements such as the NAFTA.

Once the NAFTA enters into force, an interested person may file a petition with the USTR requesting section 301 action in any case in which the person considers that another NAFTA government has failed to honor a provision of the Agreement or has caused the nullification or impairment of benefits that the United States could reasonably have anticipated under the Agreement. Alternatively, the USTR may, on his or her own initiative, institute a section 301 proceeding.

If the USTR decides to initiate an investigation under section 301 with respect to alleged Canadian or Mexican practices, section 303(a) of the Trade Act requires the USTR initially to attempt consultations with the government of the relevant NAFTA country to resolve the matter. If the case involves a possible breach of the NAFTA or impairment of U.S. rights under the NAFTA, and if consultations have failed to produce a mutually acceptable solution, then section 303(a) requires that the matter be submitted to the formal dispute resolution procedures of the Agreement, or to the applicable dispute settlement procedures of another trade agreement to which the United States and the other NAFTA country are parties. The USTR will seek information and advice from the private sector, including from the petitioner, if any, in preparing U.S. presentations for consultations and formal dispute resolution procedures.

Section 301 provides the USTR with authority to take appropriate retaliatory action in the event that a panel report upholds a U.S. allegation that another NAFTA government has breached the Agreement or nullified or impaired U.S. benefits and the other government does not take satisfactory remedial action or provide satisfactory compensation.

### **c. Appointment of Environmental Experts**

Section 106(c) of the bill calls for the United States to encourage the appointment of environmental experts if a Chapter Twenty panel is convened to consider a U.S. environmental law. Under Chapter Twenty procedures, the governments participating in a panel proceeding normally will select panelists from the agreed roster. However, a government may appoint panelists from outside the roster where the other government does not object to the selection. In implementing section 106, the Administration will work with Canada and Mexico to ensure that panelists have appropriate environmental expertise. The Administration will also make use of scientific review boards in appropriate cases to assist panelists with environmental or other scientific issues that may arise in the course of panel proceedings.

## **CHAPTER TWENTY-ONE: EXCEPTIONS**

### **A. SUMMARY OF NAFTA PROVISIONS**

Chapter Twenty-One spells out various exceptions that apply to all or large portions of the Agreement.

#### **1. General Exceptions**

Article 2101 makes the "general exceptions" set forth in GATT Article XX applicable to those NAFTA provisions covering trade in goods and technical barriers. Article 2101 clarifies the three governments' understanding concerning the scope of two of these exceptions, namely that:

- GATT Article XX(b) -- the exception for measures necessary to protect human, animal or plant life or health -- includes environmental measures; and
- GATT Article XX(g) -- which provides an exception for measures relating to the conservation of exhaustible natural resources -- applies to both living and non-living exhaustible natural resources.

Article 2101 also makes clear that the various services provisions of the agreement do not prevent a NAFTA government from taking nondiscriminatory enforcement actions against service providers from other NAFTA countries. This exception is similar to the exception for trade in goods set out in GATT Article XX(d) and incorporated into the NAFTA by Article 2101.

#### **2. National Security**

Article 2102 governs the extent to which a government may take action that would otherwise be inconsistent with the NAFTA in order to protect its essential security interests. The article does not apply to energy trade between the United States and Canada or to measures related to government procurement. Articles 607 and 1018, respectively, establish specialized national security exceptions in those areas.

Article 2102 is based on CFTA Article 2003, which in turn tracks in major part GATT Article XXI. The NAFTA provision departs from the CFTA by including among the types of measures subject to the exception those related to services and technology transactions. This expansion reflects the broader sweep of the NAFTA as compared to the CFTA. The national security exception is self-judging in nature, although each government would expect the provisions to be applied by the other in good faith.

#### **3. Taxation**

**a. Scope and Coverage**

Article 2103 limits the extent to which tax measures are subject to the NAFTA. Paragraph one makes clear that only those provisions listed in the article are applicable to taxation measures. Paragraph two provides that whenever one of the NAFTA provisions listed in the article and a double taxation convention between two NAFTA countries cover the same tax measure, those countries will exclusively rely on the convention and its dispute settlement provisions to decide any controversy concerning the measure.

**b. Tax Measures Affecting Trade in Goods**

Paragraph three provides that two NAFTA provisions apply to existing and future taxation measures affecting trade in goods. These are NAFTA's prohibition on export taxes and its rule requiring national treatment for imported goods. This latter provision prohibits, for example, discriminatory sales or excise taxes on imported products.

**c. Income and Capital Tax Measures Affecting Cross-Border Services and Financial Services**

Under subparagraph (a) of paragraph four, the national treatment provisions of NAFTA's two services chapters will apply in respect of income tax and certain capital tax measures, but only where the tax in question applies to the purchase or consumption of particular services. The idea is to prevent the use of this kind of tax on consumers to induce them to purchase services from domestic suppliers rather than from suppliers from other NAFTA countries. For example, a NAFTA country's tax law could not provide a deduction for the cost of consulting services purchased from domestic consulting firms but not from firms in other NAFTA countries.

This limited national treatment obligation will not prevent the application of U.S. anti-abuse rules (such as transfer pricing rules or earnings stripping rules), the imposition of limitations on deductions for contributions to pension plans, the application of anti-tax avoidance measures, or the limitation of credits (including credits for research activities) to services performed within the United States.

**d. Other Taxes Affecting Services and Investments**

Subparagraph (b) describes the extent to which certain NAFTA national treatment and most-favored-nation ("MFN") treatment provisions apply to taxation measures other than those on income, capital, estates, gifts, inheritances and generation-skipping transfers. For taxation measures not included in the preceding list (for example, excise taxes), the MFN and national treatment rules set out in NAFTA's investment and services chapters will apply.

**e. Exceptions**

The applicability of subparagraphs (a) and (b) is limited by the remaining subparagraphs in paragraph four. For example, subparagraph (c) provides that NAFTA's MFN provisions do not prevent a NAFTA government from providing another country exclusive bilateral advantages under a tax convention.

In addition, a "grandfathering" provision in subparagraph (d) limits the application of subparagraphs (a) and (b) to taxation measures that are adopted after NAFTA goes into effect. This allows existing taxation measures to remain in place even if they are inconsistent with NAFTA's national treatment or MFN rules for services and investments. Furthermore, subparagraph (g) makes clear that NAFTA governments can generally adopt taxation measures in the future that are inconsistent with those rules where such measures are "aimed at ensuring the equitable and effective imposition or collection of taxes."

#### **f. Performance Requirements**

Paragraph five provides that those portions of the NAFTA investment chapter prohibiting "performance requirements" apply to taxation measures, thus precluding a government from conditioning the receipt of a tax advantage on compliance with such requirements. For example, a NAFTA government may not condition a tax holiday on an investor's purchase of locally-produced goods or on the manufacture of goods with a certain level of domestic content. It should be noted that these provisions do not bar a government from conditioning receipt of a tax advantage on the performance of services in its territory and do not apply to export promotion or foreign aid programs.

#### **g. Expropriations**

Paragraph six applies NAFTA's expropriation rules to taxation measures. This means that a NAFTA government may not use taxation measures directly or indirectly to nationalize or expropriate an investment owned by a company or national from another NAFTA country, or apply a taxation measure that is tantamount to nationalizing or expropriating such an investment, unless certain conditions are met, including the payment of compensation.

Before an investor may challenge a taxation measure as impermissible expropriation under the investment chapter's arbitration provisions, paragraph six provides for the tax authorities of the two governments to consult on whether the measure amounts to an expropriation. If the two governments decide within six months that the measure is not an expropriation, the investor may not initiate arbitration.

### **4. Balance-of-Payments**

Article 2104 allows certain government restrictions to address serious balance-of-payments (BOP) difficulties or the threat of such difficulties. Such restrictions may not take the form of quotas, tariff surcharges, licenses or similar measures when applied to goods, investment or non-financial services transactions. Certain exceptions to these rules apply for financial services because of the unique characteristics of this sector.

Paragraphs two through four provide general guidelines that a government must follow whenever it imposes transfers restrictions justified for balance-of-payment reasons. Under paragraph two, the government must submit any restrictions to the International Monetary Fund (IMF) for review, consult with the IMF on adjustment measures that address the underlying economic problem and implement any IMF recommendations arising out of the consultations.

In addition, paragraph three requires that any BOP restriction must:

- avoid unnecessary damage to other NAFTA countries;
- not impose a greater burden than necessary;
- be phased out as the situation improves;
- be consistent with IMF rules; and
- be applied on a non-discriminatory basis.

Under paragraph four, governments cannot provide protection to a local service industry, but are permitted to impose multiple exchange rate regimes under which essential services are given access to lower exchange rates than non-essential services. Such a regime must also be consistent with provisions of the IMF Articles of Agreement that require IMF approval.

In addition to the general rules described above, paragraph five imposes specific additional limitations for BOP restrictions imposed on transfers in connection with investments, trade in goods and non-financial services. The most important such limitation is that BOP restrictions may not take the form of trade measures, such as tariff surcharges, quotas, licenses or similar measures. BOP restrictions on transfers covered by the paragraph are limited to multiple exchange rate arrangements (*i.e.*, a regime under which the government establishes different exchange rates for particular categories of transactions). Furthermore, any such arrangements must be consistent with Article VIII(3) of the IMF Articles, which requires IMF approval of the restriction. Finally, such multiple exchange rate arrangements may not substantially impede transfers related to goods and investment from being made at a market rate of exchange in a freely usable currency.

Paragraphs six and seven provide an exception from the above-described rules for restrictions imposed on transfers in connection with cross-border financial services transactions, such as deposits to or withdrawals from foreign checking accounts. In order to allow a NAFTA

government to prevent destabilizing, sudden movements of its currency, quotas, licenses and other restrictions may be imposed on such transactions. These transactions do not include transfers related to an investment, which are covered by the other provisions of Article 2104.

#### **5. Disclosure of Information**

Article 2105 permits a government to withhold information otherwise required to be disclosed to another government under the NAFTA where such disclosure would impede domestic law enforcement or contravene laws protecting personal privacy or financial records.

#### **6. Cultural Industries**

Article 2106, which calls up Annex 2106, carries forward CFTA Article 2005. Article 2005 exempted "cultural industries" (*i.e.*, the print, film and video, music, radio and television sectors) from a number of the obligations of the CFTA. Article 2005 also exempted from all CFTA obligations "measures of equivalent commercial effect" taken in response to actions that would have been inconsistent with the CFTA but for the exception. Under Article 2106 of the NAFTA, Canada and the United States retain *vis-a-vis* each other the same rights to take actions with respect to those industries and the same right to respond to harm caused thereby.

Under the NAFTA, Annex 2106 will apply only between Canada and the other NAFTA countries. Mexico and the United States have not taken an exception of this nature in respect of each other. The exception for "cultural industries" does not apply to the three governments' tariff elimination commitments in the relevant sectors.

### **B. ACTION REQUIRED OR APPROPRIATE TO IMPLEMENT THE NAFTA**

Annex 2106, covering "cultural industries," is drafted to apply the corresponding provision of CFTA Article 2005 equally and reciprocally to the United States and Canada. However, it was Canada alone that sought an exemption for "cultural industries." The United States agreed to include the exemption only in return for an explicit agreement that any action by Canada that would have been inconsistent with the CFTA in the absence of the exemption would be subject to immediate suspension of trade benefits by the United States.

The Administration is committed to using all appropriate tools at its disposal to discourage Canada and other countries from taking measures that discriminate against, or restrict market access for, the U.S. film, broadcasting, recording and publishing industries. The Administration will consult with the Canadian Government regarding any proposed Canadian measures or policies that might lead to the exercise of, or reliance on, the "cultural industries" exemption. Should Canada choose to institute such measures, the Administration, in consultation with the relevant industries, is prepared to exercise fully the right to respond granted in the Agreement.

At such time as the Administration takes remedial action in response to a Canadian measure, it will endeavor to fashion a response in such a manner as to discourage the creation of a similar non-tariff barrier in other countries. The Administration will review at least annually any response to determine if a modification is warranted in light of changed circumstances.

Section 513 of the bill adds a new subsection (f) to section 182 of the Trade Act of 1974. Subsection (f) requires the U.S. Trade Representative to identify, within 30 days of the release of the annual National Trade Estimates Report on Foreign Trade Barriers, any new Canadian act, policy or practice affecting cultural industries that is actionable under Article 2106. In deciding whether to identify an act, policy or practice, the Trade Representative will consult with the relevant domestic industries, the appropriate advisory committees and officers of the Federal Government, and take into account such other information as may be available. Any act, practice or policy identified under subsection (f) will become the subject of an investigation under section 301 of the Trade Act of 1974 unless the United States has already taken action against it.

No legislative or administrative action is required to implement the other provisions of Chapter Twenty-One.

## **TITLE V OF THE IMPLEMENTING BILL**

### **A. TRANSITIONAL ADJUSTMENT ASSISTANCE**

While the NAFTA will result in net economic benefits and increased job opportunities, some workers may have to find new employment. To address the issue of employment dislocation over the longer term, the Administration is developing a comprehensive program to provide workers who have permanently lost their jobs with the opportunities and resources to find appropriate reemployment. This comprehensive program, which is expected to be introduced early in 1994, would establish a single standard of eligibility to encompass permanently laid-off workers without regard to the cause of their dislocation, including those job losses that may result from international trade agreements such as the NAFTA.

In the short term -- between January 1, 1994, when the NAFTA takes effect, and July 1, 1995, when the Administration expects the new comprehensive program to become operational -- it is essential to provide full support and assistance for any workers that may be adversely affected as a result of the NAFTA. To provide this support, the Administration is proposing a transitional worker assistance program that will have two components. First, sections 501 through 506 of the NAFTA implementing bill amend Chapter 2 of Title II of the Trade Act of 1974 (which established the Trade Adjustment Assistance program) to provide assistance for workers in firms that are directly affected by imports from or shifts in production to Mexico or Canada. Second, through administrative action, the Secretary of Labor will use existing authority under Title III of the Job Training Partnership Act (commonly referred to as "EDWAA") to provide assistance to workers in secondary firms that supply or assemble products produced by firms that are directly affected.

This transitional program will draw on the best aspects of existing programs, EDWAA and Trade Adjustment Assistance ("TAA"), and provide affected workers with both rapid and early intervention and the ability to engage in long term training while receiving income support.

#### **1. Assistance to Workers in Primary Firms**

Under the first component of the program a group of workers, including farm workers, or their authorized representative (including community-based organizations) must file a petition for certification of eligibility for services with the governor in the state where the firm is located.

Within ten days, the governor will make a preliminary finding of whether the petition meets the criteria described below (except for the "contributed importantly" criterion). The governor will forward all petitions -- whether they have been found to meet the criteria or not -- to the Secretary of Labor, who will review all criteria and make a decision regarding certification for eligibility within 30 days.

The criteria that will be used to determine eligibility under this component will be that:

- 1) a significant number or proportion of the workers in the firm or subdivision of the firm have become totally or partially separated, or are threatened to become separated from employment; and
- 2) either that:
  - (a)(i) sales or production of such firm or subdivision have decreased absolutely;
  - (ii) there have been increases in imports from Mexico or Canada of goods that are directly competitive with goods produced by such workers' firm or subdivision; and
  - (iii) the increase in imports contributed importantly to the workers' layoff and to the firm's or subdivision's decline in sales or production; or
- (b) there has been a shift in production by the workers' firm or subdivision to Mexico or Canada of goods that are directly competitive with goods produced by the workers' firm or subdivision.

Once the governor finds that the group's petition meets the criteria, workers covered under the petition will receive rapid response and basic readjustment services available under other federal law.

When the Secretary certifies eligibility, the adversely affected workers will be provided a broad range of adjustment services, including:

- employment services, such as counseling, testing and job placement assistance services and support services;
- appropriate training that is reasonably expected to lead to employment upon completion;
- trade readjustment allowances (*i.e.*, income support payments in a weekly amount equal to a worker's unemployment compensation payment and payable for a period of up to 52 weeks), available to workers who are enrolled in a training program by the end of the 16th week of the worker's initial unemployment compensation benefit period or, if later, six weeks after certification of a petition (although the Secretary may extend these deadlines for up to 30 days if there are extenuating circumstances that delay the worker's enrollment, such as that the first available enrollment date is past the deadline or a course is abruptly canceled);
- job search allowances providing reimbursement for job search expenses; and
- relocation allowances.

No waiver of the requirement that a worker must be enrolled in training to receive income support will be permitted under this component. Such waivers are permitted under the existing TAA program, and recent reports have identified abuses of this authority. The Department of Labor is taking administrative action, including the issuance of new regulations, to eliminate such abuses. The limited extension in the enrollment period provided under this component is not intended to constitute a waiver and is consistent with the overall intent of ensuring that income support is linked to participation in training.

This component is to take effect on the date the NAFTA comes into force and workers separated on or after that date would be eligible for assistance. In addition, there is a "reachback" provision that ensures assistance under this component will also be available to those workers who are laid off between the date of enactment of the implementing bill and the entry into force of the Agreement.

## **2. Assistance to Workers in Secondary Firms**

Under the second component of the program, workers in firms that are indirectly affected by the NAFTA would be eligible to receive assistance pursuant to the national grant program administered by the Secretary of Labor under Part B of Title III of the Job Training Partnership Act. The Secretary will reserve funds for this purpose. These firms will include suppliers of the firms that are directly affected by imports from Mexico or Canada or shifts in production to those countries. Secondary firms will also include "upstream" producers, such as direct processors, that assemble or finish products made by directly-affected firms. Family farmers and farm workers who are adversely affected by the NAFTA but do not meet the "group of workers" requirement under the first component will also be eligible under this component.

Workers in these firms will receive the same rapid response, basic readjustment and employment services, job search and relocation assistance, training and income support available to workers in directly affected firms. In addition, income support would be available under this component to workers who are covered by a petition certified under the first component of the program but who are not eligible for income support under that component because they are not eligible for unemployment compensation, do not meet the tenure requirement, or were unable to meet the enrollment deadline because the first available enrollment date was past the deadline or a course was abruptly canceled.

For income support under this second component, workers will be required to enroll in training by the end of the 16th week of unemployment or, if later, six weeks after the Secretary has approved the application for assistance. Limited extensions of these requirements will be permitted only for justifiable cause.

As under the first component of the program, income support will be available to workers in secondary firms to enable them to participate in training and only after a worker has exhausted unemployment compensation. The weekly amount of income support will be the same as the

worker's unemployment compensation payment and the maximum duration of such support will be 52 weeks. Workers who do not qualify for unemployment compensation, such as certain farm workers and seasonal workers, will be eligible for income support if they worked at least eight weeks during the previous year. The weekly amount will be equal to the minimum unemployment compensation benefit level in the state and will be available for up to a period that equals the number of weeks that the worker was employed in the previous 52 weeks.

The process of applying for a grant under this component will parallel the filing of a petition under the first component of the program. A group of workers (or a family farmer) or their authorized representative will submit an application to the governor, who will provide rapid response and basic readjustment services and forward the application to the Secretary within ten days. The Secretary will make a determination relating to the application within 30 days of receipt.

In addition, the Secretary of Labor will include, as an element of both components of the transitional program, appropriate English language and occupational skills training for those workers who need it in order to achieve the program's objective of successful employment. A wide range of training opportunities, including on-the-job training, also will be available under this component. The Secretary of Labor will provide outreach services and technical assistance, including services and assistance in the language most effective for communicating with the particular work force, so that the workers have the information they need to apply for services.

### **3. Termination**

Finally, the transitional program will be phased out so that workers who are participating in either component on the expiration date of the program will be able to receive the balance of assistance for which they otherwise would have been eligible prior to that date.

It should be noted that the implementing bill authorizes the first component of the program until the earlier of September 30, 1998, or the date the comprehensive program takes effect. This provision ensures that a full array of services and benefits will be available over the long term to any workers that may be adversely affected by the NAFTA.

## **B. SELF-EMPLOYMENT PROVISIONS**

Section 507 of the implementing bill would authorize states to establish self-employment assistance programs as part of the state unemployment compensation system by amending the Internal Revenue Code. Under these programs, states may pay a self-employment allowance in lieu of unemployment compensation to help unemployed workers while they are establishing businesses and becoming self-employed. These programs also include entrepreneurial training and technical assistance to support the self-employment effort.

Section 507 establishes standards that self-employment assistance programs must meet, *e.g.*, for participant eligibility, required activities and the terms and conditions of allowance

payments. It makes necessary technical changes to the Internal Revenue Code and authorizes states to withdraw funds to pay allowances under the program. The costs of administering the self-employment allowance would be paid from the Unemployment Insurance administrative grants provided to the states under Title III of the Social Security Act.

The section requires an annual report to the Secretary of Labor by any state operating a self-employment program, and, within four years of enactment, a report by the Secretary to Congress on operation of the program nationwide. The authority for these programs will terminate five years after enactment.

Providing states the authority to establish and operate self-employment programs would significantly benefit workers that may be dislocated because of the NAFTA. The traditional system of unemployment compensation is primarily designed to provide income support for workers who are temporarily laid off or expect to be unemployed for only a short time. However, as a result of the NAFTA, some workers may lose their jobs permanently and need additional tools besides the basic income maintenance provided by the unemployment insurance system in order to re-enter the work force. For some of those workers, access to a self-employment program would be the best path for them to re-enter the work force. This provision gives states the ability to add the tool of self-employment training and support to the options available to help speed the transition of dislocated workers back into the work force.

### **C. STUDY AND REVIEW OF NAFTA**

Section 512 of the implementing bill requires the President to undertake a comprehensive study of the operation and effects of the NAFTA three years after its entry into force. This study will assess the extent of economic effects resulting from the agreement, including macroeconomic and microeconomic effects. Accordingly, the study will examine the effect of the NAFTA on United States gross national product, trade and current account balances, and employment, as well as the specific industries experiencing significantly increased exports to or import competition from Mexico or Canada as a result of the agreement. The study also will assess the extent to which the NAFTA may have led to shifts in investment, both into and out of the United States, and the effects of such investment shifts on employment in the United States.

In addition, Section 512 requires the study to assess the extent to which the NAFTA contributes to improvements in real wages and working conditions in Mexico, and protection of workers and the environment.

Section 512 makes clear that the study must attempt to separate the consequences of the NAFTA and events that likely would have occurred without the NAFTA. This requirement is an acknowledgement that many global and national economic trends have a strong effect on United States growth, trade, investment, productivity, and employment.

#### **D. HEMISPHERIC TRADE CENTER**

Section 515 of the bill directs the Commissioner of Customs, after consultation with appropriate officials in the state of Texas, to make grants to an institution or consortium of institutions to assist in planning, establishing and operating a Center for the Study of Western Hemispheric Trade in Texas. Among its activities, the Center will examine the NAFTA's impact on economies in the Western Hemisphere and the negotiation of future trade agreements, including possible accessions to the NAFTA. Section 515 establishes selection criteria; describes the Center's programs and activities; requires an annual report by the Commissioner to the Ways and Means and Finance committees concerning the Center's operations; and authorizes appropriations of \$10 million for fiscal year 1994 and such sums as may be necessary in the three succeeding fiscal years.

#### **E. FUNDING**

Sections 521 through 523 provide for offsets against the revenue losses attributable to the elimination of tariffs under the NAFTA, in accordance with the "pay-as-you-go" provisions of the Budget Enforcement Act. The bill will:

- give the Customs Service access to certain tax information to improve its efforts to enforce current tariff laws and detect fraud;
- implement a new electronic fund transfer system that will reduce paperwork and increase IRS efficiency; and
- increase temporarily the air and sea passenger processing fee from the current \$5.00 to \$6.50 to cover inspection and processing costs, and temporarily eliminate the current statutory exemptions.

Section 522 of the bill amends section 6103 of the Internal Revenue Code to enable the Customs Service to receive certain tax return information that will aid the Customs Service in assessing and collecting duties. Revenue would increase either through audit findings or increased importer reporting of accurate valuation figures. The Secretary of the Treasury will issue temporary regulations to carry out section 6103(1)(14) of the Internal Revenue Code, as added by this section, no later than 90 days after the date of enactment.

Section 523 amends section 6302 of the Internal Revenue Code to phase in a new system to transmit electronically tax funds and tax information, thereby eliminating the need for banks to process paper tax forms. As the new system is implemented, federal tax deposits will be credited to the Treasury Department's account one day earlier. This system provides for a change in payment methods only. It will increase IRS processing efficiency, reduce administrative burdens on taxpayers and enable tax payments to be credited to the Treasury's account on the due date.

Section 523 also sets out annual minimum conversion targets to assure that this change to electronic processing is implemented in a phased, orderly way. The change provides for permanent acceleration of tax receipts and a resulting increase in federal revenues during the implementation period.

Section 521 amends section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 to increase the current \$5.00 passenger user fees by \$1.50 for all international air and sea arrivals from the time the NAFTA enters into force through FY1997, at which time the fee will revert to \$5.00.

Section 521 will also raise the current fee exemptions for air and sea passengers arriving from Mexico, Canada, the Caribbean and the U.S. territories from the time the NAFTA enters into force through FY1997, at which time the exemptions resume. Puerto Rico is considered a state for this purpose and passengers arriving from Puerto Rico will not have to pay a user fee. The increased user fee revenue will be dedicated, subject to appropriation, to cover the costs of Customs Service inspections that are not covered by current user fees. All customs user fees are extended through September 30, 2003.

The bill also extends the Customs Service passenger processing and conveyance fees and the merchandise processing fees through FY2003.

## **F. COMMISSIONS ON LABOR AND ENVIRONMENTAL COOPERATION**

Sections 531 and 532 provide for U.S. participation in two trilateral commissions related to the NAFTA. These commissions are intended to ensure that the economic growth generated by the NAFTA is accompanied by increased cooperation between the NAFTA governments on environmental and labor matters and by improved enforcement in each country in these areas.

Section 531 of the bill authorizes U.S. participation in the Commission for Labor Cooperation. This section would allow the President to designate the Commission and its employees to receive appropriate privileges and immunities, as required by the North American Agreement on Labor Cooperation, pursuant to the International Organizations Immunities Act, 22 U.S.C. 288 *et seq.*

Section 531 also authorizes \$2,000,000 to be appropriated to the President for fiscal years 1994 and 1995 for payment of U.S. assessed contributions to the Commission. It also clarifies that funds appropriated pursuant to the authorization are in addition to funds that may otherwise be available for the same purpose, such as funds appropriated to the Contributions to International Organization account or the International Conferences and Contingencies account in the annual Department of State appropriations acts.

Section 532 authorizes U.S. participation in the Commission for Environmental Cooperation. This section would allow the President to designate the Commission and its employees to receive appropriate privileges and immunities, as required by the North American Agreement on Environmental Cooperation.

Section 532 authorizes \$5,000,000 to be appropriated to the President for fiscal years 1994 and 1995 for payment of United States assessed contributions to the Commission for Environmental Cooperation. It contains the same clarification regarding funds appropriated pursuant to the authorization as set out in section 531.

#### **G. BORDER COMMISSION AND NORTH AMERICAN DEVELOPMENT BANK**

The implementing bill authorizes the President to participate in a bilateral Border Environment Cooperation Commission ("BECC") with Mexico, and to accept membership for the United States in the North American Development Bank ("NADBank"). The BECC will marshal funds, some of which will be provided through the NADBank, for environmental projects in the U.S.-Mexico border area. The BECC will initially give preference to waste water, water treatment and solid waste projects. Such facilities will be important to improve environmental conditions in the border area and to ensure that increased trade generated by the NAFTA does not adversely affect environmental quality in that region. The BECC will certify that projects seeking funding by the bank or other sources of financing comply with necessary environmental and financial standards.

Section 533 authorizes U.S. participation in the BECC. This section also allows the President to designate the members of the BECC and its employees to receive appropriate privileges and immunities. The BECC's office will be located in the border region, along with a proposed EPA border office.

Section 533 authorizes \$5,000,000 to be appropriated to the President for each fiscal year beginning with fiscal year 1994 for payment of U.S. assessed contributions to the BECC. It contains the same clarification regarding appropriated funds as set out in sections 531 and 532.

Section 533 also provides that for the purpose of any civil action brought by or against the BECC, the BECC shall be deemed to be an inhabitant of the federal judicial district in which the BECC's principal office in the United States, or its agency appointed for the purpose of accepting service or notice of service, is located. Any action to which the BECC is a party will be deemed to arise under the laws of the United States, and the federal district courts shall have original jurisdiction over such actions. The section specifies that state court actions against the BECC may be removed to federal court. Section 541 contains an analogous provision for the NADBank.

Section 541 authorizes the President to accept U.S. membership in the NADBank and authorizes the Secretary of the Treasury to subscribe to the U.S. shares of the capital stock of the

NADBank. Section 541(b) provides that any such subscription will be effective only to such extent or in such amounts as are provided in advance in appropriations acts. This section also authorizes the appropriation of \$1,500,000,000 (representing \$225,000,000 in paid-in capital and \$1,275,000,000 in callable capital) for the U.S. subscription to its shares of the NADBank. In addition, section 541(b) provides that, for fiscal year 1995, the Secretary of the Treasury will pay to the NADBank out of any sums in the Treasury not otherwise appropriated the sum of \$56,250,000 for the paid-in share portion of the U.S. share of the capital stock of the NADBank, and will subscribe to the callable capital portion of the U.S. share of the capital stock of the NADBank in an amount not to exceed \$318,750,000.

The NADBank will be governed by a six-member board, with three members appointed by Mexico and three by the United States. Section 541(c) provides that the U.S. board members will not be entitled to any salary or other compensation from the bank or the United States for services as a board member.

Section 541(d) provides that the provisions of the Bretton Woods Agreements Act relating to the National Advisory Council on International Monetary and Financial Problems will apply with respect to the NADBank to the same extent as with respect to the World Bank and the International Monetary Fund.

Section 541(e) provides that, unless authorized by law, the United States may not subscribe to additional shares of stock to the NADBank, vote for or agree to any amendment of the agreement establishing the NADBank that would increase the obligations of the United States or change the purpose or functions of the NADBank, or make a loan or provide other financing to the NADBank.

Section 541(f) provides that any Federal Reserve bank that is requested to do so by the NADBank must act as its depository or as its fiscal agent, and that the Board of Governors of the Federal Reserve System will supervise and direct the carrying out of these functions by the Federal Reserve banks.

Section 541(h) extends to the NADBank certain exemptions from U.S. securities laws that have been given in the past to the various multilateral development banks, and establishes related reporting requirements.

Section 542 provides that the status, privileges and immunities provisions of the agreement establishing the NADBank will have full force and effect in the United States.

Section 543(a) of the bill provides that the President may enter into an agreement with the NADBank that facilitates implementation by the President of a community adjustment and investment program in support of the NAFTA pursuant to the agreement establishing the NADBank. The agreement provides that the total amount of loans, guarantees and grants provided for community adjustment and investment must not exceed ten percent of the sum of

the paid-in capital actually paid to the bank by the United States and the amount of callable shares for which the United States has an unqualified subscription.

In furtherance of this program, the President will be authorized to receive from the NADBank ten percent of the paid-in capital actually paid to the bank by the United States and to transfer those funds to federal agencies that make or guarantee loans to pay the subsidy and, as appropriate, other costs associated with such loans or guarantees.

As specified in section 543(a)(4), such loans or guarantees will be subject to the restrictions and limitations that apply to the particular agency's existing loan or guarantee program, except that any funds transferred to an agency will be in addition to the amount of funds authorized in any appropriation act to be expended by that agency for its program. Subsection (a)(5) provides that the President will establish guidelines for the loans and loan guarantees to be made by federal agencies under the community adjustment and investment program and endorse the grants and any loans or guarantees made by the NADBank for the community and investment program.

Section 543(b) provides for the establishment of a public advisory committee in accordance with the Federal Advisory Committee Act. The committee will be composed of representatives of community groups whose constituencies include low-income families; non-governmental organizations; business interests; and other appropriate entities, to be appointed by the President. As set forth in subsection (b)(3), the committee will provide advice to the President regarding the establishment of the community adjustment and investment program, including advice on the guidelines for loans and guarantees to be made under the program, advice on identifying the needs for adjustment assistance and investment in support of the goals and objectives of the NAFTA, taking into account economic and geographic considerations and advice on such other matters as may be requested by the President. The advisory committee will also review on a regular basis the operation of the community adjustment and investment program and provide the President its conclusions.

Section 543(b)(4) provides, among other things, for the reimbursement of advisory committee members for travel, *per diem* and other necessary expenses incurred in the performance of their duties, and for the provision of Secretariat and other services for the committee by appropriate federal agencies.

Under section 543(c), the President will appoint an ombudsman to provide the public with an opportunity to participate in the implementation of the community adjustment and investment program. The ombudsman will establish procedures for receiving comments from the public on the operation of the program, and will provide the President with summaries of those comments. The ombudsman will also perform an independent inspection and audit of the operation of the program and provide the President with the conclusions of the investigation and audit.

## **TITLE VI OF THE IMPLEMENTING BILL**

### **A. IMPLEMENTING BILL**

Title VI of the implementing bill incorporates the provisions of the Customs Modernization and Informed Compliance Act ("Modernization Act"). The Modernization Act will greatly enhance the ability of the Customs Service to implement and enforce the NAFTA, as implemented through this bill and under Customs Service regulations, as well as other U.S. customs laws.

The principal features of Title VI of the implementing bill are,

- improvements in customs enforcement generally;
- enhanced regulatory audit procedures;
- clarified drawback authority and new drawback penalties for false drawback claims;
- the creation of a National Customs Automation Program; and
- the acceptance of reconciliations with respect to prior entry summaries.

#### **1. Improvements in Customs Enforcement**

Subtitles A and B of Title VI institute a number of improvements in the enforcement of U.S. customs laws. For example, section 637 of the implementing bill, which amends section 484 of the Tariff Act of 1930, will impose on importers for the first time a statutory duty to exercise "reasonable care" in providing the Customs Service with accurate and timely classification, appraisalment and other data upon entering cargo. The Customs Service will establish the final classification, appraisalment and rate of duty applicable to an imported good based on the importer's data. Thus, it will be the importer's responsibility to appraise and classify the merchandise correctly and the responsibility of the Customs Service to verify that it was done correctly. Any importer that fails to exercise reasonable care will be subject to penalties.

In addition, to ensure compliance with U.S. laws, section 615 of the bill, which amends section 509 of the Tariff Act of 1930, creates new recordkeeping penalties that will require an importer to maintain supporting records for entry data. Penalties of up to \$100,000 per release are provided if the importer fails to do so.

The assumption by importers of greater legal responsibility in the customs process will be an important element in permitting the Customs Service to deal effectively with the increased

trade flows that are likely to be generated between the three countries by the NAFTA. In light of increasing budget restrictions, the enforcement provisions of the bill are essential to provide Customs the authority it will need in order to verify the correctness of entry data provided by importers.

## **2. Regulatory Audit Procedures**

Section 615 of the implementing bill, which amends section 509 of the Tariff Act of 1930, establishes clear, standardized requirements for the conduct of regulatory audits. Current regulatory audit procedures have been subject to criticism, and similar concerns have been raised with regard to the prospective implementation of the NAFTA. The provisions of section 615 of the bill, which were developed in close cooperation with the trade community, are designed to address these concerns.

## **3. Drawback and Drawback Penalties**

Customs payments for drawback have increased by over \$150 million in recent years. Currently, U.S. customs laws provide no penalties for companies that file false claims and thus there is no legal incentive for claimants to invest the time and effort to file the claims correctly. Section 622 of the implementing bill addresses this problem by establishing penalties for intentionally or negligently making false claims. This provision will provide a strong incentive for drawback claimants to ensure that claims are filed correctly and with the necessary supporting records. Section 632 of the bill clarifies conditions under which duty drawback claims may be made and revises the provision for drawback on finished petroleum derivatives. Sections 664 and 665 will also make technical changes to accounting procedures related to drawback claims on bonded aviation fuel transported by pipeline and for fuel withdrawn from bonded warehouses for use on qualifying aircraft.

NAFTA will eventually impose strict limitations on the availability of drawback on goods exported from the United States to another NAFTA country. During the transition period, however, the Customs Service must operate a complex administrative scheme that will require the three countries to monitor drawback information closely. This monitoring can be carried out effectively only through the exchange of electronic information provided for in Title VI of the bill. Furthermore, Title VI establishes a drawback penalty structure sufficient to ensure accurate claims under the NAFTA drawback restrictions, and facilitates the automated entry processing of the claims.

## **4. National Customs Automation Program**

Outdated customs laws require importers to file paper entry documents with the Customs Service at the ports where their imports arrive. Subtitle B of Title VI will establish the National Customs Automation Program ("NCAP"), which will permit importers to file electronically if they so choose, provided that they meet the computer requirements established by the Customs Service. The NCAP will also permit "remote location filing," through which importers may file

entry data electronically from locations other than the ports where the imports enter. Importers will also be able to file entry data and pay estimated duties periodically under the program.

The Customs Service has made a substantial investment in automation during the 1990s. However, current statutes do not permit the Customs Service and the trade community to reap the full benefits of that investment. The NCAP will establish the requisite legal basis and remove provisions of current law that limit the ability of the Customs Service to take advantage of computerization. The Act will significantly increase the ability of the Customs Service and the trade community to process entries electronically. In light of the anticipated increase in trade with Canada and Mexico resulting from the NAFTA, electronic processing under the NCAP will form an essential element of the effective enforcement of the Agreement.

## **5. Reconciliation**

Section 637 of the implementing bill, which amends section 484 of the Tariff Act of 1930, will generally allow parties to submit reconciliations within 15 months of filing electronically an entry summary or import activity statement. Although this new feature of U.S. customs law is expected to be used in a number of situations, it will be particularly useful for those entities subject to the NAFTA's value content averaging rules for automobiles. Under the NAFTA, exporters or producers must use the net cost method set out in Article 402(3) of the Agreement for calculating regional value content of automobiles and automotive parts to determine whether they qualify as "originating goods" and are thus entitled to preferential NAFTA tariff treatment. The producer may average its calculation over its fiscal year. Use of reconciliations provided for in this section will greatly simplify the process of appraisal and final liquidation of these entries.

## **B. ADMINISTRATIVE ACTION**

The Modernization Act represents a fundamental revision of U.S. customs law and procedure. This is particularly appropriate and timely in the context of NAFTA implementation.

The Customs Service estimates that over 50 percent of its regulations concerning commercial processing will need to be revised to implement Title VI. The regulatory changes that will be required include those with respect to: automation generally; entry processing; penalties; vessel entry; recordkeeping; protest procedures and appeals; accredited private laboratories; regulatory audit procedures; drawback claim processing; rulings procedures and publication of rulings; customhouse brokers; settlement of claims; and use of private collection agencies.

In light of the significant scope of the legislation and the administrative action that will be required to implement it, the Customs Service will be required to provide various reports to

the Congress, including a detailed report regarding the NCAP that must be submitted within 180 days of passage of the implementing bill.