NORTH AMERICAN ECONOMIC INTERDEPENDENCE

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

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NORTH AMERICAN ECONOMIC INTERDEPENDENCE

WEDNESDAY, JUNE 6, 1979

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m. in room 2221, Dirksen Senate Office Building, Hon. Max Baucus, presiding.

Present: Senators Baucus, Bradley, Dole, and Durenberger.

[The press release announcing this hearing follows:]

FINANCE SUBCOMMITTEE ON INTERNATIONAL TRADE ANNOUNCES HEARING ON NORTH AMERICAN ECONOMIC INTERDEPENDENCE

The Honorable Abraham Ribicoff (D., Ct.), Chairman of the Subcommittee on International Trade of the Committee on Finance, today announced that the Subcommittee will hold a hearing on issues relating to North American economic interdependence. Senator Max Baucus (D., Mt.), who will chair the hearing, stated that the hearings are intended to educate the Congress and the public about likely changes over the next decade in the economic relationships among the United States, Mexico, Canada, and the countries of the Carribean. He noted that, "We want to encourage the American people to start thinking of North America as a geographic unit with vast potential for all its people. We want to assess the current relationships and encourage the best minds in the region, both in and out of government, to begin exploring whether there are ways to increase the already high level of cooperation to our mutual benefit."

The hearing will begin at 10 a.m., Wednesday, June 6, 1979, in Room 2221 Dirksen Senate Office Building.

Representatives of the Office of the Special Representative for Trade Negotiations, the Department of State, and the Department of Energy will appear on behalf of the Administration. Witnesses representing various United States, Canadian, and Mexican interests will also present testimony.

Written statements.—Persons who desire to present their views to the Subcommittee should prepare a written statement for submission and inclusion in the printed record of the hearings. These written statements should be submitted to Michael Stern, Staff director, Senate Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, Not later than Wednesday, June 20, 1979.

Senator BAUCUS. The hearing of the International Trade Subcommittee will come to order. I want to welcome today all of the witnesses who are here to testify.

Today's hearing is the first of several I plan to conduct during the next few months to examine trade between the United States, Canada, Mexico and other nations in the northern portion of the Western Hemisphere.

To most Americans trade with Mexico and Canada means one thing: oil. Mexico's recent discoveries of vast reserves of oil and natural gas are an attractive alternative to Middle East oil.

At a time when lines at gasoline stations have reappeared and weekend closings are again common, such a large supply of oil on our southern border looks even more tempting.

Canada has in the past been a major supplier of energy to the United States. In my home State of Montana, Canada remains a major source of oil for refineries in Billings.

Several bills have been introduced this year that encourage energy cooperation among the three nations. Several proposals to establish a North American Common Market have come forward. We are a long way from that kind of a relationship. Our neighbors are rightfully cautious about such talk and even the mention of common markets and free trade zones legitimately and correctly cause concern.

This Nation's relationship with Canada and Mexico is much more complex than simply oil. The United States conducts more trade with Canada than with any other nation by a wide margin.

In 1977, the United States sold over $25.7 billion worth of products to Canada compared to $10.5 billion to Japan. Americans bought nearly $39 billion worth of imports from Canada compared to $18 billion from Japan.

The value of U.S. trade with Canada in 1978, totaling $62 billion, is more than the amount of U.S. trade with all of the members of the European Common Market.

We are also Mexico's largest trading partner, buying 70 percent of its exports. Last year, trade between the United States and Mexico totaled $12.7 billion, up 34 percent over 1977.

Trade with Mexico and Canada is one-quarter of this Nation's total international trade. Obviously, decisions made here have a dramatic impact in their capitals and upon their people.

Today, I hope we can begin to look beyond the statistics. We should look at the quality of our relationship with these nations.

How is our Government organized to handle North American affairs?

What do Mexico and Canada want in return for selling us their oil and other resources? How willing are American firms to share their research and development with the Canadian and Mexican firms?

How do we reduce and eliminate both tariff and nontariff barriers to trade? How do we provide some organization to the dozens of agreements that now govern trade?

These are some of the questions that I hope we can examine. Also, I am inserting at this point in the record a more complete statement for the record.

[The material referred to follows:]

The purpose of the hearings we are beginning today is to focus public and Congressional attention on the current status of North American relations in the field of trade and other areas, and to encourage serious thinking—both within and outside of our government—about the future direction of these relations.

Today's witnesses will address themselves primarily to issues in United States-Canadian and United States-Mexican relations. However, we should at the outset note that a systematic study of the possibilities for greater cooperation among the countries of the northern portion of the Western Hemisphere should also include consideration of the nations of the Caribbean as well.

We are witnessing an interesting change in American perceptions of our two large neighbors. Traditionally, little attention has been paid to the extensive and varied bond between our country and Canada and Mexico: We have tended to take them for granted.

Fortunately, this is now changing. This increased American interest is a product of our own domestic needs. As our economy has slowed down and our balance of payments deficit has steadily risen, we have paid increasing attention to international trade. And as the energy crunch has become more acute, we have become more aware as a nation of the foreign sources of our energy. Analysis of where we stand in regard to energy or to trade leads inevitably to a discussion of our relations with our two major neighbors.

Already the vastness and intricacy of the existing ties are apparent. Canada and the United States are each other's largest trading partner. The total value of U.S. trade with Canada alone ($62 billion in 1978) is slightly more than U.S. trade with all of the members of the European Common Market, and exceeds U.S.trade with the OPEC nations as a group.

The statistics in relation to United States-Mexican trade are no less impressive. We are Mexico's largest trading partner, taking approximately 70 percent of their exports. Mexico ranks within the top five of the nations with whom we trade. In 1978, trade between the United States and Mexico totaled $12.7 billion, up 34% from $9.5 billion in 1977.

In the field of energy, Canada's importance as a source of fossil fuel and hydroelectric generation, as well as a conduit for Alaskan oil has loomed large. Similarly, the monumental recent discoveries of oil and gas reserves in Mexico must inevitably enter our calculations about sources of future energy needs. Our interest in Mexican and Canadian energy resources has been matched by a desire in both of those countries to protect their natural resources, and to use them imaginatively and sparingly for the important tasks of their own national development.

Energy and trade are only two facets of the complex interrelationship. Migration patterns, cultural concerns and questions of national identity make difficult any simple analysis of cross border patterns.

The simple fact is that our own needs have propelled us to look more closely than ever before at North America as an economic unit, and, not to the surprise of experts, we are discovering the strength of this continent as an economic entity. Without doubt, the United States, Canada and Mexico taken together, form the largest single, and most vital economic trading block in the world. It is the seat of three vibrant democratic nations, and the home of aspiring and energetic populations.

The opportunities appear almost limitless, but there can be no doubt that there are significant obstacles to greater cooperation.

The task which confronts us as nations is to develop structures which will allow us to work together to our mutual benefit.

Legislation has been introduced into this Congress to encourage cooperation among the three nations, especially in the field of energy. Today some witnesses may speak about the proposed legislation and while this would be welcome we should not lose sight of the fact that this hearing and ones which will follow are primarily educational and informational in nature. We are looking for answers, but in fact, we are just beginning to formulate the right questions.

We must assess the full panoply of the existing relationships. For instance, I believe that there is far more governmental contact at the state and province levels than is commonly realized. These should be adequately catalogued.

We must know more about our ability as a government to improve existing relations. I am concerned that our relations with the two nations are too often compartmentalized within our own administration with the net result that our right hand does not know what our left is doing.

We must study further the reactions and sentiments of the people of Canada and Mexico themselves to the possibilities of increased cooperation. No progress is likely if we are insensitive to their views. There is a long legacy in both Canada and Mexico of suspicion of American motives. We must conduct ourselves in such a way to convince our neighbors that we are interested in arrangements that help us all, not just arrangements that help us get all of theirs.

We must seek out and listen to the views of all important elements of the American economy and pay particular attention to the concerns of this country's working men and women.

We must honestly ask ourselves whether, given the great differences in economic development between Canada and Mexico, it makes sense to try to deal with the two nations as part of a trilateral entity. Are we better off forgetting about continentalism and focusing on promoting better bilateral relations with each? I frankly do not know the answers to these questions, and I want to have this Committee promote public discussion of them.

The next decade may see profound change in our relations with our two neighbors, brought about by significant domestic developments in each. Mexico will undergo serious stress as it copes with the important questions that will be raised concerning the internal distribution of its new oil wealth. How this wealth will be used, by whom, and for whom, are likely to be the central issues of Mexican politics in the next decade. It will be a time of profound questioning. Similarly, in Canada, it is likely that the next decade will see a period of continued national self examination. The very unity of Canada is being called into doubt and while this is a question solely for Candians to decide among themselves, it will be foolish for the United States to remain unaware or unconcerned about possible ramifications for ourselves.

I am pleased that today we shall hear from not only spokesmen from the Executive Branch, but from individuals from private industry and the academic world, as well as representatives of private opinion in both Mexico and Canada. They will each express to us in their views about the need and possibility for increased hemispheric cooperation. Hopefully, today we shall begin a process—which is likely to be long and arduous—which will lead to greater understanding.

Senator BAUCUS. I hope this hearing will necessarily be the beginnings of a very long search into the general question, but also one that is delicate and sensitive to the countries and the people concerned.

We will begin with our first witness, the Honorable Alan Wolff, Deputy Special Representative for Trade Negotiations. Mr. Wolff, you are certainly no stranger to this committee. We are happy to have you here. You may proceed in any manner that you wish.

STATEMENT OF HON. ALAN W. WOLFF, DEPUTY SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS

Mr. WOLFF. Thank you, Mr. Chairman. If I might, I will attempt to summarize some portions of my testimony this morning.

I appreciate the opportunity to appear before this committee on the subject of international trade, and particularly the topic of North American interdependence.

Your proposal, which was adopted by the joint meeting of the House Ways and Means Committee and the Senate Finance Committee in its preparation for recommendations for the trade agreements which the President is due to submit in about 10 days, recommended to the administration, and the administration has agreed, to undertake a study of the economic interdependence between the United States and our neighbors to the north and south.

Under the draft bill, this study would address, among other subjects—

> the desirability of entering into trade agreements with countries in the northern portion of the Western Hemisphere to promote * * * economic growth and the mutual expansion of market opportunities.

The draft legislation goes on to call for—

> an examination of competitive opportunities and conditions of competition between such countries and the United States in the agricultural, energy, and other appropriate sectors.

There are two other witnesses from the administration here this morning, Mr. Peter Borre, Department of Energy, and Mr. Julius Katz, Assistant Secretary of State.

I feel that this proposal is an important one. As you expressed yourself, there is some uneasiness across both borders when we talk about economic integration. There is concern about U.S. domination.

Former Prime Minister Trudeau used to talk about the relations with the United States, viewing the United States as a neighbor, as something like being in bed with an elephant. He cautioned against a friendly elephant who may roll over in the middle of the night, which may be a cause of some concern.

Our Mexican colleagues, even those quite friendly to the United States, have used somewhat earthier analyses in terms of their concerns of having the United States as a neighbor. There is some political history concerning the northern border of the United States, if you look at some forts the Canadians have, those forts were built to keep us out during an invasion, during the American Revolution. There is a little bit of Mexican-American history, too, that we have taken a long time and a lot of effort to resolve.

Your amendment, it seems to me, leads us in the right direction. Of course, we do not see U.S. commercial dominance over either, or both, of our two good neighbors. None of our actions should give rise to unnecessary concerns over either of these neighboring peoples. Rather, I would hope that both of these countries would join with us in seeking to find new and better ways of mutual cooperation and coordination of our economic opportunities which really, can be much to our mutual benefit.

Economic interdependence among the United States, Canada, and Mexico is a major factor in the economic life of all three countries. This has been brought out by the important position of trade and direct investment flows among the three countries relative to each country's total trade and foreign investment flows. You just cited some of the trade figures. The United States accounts for over 75 percent of total Canadian exports and imports, 60 percent of total Mexican exports and imports, and Canada and Mexico together account for 25 percent of our total trade, both export and import; so together we have a lot at stake.

In direct foreign investment, there are similar figures. Canada and Mexico account for over 25 percent of United States direct investment abroad. Canada has more United States foreign investment than any other single country, with Mexico not far behind.

Despite the already large trade flows among these three countries, there are large opportunities for expanded trade that deserve to be explored. Also, there are mutual problems that will have to be dealt with in a mutually satisfactory manner.

Let me first address trade with Mexico, if I might. Almost 10 percent of Mexico's GNP is now generated by exports, only slightly above that of the United States. The United States is, by far, Mexico's most important customer.

Access to the United States market will continue to be of importance, especially if Mexico shifts to a policy of export growth.

Oil revenues give Mexico a unique opportunity to reorient its commercial policy in the direction of trade liberalization. For the first time, Mexico will be able to pay for the increased imports which trade liberalization would involve. This, in turn, would enable Mexico to develop more efficient export industries.

Trade liberalization can provide new impetus for Mexican development, creating employment and bringing about productivity gains necessary to raise real incomes. By the same token, the economic growth generated by Mexico's oil as well as its general economic dynamism should make it an increasingly important customer for the United States.

In fact, I think our private sector should see Mexico as the single most important growth area in trade opportunities in the coming decade, or decade and a half. Some predict that Mexico's annual rate of imports will expand five times from $5 to $25 billion in 1985.

So it represents an enormous market opportunity. There is an enormous range of new opportunities for a variety of United States businesses and Mexican businesses alike. There are two key trade issues in the United States-Mexican relationship right now which continue to cause friction, preventing both countries from obtaining greater mutual advantage.

In the case of Mexico, there is a good deal of protectionist sentiment that masquerades as a desire to develop. It is one of the great problems in developing countries to protect infant industries and, as the infants grow up, it is always difficult to remove the protection.

We have invested in infants of our own, and we know once protectionism applies, is very difficult to reduce or remove.

From our side of the border, our producers have their own concern about increased Mexican competition. Thus, we need to do two things, it seems to me, in our trade relations with Mexico. We have to deal with the pressures of protection as we seek ways to manage the shifting patterns of trade responses to the shifting patterns of trade with Mexico, as with other developing countries.

On the other hand, we have to encourage the Mexican Government—and I think they realize this—that it is in their own interests to engage more fully in the process of trade liberalization.

Let me give you a specific example which has been before this committee recently, the matter of winter vegetables. That trade causes a very serious disruption of our market, which occurs at certain times seasonally. Our reaction this time around, in the case of winter vegetables, has been a filing of a complaint under our Antidumping Act against Mexican tomatoes and other winter vegetables.

Absent a satisfactory solution of that action, that trade will cease, and that will not be a healthy thing for the U.S. consumer. It would not even be a good thing for the Florida growers or the growers in California or Texas or Arizona and it would certainly cause a sharp deterioration of our economic relations with Mexico, with which we are working hard to avoid having that result.

Further strong efforts will be needed. We are not yet within sight of a solution. We have not yet managed to come together with Mexico and find our way through this problem. It is going to be a very serious one if we do not deal with it quickly.

Mexico, on the other hand, views the United States as essentially protectionist through tariff and nontariff barriers on quite a number of goods that Mexico produces. We would say, while there is some truth in the fact that the tariff and nontariff barriers in the United States impact on Mexican products, that Mexico suffers more fundamentally, not from our barriers, but from a lack of competitiveness with Mexican exports.

Like many less developed countries, Mexico has followed a policy of excessive protection of its industrial sector against import competition. Mexico has high tariff walls and, over the last couple of decades, has put into place a comprehensive and essentially restrictive system of import licensing.

The licensing system has been a major complaint of United States exporters, particularly in the case where the Mexican government restricts entry even when Mexican exporters have established an export market in the United States and protection is no longer necessary for developmental reasons.

In addition to Mexico's basic system of high tariffs and licensing, Mexico has an extensive array of indirect trade controls such as domestic content requirements and a system of official evaluation of imports, which have had a restrictive effect.

I hope that we will arrive at a significant MTN agreement with Mexico. We do not have one yet. We are in the process of negotiation. It has been very difficult, more because of our proximity than because of difficulties posed by negotiations with other trading partners. We are close, and therefore we have significant problems in our trade relations.

On our side, we have a number of programs that have been of benefit to Mexico, which are detailed in my statement and can be included in the record. The United States Tariff Schedule 806-807 program that supports Mexican border industries, and our generalized system of preferences which benefits Mexico to about half a billion dollars a year in trade coverage, are examples.

Mexico has some criticisms of those programs, particularly the generalized system of preferences and the competitive need limitation which is now something on the order of $37.2 million each year. But, in fact, the future of our trade relations lies not in unilateral grants of U.S. market access, but in the opportunities that the Multilateral Trade Negotiations (MTN) can give for permanent market access.

Now, turning if I may, for a moment, to Canada, in spite of the fact that United States-Canadian trade is considerably larger than United States-Mexican trade, we have, right now, relatively fewer problems. I mentioned earlier the psychological problem that Canada has with the appearance of domination by the United States in Canadian trade.

In fact, the United States provides duty-free access to something between a third and a half of all United States imports from Canada, and the average tariff on dutiable imports from Canada will be reduced to about 3 percent on industrial trade as a result of our MTN agreement with the Canadians.

That is by the year 1990, a phase-in from 1980 to 1990.

While Canada recognizes there are important benefits provided by the MTN in our market, she still feels uncomfortably dependent on the United States market and has engaged in a major effort in recent years to strengthen economic ties with the European community through a framework agreement, and with Japan and other areas in order to diversify its economic context, which is understandable from a political point of view.

While overall United States trade relations with Canada have been good, there still are a number of problems. One is tariff disparities, about which United States producers have often come to this committee and to our office and said the Canadian tariff on our products is much higher than our tariff on the same product when imported from Canada.

Our MTN agreement with Canada will significantly reduce the United States-Canadian tariff disparities for a large number of products of United States trade interests.

The Canadian tariff reduction on industrial products is in the range of 42 to 43 percent. The United States will reciprocate with about the same level of cut.

So generally, we will have lowered our tariffs on industrial dutiable tariffs to 3 percent, a cut of 3.2 points over the next 8 to 10 years. Canada, which has had a higher tariff historically on the dutiable goods—more of the trade in the past has been duty free—will reduce by about 6.5 points its tariff to a level of 8.3 percent.

That gives a picture useful for trade negotiation purposes, but in terms of our overall trade interest, United States tariffs to Canada will drop from a level currently of 1.5 to 0.9 percent by 1990.

This is not dramatic, but it is a continued improvement in the right direction, while Canada's average tariff protection to our exports will drop from 10.6 to 6.1 percent.

A major reason for the gap in tariff levels is that they are weighted by trade and the large volume of United States imports from Canada, such as woodpulp. Those are either duty-free or carry a very low duty.

Our MTN agreement with Canada also will substantially reduce another major area of trade frictions. The machinery program, the made in Canada program, where there is a good deal of uncertainty on the part of the United States exporter who begins to export to Canada, is a case in point. If the Canadians came onstream with production and a tariff increase of up to 15 percent under that program, that would impact substantially.

Our achievement with Canada has been a very good one in the MTN. Trade problems have continued to arise, but under the nontariff agreements, which I hope both Mexico and Canada will join, a lot of them that we face, specifically in subsidies and the application of countervailing duties, customs valuation and product standards and government procurement, will be solved through the mechanisms available under the nontariff codes.

I believe that the time has come for a fuller exploration of new trilateral trade opportunities. This is called for by the Baucus amendment. It is fundamentally in the interests of Mexico, Canada, and the United States, and I would urge the governments of the two neighboring countries to engage in parallel studies with private sector groups, and I know that the National Association of Manufacturers, for example, is interested in this. Each of our countries needs to provide our governments with advice and support on this subject.

Perhaps some private sector groups will engage in joint efforts and studies with their counterparts in Mexico.

Thank you, Mr. Chairman, for the opportunity to testify, and I will answer any questions you may have.

Senator BAUCUS. Thank you very much, Mr. Ambassador. There are a lot of ways to approach this subject, to bring it into focus. As I listen to you, essentially you are saying that in the administration's negotiations and discussions with both Canada and Mexico, there have been substantial areas of improvement in lowering the tariff and nontariff barriers.

I wonder if you could generally outline the greatest problems that you are having in respect to trade barriers with Mexico and with Canada.

The more we can identify some of those areas, the more we can begin to see where it makes sense to progress and where it does not.

Mr. WOLFF. There are two very different situations now in our negotiating posture with Mexico and Canada, because with Canada we have an agreement—which I think is a good one—and with Mexico, which we are still not quite within sight of good agreements.

Let me start with Mexico first.

Senator BAUCUS. You might also explain to the degree that you sense Mexico might join GATT.

Mr. WOLFF. Mexico has indicated its desire to negotiate a session to GATT and is proceeding with that. There is a great deal of public debate still in Mexico as to the benefits of GATT membership for Mexico.

It seems to me to be fundamentally in Mexico's interest to join GATT. That is why the President of Mexico took the decision to accede to the GATT.

Mexico is at the point where it should be playing a full and rightful role in international economic affairs. It cannot do so outside of GATT.

GATT is the major trade organization in the world. It sets the rules for world trade. To participate in the MTN, to influence the rules and to be a full partner in the administration of those rules, is a political and economic judgment, and a hard judgment, for Mexico. It took the right approach in deciding to negotiate accession to the GATT, and I hope that it will proceed.

Senator BAUCUS. What is the delay? What is the internal resistance in Mexico?

Mr. WOLFF. The internal resistance is that there are disciplines imposed by membership in the GATT. That is one of our interests in seeing Mexico in the GATT with us. United States businesses would like to know when they export to Mexico, that the Mexican trade regulatory system is subject to some international disciplines provided by the GATT.

Those who are more protectionist in Mexico will say we have access to other markets. Why should Mexico join in this international organization that basically brings trade regulation?

There are a couple of answers to that. One is, every government needs some international discipline to offset domestic pressures. There are no easy offsets other than consumer benefits to domestic pressures for protection.

I think it is in Mexico's longrun interest to join GATT. There is also a feeling that there ought to be a reassessment now that there is a great deal more oil and gas in Mexico as to how Mexico ought to conduct its trade.

Senator BAUCUS. I take it you think the benefits outweigh the negative. I wonder if you could outline the major benefits as compared to the disciplinary restraint.

Mr. WOLFF. More specifically, we are entering into a time—we are in it—that it is going to be very difficult in international economic relations. We had the Multilateral Trade Negotiations in place 5 years ago. They prevented developed countries from taking clearly illegal, or clearly unreasonable actions in the trade area against developing country imports in particular.

The strain of being in that negotiating posture is disappearing with the end of these negotiations. You cannot haul off and sock the guy across the table all that easily. We are coming out of these negotiations, and those that are not members of the GATT, not contracting partners, not part of this agreement, may just find that such restraint is very weak when it comes to actions by the developed countries against their exports.

There is a theory of a clear and present danger, so it is fundamentally in every country's interest to be in the room to be able to complain about foreign barriers, about restraints to their exports. I am not one of the official prognostigators of the U.S. Government in terms of economic activity next year or in the fall, as to whether or not there will be a downturn globally or in the United States.

I do know in Europe the level of total employment today in several major countries is less than it was in 1974. There is not total recovery from the recession. There are sectors where there is tremendous overcapacity and tremendous pressures, Mexico, and other advanced leading underdeveloped countries are exposed to a risk, and can protect their interests by being members of the international community in the trade area, rather than standing on the outside and going it alone.

Senator BAUCUS. What significant barriers which now presently exist between ourselves and Mexico and Canada are most likely to be resolved.

Would you rank them from those which are most likely to be resolved fairly soon to those which are the most difficult.

Could you name one or two on the top and one or two on the bottom?

Mr. WOLFF. Let me start with the clearly most difficult problem between ourselves and Mexico. That is the problem of winter vegetables. It is a politically highly charged problem and economically it could be a difficult problem. The tools that we have to deal with it are not adequate.

The Antidumping Act, from the domestic producers' point of view, is very clumsy, a very slow kind of tool, not designed for what it has to deal with. From the Mexican point of view, there is a great uncertainty in shipping to the United States market because there can be interruptions.

We have to find a longer term solution with the Mexicans. It is going to be difficult but it really is essential to our economic and political relationships with them in the future.

Senator BAUCUS. If you had to very tentatively guess to the direction of the long-term issue, what would it be? Something must come to mind as you are driving to work, taking a shower in the morning. What kind of beginnings?

Mr. WOLFF. I would like to speak in general terms because it is a matter of negotiation right now. I would think greater certainty could be achieved through consultative mechanisms with some idea of what was acceptable, which could be acheived in terms of either price or quantity. It is worth further exploration. We are not looking for a restrictive solution, a prohibitive solution. Our consumers need Mexican vegetables. I do not think the Florida fruit and vegetable industry is in favor of excluding the Mexicans from the market, but some more rational, long-term approach. We will pursue that subject further.

If the dumping complaint goes to its natural conclusion, there may be the effective prohibition of this product from our market, which really is an unintended result and not backed by the Floridians.

Senator BAUCUS. What about the subject of steel?

Mr. WOLFF. Steelmaking process?

Senator BAUCUS. Yes.

Mr. WOLFF. I think, for example, the subsidies code, the adoption and adherence by Mexico to the subsidies code, plus the customs valuation code, will help to solve a number of our problems. I think we are pretty close to an acceptable industrial package, a substantial industrial package, on both sides, including liberalization of licensing by Mexico and reduction of both tariffs and subsidies.

I should mention that there are further agricultural problems. We have been in a position of providing access to the Mexican markets for a large number of fruits and vegetables, and the Mexicans are resisting access to similar American exports.

There are bilateral problems going both ways in terms of seeking greater access in the Mexican and America markets for this trade.

Senator BAUCUS. Have you ever sat down in three-way negotiations with Canada and Mexico or do you deal separately with the Mexican Government and Canadian Government?

I am wondering whether you have given any thought to three-way negotiations? If you have actually met, what has been the outcome of those meetings?

Mr. WOLFF. There has not been much of that, in fact. There has been an effort in recent times in particular in the Carter administration to address the problems of United States-Mexican economic relations, in a much improved way; problems of illegal immigration, of energy, of drug traffic, of trade. Quite a number of areas; a comprehensive overview.

There has not been a substantial effort on a trilateral approach in the Western Hemisphere.

Senator BAUCUS. Do you think there has been success?

Mr. WOLFF. In some areas, not comprehensively. I do not know whether the Mexicans would like to sit down and discuss winter vegetables with both Canada and the United States, although we share those problems.

I will let my colleague from the Department of Energy address the energy side, but it might be useful to have some greater degree of economic consultation in that regard.

I do not think that all of the problems, or a majority of the problems, would necessarily be susceptible to a trilateral approach.

Senator BAUCUS. Do any problems come to mind that might be susceptible to a trilateral approach? Energy?

Mr. WOLFF. Energy, maybe. Transportation may be another.

Senator BAUCUS. How about the restrictions on investment?

Mr. WOLFF. Possibly. Maybe Julius Katz will have some views on that.

Of course, we have very little in the way of restrictions ourselves and it is mainly a defensive attitude of others toward our capacity.

Senator BAUCUS. In your judgment, would it make any sense if Mr. Kreuger is confirmed by the Senate as a kind of economic ambassador to Mexico, to broaden his portfolio to include Canada?

Would it make sense to broaden the scope?

Mr. WOLFF. It seems to me a range of bilateral problems are sufficiently extensive that are not shared by the three countries together that a trilateral approach to coordination of the problems, may be the answer. We happen to have on our plate quite a number of problems with Mexico that require immediate attention that have focused Government attention on Mexico, so probably they should be kept separate from our problems with Canada.

A result of the study might lead to some form of U.S. Government coordination with both governments at the same time. That could be most useful.

I doubt if the question has received a good deal of attention today.

Senator BAUCUS. What mechanisms do you have to consider the effects of our policies toward one country might have on another? That is to say, if we reduced the tariff on Mexican-produced railroad cars entering the United States, what effect would that have on railroad traffic between the United States and Canada? Do you have a mechanism to look at such connections?

As I listen to you, I sense we are still in a situation where in relation to North America, the State Department negotiates bilaterally directly with one country and tends not to have a mechanism sufficient to look at the effects it might have on adjacent countries.

Mr. WOLFF. It might come to our attention on something like railroad cars, but in general I do not think we have sufficient mechanisms to coordinate policies in different areas. That is one of the reasons why Mr. Kreuger has been named for the job to coordinate the various policies in Mexico.

There is more than that. There is an impact of these various policies in related areas. One of the things that has interfered, has caused the most anguish, both in Mexico and Canada, is tax treatment abroad. I think that is something in the way, something of a trilateral problem more than a problem between ourselves and other countries.

Senator BAUCUS. Senator Bradley?

Senator BRADLEY. I will yield to the Senator from New Mexico for his comments.

STATEMENT OF HON. PETE V. DOMENICI, A U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator DOMENICI. I do not have any questions. I just came because I wanted to compliment your subcommittee for the hearings. I am not sure what is going to come of them.

I want, as one Senator not on the committee, to tell you that I truly believe that North American economic interdependence is a concept for which the time has arrived, and we had better get on with it.

For so long, we have considered America's relationships of a trade nature and otherwise with foreign countries and we have always looked far, far away, and I truly believe that for this country to succeed and to remain a strong, free society, to remain economically sound, that we have to look at this continent in relationship between the countries.

I was going to use tourism and the tax on conventions as an example, not because what I am going to suggest as an idea would necessarily relate to that, but I submit that it is an insult to consider the elimination of a convention deduction and to treat every country in the world identically and never to have considered our friends on this continent and the impact that we might have on them by changing that tax law.

To not consider that differently is precisely what the Mexican people are saying about the relationship with America, that there is not any special relationship.

For instance, we would not have liked it very much if our tourism promotion of this country was building hundreds of thousands of new rooms to employ our people, relying upon Mexicans to come and use them, if all of a sudden we changed our tax laws and had not even considered the impact on our neighbor, or vice versa.

So I use it only as an example.

I urge that you be somewhat more bold than we have been in the past, that the Finance Committee recommend that our President begin negotiating for the establishment of an exploratory commission between the three countries—not that we dictate what it would be, but that we firmly suggest that there be a trade commission for exploration of what it might do for the three countries, and that our President be encouraged by the Senate to take the lead in that.

It may never work. The Mexicans may not want it. The Canadians may say that there is too much disparity between the three, but I think that is the kind of thing that should come out of the tremendous hearings that you are having on the interrelationship between the countries.

I have been there. I speak the language. I am going to become their friend, whether I am on this committee or otherwise. I am going to try to work toward better relationships with Mexico. I am terribly impressed with the disparity between their public view and their real view. Their public view is anti, their private view is the view of a friend. Their public view is political and their private view is realistic, and I think that we have to take advantage of that with mutually beneficial approaches—not good for America, but mutual; the creation of a group to look at that, not saying, let's have a common market right off. That scares everyone. Maybe that is what it will be 50 years from now. It will never move that way unless we are bold enough to encourage some evaluation of the creation of the Commission to look at these things.

I thank you for the time.

Senator BAUCUS. I thank the Senator. You have a good idea, to establish a commission, introduced already in the Senate. I think that we would all agree that potentially, it is a great idea. The whole point is to see how far it goes and push as diligently as we can. If we find a dead end, we will explore that dead end and know that exists.

I suspect that probably our endeavors will result in significant advancement toward this end. This is a question of degree of the problem more than anything else.

I thank the Senator for his contribution.

Senator DOMENICI. Thank you.

[The prepared statement and attachment of Senator Domenici follows:]

STATEMENT OF SENATOR PETE V. DOMENICI

Mr. Chairman, I first want to thank you and my other colleagues on the International Trade Subcommittee for granting me the opportunity to appear before you today to speak on an issue about which I am extremely interested.

Common issues, which affect the major nations of North America, multiply as we grow more dependent on each other as allies, as major trading partners, and as suppliers of both raw and finished goods to one another. Three decades of growth so rapidly as to be unprecedented in history have brought us face to face with the need to establish a forum for quiet consideration of those thorny little problems that crop up from time to time between great trade partners isolated on one continent.

During my recent trip to Mexico, I was struck by the fact that no such forum exists which includes only our three countries, and before which these small problems can be met with a spirit of accomodation.

We have no mechanism which allows an immediate check with both of our neighbors to see what effect a small change in our domestic trade regulations will have upon each of their economies, or for them, in turn, to consult with each of their own other two neighbors.

Trade carries with it, of course, a variety of other issues which deal with movements of food, movements of manufacturing plants, and the creation of greater industrial capacity to increase productivity across a broad range of products manufactured on the North American Continent. And again, we have neither council, assembly, body or commission to study and to weigh these small, but potentially serious, questions of singular urgency to the Canadians, the Mexicans, Americans and to citizens of other countries in North America. The issue being discussed here today, that of North American Interdependence, can eventually lead to a better life on this North American Continent.

RESOLUTION

Expressing the sense of the Senate with respect to establishing a North American Contintental Trade Commission.

Whereas the United States, the United Mexican States, and the Republic of Canada share mutual borders, ideals, and economic aspirations;

Whereas issues diverse and sundry, common to and affecting the United States, the United Mexican States, and the Republic of Canada, are escalating as such countries grow uniquely interdependent;

Whereas three decades of unprecedented growth in international trade mandates political and social action to unify and safeguard mutually beneficial world regional and continental trade relations;

Whereas the success of Euopean countries in applying economies of scale to the concept of regional trade groupings in intercontinental trade has succeeded beyond expectation;

Whereas dislocations reminiscent of those extant in Western Europe prior to formation of the European Economic Community today begin to belabor North American countries;

Whereas no tripartite council, assembly, or body now exists to weigh the impact of the trade actions of any North American country upon the economy and well-being of its other North American neighbors; and

Whereas the creation of such a tripartite council, assembly, body or commission to explore, study, and weigh these and other interdependent questions of singular urgency is deemed worthy: Now, therefore be it

Resolved, That it is the sense of the Senate that the President should enter into negotiations with the Government of the United Mexican States and the Government of the Republic of Canada to establish a North American Continental Trade Commission.

Sec. 2. The Secretary of the Senate shall transmit a copy of this resolution to the President.

Senator BAUCUS. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Ambassador Wolff, a few months ago it was reported that Canada and the United States were entering into talks to limit government subsidies for investment on each side of the border. Do you know anything about those talks, or what is the status of those talks?

Mr. WOLFF. I am not sure what the particular reference is to, but Julius Katz will be along shortly to speak to the investment questions.

Senator BRADLEY. It was reported in the Journal of Commerce that talks—you do not know anything about them? This was conerning limitation of government investment subsidies for industries across the board.

Mr. WOLFF. Excuse me. I missed the word "subsidies" in your question.

The subsidies code that we entered into in Geneva that was initialled April 12 was of principal importance. I would say that only two countries in the world that we have a code of conduct to begin with, the United States and Canada. One of the key questions was if we could not agree to avoid domestic subsidies to investment to cause serious pressures on the trade interests of others. We managed to receive that commitment internationally. There may be something further than that to which the Journal of Commerce is referring.

It was the United States and Canada in a joint effort to address these questions. We now have that with the use of the code obligation and the amendments to the countervailing duty law, which I suspect Canada will emulate. We will have the means to deal with excessive subsidization from other countries, including Canada.

Senator BRADLEY. Well, what direction might that take? What are examples of subsidies that you might seek to eliminate?

Mr. WOLFF. We will have to see case by case exactly where the code will go, but there have been instances in the name of regional aids, in the name of maintaining plants which are uneconomic in particular areas where excessive subsidization has led to really, in bilateral United States-Canadian relations, the appearance of stealing the plant, getting a plant to locate, not from one area of the country into another, but from one country into the other, when it serves the other country's market.

We do not have much in the way of influence over our States and localities. Frankly, the Canadians have even less influence over their Provinces in the area of tax laws. I expect both of us see a lot of movement in that direction. When it is Federal money, we should, under our obligations, feel a bit more restrained, essentially. So should the Canadians.

Senator BRADLEY. You know, in Canada, for example, would one of the targets be the regional investment operations at the Federal level. The Maritime Provinces have received a great deal more subsidy from the Federal Government for stimulation of economic development than has Alberta, for example. What I am asking, is this the kind of thing that would be under attack if we sought to reduce subsidies?

You mentioned regional subsidies.

Mr. WOLFF. A determination would have to be made on a case by case basis, product by product transaction, subsidy by subsidy. We have regional aids in our country as does every other country. The Canadians have them as well. It is considered to be a matter solely within the sovereign concern of our own Nation, or theirs.

That position is not defensible when it seriously adversely affects the trade interests of another country. Where these particular measures that you have mentioned result in injury to our industries, the United States has a clear and understood right to offset those subsidies with the use of countervailing duties, and the Canadians have agreed to that.

On the other hand, when there is no injury, we ought not to be countervailing. We have the means of dealing with these questions to a greater extent, to a greater degree of mutual understanding, than we have ever had in the past.

Senator BRADLEY. As of now, you know nothing about continuing talks between the United States and Canada? These talks were announced by Fred Bergsten, Assistant Secretry of the Treasury for International Affairs.

Mr. WOLFF. Yes; there were particular talks that Julius Katz and Fred Bergsten had in Canada with respect to automotive manufacturing subsidies. Perhaps Mr. Katz could address that.

I do not know whether there has been any followup in recent months.

Senator BRADLEY. If this trilateral relationship involving Canada, Mexico, and the United States progresses, do you see any way that preferential agreements on price and long-term supply might violate the GATT principles?

Mr. WOLFF. With reference to any particular product?

Senator BRADLEY. With reference to no particular product. The thought was that there would be preferences for long-term supply and prices on specific commodities and products.

Would this, in any way, violate the GATT accords?

Mr. WOLFF. If there is discriminatory treatment, it would violate the most favored nation clause of the GATT. Where in effect there is subsidization, and there have been a number of such schemes in Canada over time—as we discussed a little earlier—Canada feels very defensive about the size of U.S. industry and it tries to offset that size, and the appearance of domination, through a variety of measures.

On occasion, both violate the new subsidy rules we have just engaged in and call for an offsetting action on our part if the Canadians persist in that direction.

Senator BRADLEY. I guess my question is, are we going down the road of greater cooperation and looking at long-term possibilities of the Canadian-Mexican-United States Common Market idea when the first steps, and certainly the realization of such an idea, would be in violation of GATT. That is the basic question.

Mr. WOLFF. The GATT has an exception—Article XXIV—the GATT has an exception for both customs duties and free trade areas.

No one has seriously considered in the U.S. Government going to a customs or free trade area with Canada or Mexico.

Senator BRADLEY. Such a union would not be in violation of GATT?

Mr. WOLFF. It would not be.

Senator BRADLEY. In the energy area, if the United States and Mexico and Canada agree to some kind of long-term energy supply arrangement, government-to-government, what sort of problems do you think would arise, because to make those agreements work, we would have to depend on the companies.

I could see possible conflict right now, for example, in the energy area. We have enormous problems getting information from companies because they do not want to release proprietary information because of the competitive aspects.

It seems to me that if we are entering into a long-term energy agreement between and among the countries, private corporations will be major actors.

Do you see any problems in this area in the long term?

Mr. WOLFF. I think this is going to be addressed in the next witness's testimony, Mr. Borre of the Department of Energy. I do not mean to be unresponsive, but that is his area of responsibility.

Senator BRADLEY. I would like to submit that question for the record if I am not here for Mr. Borre.

Senator BAUCUS. Fine.

Senator Durenberger?

Senator DURENBERGER. I have no questions.

Senator BAUCUS. One final question, Ambassador Wolff—actually, two.

As I understand it, Canada is a bit upset with American tax policy which does not allow business deductions for conventions in foreign countries. Meanwhile, some American firms are upset because Canadian companies who advertise in American magazines or U.S. televison stations do not receive deductions on their Canadian taxes.

How far along are we in negotiating a resolution to these problems?

Mr. WOLFF. We have, to date, failed to make progress on those questions, but there has been a change in government in Canada, of course, and the policies of the new government have not been established in that area. We have scheduled talks with the Canadians on this subject as early as next week. We will have some follow-up talks with them.

We are not without hope, but we were about at that stage with the last government.

Senator BAUCUS. What is the problem? What has the problem been?

Obviously, there is interest on both sides.

Mr. WOLFF. There is a feeling in Canada of cultural as well as econonic domination, with broadcasting, the stations south of the border receiving a good deal of revenue from Canadian advertisers to broadcast in Canada, which was considered regrettable. There had been something of a similar motivation in the magazine problem earlier.

Senator BAUCUS. Is there any significant difference in the status of Canadian Provinces versus the Federal Government on the one hand and Mexican states and the Mexican Government on the other?

Is that worth mentioning at this point? As you know, the Canadian Province has a lot more autonomy than certain American States and Mexican states.

As you also know, the western Provinces possess most of Canada's energy and agricultural resources.

To what degree is the Canadian federal-provincial relationship a factor in United States-Canadian trade negotiations? Do you have any views on that broad subject?

Mr. WOLFF. In the Multilateral Trade Negotiations, the Canadian Government, the Federal Government, had a very cautious concern about the specific trade interests of the individual Provinces. That was a political problem which was matched more for them by regions than by State interest for us in the United States.

Senator BAUCUS. Is it not more of a problem now with the recent election in Canada? The Quebec problem is also a problem that occurs to us. Does that not create more difficulties here?

Mr. WOLFF. Yes, I think in the energy area where the Provinces have of good deal of autonomy, which our next witness will address, I am sure, it is going to be an increasing problem.

Senator BAUCUS. Does the STR negotiate at all with the Provinces?

Mr. WOLFF. Not at all.

Senator BAUCUS. As I understand it, there are a thousand different agreements between the States and Provinces, concerning a wide variety of issues from license plates on up.

Mr. WOLFF. The commercial responsibilities of the Canadian federal government is a little bit akin to our negotiating solely with the European Commission of the European Common Market. We do not negotiate directly with the constituent bodies.

Senator BAUCUS. Thank you very much, Ambassador Wolff. You have been a great help. It is only the tip of the iceberg.

[The prepared statement of Mr. Wolff follows:]

STATEMENT OF ALAN W. WOLFF, DEPUTY SPECIAL TRADE REPRESENTATIVE

NORTH AMERICAN ECONOMIC INTEGRATION

Thank you for this opportunity to testify before the Subcommittee on International Trade on the topic of North American interdependence.

On the basis of a proposal by Senator Baucus, the House-Senate "Trade Agreements Act" Conference recommended and the Administration has agreed to undertake a study of the economic interdependence between the United States and our neighbors to the North and South. Under the draft bill, this study would address, among other subjects, "the desirability of entering into trade agreements with countries in the northern portion of the western hemisphere to promote . . . economic growth and the mutual expansion of market opportunities." The draft legislation goes on to call for "an examination of competitive opportunities and conditions of competition between such countries and the United States in the agricultural, energy, and other appropriate sectors."

Senators Domenici, Dole and others have made similar proposals.

In the past, there has been some uneasiness about these proposals across both borders. Both our partners seek to avoid U.S. "domination." You remember former Prime Minister Trudeau's reproach about being the neighbor of the United States is like being in bed with an elephant. Even a friendly elephant can roll over in the middle of the night, and that is a course for concern. I have heard somewhat earthier comments from Mexican colleagues who are well-disposed toward closer relations with the United States.

Of course, the United States does not seek commercial dominance over either or both our two good neighbors, and none of our actions should give rise to unnecessary concerns among either of these neighboring peoples. Rather, I would hope that both countries would join with us in seeking to find new and better ways of mutual cooperation, and coordination of our economic opportunities to our mutual benefits.

Economic interdependence amont the United States, Cananda and Mexico is a major factor to the economic life of all three countries. This is brought out by the important position of trade and direct investment flows among the three countries relative to each country's total trade and foreign investment flows.

From the perspective of U.S. international trade, Canada is our first and Mexico is our fourth largest trading partner. Together, Canada and Mexico account for 25 percent of total U.S. exports and imports. From the perspective of Canada's and Mexico's trade, the relative importance of the United States ~~is~~ even larger. The United States accounts for over 75 percent of total Canadian exports and imports and over 60 percent of total Mexican exports and imports.

There is a similar pattern in foreign direct investment. Together, Canada and Mexico account for over 25 percent of U.S. direct investment abroad. Canada has more U.S. foreign direct investment than any other single country, but Mexico also ranks high on the list.

In spite of the already large trade flows among the United States, Canada, and Mexico, there are large opportunities for expanded trade. There are also important problems that will have to be dealt with in a mutually satisfactory manner.

United States-Mexican Trade

Almost 10 percent of Mexico's GNP is now generated by exports and the United States is by far Mexico's most important customer. Although oil exports will in all probability erase Mexico's trade deficit, access to the U.S. market will continue to be of importance, especially if, as seems possible, Mexico shifts to a policy of export-led growth.

Oil revenues will give Mexico a unique opportunity to reorient its commercial policy in the direction of liberalization. For the first time, the country will be able to pay for the increased imports which trade liberalization will involve as efficient export industries are developed to generate additional revenues. Trade liberalization can provide new impetus for Mexican development, creating employment and bringing about productivity gains necessary to raise real incomes.

By the same token, the economic growth generated by Mexico's oil, as well as its general economic dynamism, should make it an increasingly important customer for the United States. By 1985, for example, some predict that Mexico's imports will have grown from their current annual rate of $5 billion to $25 billion. This will represent a market in which U.S. exporters can participate fully to the mutual benefit of our two countries.

There are two key trade policy issues in the United States-Mexican relationship which continue to cause frictions which prevent both countries from obtaining substantially full mutual advantage of the presence of the other economy just across the border.

In the case of Mexico, there is harmful protectionist sentiment that masquerades as a desire for measures necessary to aid in development. On our side of the border, our producers have their own concerns about increased Mexican competition. Thus, an effort on two fronts is required: domestically, we have to deal with pressures for protection as we seek ways to manage the shifting patterns of trade which the development of Mexico (in common with other "upper-tier" developing countries) brings about; in our policies with Mexico, we will have to try to encourage the Mexican Government to engage more fully in the process of trade liberalization.

Mexican exports of winter vegetables, particularly tomatoes, have now become a serious issue between our two countries. This year, Florida producers have filed an anti-dumping complaint on tomatoes and other winter vegetables. Absence of a satisfactory solution can easily cause a sharp deterioration of our economic relations with Mexico. We are working hard to avoid this unfortunate result. Further, strong efforts on both sides will be needed.

Mexico has long felt that U.S. tariff and non-tariff barriers significantly restrict its exports to the United States. In fact, U.S. tariffs and other measures clearly restrict some Mexican imports into the United States. These are not the major impediment to Mexcian exports, however. Rather, it is the relative lack of competitiveness of Mexican products.

Like many other less-developed countries, Mexico has followed a policy of protecting its industrial sector against import competition. In the Mexican case, high tariff walls have been supplemented, particularly over the last two decades, by a comprehensive and essentially arbitrary system of import licenses. The licensing system has been a major complaint of U.S. exporters, particularly in cases where the Mexican Government restricts entry of products for which it has developed an export market in the United States. In addition to the basic system of high tariffs and licensing, Mexico has also had an extensive array of indirect trade controls, such as domestic content requirements imposed on particular industries, and a system of official valuation of imports which has a restrictive effect.

Mexican exports to the United States under the provisions of Sections 806 and 807 of the Tariff Schedules are an important and controversial factor in United States-Mexican trade. Under these provisions of law, parts or piece goods produced in the United States may be shipped abroad for assembly and re-export to the United States, paying duty only on the value-added through the production process abroad. U.S. firms use these provisions of law to perform labor-intensive phases of their manufacturing process at "in-bond" plants located abroad. There are now about 500 in-bond plants in Mexico, employing almost 85,000 Mexicans. In 1977, Mexico exported $1,107 million to the United States under Section 806 and 807, or about 23 percent of Mexican export to the United States and nearly one-third of Mexico's total industrial exports.

The in-bond operations provisions are likely to continue to be a rapidly growing sector of Mexican labor-intensive manufacturing.

These provisions of the U.S. Tariff Law are criticized by some sectors in the United States as a subsidy for "runaway plants", transferring U.S. jobs to lower wage foreign production. U.S. labor groups have made repeated efforts in the U.S. Congress to repeal Sections 806 and 807 of the Tariff Schedules.

At the same time, because of the relatively high wage levels in the Mexican border areas, these industries are beginning to experience competition from in-bond plants located in other less-developed countries.

U.S Government analysts have disagreed with the assessment that this tariff treatment causes a loss of U.S. jobs. On the contrary, it is felt that production of the entire product would move off-shore in the absence of these provisions.

Mexico is a major beneficiary of the U.S. Generalized System of Preferences, which provides duty-free entry to the United States for a large number of products originating in developing countries. In 1976, Mexico was the fourth highest beneficiary of the U.S GSP program, exporting goods valued at $245 million to the United States duty-free under GSP. In 1977, Mexico increased its GSP exports 45 percent to $368 million or nearly 10 percent of all shipments under GSP. The first six-month data for 1978 shows another 40 percent increase in Mexico's GSP exports as compared to the same period in 1977, and best estimates are that Mexico's GSP exports to the United States may reach $500 million in 1978.

Mexico has criticized the competitive need limitations (withdrawal of GSP if the value of exported items exceeded a certain amount—$37.2 million in 1978—or if the item accounted for over 50 percent of total U.S. imports of that product) and the value-added requirements of the System (the requirement that at least 35 percent of the cost of materials and the direct cost of processing originate in the beneficiary country in order for a product to receive GSP). Competitive need provisions (which are designed to eliminate preferences on those products where the beneficiary country is already competitive in the U.S. market) excluded Mexico from GSP treatment for $407 million in exports in 1976 and $501 million in 1977. With the conclusion of the recent session of Congress, Mexico failed to obtain relief from the 18 percent tariff on its railroad cars, which lost GSP status of competitive need. During 1977, $347 million in exports also lost GSP primarily due to the value-added criteria. Many products not eligible for GSP by virtue of the competitive need or value-added criteria do, however, receive favorable treatment under 806/807 provisions of the U.S. Tariff Schedule, which benefit imports from border industries.

We have not yet concluded a bilateral product specific agreement with Mexico in the Multilateral Trade Negotiations, despite intensive efforts. The problems are primarily but not solely agricultural, where each side has desired greater access to the other's market, and where some solution must be found to the difficult mutual problems of winter vegetables.

United States-Canadian Trade

In spite of the fact that United States-Canadian trade is considerably larger than United States-Mexican trade both absolutely and relative to each country's GNP, trade problems are now relatively fewer.

The primary concern from the Canadian perspective may be a psychological one, the appearance of dominance of the United States in Canadian trade. In fact, the United States provides duty free access to over one-half of U.S. imports from Canada and the average tariff on dutiable imports from Canada will be reduced to about 3 percent on current dutiable imports as a result of the MTN. While Canada recognizes the important benefits that are provided by virtually unrestricted access to the U.S. market, Canada still feels uncomfortably dependent upon the U.S. market. As a result, Canada seeks to strengthen its ties with the EC, Japan and other areas in order to reduce its dependence on the U.S. market.

While overall trade relations with Canada have been good in recent years, there have been a number of problems and areas of trade friction.

A primary problem has been Canadian tariff levels which often times considerably exceeded the corresponding U.S. tariff level on the same product (the problem of "tariff disparities"). This gives the appearance and reality of inequitable tariff treatment for particular U.S. exports, although many U.S. exports to Canada are duty-free. Our agreement with Canada in the MTN will significantly reduce United States-Canadian tariff disparities on a large number of products of U.S. trade interest. Canada will its tariffs on dutiable industrial products by about 42 percent. The United States will reciprocate with about the same level of cut. Our generally lower level of tariffs on dutiable imports from Canada will be reduced by a further 2.2 percentage points to a level of 3 percent. Canada's higher tariff on dutiable industrial goods will be reduced by about 6.5 percentage points to a level of 8.3 percent. Including duty-free trade, the overall U.S. tariff to Canada will drop from 1.5 to 0.9 percent; by 1990; while Canada's average tariff protection to our exports will drop from 10.6 to 6.1 percent. A major reason for the gap in tariff levels is that they are weighted by trade and large volume U.S. imports from Canada, such as wood pulp and other raw materials are imported either duty-free or very low duties.

Our MTN agreement with Canada will also substantially reduce another major area of trade friction. Certain provisions in the Canadian Tariff Schedule ("made in Canada") have given Canada the authority to raise tariff rates on products which begin to be produced in Canada. Oftentimes a U.S. exporter found that his product, which had been entering Canada free of duty, would become dutiable at 15 percent. Our MTN agreement with Canada will substantially reduce, and in some cases, fully eliminate the contingent tariff liability.

Our MTN agreement with Canada is an example of the outstanding record which the U.S. and Canada have in both anticipating and resolving potential bilateral trade problems before they result in serious controversies. While trade problems will continue to arise, the existing consultative mechanisms and the mutual commitment of United State and Canada to strengthen cooperation in the trade area have served us very well in the past.

Conclusion

We have made substantial progress with Canada in the MTN on our major trade problems, and still hope to do so with Mexico in the next few weeks. Certainly there are many areas that go beyond the accomplishments of the MTN, and particularly its nontariff agreements, that would mutually benefit the three nations of North America. A full explanation of new opportunities, as called for by the Baucus Amendment, is fundamentally in the interests of Mexico, Canada, and the United States. I would urge the Governments of our two neighboring countries to engage in paralled studies, and for private sector groups in each of our countries to provide their governments with advice on this subject.

Senator BAUCUS. Before you proceed, Mr. Borre, I believe Congressman Arlan Stangeland is here.

Congressman Stangeland, would you like to present your testimony at this time?

STATEMENT OF HON. ARLAN STANGELAND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Representative STANGELAND. Thank you, Senator Baucus, Senator Bradley, Senator Durenberger. First, let me express my appreciation for the opportunity to be here and testify on a matter that I think is of a fair amount of importance to us in this country. Hopefully, the hearings you are holding will bring about a better relationship and, perhaps, a facility to do some of the things I am concerned about, this country is concerned about, and what I am going to address myself to today.

Primarily, I am talking about energy.

I will just read from my testimony, if I may, and would be most happy to stand for questions when I am through.

The military and economic security of the United States and its major allies are seriously threatened due to the critical energy situation that is currently confronting the world's oil importing countries. Since the United States uses one-third of the world's energy, this security threat is due in a large part to our country's increased dependency on foreign oil imports necessary to alleviate the growing shortfall between domestic petroleum production and consumption.

Moreover, stagnant U.S. energy production over the last 2 years, despite the addition of Alaskan North Slope crude to our domestic supplies, coupled with the multiple repercussions of the Iranian situation, have increased the possibilities of a major global energy shortage by the 1980's.

In 1959, for example, the United States received 70 percent of its oil imports from countries that comprise the Organization of Petroleum Exporting Countries. In 1978, the United States received 83 percent of its crude oil imports from these same countries. While this amounts to an increase of 13 percent, it is essential for an accurate comparison to note that the total volume of imports has expanded dramatically.

In 1971, the United States imported 3.9 million barrels per day at a price of $4 billion to the foreign oil producers. 1979 estimates indicate that the United States will import between 8.5 to 9 million barrels per day costing in excess of $50 billion. According to the U.S. Department of Energy, crude oil and petroleum imported from OPEC members have increased 20 percent per year since 1970.

Particularly disturbing about this trend and similar trends in other oil consuming nations is the apparent unwillingness on the part of these nations to establish a viable international energy policy. Unfortunately, as United States imports multiply, there is an increasingly stronger likelihood that oil imports will unduly influence American foreign policy. For this reason, the growing dependency on politically precarious supplies of foreign oil poses major economic, political, and social ramifications to all nations.

To a lesser extent, Canada has also been subject to larger imports from OPEC. Up until 1973, Canada was self-sufficient for its crude oil requirements. As of November 1978, Canada received 75.1 percent of its oil imports from the OPEC cartel, amounting to a volume of 477,000 barrels per day.

While these figures are substantially smaller than U.S. oil import figures, it is important to recognize the adverse economic reverberations resulting from the large price increases for crude oil, even though a particular country's imports may not be great compared to those of the United States. For example, in 1972, Mideastern crude oil was selling for $2.80 a barrel. As of April 1, 1979, this same oil was selling for at least $14.54 per barrel, with all indicators pointing to another price increase later this month. The effect of such price increases on a particular country's currency and balance of payments is readily apparent and will continue to devastate the economies of all oil consuming nations, particularly the developing countries, until the price is stabilized by either reducing demand or augmenting the supply of crude.

NORTH AMERICAN ENERGY RESOURCE BASE

Unlike many regions of the world that depend upon oil imports, North America possesses substantial energy resources for development and diversification. For example, while factors such as economics, distribution systems, social considerations, national pride, and other considerations may prevent the optimal use of our oil resources, nevertheless, the estimated ultimate recoverable conventional oil resources of the North American continent amount to 200 billion barrels. The development of these sources will help stabilize the North American economy while also benefiting other oil consuming nations that are compelled to rely on OPEC. By even marginally increasing the supply that is available to these other countries, the world oil situation should improve.

MEXICAN ENERGY RESOURCES

Mexico probably best exemplifies this continent's energy wealth. While Mexico now ranks sixth in world crude oil reserves with over 40 billion barrels, estimates range over 100 billion barrels for potential oil reserves. Additionally, as Mexico's oil production increases, available natural gas supplies will correspondingly increase.

The critical question to consider in evaluating Mexico's energy resources is the timetable by which these resources should be developed. President Lopez Portillo has repeatedly stated that Mexican oil reserves will be developed at a rate compatible with Mexico's economy and not subject to foreign pressures or a desire to rapidly expand its oil industry. On the surface, such action may seem contrary to the best interests of Canada and the United States, two natural customers for Mexican crude. Nevertheless, it is imperative that the United States and Canada realize that development of the Mexican oil fields be undertaken in such a manner as to benefit all countries involved. Furthermore, since Mexican oil is sold at or above the OPEC price, the major advantage of this supply source is its relative security as compared to that of unstable Persian Gulf crude oil. In order to best assure a continued supply of safe crude oil imports from Mexico, a healthy Mexican economy is essential. All-out production, while superficially attractive to oil-consuming nations such as Canada and the United States, may cause spiralling inflation due to the rapid expansion of revenue entering Mexico's economy. In fact, several experts contend that the Iranian turmoil has been at least partially caused by an unstable economy, due to a rapid influx of revenues incapable of productive use by Iran's economy.

The development of a market for Mexico's natural gas supplies could also affect the amount of future Mexican oil exports to the United States. Since the Mexican domestic market for natural gas cannot use all the natural gas from rapidly developing southern oil fields, a market such as the United States is significant. Without natural gas sales to the United States, Congressional Research Service estimates that Mexico may have to lower its oil production goals by as much as 25 percent. Furthermore, strong political opposition toward hydrocarbon exports to the United States has developed due primarily to the U.S. Government action vetoing a price previously agreed to by Pemex and a consortium of U.S. companies for Mexican natural gas. While Mexican officials felt that the price of $2.60 per thousand cubic feet was equitable, the United States feared that this might immediately trigger an increase in the price for Canadian natural gas. This intervention by the U.S. Government was interpreted by Mexico as a rebuff, particularly disturbing since a large pipeline from the Reforma oilfields to an area near the Texas border was already under construction.

CANADIAN ENERGY RESOURCES

Another North American neighbor with substantial energy resources is Canada. While Canadian tar sands located in the province of Alberta may be considered an unconventional source of oil, commercial development has commenced and, with the constantly increasing price of crude oil, may become a viable energy source in the not-too-distant future. Other energy resources located in Canada are ample supplies of natural gas and crude oil. While the Canadians use substantially all of their crude oil for domestic requirements, there is a considerable amount of natural gas exported to the United States.

U.S. ENERGY RESOURCES

The United States is blessed with huge deposits of coal and oil shale, in addition to its oil and gas reserves. Coal is the Nation's most abundant energy resource and estimates place these resources at between 10–12 trillion tons, 6 percent or 640 billion tons of which can be considered our present day reserves. At current consumption levels, this is enough coal for several hundred years.

Additionally, the United States has vast reserves of oil shale in Colorado, Utah, and Wyoming containing an estimated 1.8 trillion barrels of oil. This amounts to roughly three times the amount of known crude oil reserves of the Middle East.

It becomes apparent that the North American Continent offers adequate energy supplies to meet its needs. Due to the great potential for development of traditional and nontraditional energy sources, a pragmatic approach to our mutual and separate energy needs would mandate an energy summit meeting to discuss international cooperation in this area. I will now discuss some of the benefits that may accrue to each country.

I would like to point out that we in the United States cannot expect to meet with Canada and Mexico unless we meet them in a spirit of mutual benefit. Any time that we meet in a spirit that we are going to be the great beneficiaries of that kind of agreement, we are going to have trouble and we are going to fail.

I think that we have to make it clear to our Canadian and Mexican neighbors that whatever we do, whatever agreement we make, we want them to have mutual benefits along with ourselves.

Notwithstanding OPEC's domination of the international petroleum market, there are several benefits for a country in diversifying its oil supply. A major problem of our current energy situation is the uneven distribution of available crude oil, heavily concentrated in the Persian Gulf, and the disastrous effect any supply interruption can have on the world oil market. Diversification of crude oil suppliers by a particular oil consuming nation such as the United States and Canada will help reduce that nation's unhealthy reliance on a single or few exporters. For that reason, programs such as that initiated by the World Bank to stimulate non-OPEC-developing countries' ability to produce oil, are essential.

Applying this premise of supply diversification to this situation, the development of a stable supply of Mexican crude oil and natural gas can benefit both the United States and Canada. Obvious benefits accrue to Mexico if this development occurs at the proper rate for the Mexican economy. Therefore, improving Mexico's economy is in the best interests of all concerned parties.

Improved trade and economic relations among the nations in the area of energy policy would provide several other benefits. The implementation of a better transportation system for oil and gas is vitally important in order to more effectively utilize our resources. Presently, efforts to transport crude oil and natural gas to market are often duplicative and inefficient, thereby contributing to spot shortages.

An example of the failure to maximize the use of pipelines between countries is the development of a large pipeline from Mexico's southern Reforma oilfields. This pipeline comes within 130 miles of the Texas border and could easily be extended to provide for natural gas shipments to the United States. To date, no action has been taken due to political and other problems.

In addition, Mexico would benefit by developing U.S. and Canadian markets for its products due to their geographical proximity to Mexico. By selling its oil to the United States and Canada, Mexico would be able to sell its oil at world prices without the correspondingly large transportation costs other producers must consider.

Apart from pipeline and transportation cost advantages, improved utilization of existing refining capacity may result from mutual cooperation. Currently, there is a limited amount of crude oil swapping between the United States and Canada. These efforts must continue and intensify. It seems incongruous that eastern Canadian refineries operate at a relatively low level of refining capacity while the United States is suffering from a lack of refining capacity. International cooperation and coordination could rectify this problem while also better furnishing specific refineries with the type of product that is best suited for its particular operation.

Notwithstanding the fact that most of Mexico's surface exploration and drilling is supplied by Pemex, the supplemental use of U.S. technical expertise could greatly facilitate the development of oil and natural gas. Technology could also be shared with Canada in order to assist that country in the development of its Albertan tar sands.

Finally, closer cooperation between our countries will remove some of the uncertainty about domestic and foreign environmental regulations that has led, in the past, to delay or abandonment of important energy projects. Environmental coordination is an important area that must be considered at any energy summit meeting if we are to aid in the development of mutually beneficial energy projects for the future.

OTHER CONSIDERATIONS

Improvement of trading relationships among the North American countries may require the consideration of other issues, either separately or during a meeting of the North American leaders. One such area deals with the encouragement of trade between the North American countries by the enactment of laws and treaties conducive to this goal.

For example, under the Natural Gas Policy Act of 1978, Mexican natural gas is priced incrementally in the American market, as compared to the "rolled-in" pricing of Alaskan natural gas. "Rolled-in" pricing averages the cost of supplemental gas with cheaper existing supplies while incremental pricing places the entire expense of the supplemental gas on the end user. Averaging the price of natural gas from Mexico with that of existing supplies may assist Mexico in developing a strong market for its natural gas. Other considerations in this regard involve the establishment of trade quotas, preferential tax treatment, and other trading incentives by the various countries in order to promote the preferred relationships between the North American countries.

Second, rather than discussing a particular energy problem in a vacuum, discussions could cover comprehensive energy policy. The development of nuclear and solar, along with other nontraditional energy sources, should be discussed in conjunction with oil and gas development. To carry this a step further, nonenergy issues, such as immigration and agricultural trade, could be included. It is my contention that such a unified, comprehensive approach to energy and other common problems will greatly improve our quality of life on the North American Continent. It is for these reasons that I am urging the President to join with the leaders of Mexico and Canada to convene an energy summit meeting.

Let me say, Senator, I have every feeling and reason to believe that there could be success in this kind of a summit. I had the pleasure of being on the Inter-Parliamentary Group. I attended my first meeting in New Orleans about a year ago—this was with a Canadian group.

One of the messages that the Canadian members spoke often of and one of the messages that came through loud and clear was their desire to work together in international agreements and look to a North American solution rather than a Canadian-American solution.

I think primarily, they recognize that together we have that much more muscle. They say—and it is true—that their concerns, their problems, their products, their economy, their socialization is very similar to ours. We are very much alike. We have the longest free border in the world. They express a desire to work more closely with us.

At the same time, they have a parochial pride, just like we have a parochial pride, and I am sure Mexico has a parochial pride. I think we have to recognize that.

We have to recognize that when you deal with these countries we assure them that we want to do things that will be mutually beneficial to them as well as to ourselves.

Senator BAUCUS. Thank you very much, Congressman. I think you have done a great job documenting the energy resources in the North American Continent, particularly coal and oil, but also other resources of interest as well as the advantages this continent has in transportation and other areas, because of the proximity of our countries.

I am also encouraged to hear you address the sensitive problem of feelings, the attitudes of the people of both those countries.

It seems to me if I were a Mexican citizen, I would be a little bit concerned about the giant to the north, or if I were a Canadian citizen, I would be a little bit concerned with the giant to the south.

To some degree, the United States, as well as all developed countries, have a reputation of developing less developed countries' resources to the benefit of the developed country.

I am curious if you have any concrete or specific proposals or ideas of avenues that we might pursue to address this problem. The Governments of each of our two neighbors and probably also the people in those countries are very sensitive to this general problem. Would you address that, please?

Representative STANGELAND. I am not as much concerned about the people-to-people relationship as I am about the Government-to-Government relationship. I think that is where you get into these sensitive areas.

I have been to Canada a number of times. I happen to be a farmer in the cattle business and I have gone there to buy cattle. Visiting with the Canadian neighbors, they have the same concerns, the same wishes, the same desires that I do living in the United States. It is a very warm and affectionate relationship that we can get together on.

I have not dealt that closely with Mexico, but I think, as you look at what is happening with, say, our illegal alien problem, if we could improve the Mexican economy, if we could help the Mexican industry and Government—and I would expect it will be the Government that will trigger that industrial dollar to grow, to create jobs in Mexico for Mexicans, to improve their standard of living—we might well reduce a great deal of our illegal alien problem.

You know, I sometimes think that our illegal alien problem is not what a lot of people think it is for the simple reason that those people come here to work. They want to work. They come in and take jobs in areas where there is no labor to fill those jobs.

I happen to have a brother in Richmond, Wash. There are any number of illegal aliens coming in there. Without them, there would be no one to fill the jobs.

I think we can work things out. It is not my role, not my feeling, that I would want to tie our President's hands in drawing narrow parameters which he should discuss. I think we should begin with a broad, general area such as with energy—I think it is critical, I think it is crucial to us, and it is crucial to Canada and Mexico as well. It is a good area to start in, and I think that there can be exceptionally good benefits to all—there has to be good benefits to all from that kind of arrangement.

Senator BAUCUS. I asked the question because I was in Mexico City about 2 weeks ago and it is very apparent to me that even though some estimates go as high as 10 million barrels a day of production in Mexico, there is universal agreement there that that is just too high. The Mexican Government cannot stand that kind of inflationary pressure.

I have tried to probe, in asking questions, what rate of production Mexico thinks is in its own best interests. My sense is it is on the low end.

I picked up very strong feelings of pride, rightfully and correctly so, and of nationalism. Certainly, as I said, our people have the same feelings.

Representative STANGELAND. I think that our President may want to sit down with the President of Mexico and discuss the goals of the Mexican Government and their goals of growth. It may well be that the U.S. technology can aid, foster and hasten that growth to the point that they can benefit and utilize the dollars that they get from petroleum.

We have to respect the President for not wanting to overproduce his oil, sell it for cash and sit there with dollars in his hand. He wants to grow economically and industrially to accommodate those dollars and utilize them as they grow so they are not inflationary, and inflationary pressures are not brought to bear.

When we find out what his goals are and what his Government's goals are for the Mexican country, we might assist in bringing those goals about and developing those goals so they encourage and hasten their development.

Senator BAUCUS. Thank you very much.

Senator Durenberger?

Senator DURENBERGER. Thank you, Mr. Chairman.

By way of additional clarification, I think it is important that you know the Congressman knows from where he speaks. He represents by far the largest congressional district in our State. He is surrounded by foreign countries. He has Canada on the north, North Dakota on the west and a Democratic Congressman surrounding him on the other side.

I think, more importantly, as he pointed out in his statement, in part because of the nature of the district and the economics of the district, there is a very natural relationship between the people of our State and our neighbors to the north.

You have spoken well to the problems you have experienced. Back when the President got into the beef import situation, you played a leading role in trying to ameliorate relations with Canadian beef importers at that time.

I was particularly struck, Mr. Chairman, as I think you were, by his concentration on the energy issue, and within that issue, the concerns for transportation. I found that the most compelling part of the statement, the fact that we, as a nation, have not addressed the problems of transportation for the distribution of oil and gas.

There are substantial economies where supply benefits would be enhanced by transportation distribution. The Congressman has his own problems in his district and he has lived through a very disastrous electric transmission problem. As we in this country address ourselves to some of these issues, it becomes very difficult for us to adequately solve some of the supply problems that we would like to have resolved in cooperation with our neighbors.

But I think he has done a real service for us in accenting that part of our relationship. I am appreciative that he has taken the time to come and say what he has had to say.

Representative STANGELAND. Thank you for those kind words.

Senator Baucus, let me point out that Senator Dole is the sponsor of the summit resolution in the Senate. I am pleased and honored that he thought enough of the proposal that he would work with me on it, and has worked with me on it, and has done a great job.

I think those of us in the Midwest—and I think Montana is a part of that—the agricultural belt of this country, are really energy devoid. We really have a problem.

The problems that we have should not be laid at the feet of our President. Those problems have been coming on over the years and we just have not had the vision to see them and appropriately respond to them.

I commend our President for addressing the energy issue. We, in Congress, have not seen fit to agree with him, but at least he has addressed it and has taken, in his own mind, the best approach to it. I think that the summit on North American energy would be another tool for him to use in his total energy policy. I think our country and the North American Continent and the world, in fact, because when we reduce the energy consumption of the North American countries, particularly the United States of OPEC oil, we free up more OPEC oil for those highly-dependent countries, for those underdeveloped countries and just-developing countries, can curtail the price rises so that their energy costs are not going to escalate the way they have in the recent past.

Senator BAUCUS. Thank you.

Senator Dole?

Senator DOLE. I am sorry I missed part of the statement. As usual, we have too many hearings at once.

In any event, I have, of course, talked with Congressman Stangeland and I appreciate his leadership with regard to our resolution urging the President to seek an energy summit meeting with the leaders of Canada and Mexico. I am not suggesting we are going to change the world with the resolution, but this resolution is a positive indication of our shared interests in the energy area with

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Canada and Mexico. The resolution should assist the President. It seems to Congressman Stangeland and myself and others that energy cooperation with Canada and Mexico is an area that should be addressed. Congressmen, I think your statement presents cogent arguments for looking to the possibility of a continental energy policy, or at least seeking greater agreement on energy matters.

Energy is a matter of great concern to all of those in the great Midwest. I thank the chairman for holding these hearings. It seems to me that it does bring a proper focus on an area of great potential that is often overlooked.

We discuss, most of the time around here, what is going on in the Mideast and OPEC countries. Very little of the time do we concern ourselves with Canadian relationships or Mexican relationships and that is really the purpose of the Stangeland resolution.

We have all been around here long enough to know that we do not solve problems with resolutions. This resolution, however, can at least serve as public indication of an area we believe deserves greater attention. I would like to include in the record at this point my statement, along with a copy of the resolution and a statement I made at the time of its introduction.

[The material referred to follows:]

STATEMENT OF SENATOR BOB DOLE

Thank you, Mr. Chairman, first, I would like to welcome our esteemed witnesses and express my personal satisfaction that such government and business leaders are willing to take time to provide us with their valuable insights regarding North American trade.

I believe one of the subjects we will be discussing today warrants increased attention. I am referring to the coordination and implementation of a continental energy policy which Congressman Stangeland and I have proposed in a concurrent resolution. We must emphasize the reality that interdependence and an international perspective for domestic economic policies must be developed if this country and this continent want to achieve our future goals.

It is clear that energy issues are of global proportions. Why, then, can't we at least consider a continental approach to the problem? I believe that the commonality of interests which Mexico, Canada, and the United States share are a nautural backdrop for a more coordinated approach to our future regional development. This approach should be based on mutual respect—not intimidation; it should be based on trust—not threats. It is my hope that our three countries can begin to adopt the necessarily broadened perspective which will serve the best interests of the citizens of each of our countries.

[From the Congressional Record, May 21, 1979]

SENATE CONCURRENT RESOLUTION 27—SUBMISSION OF A CONCURRENT RESOLUTION TO ESTABLISH A COMMON ECONOMIC BOND OF ENERGY COOPERATION

Mr. Dole submitted the following concurrent resolution which was referred to the Committee on Foreign Relations:

S. CON. RES. 27

Whereas the United States is dependent on foreign oil for one-half of its petroleum energy;

Whereas the dependence on foreign crude oil is adversely affecting the balance of payments, weakening the value of the dollar and exacerbating domestic inflation;

Whereas the United States imports most of its petroleum from politically unstable areas of the world and that the instability of supplies for the energy needs of the country is a threat to national security;

Whereas the price and production of oil are being artificially controlled by foreign countries making the United States and other nations susceptible to the use of oil as a political weapon;

Whereas the current exploration and development of petroleum and the refining and distribution of petroleum products are inadequate to meet the need for fuel in all segments of the country;

Whereas the United States and the countries of Mexico and Canada share many of the same problems and concerns regarding the exploration, development, distribution, and refining of their domestic petroleum and other energy resources;

Whereas the joint participation in research and development of alternative energy sources would be beneficial for the United States, Mexico, and Canada, because it would reduce the dependence on any single energy source; and

Whereas a joint effort by the countries to promote a continental energy policy, would improve diplomatic relations, reduce duplication of energy research and provide favorable marketing conditions among the countries: Now, therefore be it

Resolved by the House of Representatives (the Senate concurring), That, it is the sense of the Senate and the House of Representatives of the United States that the United States, Mexico, and Canada should establish a common economic bond of energy cooperation and that the President of the United States should invite the leaders of Mexico and Canada to a summit meeting with the United States to discuss energy issues including the energy needs of the countries, the joint development of energy sources, energy marketing incentives, the balance between energy development and environmental protection and establishing a North American partnership between the countries.

Mr. DOLE. Mr. President, I am submitting today a concurrent reolution which calls for closer cooperation with Mexico and Canada on energy issues. I am pleased to have Congressman Strangeland of Minnesota introduce the companion measure in the House today.

Mr. President, America has had a tradition of cooperation between our closest neighbors. Now, with the energy crisis upon us, it is more important than ever to pull together on issues of mutual concern.

Mr. President, the 1973 OPEC embargo signaled the end of inexpensive and abundant energy. Since that time, we have made little progress in escaping the grip of our dependence on foreign petroleum. Last year oil imports made up 47 percent of our domestic consumption, with 41½ percent of those imports coming from the politically unstable Middle East and 83 percent of the imports coming from the OPEC cartel.

The price of foreign energy continues to increase. Recently, Iran announced additional price hikes. Other countries are adding oil surcharges which have pushed the price of oil above $18 per barrel.

Mr. President, the dependence on foreign crude oil is adversely effecting our balance of payments and is continually weakening the value of our currency. The instability of our supplies of oil poses a threat to our national security.

The main causes of our increasing dependence on imports has been the governmental barrier to full development of domestic resources. The price control system on domestically produced oil has kept prices artificially low and, in fact, has acted as a subsidy on imports. There is no question that as long as price controls remain, the drilling activity will be concentrated in areas where oil has already been discovered in order to minimize the risk.

For these reasons I support belated action taken by the administration to decontrol domestically produced oil. In order to promote new domestic supplies, I also believe that Congress should enact the properly structured tax on the decontrolled revenues which encourages new domestic exploration.

Mr. President, Canada, Mexico, and the United States all have abundant energy resources. The United States has oil and gas reserves plus huge deposits of coal, oil shale, and geothermal energy. Mexico is rapidly developing its new oil resources and currently 85 percent of oil exports goes to the United States. Canada has reserves of oil and gas. The United States is a leader in energy technology, management, and finance.

Mr. President, a comprehensive national energy policy should include close cooperation with Mexico and Canada. It should be a policy based on mutual respect not intimidation. It should be a policy based on trust, not threats.

Canada and Mexico share many of our problems and concerns. I believe the United States should initiate a course of total cooperation with them on energy issues. A joint effort to accomplish common goals and promote a continental energy policy would be in the best interests of all the parties.

Senator DOLE. I thank Congressman Stangeland for his efforts.

Senator BAUCUS. Thank you, Senator Dole.

Congressman Stangeland, we appreciate your testimony and contribution. Thank you very much.

The next witness will be Secretary Julius Katz.

Mr. Secretary, we are glad to have you here. Proceed in any manner in which you wish. I encourage you to summarize your testimony.

STATEMENT OF HON. JULIUS KATZ, ASSISTANT SECRETARY OF STATE FOR ECONOMIC AND BUSINESS AFFAIRS

Mr. KATZ. Mr. Chairman, I have a prepared statement which I have not completed. If I may, I would like to submit it for the record later and make some brief opening remarks.

In my statement I deal with some of the facts in our relationship with Canada and Mexico, the explosive growth in our trade, particularly with our neighbor to the north, with the substantial investment flows, the growth in transportation links, migration and so forth. And I address some of the opportunities that are presented in the relationship for closer integration of the economies.

In fact, there has, over the years, been a substantially growing integration of our economy with the Canadian economy. As a result of successive trade negotiations, more than half of our two-way trade, is now duty free. We have a relatively open border.

The situation with Mexico is somewhat different, Mexico being a smaller, weaker economic partner. It has pursued policies, trade policies in particular, which are more protective of its economy, of its producers, and of its economic development policy. Our economic relationship is therefore absolutely and relatively smaller with Mexico than it is with Canada.

There are opportunities for further expansion here, as well. The Mexican Government, for many years, abstained from international trade negotiations. Mexico however, was a full participant in the recently concluded Multilateral Trade Negotiations and we are still negotiating a bilateral agreement with opportunities for expanded trade.

The issue of energy, of course, is one which is naturally on everybody's mind. Energy trade has been an important part of our economic relations, both with Canada and Mexico. It does have prospects for expansion.

In the case of Canada, Canada used to be a major source of oil imports. It is not that now. At the peak, we imported 1 million barrels a day from Canada. They decided some years ago to phase-out those exports, and we now import on a net basis about 155,000 barrels a day. But we do import large quantities of natural gas from Canada, almost 3 billion cubic feet a day, with the prospect of perhaps another billion cubic feet a day, if applications now pending before the National Energy Board are approved.

We have substantial electricity exchanges with both Canada and Mexico. In the case of both countries, we are engaged in discussions to explore expansion of those electricity exchanges.

In the case of Mexico, we now import less than one-half million barrels a day of crude oil, but it is probable that our imports from that source will grow. We now take about 80 percent of Mexico's crude oil exports. They have indicated their desire to diversify their markets so that the United States might only represent 60 percent of their exports. That would still mean a growth in imports from Mexico in absolute terms.

We have not imported natural gas from Mexico. We are engaged in discussions with the Mexicans to explore possible imports of natural gas.

I have referred already to the electricity exchanges which are important and have the potential for growth. There is, I think, an impression in the country that either Mexico or Canada or both might represent our salvation in energy, or at least might be very substantial sources of energy imports.

I think that we need to realize that Mexicans and Canadians, no less than Americans have a particular view about natural resources, in particular energy resources. They believe that their energy resources should serve their national interests. They are particularly sensitive about the need to conserve to the maximum extent those resources for future generations. They do not see their resources of energy as a means of satisfying foreign markets, or even the U.S. market, but rather of serving their own national policy interests.

So I think that those who expect vast volumes of imports from either country are likely to be disappointed.

I deal in my statement, Mr. Chairman, with some of the investment flows between the countries. They are very important for Canada in both directions.

In 1977, we had a value of $35 million worth of investment in Canada. Canadian investment in the United States has grown rapidly: $6 billion in 1977. Actually, there is more Canadian investment on a per capita basis in the United States than the other way around.

With Mexico, investment is not growing as quickly. U.S. investment there is $3 billion. Mexican investment in the United States is very much smaller, perhaps $100 million.

There are particularly opportunities for integration of the economies on a sectoral basis. Automobiles is probably the most dramatic example of that opportunity.

We have had, since 1965, a bilateral agreement with Canada providing for integration of the United States-Canadian automobile industries with spectacular results.

There has been explosive growth in trade. Automotive trade with Canada grows 15 percent a year, or $3 billion to $4 billion per year. The agreement has permitted rationalization of the industry across-the-board, more efficient production, employment gains in both countries and notable advantages to consumers as well.

Finally, let me just say while there are opportunities for integration of the three economies on a sectoral basis, I do not detect any interest in either Canada or Mexico.

Integration of economies of unequal size, and unequal strength, presents particular problems of adjustment. Even in the case of the automotive agreement with Canada, which as I have indicated is a real success story, there continue to be concerns expressed in some sectors in Canada as to whether Canada gets a fair shake. Do they get sufficient investment? Do they get sufficient employment opportunities?

Automobiles are probably the strongest case for integration. As you examine other industries where there are greater disparities in industrial strength problems of that kind are magnified.

Finally let me just say that the path to interdependence and integration is not a smooth one. Rapid change brings with it problems of adjustment. We have certainly had problems of adjustment in trade between the two countries. They have not been momentous problems, but rather substantial irritants.

Horticultural imports such as tomatoes from Mexico are a particular example. Strawberry imports from Mexico have been a continual problem and kind of a running sore in our trade relations with Mexico.

We have had various problems with Canada. Frequently we resort to various provisions of law dealing with unfair trade practices.

Some of this, we think we have perhaps improved with the MTN agreements. Particularly the subsidy code we think will benefit us.

Mr. Chairman, I will stop at this point and take any questions you may have.

Senator BAUCUS. Thank you, Mr. Secretary.

It seems to me that because Canada and Mexico both export and import so much from the United States compared to other countries in the world, it might be useful to look at the organization of the State Department.

I understand that the Canadian desk is in the European Bureau. In your judgment, would it not make more sense to have a different kind of organization in the State Department which would focus on Canadian relationship with North America rather than with Europe? Certainly Canada trades much more with the United States than it does with Europe, though I know that Canada wants to diversify and is nervous about its overly close reliance on the United States.

I also understand that despite their attempts to diversify, the fact of the matter is that Canadian trade has increased on a percentage basis with the United States. Would it make more sense for the Canadian desk to be in a North American Bureau, or somewhere other than in a European Bureau?

Mr. KATZ. Mr. Chairman, one of the favorite pastimes in this city is looking at government organizations, and I have engaged in the sport over the years myself. Frankly there is no organization that is completely ideal.

There are both historical and practical reasons why Canada is in the European Bureau. Originally, of course, it was a part, is a part, of the Commonwealth but its ties with Britain were stronger than with North America. Indeed, at one time, Australia used to be a part of the European Bureau.

But there are, even now, substantial Canadian ties to Europe. There are Canadian interests that are greater with Europe, NATO being one example, Canadian ties greater with Europe than with, for example, Latin America, although Canadian interests in Latin America have been growing sharply.

There have been proposals to create a separate Bureau for Canadian affairs, given the importance of our relationship with Canada.

A recent proposal resulted in the creation of a separate Deputy Assistant Secretary in the European Bureau for Canadian Affairs.

I have to say that I really do not think the organization is that important. I do not think it justifies the amount of time we may spend discussing it. Canadian affairs I regard as being very important in the State Department, and they certainly do not get short shrift. Whether they are in one Bureau or another, I do not think really it is going to change the course of history.

Senator BAUCUS. I agree, organization is less important than the people and their intentions. However, it occurs to me that we should look closely at the mechanisms that the State Department utilizes to address foreign matters which have very strong domestic implications.

In your judgment, do you think there should be any different mechanism for approaching the general question of the domestic implications of international affairs, and also more specifically with respect to Mexican and Canadian affairs.

Mr. KATZ. I might point out, Mr. Chairman, there are two forms of organization in the State Department. There are geographic bureaus that look at particular countries and regions and have primary responsibility for bilateral relations with countries, and there are functional bureaus. The bureau that I head, the Bureau of Economic and Business Affairs, is one of those functional bureaus. And we like to think that we are less client oriented than either geographic bureaus or domestically oriented agencies with whom we have very close contacts. We are really the interface between the geographic bureaus in the State Department and the domestic agencies.

So I think there are sufficient inputs, both the foreign policy interests and domestic policy interests. My bureau, for example, has very close relations with all of the domestic agencies and represents the State Department as well in the interagency groups where we are exposed to domestic policy interests. Our role is really to translate general economic policy, for example, into international economic policy, or the other way around, to assure that our international economic policy interests are reflected in our broad national policies.

Senator BAUCUS. My understanding, too, is that Canada tends to be restrictive about potential American investment there, in its domestic review procedure, while Canadian investment flows with relative ease into the United States.

Apparently, a major Canadian firm was about to invest in the United States but for some reason it was called off. Your own figures indicated Canadian investment is higher in America than American investment in Canada.

I sense that probably Canada is a little nervous over U.S. investment in Canada. That is a part of the problem that arises with the questions of free trade zones.

Do you have any reactions to that general question?

Mr. KATZ. Yes, sir.

On a relative basis, one would have to say that Canadian policies in investment are more restrictive than ours. But, as a practical matter, Canadian investment policies are really quite liberal. Just recently, a few years ago, the Canadians did install an investment review board that screens investments. They have certain criteria by which they review investments and decide to permit, or not to permit them. In fact, it has really operated with great liberality. I cannot even think of a particularly outstanding case since the creation of that board where there was a turndown of American investment.

They generally do not look kindly on takeovers that do not contribute anything to the economy. As I say, I cannot think of a recent case that was particularly—at least, that came to my attention—where there was sufficient concern that somebody came to the government and complained about unfair treatment.

The problems of investment in Canada, or in other countries, are not unlike those that we have recently experienced here. For example, the concern about foreigners coming in buying up farmland in the United States. We have a somewhat ambivalent attitude in this country about foreign investment. On the one hand, we like the employment that it brings. On the other hand, we are worried about foreigners coming in, taking over our banks or our farmland or, more particularly, key industries.

Viewed from the other side of the border, where the reference is made to living next to an elephant, America's investment in Canada looms very much larger in Canada than does Canadian investment in the United States. I think it is just a matter of the relative sensitivity that comes from this disproportionate size; but I do not think it is a serious problem, Mr. Chairman. I think really that their approach has been quite liberal.

Senator BAUCUS. What are the most serious example, in your judgment, of tariff or nontariff barriers between the two countries? You say half of the trade is free already, but I am curious. What is the most significant problem?

Mr. KATZ. There have been some significant problems that have been dealt with quite satisfactorily in the MTN. For example, Canada did have a made-in-Canada tariff provision, that provided that when a particular machine was made in Canada, the tariff would jump to 15 percent. If it were not made in Canada, it would be duty free.

That provision is going to be phased out. There have been government procurement policies which have been restricted, not only by the Federal Government, but by the provinces in Canada. Those are dealt with in the code.

In truth, I would have to say we have not had very serious problems with Canada. We have had a number of irritants. There have been a number of things that have bothered American exporters. The Canadians have been bothered by the frequent resort of U.S. manufacturers to the antidumping statute and the countervailing duty statute.

The latter situation should be improved as a result of the subsidies countervailing code, both in terms of reducing the incidence of subsidy as well as providing an injury test in the U.S. law.

To the extent that we do have problems with Canada, they will be alleviated as a result of the MTN agreements. With respect to Mexico, the problems are somewhat different. Mexico, as I indicated, has a much more restrictive trade policy. They have high duties. They have had quotas on many of their products. They have now taken the first step toward moving in the direction of trade liberalization. That is a source of some encouragement.

We have not concluded our bilateral agreement with them; but we are hopeful that when we do, it will provide some further opportunities.

Senator BAUCUS. One more general question and I will submit the rest for your answer to the record.

As you know, there is a backwash theory: The more you reduce trade barriers, the rich get richer and the poor get poorer.

However, some economists argue that the reverse happens. For instance, in a free trade North American labor would flow to Mexico where labor is less expensive, causing problems in our country.

I am curious to what your view is on that general question and with respect to the United States, Canada, and Mexico.

Mr. KATZ. I think that it has been demonstrated; I think the case is pretty conclusive, that expanded trade, freer trade, provides a great many benefits, many more benefits than problems. But it does cause problems, particularly when trade has grown very rapidly, particularly when it is competitive.

To a large extent, our trade has been complementary, but as economies have developed on both sides of the border, there are greater elements of competition. And competition, of course, causes a certain amount of grief, as well as provides benefits.

Our task, therefore, is to alleviate those burdens of adjustment that come from rapidly growing trade.

I would say that the case is very strong to continue to expand trade wherever we can, to lower barriers wherever we can, recognizing in some cases it is going to take longer than others. In some cases, it is going to present problems of adjustment that we are going to have to deal with on an ad hoc basis.

Senator BAUCUS. Thank you very much.

Senator Dole.

Senator DOLE. Just one specific question, and that is on the gas negotiations with Mexico. Are you directly involved?

Mr. KATZ. Yes, sir.

Senator DOLE. Is progress being made?

Mr. KATZ. It is slow.

Senator DOLE. What is the basic reason, because they would like to peg gas prices to oil prices?

Mr. KATZ. Let me say first, without going into the specifics of this, we are talking about a lot less gas than people have assumed. Some of the numbers that have appeared in the press are really out of line in terms of what the Mexicans really have available.

Mexico is not in a hurry to sell its gas, contrary to the popular assumption that somehow Mexican gas is a limiting factor on oil production. That is not the case. They are able to use all of their associated gas domestically in Mexico. Essentially, what they are talking about is not associated gas.

We have been talking about volumes. We have been talking about the terms and duration of contracts, and finally we have been talking about the competitive relationships among fuels.

We have not directly addressed the price issue in specific terms. We need to do that.

There are some obvious questions in that regard, with respect to the competitive nature, to the Mexican gas vis-a-vis other fuels.

Senator DOLE. Do you have any idea, do you have any timetable when there might be some agreement?

Mr. KATZ. No, sir. I cannot really guess.

We have had several meetings. We expect to have another meeting shortly. The discussions have been quite constructive, but there is no great pressure as far as the Mexicans are concerned. I am not sure that they have altogether made up their mind on what they want to do.

They have tended to look at the earlier discussions as being somewhat exploratory, moving toward the development of a position.

Senator DOLE. Thank you.

Senator BAUCUS. Thank you very much, Senator Dole.

Thank you, Secretary Katz. You have been a great help. Thank you very much.

[The prepared statement of Mr. Katz follows:]

STATEMENT OF JULIUS L. KATZ, ASSISTANT SECRETARY OF STATE FOR ECONOMIC AND BUSINESS AFFAIRS

Mr. Chairman, I am pleased to respond to the Committee's invitation to discuss the prospects for and problems posed by increased economic interdependence in North America and with the Caribbean.

The economies of this region are in many ways complementary and this fact is reflected in the rapidly growing economic relationship among the countries. Trade flows, investment, tourism, migration, transportation links and financial ties have all expanded dramatically in recent years. In some sectors and between some of the countries integration has proceeded rather far. Rapid change brings with it opportunities as well as problems of adjustment. In this statement, Mr. Chairman, I would like to review briefly some of the recent developments in our economic relations with our neighbors in North America and to discuss both the opportunities and problems presented by our growing interdependence. Because of the limits of time I do not deal directly with the Caribbean area in my statement but I would be glad to respond to any questions the Committee may have with respect to Caribbean countries.

First, let me review some of the facts bearing on our economic relationship with our neighbors in North America. Two-way trade with Canada has risen from \$39 billion in 1974 to over \$63 billion last year. Even allowing for inflation, the increase is dramatic. Our bilateral trade in the integrated United States-Canada automotive industry alone increased by over 15 percent per annum for the past 5 years, or as much as \$3 to \$4 billion per year.

The growth of United States-Mexican trade, on a relative basis, is as impressive. United States trade with Mexico has increased from \$6.4 billion in 1974 to almost \$13 billion at present. Mexico's rapid economic growth provides United States exporters with significant expanded opportunities to export capital goods and technology.

Energy trade has been and will be an important element of trade between the three countries. United States crude oil imports from Canada are well below the peak of 1 million barrels per day reached in early 1974. At present, our net oil imports from Canada are only 155,000 barrels per day. However, we import from Canada almost 3 billion cubic feet per day of natural gas or about 4½ percent of United States consumption. There are now pending before Canada's National Energy Board additional applications for natural gas exports to the United States which could eventually amount to another billion cubic feet per day. We have an extensive electricity exchange with Canada, with the United States being a net importer of some 17.5 million megawatt hours per year.

Our energy relations with Mexico are less extensive than with Canada but they are growing. We import more than 400,000 barrels per day of crude oil, and this volume should increase as Mexico's crude oil production expands. The United States now takes 80 percent of Mexico's crude oil exports. The Mexican Government has indicated a desire to diversify its exports so that Mexico might eventually export only 60 percent of its oil to the United States. But in absolute terms the volume should increase well above present levels. We do not now import natural gas from Mexico, but as the Committee is aware, discussions are underway with the Mexican Government with respect to possible gas exports to the United States. We also have the potential for growing electricity exchanges—the United States now is a net exporter to Mexico of some 68,000 megawatt hours annually.

Investment flows are another substantial element of our economic relationship. In 1977, the net book value of United States investment in Canada was more than $35 billion, representing about one-fourth of total United States direct investment abroad. Canadian investment in the United States has increased markedly in recent years reaching almost $6 billion in 1977. U.S. direct investment in Mexico in the same year was over $3 billion. With our rapidly growing economic relationship has come a growing integration of our economy with those of Canada and Mexico. The most dramatic example of this is the United States-Canadian automotive industry which has been substantially rationalized and integrated across the border pursuant to the United States-Canada Automotive Agreement of 1965. As a result of this agreement trade in automotive products between the two countries has grown explosively (from $740 million in 1964 to over $21 billion in 1978) with great benefits to both countries in terms of increased employment opportunities, more efficient production, and thus benefits to consumers as well as investors in the industry.

As the result of successive trade negotiations since World War II a substantial part of our trade with Canada is presently duty free both into Canada and the United States. In 1978 about 70 percent of United states imports from Canada entered free of duty, and 60 percent of United States exports to Canada entered duty free. If our MTN offers of duty elimination had been in effect last year, 80 percent of Canada's exports to us would have been duty free as would 65 percent of our exports to them.

Our trade relations with Mexico are at a lower volume and the evidences of integration fewer. As part of its economic development program Mexico has pursued a highly restrictive trade policy. Until the recent multilateral trade negotiations Mexico abstained from participation in international trade negotiations and did not become a member of GATT. In 1977 we signed a small bilateral trade agreement with Mexico, the first since 1942, and have been negotiating a fuller MTN Agreement with the Mexican Government, which is now actively considering GATT membership.

The rapid expansion of our economic relations with Canada and Mexico and the evident benefits derived therefrom have raised the question whether we should not more actively pursue a deliberate policy of integration of the North American economies. Clearly all three countries would benefit from the freer movement of goods, services, and people. Integration of the three economies would promote more rapid economic growth in the three countries. It would promote greater efficiency of production and the development of resources. It is in the latter area that many people see particular advantages having in mind the potential energy resources available in Canada and Mexico.

On the other hand, efforts toward economic integration confront a number of hard realities. First the people of Canada and Mexico, not unlike the people of the United States, are sensitive about the development or utilization of their natural resources and particularly their energy resources. They believe these resources must be used to serve their own national interests, having in mind the need to conserve those resources to the maximum extent possible for future generations. Thus those who see Canada and Mexico as either the salvation or at least a substantial answer to our energy problems are likely to be severely disappointed.

This is not to say that we do not have the possibility of a substantial and even growing energy trade with Canada and Mexico. We must, however, recognize and be sensitive to the national policy concerns of our neighbors to the North and South with respect to energy resources.

The prospects for increased integration of the United States economy with those of Canada and Mexico exists in a number of sectors. To some extent, integration will progress as our trade in particular sectors grows and as our barriers to exchanges between the three countries are dismantled. We should recognize at the same time that with the benefits of integration come some problems. Rapidly growing trade in particular sectors, particularly sectors that involve commodities with established producers brings with it problems of adjustment. Thus we have found calls for protection against rapid imports of particular products such as Horticultural imports from Mexico. Also with the rapid expansion of trade has come resort to various provisions of law dealing with unfair competition such as antidumping, countervailing duties, etc. Frequent resort to such provisions have produced considerable irritation in our trade relations with our neighbors. Such measures are not, of course, limited to United States producers. Canada and Mexico have taken similar actions or have resorted to other means to protect their domestic producers.

Notwithstanding the occasional problems we have had in our trade relations with Canada and Mexico, we have made significant progress both in dealing with these problems and in laying the basis for further trade expansion through the recently concluded Multilateral Trade Negotiations. With Canada, we have agreed to cut tariffs on a bilateral basis by about 40 percent. Canada has agreed to adhere to the customs valuation code and progressively to eliminate valuation practices that have irritated American exporters for many years. Canada has also agreed to modify its practice of imposing a 15 percent duty on machinery imports when Canada produces machinery like that imported. The United States, for its part, has agreed, in exchange for stricter rules on the use of subsidies, to add an injury test to our countervailing duty statute as Canada, among others, had requested. The improved dispute settlement mechanisms under the GATT negotiated in the MTN will improve our ability to deal with various bilateral trade problems.

Our bilateral negotiations with Mexico are not yet concluded. We are optimistic that, in the settlement we hope to conclude, a basis will be laid for a substantial increase in trade between our two countries.

Another element of the growing interdependence of the North American economies has to do with investment the United States has traditionally favored two-way investment flows. Increased investment promotes economic growth and empoloyment and contributes to expanded international trade. On the other hand, investment can be a problem when countries or governmental units compete for investment in particular sectors by offering extrodinary incentives. Such practices can distort rational investment decisions creating employment opportunities in one region at the expense of employment in another region. The problems arising from investment incentives have been a matter of growing concern—one that we have been discussing not only with our neighbors but with our trading partners in the OECD as well. We have undertaken bilateral discussions with Canada in particular to explore means of limiting investment incentives in both countries. A bilateral understanding in this area might well build on procedures negotiated in other areas in the MTN.

In conclusion, Mr. Chairman, I have in this brief statment tried to reflect the elements of our growing interdependence with our neighbors in North America, with the opportunities that such growing interdependence presents to the three countries and finally, to certain of the problems that are raised thereby. I would be glad to respond to any questions the Committee may have.

Thank you.

Senator BAUCUS. Next, a slight change in plans here. Mr. Borre, you have been very, very patient. Unfortunately, there has been an additional complication here. Mr. Oreffice is here and his grandchild is graduating today—not in the Washington, D.C., area—and he has a plane to catch.

I wonder if possibly we could hear Mr. Oreffice next, so he can attend his grandchild's graduation.

STATEMENT OF PAUL F. OREFFICE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, DOW CHEMICAL CO.

Mr. OREFFICE. It is my son. I am not that old.

As you know, I am Paul Oreffice, president and chief executive officer of Dow Chemical Co. I have been convinced for quite some time that Canada, Mexico, and the United States need to re-evaluate their total working relationship and not just trade matters. I have spoken out publicly on this matter for some time. I am delighted to have this opportunity to share some of my thoughts.

My convictions are really deeply rooted. I spent one-third of my working life in Latin America. I speak fluently enough Spanish that most Latins take me for a native, and we also have had an operation in Canada for 35 years.

From the U.S. standpoint, the basics are easily stated.

First, the most serious problem facing this country is energy.

Second, North America can be self-sufficient in energy.

Third, the United States has enough to offer its neighbors in terms of technology, markets, jobs, and financial resources to make it the most attractive customer for energy its neighbors choose to sell.

So I conclude that all three countries have much to gain and little to lose from the development of such a North American alliance.

Because energy is the key, I want to comment briefly on the U.S. energy situation. Dow is a large net energy consumer, so we certainly have no pro-oil company bias. At the same time, our very existence is threatened by an energy policy, or lack of an energy policy, which has made the U.S. exploration less attractive, ignored coal, alienated our neighboring countries, and resulted in product shortages and public outrage.

This country is like a person who is being mugged but will not fight back because it is too busy destroying all its weapons.

Among those weapons are coal, nuclear, solar, conservation, and the most important of all—American ingenuity. Yet, we seem bent on systematically destroying or suppressing all of them. Let me use coal as an example.

Everybody agrees it is our largest energy resource. We know how to use it, and we have huge reserves. Programs for coal production, liquefaction, gasefication, should be heavily supported. Instead, there is a constant attack against the mining and use of coal for both real and imagined environmental damage.

The New Clean Air Act amendments in effect in July of this year will make it impossible to build a coal-fired powerplant in most of the country. Incredibly, I do not hear much coming out of this town that would permit us to tap this great resource. We do not need to ruin the environment, but we do need to take a realistic approach both to strip mining and to the absolute purity we require in the air emanating from a powerplant. Only the Congress can do this, by changing the stifling and exaggerated environmental laws they have passed.

American ingenuity is the greatest strength of this country. Yet, we are so burdening that ingenuity with a welter of regulations, constraints and disincentives that we are rapidly blunting its effectiveness. I sincerely hope this Congress will act to restore some balance to our regulatory process.

You asked about U.S. investment in Canada. I daresay U.S. investment in Canada is becoming easier than U.S. investment in the United States.

This country is at a point in its history where another kind of ingenuity is needed—ingenuity in strengthening our dealings with our neighbors. I believe the time has come to form a North American Alliance.

Let me explain.

The United States is short of energy sources but the United States also is very long on agricultural commodities and has the technology and the land to grow more. The United States, further, has a large consumer market for products of all types and has a large job market that today is being filled in part by Mexicans who find it necessary to enter this country illegally.

Canada has abundant energy resources, mainly huge natural gas deposits, but much of Canada is underpopulated and they can certainly use elements of U.S. technology and financial resources as well as an opening to the U.S. markets. Canada also represents a fertile opportunity for increased research and development effort, and an exchange of technology can be mutually beneficial.

Mexico, on the other hand, has an abundance of oil and gas that the United States could use, but Mexico also has some fundamental problems caused by overpopulation and a backward agricultural economy.

Mexico has a population of more than 60 million people. Additionally, it is said that there are more than 5 million Mexicans who live and work in the United States illegally. Mexico's population growth rate of 3.2 percent per annum, compounded, will give her 100 million in another generation or so.

What a great chance, then, to take all of these problems and all of these strengths and combine them to create better opportunities for all. I realize that regional economic blocks are imperfect at best, but I can get excited about this one. There seems to be so many things going for it.

A recognition of the United States problem could lead to an open flow of oil and gas from its neighbors to create a self-sufficient North America. A recognition of Mexico's people problem could lead to the free flow of needed Mexican labor into the United States. A recognition of the Mexican agricultural problem could lead to better markets for United States and Canadian agricultural commodities; maybe it would even lead to a reduction of that national scandal that makes us pay farmers not to plant certain crops when there are people going hungry.

A recognition of the need to industrialize by our neighbors would lead to a free flow of products in and out of all three markets.

A recognition of our neighbor's technological needs could lead to a free flow of technology and technicians from our great research establishment to both Canada and Mexico.

Such a flow is much more important than most people realize. All too often, countries anxious to improve their industrial base have negotiated one-shot infusions of technology and processes, only to find them quickly obsolete without the massive and continuing research backup available in the United States.

These are some of the specifics, but there are many, many, more advantages that could flow from an economic union that goes from the frozen tundras to near the tropics.

The strength of such an alliance could do wonders in terms of our negotiating power with blocks such as the European Common Market, it could do wonders in human terms by eliminating the ugly steel fence from one of our borders and uniting different cultures for the betterment of all. It could do wonders in terms of eliminating the suspicions and complexities that exist among neighbors by making each of these three proud, powerful, and independent national equal partners in a joint venture that is bound to prove stronger than the individual pieces.

It is time we went to work on some of these ideas. I wish that President Carter had taken some of these ideas on his trip to Mexico, instead of just pleading for oil and gas. Let me give you some very tangible evidence from Dow's experience to dramatize this country's economic interdependence with Canada and Mexico. The largest single capital project in the history of our company, some $700 million, is being built right now in Alberta. It uses United States technology, Canadian raw materials, financial support from both countries and provides jobs and products for all of North America.

Also, we are building a big crude oil processing plant in Texas, and recently signed a contract with Pemex, the Mexican national oil company, to obtain crude oil from Mexico as a part of the feedstock for that unit. At the same time, we supply Pemex with many products and services originating in the United States. Pemex, as a matter of fact, is one of Dow's 25 largest customers worldwide.

I am sure that many other companies have similar experiences. The time has come for government to realize what we already know—that our three countries have immense stakes in each other's well being and that our fortunes are in inevitably intertwined.

I have some advice for those who would pursue this concept—it is not a time for arrogance. The days where the United States can flex its muscles are long gone. We must enter such discussions as equals and recognize that the only way such an alliance can work is if it is truly to the advantage of all parties.

Finally, I believe we are talking about an alliance far more fundamental than a trade agreement. We are talking about a basic change in philosophy which should permeate our every tie to our proud and powerful neighbors.

Mr. Chairman, we are at a crossroads. We can either solve our energy problems or watch this dynamic country grind to a halt as our dependence on others for energy makes us a second-class world citizen.

We can either decide to develop a powerful coalition with our neighbors, or watch the tensions between us grow as they covet our jobs and markets and we covet their resources.

The time for action is short—almost too short. We are way overdue, as a matter of fact. These hearings can be an important first step, and I commend this subcommittee for its initiative.

Thank you very much.

Senator BAUCUS. Thank you, Mr. Oreffice.

Since you speak Spanish and have spent a period of your life in Latin America, I am curious if you have any suggestions as to the general mechanisms, by which, we could pursue the kind of suggestions you have. What avenues other than governmental ones? Sometimes there are private entities which can cross borders more easily than governments and can reach decisions and solutions to problems in a more rapid fashion.

I am interested in your general suggestions, particularly in respect to Mexico.

Mr. OREFFICE. Let me answer the last one first. In a lot of specifics we would do a lot better if our government got out of it.

The gas that Senator Dole asked a question about of previous witnesses is a prime example. It is essentially a deal made by some private companies, until the Government said the price is too high, and you cannot make that deal.

By the way, I would like to take exception with our previous witness' saying the Mexicans really have plenty of use for the gas. They did not have uses when the United States said you cannot ship it up there. They had found alternative uses and the pipeline that was going to come to the United States is now being used in a part of Mexico.

But essentially, while I think the Government should stay out of all the specifics, I think we do need a government-to-government three-way sit down, a commission, if you will, of the three, trying to look at all of these broad aspects.

I think the biggest problem we have with Mexico is that, in the past, I think—you have stated, as many witnesses have stated, they have feared this powerful, big neighbor to the north. I think our policy has been one of sometimes arrogance and strength.

Now their attitude is just because we have oil, you want to talk to us. I think we need to sit down with them, showing that we have enough things to offer in exchange for some of this freer flow of oil. I do believe we have a lot of things to offer, and I have tried to outline some of them, outline them to some of my Mexican friends, and I have found a great deal of sensitivity of the people in Mexico to the thought that we should sit down, not just talk energy. They would resent it if we only wanted to talk about taking their oil and gas.

We need to sit down in a much broader aspect. This question of immigration to the United States is one that weighs very heavily. I think all the Mexicans want it.

We need to sit down and show them, we have lots of things to offer you to solve your problems in exchange for things you have to solve some of our problems.

Senator BAUCUS. Thank you very much.

Senator Dole?

Senator DOLE. I have no questions. I think it is an excellent statement. I appreciate it very much.

Senator BAUCUS. Thank you very much, Mr. Oreffice. I appreciate your testimony.

Mr. OREFFICE. Thank you for moving me up.

Senator BAUCUS. You are very welcome.

Finally, Mr. Borre?

Mr. Borre is Deputy Assistant Secretary for International Energy Resources. You may proceed, Mr. Borre.

STATEMENT OF PETER BORRE, DEPUTY ASSISTANT SECRETARY OF ENERGY FOR INTERNATIONAL TRADE AND RESOURCES

Mr. BORRE. Thank you, Chairman Baucus and Senator Dole. I think I will summarize my statement, given the lateness of the hour, and the fact that the previous spokesmen touched on some issues I would have covered.

At the risk of sounding argumentive, between the topics of organization within the Department of Energy and the Mexican gas negotiations, there is a real Hobson's choice as to what one should address. Let me speak to the price in the Mexican gas negotiations question from the facts on the record.

I think there is embedded in the public consciousness the knowledge of the initial asking price of $2.60 at the border toward the end of 1977. Based on the formula under discussion in 1973, but not under Government review, that formula would yield today, based on perhaps the abnormal developments in the distillate spot market in New York Harbor, a border price of $3.60 rather than $2.60.

With respect to the effect on Canadian prices, as a rule of thumb, a 10-cent increase in the border price of a tax in Canada translates into $100 million of extra burden on the U.S. consumer, given the magnitude of deliveries of gas from Canada to the United States, which is just under 1 trillion cubic feet.

On the subject of Department of energy organization that you touched on, Mr. Chairman, I would say very succinctly that we, in the Department of Energy have focused yet again, reorganized yet again, to take Secretary Katz's point about boxes being a sport in this town.

We have put more focus on the producing country's side of the equation, particularly in the Western Hemisphere, not only Canada and Mexico, but the upper and lower Caribbean as well as Venezuela and further south in Latin America. These respective areas hold oil and gas promises as well as other resources, such as coal in Colombia.

Generally speaking, Mr. Chairman, the administration shares your belief that close cooperation with Canada and Mexico is of critical importance. You propose the creation of a North American energy market or energy system. It is our impression that we have, indeed, the workings of such a system that is beginning to emerge, more strikingly in Canada, perhaps, than in Mexico.

In addition, we in the Department of Energy have taken numerous steps to assure the highest level of cooperation in trade with our Northern Hemisphere neighbors.

I would like to stick to my text to emphasize a rather important point—perhaps an obvious one—that the overriding principle in developing our energy relations with both Canada and Mexico has been to explore areas of mutual interest and develop mechanisms, if appropriate, to further those interests within the context of respect for national sensitivities and public differences. A Northern Hemisphere policy cannot be dominated solely by the interests of the United States. If we hope to have close cooperation among the nations of the Northern Hemisphere on energy policy, it must be a policy that is not self-serving.

While recognizing and accommodating U.S. interest, it must benefit all the nations concerned. This factor is particularly important in developing trade policies in an area such as energy which all nations realize is essential and increasingly significant to their national security and economic growth. In this regard, United States-Canadian energy relations have proven successful on an overall basis and may serve as a helpful format for further development of United States-Mexican energy relations.

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United States-Canadian energy relations have been characterized by intensive work at the senior staff level supplemented with fairly frequent high level meetings at the political, ministerial and senior staff levels. More recently, President Carter and former Prime Minister Trudeau agreed to regularize these meetings in order to facilitate implementation of those projects underway, create a new forum for new initiatives, and assist in the understanding and resolution of bilateral policy issues.

Thus, they agreed to establish the United States-Canadian Energy Consultative Mechanism, whose first meeting was held in Washington, D.C., on March 27 of this year, and which covered a wide range of topics.

We look forward, with the new Government installed in Canada, to a meeting in the near future, subject to the convenience of our Canadian neighbors.

On the subject of oil trade, I think that you, Mr. Chairman, are well familiar with the developments in northern Canada, the policy of phaseout by 1981, and the acute problems thereby created for the northern tier States.

I would say that, at this juncture, the Canadian Government has indeed been helpful in assisting us with regard to the logistic problems that are posed. Perhaps the most recent measure was that in December, roughly December 8, 1978, when Secretary Schlesinger visited Mr. Gillespie in Ottawa, and it was agreed that one of the key elements of the problem of supply of light oils to the northern tier States, would be maintained at a level of 55,000 barrels a day.

We had asked for a fixed term, but their response was for the near future. But I think that there is a rather open attitude on the part of our Canadian colleagues in this matter, which is of crucial importance to us.

Moreover, in January, as a result of uranium downturn, the Canadians relaxed previous policy and Portland-Montreal exchanges have now grown significantly in volume. Previously, as you know well, these exchanges were limited to the system and logistical bottlenecks retarding progress.

I would like to touch very briefly on what Deputy Secretary O'Leary has referred to as the "energy omelette" on the west coast; given the Sohio decision as it stands today, our minds are rather more focused than they were in the past, although our attention has been keen throughout.

As you know, the Department of the Interior, specifically the Secetary of the Interior, has to come up with a review of the various transportation options, and it is my understanding that he intends to submit his recommendations to the President by October 15 of this year. The President has announced his intention of reaching a decision in this regard by the end of this year.

Quite clearly, three of the options are substantially Canadian-based. It is very important in our evaluation to have available technical data, as well as indications of interest and attitudes on the part of the Canadian Government. This is an issue that we raised in the Senior Consultative Mechanism, and intend to raise again.

It appears—and this is a judgment based on a meeting now some 2 months old—that the Canadian Government would be in a difficult position by October 15 of this year to render definitive views on the relative attractiveness of the three so-called Canadian options. But, we are told that they are giving best efforts in this regard, and we intend to continue pressing this matter.

I would touch very briefly on the subject of the Strategic Petroleum Oil Reserve (SPOR), which has become a bilateral concern. You may be familiar with the fact that there is now a so-called turnkey procurement process underway. As a part of that process, we have had two Canadian bids for sites, each of which has had an approximate capacity of 100 million barrels.

We are engaged in negotiations on a government-to-government basis with our Canadian colleagues to attempt to obtain from the Government of Canada the assurances that we would need in the event of a Canadian site selection, so that it would not only be developed in accordance with our full array of standards, but also we would have adequate assurances on key political questions that go beyond the simple technical specifications of such a project.

Just 2 days ago, on June 4, the United States and Canada signed a Memorandum of Understanding, for Research and Development in Tar Sands and Heavy Oils. You may be familiar with the particular resource promises up in Canada, particularly in Alberta and Saskatchewan, in this area. We believe we have a substantial contribution to make on the matter of easing our dependence on conventional oils. We believe the pilot plant phases of such a heavy oil/tar sands effort could be accelerated for our participation.

Secretary Katz touched briefly on the joint electricty study between the United States and Canada. We expect that it will be published shortly. It was completed some 2 months ago. But, in deference to both the need to translate this into French, which was an across-the-board concern, and also to give the incoming Government and administration a chance to review the study, publication has been withheld for a matter of another week or two.

The findings are striking. They show on a regional basis mutual advantages in increased trade in electricity.

The Canadian NEB had supply hearings last year had indicated that an additional 2 trillion cubic feet of natural gas might be exportable surplus to the United States over the next 8 years. Currently, we are importing at a level of slightly under 1 trillion cubic feet from Canada. There are hearings scheduled in Canada this summer to determine the number and volume of gas export licenses to be approved.

I will skip over the nuclear area. It is in the statement.

In conclusion, with respect to our energy relations with Canada, I would simply like to say one can conclude the United States-Canadian energy cooperation has made significant progress in the past, and we look forward to working with the new Canadian Government to explore new tools to enhance these energy potentials.

We have indicated we are interested in a very senior level meeting in the energy area in the near future, of course, at the convenience of the incoming minister.

Senator BAUCUS. Thank you very much.

A question comes to mind. Do we have an overall framework to look at the strategic oil and energy problems of North America as a whole? We discussed several negotiations directly with Mexico, several with Canada. I am curious.

Mr. BORRE. Mr. Chairman, I have some concluding observations on our neighbor to the south and I would not want to draw the inference that we are not concerned about our relations to the south, as well as to the north. I will try to be quite brief. I can be very brief, indeed, although I would urge those who are interested in this topic to read the statement.

I think Secretary Katz has talked about the volume of exports. I would underline what he said. There were public statements by the Government of Mexico that emphasized the fact that it is, indeed, a Mexican objective to diversify its oil exports. We are presently importing 80 percent.

It is conceivable that this so-called proportion could go down to some 60 percent, but as Mr. Katz said that would represent, in the context of growing Mexican production, an absolute increase to the United States. It is a matter of Mexican sovereign judgment as to how to diversify its export pattern.

Second, at the risk of repeating the obvious, the level of oil production in Mexico, as you observed so correctly Mr. Chairman, is a rather vital domestic concern in Mexico and goes beyond the technicalities of geologic or generic potential. The indications we have are that through 1980, PEMEX will reach its objective of 2.2 million barrels a day. Beyond 1980, it will be a matter for the Mexican Government—probably the highest levels—to determine an appropriate pace for future expansion.

I would add the additional point, given the nature of the Mexican Presidential system, that it appears to be a tradition there that an incumbent President is reluctant to commit beyond the end of his term to his successor, to the extent that such a commitment or constraint can be avoided.

Mr. BAUCUS. When is his term up?

Mr. BORRE. 1982.

The gas trade issue has been handled in testimony by Secretary Katz.

I would conclude by saying we do have a joint electricity study with the government of Mexico, patterned very much along the lines of our published study with the Government of Canada. Also, I would like to pick up a point that some other people mentioned. We are well aware of the fact that Mexico is much more than an oil reservoir or a series of gas deposits. We have initiated a number of bilateral energy R. & D. contacts of personnel, information exchange nature in the area of solar energy, energy information exchanges, geothermal, enhanced oil recovery techniques, and the like.

We, at least, intend to build very strongly on this to show Mexico that our attitude is one that is respective of their own apparent desires to expand their capabilities across the board through most energy sectors and not be limited to oil and gas.

That concludes my statement, sir.

Mr. BAUCUS. Thank you very much, Mr. Borre.

You mentioned that the Department now is spending more time to look at the Western Hemisphere. Is that in the nature of a study? Is there going to be a Department study that will be available at some time?

Mr. BORRE. My experience is not as Secretary Katz's, but I have recollections of studies that are advertised, promised to congressional subcommittees or committees, and then somehow are hanged in limbo. We are assembling, virtually on a daily basis, facts and figures that relate to the Western Hemisphere as a whole. We have a focused look now on the Venezuelan issue, including its potential.

Whether these would be synthesized into a study to be published is a question that is open. If you would want to go into more depth, in a comprehensive way, that would draw in the Caribbean countries as oil and gas producers and refiners, Venezuela is a significant producer of conventional oils and prospectively for gas as well. Should we produce the material in a coherent fashion we would be glad to present it to you.

[The following was subsequently supplied for the record:]

The testimony submitted by the Department of Energy focuses on the issue of North American Energy Trade, specifically our energy relations with Mexico and Canada. However, it is useful to expand this outlook to the Western Hemisphere energy market in which Venezuela and the Caribbean play a very important role; Venezuela is the other major oil producer and oil exporter in the Western Hemisphere and the Caribbean is key to Western Hemisphere oil product trade.

The United States has devloped a broad bilateral energy relationship with Venezuela, which includes extensive trade in crude oil and product as well as joint cooperative efforts in the energy field. The United States and Venezuela are planning research and development cooperation in the Orinoco tar sands, heavy oils, and enhanced oil recovery techniques. In addition, recent bilateral talks between the Department of Energy and the Venezuelan Ministry of Mines and Energy are expected to result in a joint comprehensive study of Venezuela's energy resources and energy planning.

With respect to energy trade, Venezuela has been a long-term reliable supplier of crude oil and refined petroleum products to the United States and there is every indication that the Government of Venezuela expects this relationship to continue and, hopefully, expand. The United States imported an average of 176,000 barrels per day of Venezuelan crude oil in 1978, or about 8 percent of Venezuelan crude production. U.S. product from Venezuela imports totaled 456,000 barrels per day of which 90 percent is residual fuel oil and 6 percent is distillate and other products. The United States market accounts for approximately 65 percent of Venezuelan product exports. Moreover, Venezuela's role in meeting the U.S. imported oil requirements is even more important than these import figures indicate. The bulk of east coast demand for residual fuel oil has been historically satisfied by imported product refined from foreign, primarily Venezuelan, crude oil. Major U.S. oil companies were the first to generate the refinery capacity for residual fuel oil in the Caribbean, utilizing largely Venezuelan crude. As U.S. Government policies developed which favored importation of residual fuel oil, several independent oil companies also built refineries in the Caribbean in order to take advantage of favorable tax treatment and transportation advantages to the U.S. east coast.

Refineries located in the Caribbean are an integral part of the refining capacity serving the U.S. domestic markets. Over the past decade, Caribbean refineries have supplied over 50 percent of total U.S. residual fuel oil demand and approximately 80 percent of total east coast residual fuel oil demand.

Investments in Caribbean refineries have permitted them to expand to meet U.S. demand for low sulphur residual fuel oil. Initially, the bulk of U.S. residual fuel oil imports came from major refining centers in Venezuela, the Netherlands Antilles, and Trinidad, but in more recent years, the Virgin Islands and the Bahamas have also become major suppliers. The substantial investment enabled capacity increases; some 1.6 million barrels per day of capacity was added from 1965 to 1975 primarily to keep pace with growing U.S. demand for residual fuel oil.

The U.S. reduced demand occurring since the 1973-74 Arab Embargo has resulted in capacity utilization of only 60 to 65 percent in the Caribbean and current surplus capacity of about a half million barrels per day. DOE is reviewing our current domestic refinery situation to determine recommendations for our future refinery policy. In this context, we are examining foreign surplus refinery capacity in the Caribbean, Western Europe, and other areas to determine the most efficient, low-cost, and secure refinery configuration for providing crude oil and petroleum products to U.S. markets. The recommendations developed with respect to the refinery capacity in the Caribbean, including the role of the crude oil supplies from Venezuela for these refineries, will be a significant part of our domestic refinery policy. This policy will impact the Western Hemisphere energy market.

Senator BAUCUS. The scope of these hearings is not specifically limited to Mexico, but because of time constraints, we have chosen to focus on Mexico and Canada today. But a lot of these issues involve the Caribbean countries as well. If you could expand it, it would be helpful.

I am curious, too, as to the degree to which the Department negotiates with private companies. The gas pipeline companies, as you know, are a little bit upset with the way the Mexican gas proposal was handled. They feel they were led along the primrose path by the Department of Energy and when the agreement was to be consummated, the Secetary, at the last hour, said no, and they were left dangling.

Can you describe how the Department negotiates with and operates with private gas companies or other interested companies that are trying to negotiate agreements with Mexico or Canada? How is all that incorporated?

Mr. BORRE. Very elaborately, very cumbersome and, based on the opinion of many observers, very unsatisfactorily, sir.

Senator BAUCUS. Do you have any suggestions as to how to improve it?

Mr. BORRE. I really feel compelled to duck bravely behind some statutory requirements which others may call impediments that limit, in a way, effective consultations with the private sector and regulatory agencies.

Here we really get into the process, if one could charitably call it that, where the FERC, Department of Energy and the Economic Regulatory Administration divide their responsibilities with respect to the review of gas import applications.

It is something that we have tried to explain in the past. It has been highly confusing to both foreign governments that have gas export dedicated projects aimed at the United States and to intermediary companies. To oversimplify, there appears to be a catch-22 in adjudicatory process that works something like this: If an individual is a so-called decisionmaking officer—and that is a legal term of art, but perhaps simplistically that means that he or she has a role in the actual decision on the adjudication, then that individual is precluded from so-called ex parte contacts.

Those contacts have to take place in the very formal adjudicatory procedure. Therefore, when a private firm comes in to express a general kind of concern, by definition, an individual who is prospectively or actually active in the review of the particular import application before the Department, cannot participate in the discussion. That discussion has to be limited to so-called general policy concerns.

Let me illustrate with a specific case in hand.

Senator BAUCUS. If you could, briefly.

Mr. BORRE. Our friends in Indonesia, for some 6 or 7 years have been trying to develop an LNG, liquefied natural gas, export venture to the United States. Part of it would flow to Japan, part to the United States.

They went through the very formal procedure and submitted their package. The package was rejected by the Administrator of the Economic Regulatory Administration, based on a very real concern regarding the price escalation provisions—there were other concerns, but I will just touch on the major ones, in my judgment.

Price escalation formulas tied the future price of this gas to the price of oil in a rather open-ended fashion. The Indonesians, not just the Government, but the national oil company, consultants, lawyers, and intermediaries, came in and said, give us an indication of the type of price escalation formula you would expect. And the response to that was, "We cannot tell you specifically; We can tell you in a very general vein what our concerns are." Quite simply, it was the notion of linking the price of a commodity expected to be in relatively abundant supply—gas—with the supplies of the commodity expected to be in tight supply—oil.

But it was up to them, over a period of months, to go back to the drawing board to try to guess from a rather cryptic general comment on these issues what an acceptable price escalator formula might be. And I can comment privately that we had our own lawyers riding shotgun on this process throughout to make sure we did not somehow inadvertently, in a private bilateral meeting, give away a decision that should, in fact, take place in an open forum.

Mr. BAUCUS. Thank you very much, Mr. Borre. I appreciate your testimony.

In addition, Senator Bradley has inserted questions that he would like to submit at this point and ask you to answer those.

Mr. BORRE. Would you like me to respond now or for the record?

Senator BAUCUS. For the record.

Mr. BORRE. Yes, sir. I will do that.

[The following was subsequently supplied for the record:]

RESPONSES TO QUESTIONS OF SENATOR BRADLEY BY THE DEPARTMENT OF ENERGY

Questions. If the United States, Mexican and Canadian Governments were to arrive at a long-term supply arrangement, how could energy companies in these countries be integrated into such an arrangement?

For example, how would they be brought into the negotiation process and how would supplies be allocated among them?

Would not antitrust problems arise? How would allocation decisions be made?

In sum, what are the problems raised by a situation where the U.S. Government will be negotiating supply agreements while private firms are responsible for carrying them out in the U.S. and to a substantial degree in Canada?

Answer. The United States Government could negotiate a direct government-to-government long-term energy supply contract with Canada and/or Mexico under the authority of the Technical Purchase Authority (TPA) of the Energy Policy and Conservation Act. Since the U.S. Goverment heretofore has not been involved in the distribution, processing, transportation, or marketing of oil, it is probable that such functions would be performed by the private sector once the U.S.G. has purchased the Canadian and/or Mexican oil. However, one of the problems that arises from such an agreement indeed is the integration of U.S. oil companies into such an agreement. While the nature of the agreement will to a certain extent determine how the integration would be resolved, the buying and selling of oil under TPA would be complex and difficult to administer. The Department of Energy recognizes these problems and they would be carefuly reviewed before such an agreement were signed.

Should the long-term supply agreement call for a minimum guaranteed quantity of oil that would be allocated to U.S. purchasers over a fixed period of time, private U.S. companies could negotiate oil contracts on a normal commercial basis with Petrocanada or Pemex, who would determine the companies that would buy and market the oil. However, allocations problems arise, should the quantities stipulated in the agreement be in an amount that would preclude for practical purposes more than one or a few U.S. purchasers. We recognize that antitrust problems can arise when a limited quantity of any commodity (i.e., oil) is allocated at a fixed price in the marketplace. In addition, certain allocation systems can discourage new entrants to the market.

It has been suggested that in order to assure supply access, the U.S. Government could negotiate a direct government-to-government supply agreements whereby the U.S.G. contracts for, and in turn allocates, the oil designated for U.S. markets by Pemex and/or Petrocanada. Section 456 of the Energy Policy and Conservation Act provides for a Technical Purchase Authority (TPA) to be used by the President, at his discretion, to purchase all or a portion of U.S. oil imports. The TPA is required to resell the crude on the commerical market and the benefits are to be equalized among refineries by resale at an average price for all imported oils of similar quality. Other restrictions are placed on the TPA. However, utilizing the authority of the TPA in essence necessitates the establishment of a new mechanism since at present the U.S. Government is not equipped to purchase or market oil, with the exception of oil for the Strategic Petroleum Reserve. This new mechanism would involve some of the functions of an integrated oil company which heretofore have been conducted by the private sector and would set a precedent for participation in the energy market. Thus, the issues arising from a government-to-government supply agreement can be complex with far-reaching consequences.

Question. There has been much talk of arranging an oil swap whereby the United States would sell Alaskan oil to Japan which would then be replaced in equal amount by oil from Mexico above the quantity which the U.S. could otherwise expect Mexico to sell. What are the cost advantages?

Answer The State of Alaska has proposed a three-way swap that would send surplus Alaskan oil to Japan in exchange for Mexican crude oil, which would be diverted from Japanese markets to the U.S. gulf coast. If DOE recommends to the President that exports or exchanges of Alaskan oil be authorized, it would probably be for amounts of oil in excess of current ANS production of 1.2 million barrels per day in order to encourage an increase in the rate of production.

Such exchanges would result in considerable transportation savings. Currently, Alaskan oil is being shipped to U.S. gulf coast refiners through the Panama Canal. The shipping cost varies according to the availability of U.S. tankers, but it is in the $3 to $4 range. The Jones Act requires that any products, including oil, shipped between U.S. ports be carried in U.S. flag vessels, whose operating costs are considerably higher than foreign flag tankers. Since the Alaska-Japan and Mexico-United States gulf coast routes are shorter than the Alaskan-U.S. gulf route and less costly foreign flag tankers coud be used, there would be considerable transportation savings—over $2 per barrel—resulting from the swap. The maritime industry is expected to oppose the exclusive use of foreign flag tankers in the three-way trade, and if they succeed, the transportation savings will be lessened, based on the differential at that time between United States and foreign flag carriers.

Question. What are the other types of advantages that could result, for example, in terms of U.S. access to higher quality or more necessary fuel grades, or in terms of refinery capacity or ease of distribution?

Answer In addition to transportation cost savings, there are several major advantages that would likely result from swaps. First, the value of existing and new production would be enhanced since the west coast surplus could be eliminated. Thus, swaps could provide incentives for investment in new oil development and in additional refining capacity. If we fail to achieve an efficient solution for the distribution of ANS crude, through swaps or other means, we could lose as much as 600,000 barrels per day of additional production in the 1985–95 time period from both existing and new, unexplored areas.

Second, the improved distribution of crude and the increased crude production that would result from a swap agreement could act as restraints or moderating influences on potential increases in the world price of crude oil, especially increases from OPEC. Any restraint on world crude prices provides significant benefits to the U.S. because of our heavy dependence on foreign crude imports.

Third, to the extent that swaps promote or encourage increased crude oil production, and other gains in economic efficiency, mainly through improved distribution and transportation, all U.S. consumers would benefit. Any increase in crude production would also have the net effect of reducing imports, thus improving the U.S. balance of payments. Additionally, tax revenues to the Federal Government, and to the State of Alaska, could increase significantly.

The value of ANS crude is pegged to the landed price of competing foreign crudes. ANS crude oil has been selling at world prices for the last few years. Although the consumer may not realize direct benefits from any efficiency gains resulting from swaps, a number of indirect benefits, as indicated above, are likely.

Question. How could the system be designed to assure that consumers would directly benefit from any cost or other advantages achieved?

Answer. The value of Alaskan crude oil is pegged to the landed price of competing foreign crudes, and ANS crude oil has been selling at world prices for the last few years. Although consumers may not realize direct benefits (e.g. form of reduced gasoline prices) resulting from any efficiency gains from swaps, substantial indirect benefits could be realized. These benefits are summarized in the above response. On the other hand, consumer interest would be protected in two important ways. First, swaps would be permitted only under contracts which could be interrupted if U.S. crude oil supplies were threatened, and under export licenses subject to revocation should that happen. Secondly, it is also possible to only allow swaps above a given production level on the North Slope (for example, 1.2 million barrels/day), thereby encouraging new production, but keeping an incentive for refinery retrofits and west-to-east pipelines.

Question. In 1977, the U.S. Government expressed its opposition to a gas deal pending between PEMEX and several American gas pipeline companies on the grounds that the price of $2.60 per million cubic feet was too high. The deal eventually could have gained as much as 2 billion cubic feet of gas per day for the U.S. Because of the U.S. Government opposition, the deal fell through. Have there been any further discussions between the Administration and the Mexican Government concerning the sale of gas to the United States? What is the status of such discussions?

Answer. The price offered by Mexico in the Memorandum of Intentions signed between PEMEX and the U.S. gas pipeline companies called for a border price equivalent on a BTU basis to No. 2 fuel oil in New York harbor and an escalation clause based on increases in that fuel price. At that time, the formula would have resulted in a price of about $2.60 per Mcf. By comparison, the Canadian price was $2.16 per MCF, at that time. and the U.S.G. had substantial indications that if we agreed to the Mexican pricing formula, the Canadian Government would have raised their gas export price shortly thereafter.

The Mexican asking price was substantially higher than the price the Administration was proposing to pay U.S. domestic producers. The Natural Gas Policy Act which was at that time being debated in the Congress called for a price of $1.75 per Mcf.

With respect to the current status of natural gas talks, Presidents Carter and Lopez Portillo discussed the future possibility of natural gas transactions during the February Presidential trip to Mexico. As a result, a sub-Cabinet team, comprised of representatives from the Department of State and Energy and the National Security Council, has resumed discussions on natural gas sales to the United States. Three rounds of meetings have been held, and each side is considering the other's position. We hope that a gas contract on terms that are fair both to U.S. consumers and to the Mexican people can be reached.

Question. I understand the Mexicans have begun to lay lateral lines across the gas pipeline from the Reforma fields to Monterrey which are intended for domestic delivery. Does not investment by Mexico in pipelines for domestic use reduce the likelihood that Mexico will be interested in shipping large gas supplies to the United States in the future?

Answer. Pemex has completed construction of the 48-inch gas pipeline from the Reforma fields in southeastern Mexico to San Fernando, which is approximately 100 miles south of the Texas border and due east of Monterrey. If a gas contract is successfully concluded with the United States, the pipeline would be extended to the Texas border, for natural gas deliveries to U.S. transmission systems. If a gas export contract is not reached with the United States, Pemex would have the option of transporting the Reforma gas through a pipeline spur to Monterrey, where it would be used primarily for industrial purposes. The natural gas would be substituted for oil consumption, thus freeing up oil for export. Thus, the Mexicans have flexibility in the utilization of their domestic gas production, which is enhanced by construction of the pipeline. Nevertheless, the export of surplus quantities of natural gas remains a viable option for the Mexican Government.

Question. Since the production of gas is linked to oil, won't a weak market for Mexican gas discourage Mexico from increasing its production of oil, and if so, doesn't this mean that we should encourage Mexican gas production with the demand from our own markets?

Answer. The production of gas is linked with oil production in Mexico, especially in the Reforma fields where high gas-to-oil ratios (GOR) occur. Rather than curtail oil production, Pemex has flared excess production of associated natural gas. This practice was due largely to lack of processing and transmission facilities; however, flaring is now held to a minimum. Gas consumption has risen rapidly over the last two years in Mexico, and Mexico is planning increased domestic use of natural gas, whether or not a gas export contract is reached with the United States. There would not be a gas-related constraint on production until at least 1981. Even at that time, Mexico will have considerable flexibility in its production and consumption plans to alleviate or avoid such a constraint.

Question. What other supplemental gas sources could be available to the U.S. in the future, for example, from Canada, through coal gasification or liquified natural gas imports. How do they compare with Mexican gas in terms of cost, availability, quality, and security of supply?

Answer. The United States currently imports approximately 1 trillion cubic feet from Canada on an annual basis or 2.5 billion cubic feet per day (bcf/d). The issue of Canadian gas exports is closely tied to construction of the Alaska Gas Pipeline project, since the proposed pipeline route should pass through Alberta, the center of Canadian gas production. The National Energy Board (NEB) approves Canadian gas exports, and the NEB has recommended that some 2 trillion cubic feet could be exportable in the future. (There is a surplus of 2 tcf of natural gas over four and possibly eight years.) The NEB is currently holding hearings on this new export policy. The current price of Canadian gas is $2.80 per mcf at the border and although the price has increased, the gas is desirable for security of supply considerations.

With respect to liquified natural gas, there are presently 13 major LNG import projects which are in various stages of operation, construction, regulatory review or under commercial negotiation. To date, three Algerian projects totaling 0.6 tcf/year have been unconditionally approved be either the Federal Power Commission or DOE; an Indonesian project calling for 0.2 tcf/year had received conditional approval. If all the projects currently under regulatory review (0.66 tcf/year, including PacIndo) or in various stages of commercial negotiation (1.6 tcf/year) were to be approved, the U.S. could import approximately 3.0 tcf annually by 1990. However, recent LNG decisions by DOE/ERA as well as departmental statements have clearly articulated a preference for new domestic gas and pipeline imports from Canada and Mexico rather than a commitment to substantially expand LNG imports. The U.S. market for imported LNG is likely to be a function of the future U.S. demand for gas, the price and availability of OPEC oil as well as supplemental gas supplies, and pricing policies of exporting companies. The price of delivered LNG is higher than domestic gas pipeline imports, because it includes high transportation and technology costs; the two are not comparable. The LNG contracts are long-term, and the DOE/ERA considers the security of supply and availability factors before approving an LNG project.

Coal gasification plans are included in the President's Import Reduction Program. The Energy Security Corporation, as proposed by the President, will direct the investment of $88 billion to produce 2.5 million barrels per day of substitutes for imported oil by 1990. Some 1 to 1.5 million barrels per day from coal liquids and coal gases could contribute to meeting this target. Estimates of the costs of producing synthetic fuels from coal vary from $27 to $45 per barrel depending on the plant's products, i.e., liquid or gas, and its location. A $38 per barrel average has been used for the purposes of budget estimates for the corporation, although it is hoped that costs will be lower.

Question. What are the advantages to be gained by a bilaterial gas swap arrangement with Canada. For example, Alaskan natural gas could be delivered to the beginning of the Canadian distribution system at Edmonton thereby freeing up Canadian/gas for delivery to the Northern United States?

Answer. The United States has no objection to bilaterial natural gas exchanges with Canada, however, the Canadians are net exporters to the United States and will continue to be well into the future. The U.S. imports almost 1 trillion feet of natural gas annually from Canada. When constructed, the Alaskan natural gas pipeline will deliver Alaskan North Slope gas to the United States, its route passing through the Province of Alberta, the heartland of Canandian natural gas and oil production. The National Energy Board of Canada estimates that Alberta's potential natural reserves could be in the range of 130 to 140 trillion cubic feet. These conditions may result in "displacement" of Canadian supplies southward to the United States.

In addition, it is projected that Canadian natural gas from the Mackenzie discoveries will also utilize portions of the Alaskan natural gas pipeline, thus, even greater supplies of Canadian natural gas can be brought to market.

Question. What are the opportunities for the sharing or swapping of refinery capacity with Canada?

Answer. Through the first half of 1979, U.S. refineries operated at about 85 percent of capacity. The recent product supply problems do not stem from a lack of refinery capacity but from a shortage of crude oil. The United States continues to purchase 140,000 barrels of crude oil daily and exchange 160,000 barrels of crude oil with Canada. There is little net trade in oil products with Canada, although Canada supplies the United States with minimal quantities of heavy residual fuel oil. Canada has no surplus of additional crude oil or product to place on the export market.

Currently, there is no economic motivation for swapping refinery capacity with Canada or other areas such as the Caribbean or Europe where there is also excess refinery capacity. The United States has excess refinery capacity and, in fact, is currently studying the domestic and international refinery capacity situation.

Due to these conditions, there is little opportunity at the moment for exchanging refinery capacity. However, we are alert to changed conditions, which may open such opportunities in the future.

Senator BAUCUS. Thank you very much. I appreciate your testimony.

[The prepared statement of Mr. Borre follows:]

PREPARED STATEMENT OF PETER C. BORRE, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL ENERGY RESOURCES

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify before your Subcommittee on the vital issue of North American Energy Trade. First, as a brief explanation, the Office of International Energy Resources was recently reorganized and the growing importance of trade especially in North America, was a significant factor leading to the reorganization. The group now includes an Office of Consuming Nations and an Office of Producing Nations. The latter is responsible for energy trade, for producing areas including oil, gas, coal, LNG and electricity as well as some energy R&D oversight. The Office has staff specialist on Canada, Mexico and Latin America as well as OPEC and other producing areas. While this new organizational structure has only been in existence a few months, it has proved an effective means for coordinating and developing our Northern Hemisphere energy trade policies.

The Administration shares your belief that close and extensive cooperation in energy with Canada and Mexico are of critical importance for our energy future. In your invitation to testify, you proposed the creation of a North American Energy Market. Mr. Chairman, I believe my testimony will illustrate that the workings of such a market already exists. In addition, the Department of Energy has taken numerous actions to achieve the highest level of cooperation and energy trade with our Northern Hemisphere neighbors.

The overriding principle in developing our energy relations with both Canada and Mexico has been to explore areas of mutual interest and develop mechanisms, if appropriate, to further those interests within the context of respect for national sensitivities and political differences. A Northern Hemisphere policy cannot be dominated solely by the interests of the United States. If we hope to have close cooperation among the nations of the Northern Hemisphere on energy policy, it must be a policy that is not self-serving. While recognizing and accommodating U.S. interest, it must benefit all of the nations concerned. This factor is particularly important in developing trade policies in an area such as energy, which all nations realize is essential and increasingly significant to their national security and economic growth. In this regard, United States-Canadian energy relations have proven successful on an overall basis and may serve as a helpful format for further development of United States-Mexican energy relations.

United States-Canadian energy relations have been characterized by intensive work at the senior staff level supplemented with fairly frequent high level meetings at the political, ministerial and senior staff levels. More recently, President Carter and former Prime Minister Trudeau agreed to regularize these meetings in order to facilitate implementation of those projects underway, create a forum for new initiatives, and assist in the understanding and resolution of bilateral policy issues. Thus, they agreed to establish the United States-Canadian Energy Consultative Mechanism, whose first meeting was held in Washington, D.C., on March 27 of this year, and covered a wide range of topics.

Let me first address crude oil imports and exports. Although the Canadian Government in 1974 announced the phaseout of all oil exports to the United States by 1981 so that Canada could extend the time before it had to increase its foreign oil imports into Eastern Canada, the Canadian Government has agreed to continue vital crude oil exchanges to those Northern Tier States which are almost totally dependent on Canadian crude oil. To avoid such dependence, they need to develop alternative sources of supply and transportation systems which involves a long, arduous process. It requires domestic pipeline reversals and construction of a new pipeline to bring Alaskan and foreign oil to the Northern Tier states but, as you know, the latter has encountered substantial delays due to environmental and financial problems. Nonetheless, the Canadian Government has been helpful in assuring the Northern Tier States that it will continue to supply Canadian crude oil despite a difficult supply adjustment period.

Our bilateral energy ties have been especially helpful to both countries during recent months as world crude oil supplies have tightened. After long discussions, in January of this year the Canadian Government agreed to permit crude oil exchanges in limited volumes on a temporary basis, through the Portland, Maine Pipeline. The exchange benefits both countries: refiners in the Northern Tier states save nearly a dollar per barrel in transportation costs and eastern Canadian refineries, which had been receiving up to 120,000 barrels daily of curde oil from Iran prior to the cutback in production, were able to replace most of these lost imports.

Previously, the Canadian Government had required that all Northern Tier curde oil exchanges be through the midcontinent pipeline system; this was much less efficient for Northern Tier exchanges. We have asked the Canadian Government at the first meeting of the Consultative Mechanism to continue these exchanges.

The continuing dialogue in other areas of oil trade also has proven beneficial. With tight overall oil supplies, the United States has regional crude supply imbalances. Relieving these imbalances depends in part on moving State oil from Southern Alaska and from Southern California refineries to the Gulf Coast. The decision by SOHIO not to build the pipeline from Long Beach to Midland, Texas will focus attention on the ongoing review proposals designed to move this oil to the inland states. Under Title V of the Public Utility Regulatory Policies Act, of the remaining four pipelines, the Department of Interior is required to determine which proposal or proposals should be recommended to the President for expedited federal permitting. The review must be completed by late September. Three of the remaining proposals—Kitimat, Transmountain, and Foothills—call for construction primarily on Canadian soil. While the previous Canadian Government appeared to favor the Foothills proposals, it is possible that the new Government may wish to reconsider this position. Whatever the outcome, continued close cooperation between our governments clearly is required to resolve this issue.

At the first Energy Consultative Mechanism Meeting, the Canadians raised the question of establishing petroleum product exchanges, which have occurred on an emergency basis. The issue will be reviewed at the next Consultative Mechanism meeting. In the interim, DOE is working with the Canadian Government to determine whether some Canadian supplies of diesel fuel oil could be exported to the Midwest on an emergency basis.

The development of our Strategic Petroleum Reserve (the SPR) has also become a bilateral concern. DOE has initiated a competitive turnkey procurement process to obtain the sites required for completion of SPR. Of the twelve sites being considered, two are 100-million barrel facilities being offered by Canadian firms. The United States and Canadian Governments are in the process of negotiating a government-to-government agreement to provide requisite assurances that if a Canadian site or sites were selected, it would be developed with the same technical safety and other applicable standards required of U.S. developers and there would exist adequate assurances regarding access, security and other issues.

Progress has also been significant in other oil trade-related areas. Just two days ago, June 4, the United States and Canada signed a Memorandum of Understanding to cooperate in the research and development of tar sands and heavy crude oils. With substantial heavy oil and tar sand reserves, Canada, particularly the Provinces of Alberta and Sakatchewan, has led in this effort. The United States can contribute technical expertise in the experimental enhanced recovery techniques.

Closer collaboration is likely to enhance the quality and pace of pilot projects, and to lead to commercially viable production of these oils. They represent a potentially significant new source of petroleum supply that will make the Northern Hemisphere less dependent on OPEC oil.

Turning now from oil issues, the United States and Canadian Governments recently completed a joint Electricity Exchange Study to determine on a regional basis what additional opportunities exist for increased electricity exchanges between the United States and Canada. The potential benefits to the United and Canada result from increased reliability of supply and cost savings.

More definitive Canadian and United States Government electricity trade policies will result from the study's recommendations and will enhance trade possibilities.

Although the Consultative Mechanism was not charged with reviewing progress on implementation of the Alaska Gas Pipeline project, the issue of Canadian gas exports is so closely tied to construction of the pipeline, that it will be included in the mandate of the Consultative Mechanism. Progress in the pipeline project over the past few months has been substantial on both sides. The Canadian National energy Board gas supply hearings, held last fall, have indicated that at least additional 2 trillion cubic feet of surplus gas could be exported to the U.S. over the next eight years. The United States currently imports approximately 1 trillion cubic feet from Canada; hearings will be held in Canada this summer to determine the number and volume of gas export licenses to be approved. On the U.S. side, the Congress recently approved a reorganization plan establishing the Office of the Federal Inspector, which will oversee the U.S. portion of the project. The Office is expected to be established by July and will provide a significant impetus for closer U.S.-Canadian coordination on gas regulatory issues.

The nuclear area is a special case; I would just mention, before leaving the subject of United States-Canadian relations, that cooperation between the United States and Canada on nuclear matters has also been close. Last December, the Preseident approved an urgent request to export 198 kilograms of highly enriched uranium for three important canadian research reactors which would have had to shut down if the approval was not granted. The Nuclear Regulatory Commission was given advance notice of the likelihood of the President's approval so that final U.S. Government approval could be expedited.

As we have had to learn to respect each other's interests, I think it is fair to conclude that United States-Canadian energy cooperation has made significant progress in the past. We look forward to working with the new Canadian Government to explore further means to enhance these energy ties.

With respect to our neighbor to the South, the United States is seeking to upgrade and broaden the base of our energy relations, similar to our experience with Canada. During the Presidential meeting between Presidents Carter and Lopez Portillo in Mexico in February, some positive measures were initiated to achieve this goal. The existing United States-Mexican Consultative Mechanism that includes a variety of interests such as Migration, Energy and Trade, will be restructured and upgraded. Since energy is obviously an essential part of our effort to improve United States-Mexican relations, a new Energy Subgroup, co-chaired by Mr. Katz, with us today, and Harry Bergold, the Assistant Secretary for International Affairs at DOE, has been formed. A newly established sub-cabinet Advisory Group to the Consultative Mechanism, headed by former Congressman Bob Krueger, will review the progress of the energy and other subgroups.

The United States has established itself as a major oil trading partner with Mexico. The United States currently accounts for some 80 percent of Mexican oil exports, which have amounted to some 500,000 b/d over the past months Recently there has been a production slowdown in Mexico due to technical reasons, but this situation is expected to be alleviated and normal export levels resumed.

The United States welcomes this new source of supply and its impact on the United States and world oil markets. It represents substantial transportation advantages for the United States and as a new Western Hemisphere source of supply, it decreases our reliance on Mideast oil.

While most of the Mexican oil is purchased by our oil companies on a commercial basis, some of the oil is used for the Stategic Petroleum Reserve. Mexico has supplied about 34 percent of total crude contracted for the SPR; some 34.4 million barrels have been purchased. While the United States would like to encourage increased Mexican oil production, it is important to note that the level of Mexican oil production will be determined by Mexico's perception of its own needs. Mexican internal factors, particularly the need for government revenues, might influence the Mexican Government, to expand production. However, Mexican officials, including President Lopez Portillo, have repeatedly emphasized that beyond 1980 the Government will reexamine Mexican oil production levels and set production targets based on Mexican economic and other considerations. United States firms cooperate with PEMEX in helping to develop Mexican oil and gas on a technical contract basis; Mexican law precludes equity ownership.

With respect to natural gas trade, the two Presidents agreed during the February visit to resume the natural gas talks on a government-to-government basis. They had been suspended since December 1977 when the Memorandum of Intentions signed between Pemex and six United States pipeline companies for natural gas imports expired. A subcabinet team, with representatives from the Departments of State and Energy and the NSC, have met twice with Mexican representatives. Both sides have agreed to evaluate each other's positions, and a future meeting is expected. The Administration hopes that any outstanding issues can be resolved so that a gas contract that is both fair to the Mexican people and the United States consumers can be reached.

As part of our goal to broaden our relations with Mexico, a Joint Electricity Study, along the lines of the Canadian one outlined above, has been initiated. The Mexicans have been very receptive to the Study and have expressed interest in electricity interconnections between United States and Mexican utilities across the border, and in cooperation on expansion of electricity interchanges. Although the volume of electricity traded is small compared to our electricity trade with Canada, it has been significant to the communities along the border. Besides direct advantages, such as better use of existing facilities and cost savings, increased electricity trade with the United States offers Mexico substantial economic and employment benefits in border areas; furthermore, in some Northern Mexican communities electricity trade with the United States might permit introduction of electric service that heretofore has not been economic to provide.

The Mexican and United States Governments have held meetings to launch and develop a work plan for the study, and its progress is well underway.

In addition, the United States and Mexico have reviewed a number of bilateral, energy-related science and technology proposals. As a result, we have specific expressions of Mexican interest in cooperation in a number of fields, including solar research and application, energy information exchange, expanded geothermal cooperation, enhanced oil recovery techniques, etc. While the initial cooperative activites may appear modest, they have served to increase the level of information and personnel exchanges, and have made us aware of each other's needs. We anticipate that joint scientific technological efforts will increase. Both governments recognize that development of the new energy technologies will decrease dependence on oil, and serve to bring oil supplies, at least in the Northern Hemisphere, into better balance with projected demand.

Thus, it is clear that energy cooperation in the Northern Hemisphere has increased over the past years. We have established a solid historical foundation for our energy relations with Canada, and now we must strive to achieve similar relations with Mexico. Mexico's significance as a major oil producer has increased, and will continue to do so as new reservers are explored for and developed. But we must not look on Mexico as merely a source of oil; Mexico will become an increasingly important energy trading partner both for the United States and the entire Western Hemisphere.

The Department of Energy recognizes that it will take a concerted effort on both sides of the border to achieve enhanced energy trade on mutually-advantageous terms. We have been working towards this objective and will continue to maximize energy trade, and in a broader context, energy cooperation, within the Northern Hemisphere wherever mutual interests permit.

Senator BAUCUS. Since we are behind time, let's convene a panel of all remaining witnesses, beginning with Mr. Sydney Weintraub, Mr. Opie, Mr. Currie, Mr. O'Connel and Mr. Van Heuven. This will be a panel on U.S. perceptions of the issue, along with Mexican and Canadian perceptions.

If you would come up to the witness table and each of you give a short statement and summarize your testimony, we will then proceed after that.

I particularly want to thank Mr. Opie for coming a great distance and sitting so patiently in the audience as well as Mr. O'Connel, and Mr. Currie who traveled great distances as well. I want to tell you how much I appreciate your presence here, Mr. Opie, and I would like you to proceed first, sir, if you please.

STATEMENT OF REDVERS OPIE, ECONOMIC ANALYST, MEXICO CITY, MEMBER OF BOARD OF DIRECTORS, UNITED STATES-MEXICO CHAMBER OF COMMERCE

Mr. OPIE. Thank you, Mr. Chairman. I will compress this as much as I can. I had intended to spend 20 minutes in reading the statement. I take it, as you are behind time, you do not want anybody to spend 20 minutes on it.

My statement will be in the record, and I want to draw the attention of the committee to the broader aspects of the problem of integration.

When I testified 2 years ago before another committee, a subcommittee of the Joint Economic Committee, I then introduced the question of economic integration or unification and I gave some historical perspective that I will not repeat now, because there is no opportunity to do so. But, lest I was misunderstood in my testimony 2 years ago, I want to say emphatically that I was not, and am not, in favor of regional common markets.

I think that is something that should be avoided in the planning over the next 10 years for the North American area. I could give a very long argument on the difference between the age-long treaty method association, which is the only practical method of associating states together, and the contrast between that and the organic act. We have only one example of that in history, and that is the 13 States which were very lucky to bring back an organic act of union, without further military action after the Revolutionary War.

This distinction is very important because it raises the question of whether a common market is going to involve a surrender or a derrogation of sovereignty. This is something that was sensitive in Mexico. It is sensitive in Canada, and something that would be getting off on the wrong track, if introduced into the vision of the future.

I wanted to give the committee a longer statement that I would make on the international economic system as I conceive it. You know that the GATT is a network of world trade. If you look at their publications, you will see that they are excellent publications and so capture the network of world trade.

This concept of a network is very important because there are not only networks of trade, but networks of other economic activities and I venture to put them into three categories outside of trade: one is the network of loan capital; second, the network of equity capital; and the third is the network of the transfer of technology, both the technology that you think of usually when you are talking about technological changes in industry and the soft technology of administrative and material know-how.

Those three networks, with the trade network, constitute the whole of the international economic system. The point I want to make is that there are two characteristics of these four networks which, of course, themselves are very interrelated in a very complex manner.

This first characteristic is that the bulk of the transactions in the networks is between the developed countries themselves. Each one of them trade, borrow, and lend in loan capital, swapping equity capital, Canada and the United States, the United States and Canada, and the transfer of technology. All of those transactions, the bulk of the transactions, are in the developed countries themselves.

What this means is that we are witnesing an historical process of the fuller internationalization of world productive processes, just as we have witnessed over the last century more or less a fuller internationalization of the world trading processes.

The second characteristic I want to bring out, the two last networks, equity capital and technological know-how, of all kinds, they have the most important characteristic that they are deliverable only through the multinational or transnational corporations.

The governments have not got any technology or know-how to speak of. The Government certainly does not have any equity capital. You can tax the people and you can borrow from the people and get some loan capital, but governments do not have equity capital.

So if all of the developing countries are going to get inside more deeply the system of interdependence, they have to use the vehicle of the multinational corporation. It would be unrealistic, and most impractical, to think of stopping this historical process of internationalizing world productive processes, and if that cannot be done, the less developed countries have nowhere to go but to use the multinational corporation in order to imbed themselves into the foreign networks.

I say this categorically, because it is an obvious fact that practically nobody is drawing attention to it, and I would like to say that my memory goes back to this concept of a network that was used by the nations in 1942. I was discussing for many months in Washington with the Swedish representative who used the metaphor in order to get into the interdependence that made it quite possible not to resist the protectionist forces that were invading the world, as they are invading the world now.

I would beg that we think of the economic part of the world as conceptualized as consisting of these four networks, nothing outside of them and if you are going to have a greater area interdependence, we want to encourage that. That should not be an obstacle to the broader, full international interdependence, but it should be contributing to the broader international interdependence.

Gentlemen, that is all I can say in this short time. I have put one document into the record, and if you would allow me to do, I will put in the other.

Senator BAUCUS. We are delighted to do it.

[The prepared statement of Mr. Opie follows:]

PREPARED STATEMENT OF DR. REDVERS OPIE

Mr. Chairman and honorable members of the subcommittee, I gladly accepted your invitation to testify in your hearings today because an examination of North American Area Interdependence over the next ten years interests me very much and I thank you for the invitation. Given my unusually long and more varied than usual experience in international economic and political affairs, I decided that the most useful contribution I could make to your Committee's deliberations would be to reflect on the philosophical background—I hesitate to say theoretical because that word is frequently read as the opposite of practical—of the state of interdepend- ency and of action to deepen it.

More than two years ago, in January 1977, I introduced the subject of regional economic integration into my oral testimony on the Mexican economic system before the sub-committee on Inter-American Economic Relationships of the Joint Economic Committee. I said to that subcommittee: "If contiguous areas exist in which the economic characteristics of the constitutent countries make them a fit subject for economic integration, the North-American Continent is surely one such area. Canada, the United States and Mexico are in many respects complementary (rather than competing) economies, and perhaps especially Mexico and the United States. These two countries have a mutuality of interest in pursuing harmonious development together".

This statement might be interpreted as indicating that I was an advocate of regional common markets. Let me say emphatically that I neither was nor am. In the early 1950's I believed and wrote that regional groupings of countries with a common tariff and other trade barriers against the outer world, were a derogation from a higher ideal of the full internationalization of efforts to reduce tariff and non-tariff barriers. This was the purpose for which the GATT was established and it has done an excellent job in pursuing the ideal.

A historical perspective on current problems is essential if we are not to repeat the errors of the past. It is therefore relevant to recall that when the U.S. Congress 30 years ago was establishing the Economic Cooperation Administration to implement the Marshall Plan for economic reconstruction, economic "integration" or "unification" was being urged on Europe, by some members of Congress and many other Americans, as the most rational solution of its problems. Eventually, in 1960 under the Treaty of Rome, the regional common market that is known as the European Economic Community (EEC) emerged from their advice. The EEC began with six countries and is still a long way from embracing the whole of Europe.

It is relevant also to recall that thirty years ago the United States encouraged and supported European union on non-economic grounds. It was thought that economic integration (even though the concept was left undefined) could be a back door to political agreement or even union. This was putting the cart before the horse, because political union must precede many types of unifying economic action. For example, as the efforts to achieve European monetary union have shown, a single Federal-Reserve-like banking system for Europe is an impossible aim, except under the sovereign authority of one state.

I believe that most, if not all, of what the EEC has done for its members could have been achieved through the GATT, with greater benefit to the rest of the world, and perhaps to the members of the EEC themselves. The same can be said, but even more strongly, of the Latin American Free Trade Association (LAFTA) and other less plausible attempts at regional common markets. It may be, however, judging with hindsight, that the mission of these exercises in "integration", and especially in Latin America, was to force countries into communicating with one another as they had never done before.

The support for "common markets", or economic integration, was and still is based on a misunderstanding, or a confusion, regarding the means of cooperation amongst sovereign states. The age-long method of cooperation—and really the only practical method—is that of association by treaty, either bilaterally or multilaterally. The sole acceptable alternative is a voluntary organic act of union.

But most organic unions of states have been accomplished through outright conquest or the threat of it. The union voluntarily created by the 13 American States is rare, if not unique, in history. It partook of the miraculous. But even that organic act of union was performed under the shadow of a revolutionary war and threats of further military action.

The confusion has not ended, for the treaty form of association is still a source of misunderstanding, and of apprehension, because it may involve "loss" or "surrender" of sovereignty. The truth is of course that adherence to a treaty, far from being a surrender of sovereignty, is an expression of the exercise of sovereign power to act, or to refrain from acting, in the common interest of all the signatories to the treaty.

So in my view, the title of the sub-committee hearings has been well chosen. With its stress on interdependence, a concept that includes all nations, it warns off supporters of regional isolationism. It also avoids the temptation to think of "creating" an integrated area in the form of a common market, which raises the spectre of surrendering sovereignty by some organic act of union.

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As in the case in other groups of contiguous countries, however, the North American group may have special interests among themselves, which give rise to a deeper and more intimate state of interdependency than they have with the rest of the world. Propinquity has indeed already in practice produced a profound depth of interdependency in the North-American area. Over the next ten years it is sure to increase. But it will be increasing within the wider context of increasing world interdependence.

The degree of area interdependence, compared to interdependence with the outside world, is not the same for each country in the North American area. In 1976, the most recent year for which figures are published, of the $9,018 million total of Mexico's merchandise trade (imports plus exports), 62 percent was with the United States and 2 percent was with Canada. Probably more than 80 percent of Mexico's total international transactions, including capital and other financial transactions and services, was with the United States. While the importance of Mexico in total U.S. international transactions is growing, it is far from reaching this level. Mexico can be said to be more deeply interdependent than the United States within the area. But this greater degree of interdependence is not justifiably called dependence in the pejorative sense, which some Mexicans (not to speak of other nationalities) are inclined to do. The different degrees of interdependence within the area are free to change; and they are certainly not inherently an obstacle to growing interdependence of individual countries with the outside world.

From the foregoing, it should be obvious that whatever special interests among some or all of the countries in North-America are to be promoted on an area basis, the instrument to be used must be the treaty method of association. It should be clearly understood and accepted, however, that the special area arrangements must not conflict with existing or future measures for promoting full international interdependence; and that the special area measures are being used because the desired ends could not be appropriately sought, or attained, through full international agreements.

As I have indicated, international economic interdependence goes far beyond trade. In describing interdependence in world trade, the GATT uses the metaphor of a network, a criss-cross of trade transactions and balances among countries. It is a realistic metaphor. And it can be used with equal realism to enhance our understanding of the rest of the international economic system. That system comprises three other networks: the network of lenders and borrowers of loan capital; the network of transfers of equity capital, known as foreign direct investment; and finally the network of transfers of technology and managerial or organizational know-how. I submit that these four networks realistically conceptualize the nature of the international economic system, with emphasis on the state of interdependence among the countries operating within the networks. Mr. Chairman, I have a paper I wrote a year ago on this aspect of the international economic system that I should be glad to put in the record if you agree.

All four networks have an outstanding common characteristic: the bulk of the transactions within them take place among the developed industrial countries themselves. And two of the networks have a still more striking common characteristic: namely, that the transfers of equity capital and of technology are virtually exclusively made by multinational (or transnational) corporations. These vehicles for transfer are at present overwhelmingly indigenous to the developed industrial countries. But they have begun to be formed by the developing countries, of which Mexico is an example, though of course in this respect far behind the United States and Canada.

In my testimony in 1977, I offered the opinion that in these two thickening networks of equity capital and technological transfers we are witnessing a historical process of more fully internationalizing world production, for which the transnationals are the instrument. It would be unrealistic and impracticable to try to stop this process. As the developing countries become more developed they will have a greater share of world production. But they can only develop by getting more deeply into the four networks; and especially the last two, which they can do only through the transnationals. This fact must condition the attitudes of area countries to intra-North American action relating to interdependence.

When and if the developing countries come to recognize that in order to develop they must inevitably get deeper into the networks, they should also recognize that the long-run enlightened self interests of all countries in the international economic system are the same, despite apparent or actual short-term divergences, because economic interdependence is worldwide. They should then cease to magnify their differences with the developed countries, and their demands for a New International Economic Order should become less strident.

The practical significance of these networks for area interdependence, and for the relation of area to world interdependence, should be obvious. Moreover, the notable absence of a network of labor transfers is especially significant for area interdependence. Obstacles to the movement of people on a world scale are too great for the network metaphor to describe realistically the thin streams of moving people. They are not yet the object of fully international agreements.

Migration of people is probably the most important aspect of North American interdependence that is likely to be the subject of bilateral or multilateral treaty arrangements over the next ten years. This particular reflection of area interdepend- ence is already a problem, of course, between Mexico (and to a lesser extent the Caribbean) and the United States.

As regards achieving greater freedom in the movement of factors of production within North America, I have considerable hope of seeing the fairly rapid breaking down of the prejudices in the capital and technology receiving countries against the transnationals, which is one of the reasons that these countries are reluctant to acept productive resources offered to them at world-market-determined prices (which, ironically, the developed countries are lapping up!). If I am right, movements of equity capital and the other productive factors that go with it, will become freer and thus deepen area interdependence.

I have less hope of getting the labor-receiving countries as rapidly to recognize the advantages of the freer migration of people. So the obstacles to the movement of labor will continue to put stricter limits to the growth of area interdependence than those that arise from restrictions on capital movements.

Labor migration is clearly a very proper subject for agreement by treaty on a purely local basis. Bilateral agreements already exist. It remains to be seen whether any advantages would ensue if the issue could be dealt with by the necessarily more complicated multilateral arrangements.

The United States is the largest receiver of illegal immigrants. Recently, Mr. Douglas S. Massey, a demographer at Princeton University, has stated that the "best demographic evidence suggests that there may be about four million illegal aliens living in the United States at any time. Furthermore, recent work indicates that this population has not greatly increased since the early 1970's. Most of these "illegal aliens" (officially designated "undocumented workers" by Mexico) are said to be from Mexico and the Caribbean.

Without wishing to detract from the political seriousness of the problem, if the estimate of four million illegal aliens rather than 12 million is nearer the mark; if the number has remained fairly constant for nine years; if most of them pay taxes; and if they are "very unlikely to use the social services", and therefore far from being a burden on the economy they are "more likely to be subsidizing it"; then I submit that these facts diminish substantially the economic basis of the political problem. (All the passages quoted above are from Mr. Massey's letter in the New York Times of May 31, 1979.) And that should make the political problem more amenable to solution, and encourage a determined attempt during the next ten years to put intra-North American movements of labor on a more rational basis.

I am impressed by the fact that in this period of rapid change the tendency is to underestimate the degree of continuity prevailing in political and economic development, and therefore to exaggerate the need for a break with the past in reforming the existing order. By underlining the mutuality of enlightened self-interest that makes all nations interdependent we can help to preserve continuity in the historical process.

On the political side, the only really important cleavage that has occurred in the last two generations is between the communist countries and the "free world" countries. On the economic side, the break with the past in all countries is not as sharp as the non-historically minded are prone to assume. I believe that the above description of the international system as a series of interconnected economic networks, growing in extent and density, helps to exhibit both the continuity in development and the underlying identity of interests.

Mr. Chairman, if I have succeeded in explaining my point of view to the Committee, it will be clear that we should be especially concerned with progressively freeing the movements of capital and of people within the area. Greater mobility of these factors of production would increase interdependency and productivity, which would make for greater political stability in the North American area as a whole.

Senator BAUCUS. Our next witness will be Martin O'Connel.

STATEMENT OF MARTIN O'CONNEL, ECONOMIST, FORMER MEMBER OF PARLIAMENT, CANADIAN MINISTER OF LABOR, TRUDEAU GOVERNMENT

Mr. O'CONNEL. Thank you, Mr. Chairman, for your invitation to participate in these Senate hearings and to the future of North American independence. My remarks will be informal and certainly unofficial.

Much interdependence exists, and is acknowledged to exist, between Canada and the United States and no doubt always will, but I take it your interest in this committee was to explore the questions: Are changes needed; are changes coming? And certainly discussion of significant changes in relationships are underway.

For example, only a few days ago, the chairman of Tenneco called for an entirely new relationship with Mexico and Canada on a bold and broad front. It would be based, he said, on giving something to the Canadians and Mexicans in the way of trade and industry relationships.

I do not profess to know what Mr. Ketelson had in mind, but it is evident from the article that some form of North American joint energy development in energy shift was the central motivation, or the central objective.

My thesis, or my point of view, before your committee this morning, Mr. Chairman, in Canada's present circumstances, North American interdependence must be based on enhanced Canadian autonomy, enhanced Canadian self-reliance.

To be achieved, I think as the Science Council of Canada has stressed, through converting our industrial base from what is often referred to as an inward-looking, branch plan system to an outward-looking, or export oriented and more importantly, research-intensive industrial structure.

And it is essential that in this area of interdependence that Canada find room and the understanding of the need for room or scope to strengthen and alter or rebalance this industrial economy, especially in the sense of making the manufacturing and processing area a larger part, a more efficient, a more technically advanced part, with greater domestic capacity for innovation.

Interdependence cannot, in my view—I have heard others state that here this morning—cannot be effected through some formal economic deal with the United States along the lines of the Common Market or bilateral trade agreement, although these concepts arouse the favorable interest in Canada—for example, in the Economic Council of Canada and in the C. D. Howe Research Institute, the Canadian version of the Canadian-American Committee. Nor would it be acceptable, at this time, to negotiate additional sector agreements, for example in energy, following the example of the auto pact or the defense-sharing agreement.

In Canada, we have too much rebuilding and restructuring and strengthening to do which would not, in my view, take place consistent with our objectives of greater autonomy and self-reliance, if sector deals or bilateral free trade arrangements were pursued.

Together with certain advantages, sector deals—for example, in the auto pact and Common Market arrangements, would lead to greater dependency for Canada and would further extend Canadian industrial weaknesses. Negotiated dependency is not the way to foster interdependency among sovereign states.

The political sovereignty of the junior partner would surely erode and the center of influence, economic and politically, would inevitably shift increasingly from Ottawa to Washington with profound relaxing effects on the interregional ties within Canada that have helped to make us a nation.

You will be familiar with the concerns of Canadians with respect to bilateral free trade. I will only allude to them very briefly here.

First, there is the concern of Canadian workers that they will lose jobs if Canada were flooded with imports from the United States, that branch plants believe Canada or rejuice expansions, rejuice new investments, referring to shipped goods from the home country under free trade conditions.

Again, the exceptionally high degree of U.S. ownership of resources and manufacturing would increase still further because of the advantages that the U.S. firms have. Again, Canada would be locked into the U.S. economic policy, industrial policy, fiscal and monetary, thus losing the flexibility and the ability to choose from the range of policy options associated with sovereignty.

Canadian resources would be sucked out at high utilization rates to pay for high technology imports. Even a growing import of standardized goods and our propensity to import services, not the least being trips to the south, notwithstanding such concerns, the interest in bilateral arrangements as the past to future interdependence was given added dimension a few months ago by the C. D. Howe Research Institute in Canada, when the president, Mr. Carl Bacon, appeared and said that responsible democracy in Canada required significantly reduced government in the economy, that this rejuiced intervention would most surely be achieved by formal economic associations—he meant bilateral free trade with the United States—thus opening Canada, by negotiation, to continental market forces and to certain, subject only to certain agreements and negotiated sovereignty protections.

This new dimension that I raise with you seems to set Canada-United States trading relations in the context of the new conservatism. Not only are the major concerns unanswered, but it should be fully expected that undesirable governmental intervention would multiply as industry and workers struggle for survival in a transition period.

Increased dependency and weakness would lead inevitably to increased interventions.

Now, there is a different direction in which to move and in the shortness of time, I do not think I really want to use your committee's time, but I have mentioned restructuring, rebalancing——

Senator BAUCUS. If you have something to say, feel free to proceed. If you have a point you want to make, do not feel inhibited.

Mr. O'CONNEL. I should refer briefly to the notions of leeway or room to alter the construction of the Canadian economy, the notions of greater autonomy or self-reliance, and the balance, which appears inappropriate today in the face of international competitive forces, not the least from the industrial countries, but the Third World.

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I mean, for example, enhanced capacity to develop technology in Canada, not to be so dependent on the imported technology, enhanced protection for product design.

We are weak in product design in general because we often come into the exercise when a product is sufficiently developed elsewhere and it comes in a standardized form for production in what are sometimes called tariff factors in branch plants in Canada.

We really need to find a way to have transferred to the Canadian subsidiaries of U.S. companies, important research and development missions or tasks that we could use to develop domestic technical capacity, product emulation.

For example, in the auto pact, which some people rate as a great success, I think it could be shown that, along with the successes, has been a weakening of the activity in Canada in the sense that no research and development is done at all. It is all imported and paid for. Therefore, there are no industrial spinoffs into other areas that could be related to interesting and important R. & D. research.

For example, into electrical batteries for cold climates, paints that withstand the salt we put on our road, or other important aspects. We are a dependent country with respect to automobiles.

Procurement slipped. It is all managed outside of the country.

Employment in the auto industry in Canada is increasingly unskilled. It is assembly work. The skilled aspects, which are in the parts production, are not there in the same proportions as in the United States. Whether it is research or the balance between assembly and parts, the tendency is toward the unskilled areas.

There can be questions raised about the long-term impact of sector arrangements. We need, in Canada, the ability to innovate domestically and then to have the world mandates for any products we have improved or created in the high degree of ownership and control that exists in our industrial pattern. It is not at all clear—in fact, it is frequently understood that it is frequently the head office which will determine where industrial activity takes place. Of course, it is the head office that retains the important research and development missions.

When we have multinationals in Canada, we tend to do the same thing. It is an indigenous, or a common feature, of multinationals. It just happens that we need to move beyond the stage that we are in before we could contemplate further sector arrangements, or across-the-board free trade, in view of the weakening effects that they are likely to bring.

We need greater specialization. We need more rationalization of too many unions in certain industries shutting down too often to change the product mix. It is difficult to rationalize with the high degree of concentration of foreign firms in our economy. We need procurement policies that would foster product innovation in Canada and aggregation, to aggregate the Canadian market.

These are going to run afoul of some of the procurement codes or subsidy codes or countervailing codes. When I say we need an understanding of that need to restructure, an understanding of the need to have room, I am really thinking of those difficulties which are not too far down the road. We ought to be using major national projects as far as liquid natural gas in movement.

We should be using such projects as these as frameworks in which to develop greater technological self-reliance and greater autonomy.

It is the same as communications, in communications satellites, for example. We have not a Canadian company, a preferred position with considerable millions of dollars so that it will be the prime contractor for the next two satellites that we need for domestic communications purposes.

Previously, we drew them from the shelf, RCA. Those are the kinds of things to illustrate what I am thinking of when I say greater autonomy, greater self-reliance, and a need for greater understanding of that motivation, and I think that is an essential need for us in this concept of interdependence.

Mr. Chairman, perhaps I will leave it at that.

Senator BAUCUS. Thank you very much, Mr. O'Connel.

Next, Mr. Weintraub, senior fellow of Brookings Institution. We are happy to have you here, Mr. Weintraub.

I read your statement. It is very concise, pithy, and to the point. I encourage you to give us the benefit of your observations. Please proceed.

STATEMENT OF SIDNEY WEINTRAUB, SENIOR FELLOW, BROOKINGS INSTITUTION

Mr. WEINTRAUB. I will even be briefer than that. If the statement can go into the record, I think I can take just a few minutes to make some of its major points.

Thank you very much for having me.

Senator BAUCUS. If you would like to react to any of the statements made this morning, that would be helpful. In fact, I would suggest any members of the panel who wish to ask any question of other members of the panel, comments in reaction to the statement, that might help this morning also.

Mr. WEINTRAUB. I was going to react to some of the statements made because I think that they were overstatements.

My paper asks what we mean by a greater integration in trade, in particular, in North America. By North America, I mean Canada, Mexico and the United States. What form might this trade integration take, and what are the economic issues that should be examined?

I will touch on these very briefly.

I am very conscious of the political opposition that would arise in Canada or Mexico if the U.S. Government, as such, were to advocate a "free-trade area" or a "customs union." The two phrases have been used much too loosely this morning. I will come to that in a moment, because they are quite different.

The last statement gave some indication of the concern that many Canadians have about the idea, not just of free trade across the board, but even of sectoral agreements. This opposition, however, is by no means the universal opinion in Canada.

Therefore, I urge that the economic analysis go forward, regardless of the political opposition. It may turn out that the political opposition, based on the analysis, is justified, or it may turn out that it is not correct.

A second suggestion is that most of the analysis should be undertaken not by the Government but by the private sectors of the three countries, that is, by disinterested institutions that exist in all of them, in order that vested interests not play quite the role they would play if the governments undertook this examination.

Greater trade integration could take place through sector agreements of one kind or the other, such as the automotive agreement. These agreements may or may not be desirable, or may or may not lead to further sectoral agreements to free trade generally.

At the time of the United States-Canadian automotive agreement, many people thought this would lead to many more agreements of this type, possibly even to free trade across-the-board between the United States and Canada. It has not done so.

Free trade areas have not led to the wholesale loss of sovereignty that some of the earlier speakers have cited. When the European free trade area came into existence, it did not involve the loss of sovereignty for Switzerland or for Sweden or for the other countries that became members of the free trade area.

A free trade area does not necessarily mean free movement of labor across borders. It can, if you wish that, but that takes another decision. It does not necessarily lead to free investment across borders. The Mexicans need not change their investment rules if they enter into a free trade area with the United States.

These steps could follow, and one would hope that they would follow, but they are not automatic and would require conscious decisions to bring them about.

To repeat these points, I think that overstatement as to the sovereignty loss involved in freeing tariffs is not helpful. This is a political statement and not one resulting from economic analysis. A country would enter into free trade sectorally or across-the-board because it felt that thus would improve efficiency and that the country would thereby benefit. It would have to be shown that benefits could be distributed more or less equitably among the member countries of whatever agreement or free trade area were concluded.

Second, there is a big difference between a customs union and what in international terms is referred to as a free trade area. A customs union, in article XXIV of GATT, involves not only free trade among the partners, but also a common external tariff. A common external tariff between Mexico and the United States would be an impossibility today. The United States would have to raise its tariff or Mexico's would have to come way down and Mexico is not prepared to do that. Canada is not fully prepared to do that now, either.

When people talk about a free trade agreement, somehow or another, this has been translated in some of the statements that there be an agreement today on free trade tomorrow. The Turkish association agreement with the European Community contemplated a 22-year transition period, and even that has since been extended because of circumstances in Turkey.

If one thinks about free trade in North America, the transition could be 20 or more years. That should be enough time for adjustment in any one of the countries.

My plea is that the economic analysis be undertaken on its own merits and not out of perceived emotion. The big issue is the one that you raised earlier in a question you asked Mr. Katz, I believe, as to whether or not there would be backwash effects of polorization. Would the rich or the more powerful country—the United States, in this case—get most of the sophisticated investment because most of the related industries and research facilities are here, and the poor areas become essentially exporters of primary commodities.

That is a real issue. It is the issue on which the Latin American Free Trade Association, Central American Common Market, and the East African Common Market foundered. It is not that they all did not benefit, but they did not benefit equally.

I do not know what the outcome would be in terms of distribution of benefits from North American free trade to come into existence over 30 years. I think that is the critical element for analysis and not some of the other things. There are arguments that go both ways. The history is that there might be some unequal benefits.

One of the arguments that goes the other way, that the poor areas might do well, is the fact that the South in the United States, which was well behind the North, has not become poorer in recent years, but has tended to become richer. Polarization is not inevitable. The disparity of income between Ireland and West Germany is quite great, but Ireland entered into a customs union, and one of the big factors in Ireland's growth is its flourishing exports.

Portugal is considering entering the European Community and the per capita income disparity between Portugal and Germany is half that between Mexico and the United States. There is no disparity in per capita income between Canada and the United States.

One issue that Mexico must keep in mind is that its development plan, as it has been carried out in the last 25 years, has succeeded in fostering one of the highest rates of economic growth among the developing countries, at least until recently. But it has created one of the most unequal societies in the world.

If you look at any kind of indicator on equality of distribution, Mexico is terribly unequal. Forty percent of the Mexican population is estimated to be unemployed or underemployed. Mexico is absorbing into jobs only about one-half the annual increase each year in its labor force.

In other words, Mexico must change its policy somewhere in the years ahead if it is to solve what I think is its major economic problem, that of creating enough jobs. There is no agreement in Mexico as to the best way to do this, but thinking of a bigger rather than smaller market, as Mexico has in the past, might, in fact, help in this process.

Let me conclude. I do not know whether a free trade area—I am not talking about a customs union now—would be a good idea or not. I do not know what the economic consequences would be. But my plea is to examine the idea on those grounds and not on perceived emotional grounds.

Thank you.

Senator BAUCUS. Thank you very much, Mr. Weintraub. I agree with your basic premise, which, in my judgment, is that governments and representative bodies tend to follow the people rather than lead the people. I agree with you that we should base our actions on objective analysis.

Mr. Currie, welcome to the committee.

STATEMENT OF NEILL CURRIE, ECONOMIC ADVISER, CANADIAN CHAMBER OF COMMERCE

Mr. CURRIE. Thank you very much, Mr. Chairman.

First, I would like to say, on behalf of the Canadian Chamber of Commerce, how much we appreciate the opportunity to participate in these hearings. The subject matter is clearly one of great interest to my country, and the initiative you have taken in providing a forum for consideration of this matter should be welcome to all the communities concerned.

It is a very broad subject, of course, and I propose to confine my remarks primarily to the question of trade, with specific reference to the question of trading relations between Canada and the United States.

It may be helpful first, just to put the issue into the perspective of Canadian history. It is 100 years since the Canadian Government of the day initiated a protective tariff policy, known as the National Policy, which has played a major role in shaping Canada's economic and commercial development.

This tariff policy was complemented by other policies directed toward the development of East-West transportation and settlement of the West. All of these policies were designed, let it be said, to strengthen the new federation with a view to assuring its independent development.

Although the level of tariff protection has been changed from time to time and has been reduced very substantially from the high point reached in the 1930's, notably as a result of the series of multilateral negotiations under the GATT, a residual degree of protectionism remains in Canada and the basic thrust of the national policy of 100 years ago persists.

Only occasionally during these 100 years has Canada officially flirted with bilateral free trade as a general policy option. The first major occasion was in 1911 when an election campaign was fought on the issue of reciprocity with the United States. The next occasion was in the immediate aftermath of the Second World War when negotiations were undertaken very briefly between the United States and Canadian authorities, but were equally quickly terminated. Also, I believe, on Canadian initiative. A similar result flowed from an attempt to achieve greater penetration of the United Kingdom market in the early 1960's.

During most of the postwar period, the emphasis has been on multilateral negotiations. For Canada, which always has been strongly dependent on exports for its economic growth and prosperity, a healthy and expanding international trade environment has been of crucial importance, and the multilateral approach has seemed the preferable course to follow in our foreign economic policies.

There have been some departures from this multilateral approach in certain areas. The defense production sharing arrangements between the United States and Canada that have been in place for about 20 years are an example. The arrangements applying to farm machinery production in North America is another.

And, of course, the automotive pact that has been in operation since the mid-1960's is the best known example, and one which has prompted consideration of other possibilities in other industrial sectors.

Several general factors have combined in recent years to cause thought to be given to policy options other than just the continued pursuit of the multilateral approach to trade liberalization. The first of these is, perhaps, the recognition that not much further progress can realistically be expected to be made in multilateral, nondiscriminatory reduction of tariff barriers, as well as recognition that nontariff barriers, which are more difficult to deal with on a multilateral basis, are assuming relatively greater importance in the protectionist armor of many countries.

The second factor leading to consideration, of alternative policy options has been the grouping in recent years of countries into trading blocs such that Canada now stands virtually alone among the industrialized countries in the world in not having free access to a market of 200 million people.

The third factor is that, for historical reasons, partly deriving from the high tariff national policy of a century ago, Canada has an industrial structure which is characterized by many small secondary manufacturing units, often truncated branch plants, producing too large a range of goods with too short production runs.

More generally, there is a growing realization in Canada that with present policies and the existing framework, Canada's ability to achieve full economies of scale in large sectors of the economy and capacity to foster an efficient technologically innovative and competitive industrial structure are severely limited.

Hence, there has been increasing discussion of policy options that could be pursued to enable us to recover our momentum and take advantage of the strengths that are inherent in our abundance of natural resources and our established industrial potential.

Consideration of industrial strategies to deal with these problems, or strategies that might be appropriate to the circumstances certainly cannot meaningfully be undertaken without reference to trade policy and the international trade framework. In this connection, the basic options that have been studied and recommended by various research groups in Canada in recent years were recently examined by the standing committee on Foreign Affairs of the Canadian Senate. In its report—which I assume that this committee is familiar with, but which I would be quite happy to leave behind with you, if it is your wish—in its report issued last summer the committee reviewed all the various options including an option very close to what Mr. O'Connel suggested, which essentially consist of domestic remedies of one kind or another designed to improve the competitive position of Canada before contemplating stepping out into the wider world of free, international competition, on a bilateral basis or otherwise.

The committee examined that option and made certain recommendations along the lines that Mr. O'Connel suggested, but came to the conclusion that "even the most vigorous application of these policies would have comparatively little effect on the competitive position of Canadian industry"—I am quoting from the report.

After examining all of the possibilities, the Senate committee came to the conclusion that the most promising option for improving Canada's competitive capacity, albeit one with many risks and one with many transitional difficulties, would be to go the route of reciprocal free trade with the United States.

The committee urged governments in Canada, as well as the business and labor communities, to consider this option seriously. While there has been a fair degree of positive and favorable response to this suggestion from individuals within Canada, I am not aware of any business group, or labor group, or government in Canada which has, to this date, responded to this recommendation in any positive sense. Indeed, a series of industrial sector task forces were convened recently to look at the question of competitiveness and so forth, in Canadian industry, largely manufacturing industries, sector by sector.

These task forces, consisting of again the representatives of the private sector, both management and labor, and the academic community with government there as an observer produced their reports and then there was an overview committee.

This overview committee put together some recommendations arising out of the hundreds of recommendations from the various task forces, some of which were obviously inconsistent, one with the other, or added up to an impossible total. And the overview committee isolated several key areas that were common to all the recommendations of the task forces.

One of the key areas identified was trading arrangements. The government of the day responded to these recommendations in what is known in Canada as the second tier response. One of these recommendations was for Canada to rely on the multilateral trade agreement route in its general trade policy; continental free trade should not be pursued as a general policy, but only as a selective sectoral strategy where appropriate. That is a recommendation arising out of the private sector, essentially.

The government's response was, as printed in this public document, reads "the government is in agreement with the committee's recommendation."

If it would be of use to this committee, we are prepared to leave these documents behind.

Also, if it is of any interest, I have all the individual industry task force reports if your research assistants would like to have access to them.

Senator BAUCUS. Thank you very much. I would like to have those.

Mr. CURRIE. I am not at all surprised at this cautious or even negative reaction, both from the private sector side and from the government side. I do not find it in the least surprising, if only because the benefits to be derived by Canada from a bilateral free trade arrangement are only potential benefits. Like Mr. Weintraub, I do not know the answers to the economic questions posed by a move to regional free trade but most economic studies suggest that there is a high degree of probability that everybody would gain by a free trade arrangement, that is, a bilateral free trade arrangement, with the benefits distributed somewhat differently between the two countries.

Some regions would benefit more than others. Some sectors would benefit more than others. But there does not seem to be any disagreement among the economists that the probability, if it is done right, is that on balance everybody would gain.

But those benefits can only be achieved in the very long run and long run benefits for the community as a whole are difficult for the individual industry or group to perceive or measure in the present, while the immediate costs and dislocations of major policy redirection are bound to seem more real, especially when the proposition is put forward in general terms, as it has been so far, without specifying the steps that are planned to achieve policy harmonization and transitional adjustment assistance and that sort of thing.

Mr. Chairman, the question of Canada-United States free trade has in fact been discussed at the last two meetings of the Canada-United States committee of the two chambers of commerce and I believe it will be on the agenda of their next meeting. No attempt has yet been made in that committee to address the modalities of achieving a movement toward free trade, but the subject is on the agenda.

I have not touched upon any of the well-known facts about the great interdependence that exists between Canada and the United States. Some earlier witnesses have already alluded to this.

Nor have I talked about the particular sensitivities in Canada that lead to public opinion's being rather cautious on this whole question of an approach to closer integration between the two countries. Some of these sensitivities have been brought to life by previous witnesses. There is no need to dwell on them at this stage.

In closing, the Canadian Chamber of Commerce finds your initiative an interesting one, and we would be pleased to consider participation in more detail in discussion at a later date.

Senator BAUCUS. Thank you very much, Mr. Currie.

You think that the vast majority of economists, if not all, agree that in the longer run, free trade would be beneficial to Canada and the United States, but in the short run, the dislocations would be a problem. Therefore it is important to identify those and to resolve them as smoothly and satisfactorily as possible.

Is that a correct summary?

Mr. CURRIE. Yes. That is right. But I think, though, that one can make a case for examining potential damage, for the loss that you cannot recover from.

Most of the studies on the Canadian side, the two major research organizations that have looked into this, the Economic Council of Canada and the C. D. Howe Institute, have both come to the conclusion that the benefits would be considerable in the long run—benefits of a variety of sorts, not only in terms of cheaper imports, but also more efficient combination of factors of production, and so forth, and the advantages of scale arising form and having access to a larger market, and all that sort of thing.

But there is, nevertheless, apart from the thought of the immediate risk, the question of how the transitional arrangements will work out. Somebody is going to be hurt for sure in the process.

There is also a very real political perception—public political, I do not mean this in a party sense, at all—a political perception that national sovereignty would, in some way, be impaired by this. My personal view—this is only a personal view—my personal view is that talking about a free trade area as opposed to a common market, of a free trade area is more likely, by improving the economic base on which a country works, more likely to improve its ability to withstand external pressures of a political and economic sort than would a country that is perceived to be going downhill.

Senator BAUCUS. I take it that you tend to agree with Dr. Weintraub's view that we should not get wrapped up in questions of political sovereignty as much as we do, and that economic arrangements and reductions in the trade barriers need not necessarily also encompass investment flow problems and labor flow problems and a vast array of other kinds of economic relationships. With reductions in trade barriers, countries still can retain their political autonomy and sovereignty and be enhanced by greater economic benefits.

Is that pretty much your view?

Mr. CURRIE. Yes; pretty much.

My view, the view I expressed in that way, is pretty largely a personal view because the organization which I represent really does not have a fully developed policy on this question.

They are prepared to study it further, I believe, but it is generally speaking my view that one should at least go first through the detailed examination stages, if you can find some way of setting aside the political considerations and sensitivities. You should go through the mechanism of studying what the effect in economic terms would be, and of proposing the various kinds of transitional arrangements, and that sort of thing in order to make an assessment of whether you want to go that route, politically.

Senator BAUCUS. The perceived political objections can often be solved through economic analysis?

Mr. CURRIE. It could be.

Senator BAUCUS. Mr. Van Heuven, you have waited very patiently——

Mr. OPIE. May I make one remark on the sovereignty question? I think there is an enormous educational job to be done in all countries, not only developing, but developed countries, because people do not realize if you act under a treaty, bilateral or multilateral, if you act under a treaty you are using your sovereign powers, exercising them in order to do something or to refrain from doing something.

Far from this being a degradation of sovereignty, it is the opposite. The job of education has to be done in all countries to get rid of the loss of force. You find it in the media; the media all talk about it, especially on the educational job. In the business world, the educational world and the political world.

Senator BAUCUS. There is no doubt that education helps.

Mr. Van Heuven?

STATEMENT OF GERARD J. VAN HEUVEN, EXECUTIVE VICE PRESIDENT, UNITED STATES-MEXICO CHAMBER OF COMMERCE

Mr. VAN HEUVEN. Thank you, Mr. Chairman. I will be very brief.

I appreciate the opportunity to speak on the subject of North American interdependence in the next decade, for it is a topic of great concern for our membership on both sides of the border.

Briefly, I would like to address several specific issues affecting United States-Mexico relations, issues which illustrate the interdependency of our two countries.

Also, perhaps of more interest to the committee, steps Congress might take toward improving these relations.

First, in the case of undocumented workers as you may be aware, approximately 40 percent of the Mexican labor force is either unemployed or underemployed. This is bound to increase, as approximately 45 percent of the population is under 16 years of age and will soon be entering the work place. This is further compounded by an annual population growth of 3.5 percent.

Mexico is dependent on the United States for assistance in providing jobs which today Mexico cannot alone provide. The United States wants to decrease the flow of undocumented workers into the United States. Therefore, it is to our mutual advantage in this situation of interrelated concerns to work together to create more jobs in Mexico.

Besides encouraging United States investment in Mexico, we must discourage United States actions which would further aggravate Mexico's unemployment situation. Today in the United States Senate, legislation exists that would restrict entrance into the United States of Mexican tomatoes by requiring stringent packaging procedures, simliar to those placed on Florida producers. These nontariff barriers, if passed, would put approximately 60,000 farm workers in the Sinaloa region out of work, thus adding to the entrance of undocumented workers into the United States.

Mexico provides a needed suppy of tomatoes to the United States. In recent years, when U.S. growers were plagued by severe winters, Mexican tomatoes reached the consumers tables. This interdependency of knowing Mexico can supplement a sagging U.S. market is of prime importance to U.S. consumers.

BORDER INDUSTRIES

Today, a number of U.S. companies have located assembly plants along the Mexican border. These plants, which are governed by TSUS items 806.30 and 807, permit U.S. manufacturers to assemble their products through utilization of less expensive Mexican labor. These products are then returned to the United States for sale, with duties charged only on value added in Mexico.

Our interdependency, in this case, lies in the Mexican labor itself. We depend upon the abundant, less expensive labor supply of Mexico to remain competitive with foreign imports into the United States, for example, from England, Japan, Germany, et cetera. Without benefit of Mexican labor, many U.S. companies might be forced out of business or move offshore, due to high U.S. labor costs. Mexico is dependent upon the creation of jobs and the training provided by U.S. firms for unskilled workers.

As this is clearly an issue where each country depends on the other—a dependency which will increase during the next decade—the chamber encourages this committee to oppose legislation which seeks to modify or repeal sections 806.30 and 807.

FOREIGN CONVENTION TAX DEDUCTIBILITY

Until 1976, U.S. business people held many of their business conventions in Mexico. However, with the passage of the Tax Reform Act of 1976, which limited deductibility of foreign conventions to two per annum with stringent reporting requirements, convention travel to Mexico has decreased significantly. This step has caused Mexico to lose $80 million in tourism trade since 1976, without even taking into consideration the increase in convention travel which would have taken place had not section 602 been passed.

U.S. convention travel to Mexico is beneficial to both countries. For the United States, the drop in convention travel has resulted in loss of income for U.S. hotel chains, airlines, travel agencies, et cetera. For Mexico, there has been a loss of significant tourism revenue—not to mention jobs in that industry.

Keeping in mind the concept of a North American interdependency relating to foreign conventions, the chamber encourages the committee to support S. 589, which calls for a North American area exemption—Canada, Mexico, the Caribbean—from the two-convention tax deduction limit for foreign conventions.

We are all aware of the recent discoveries of oil and gas in Mexico and our dependence on Mexico in the future. More significantly, the interests of the committee might be Mexican dependence on the United States for technology and equipment to develop that oil and gas.

Approximately 7 percent of the equipment purchased by the government-owned oil company is purchased from outside sources and a good part of that is purchased from the United States.

In the next 6 years, Pemex objectives in oil and gas in the exploration field call for drilling 1,300 new wells, 10 times as many as in previous years.

REFINING

They plan to double capacity to 1.7 billion barrels daily, at a cost of $2 billion.

CRUDE OIL PRODUCTION

They plan to increase production 120 percent, from 1 million barrels daily in 1970 to 2.2 million barrels daily in 1980, at a cost of $7 billion.

GAS PRODUCTION

They plan increasing 80 percent, from 2.2 billion cubic feet daily to 4 billion cubic feet per day.

PLANNED EXPORTS

The exports of crude oil will rise from 200,000 barrels daily in 1977 to 1.1 million barrels in 1980. Of particular interest to this committee is the fact that exports of gas, which would approach 2 billion cubic feet daily by 1984, had the U.S. purchased the gas at Mexico's asking price of then $2.60 per thousand cubic feet.

The last area I would like to mention, an issue of major concern between the two countries, has to do with the generalized system of preferences.

This is a system set up by the United States which provides for duty free treatment of certain imports from eligible developing countries. To continue to be eligible for GSP treatment, a country must not exceed the "competitive need ceiling" which is 50 percent of total U.S. imports of that product, or a certain dollar value—currently $37.2 million.

GSP, though designed to assist developing countries in getting access to the U.S. market, has sometimes, in fact, blocked that access—as in the case of Mexican railcars.

Today, the United States is still in need of railcars, specifically gondolas and boxcars, to ship grain, cattle, and produce to market. This situation reached a crisis level in 1978, when at the worst point, the United States was 115,000 cars short of demand.

In 1977, Mexico was a major supplier of gondolas and boxcars to the United States. These cars entered duty free under GSP treatment. However, in 1977, unlike previous years, other suppliers of railcars failed to export their cars to the United States. Mexico, by supplying a small number of cars—34—surpassed 50 percent of total imports, thus losing its GSP treatment. An 18 percent duty was assessed on each railcar sold to the United States.

The committee should know that, of these cars sold to the United States in 1977, $5.2 million, or 49 percent of the total value, consisted of United States components. Another $12 million worth of United States components were used to build railcars for Mexico's use alone.

In 1978, Mexico imported more than $33 million worth of U.S. components. Those cars sold to the United States are still being assessed an 18 percent duty.

If there is a place to begin to strengthen U.S. ties with Mexico, and clearly demonstrate our sense of interdependence, the railcar issue may indeed be such a place.

As the Canada/United States Automobile Agreement was a major step foward in trade relations with Canada, so would a similar agreement on Mexican railcars be a monumental move in establishing better relations with Mexico. Through having the above successes both in Canada and Mexico, we are indeed paving the road toward more meaningful discussions on North American interdependence. We now have to begin with some meaningful accomplishments in order to achieve even greater ones in the future.

Mr. Chairman, I would like to commend you on sponsoring the legislation that would remove the 18-percent duty on Mexican railcars. We feel that this is a very big step in moving toward North American area interdependence.

Thank you for giving the chamber an opportunity to testify.

Senator BAUCUS. Thank you very much.

I wonder whether you or Mr. Opie—would give us your reaction to the point raised by Mr. Weintraub concerning potential backwash, that is, the richer countries get richer and the poorer get poorer in situations of free trade.

In answer to the question, I wonder if you could address some concrete policies that the United States, Mexico, and Canada have pursued to ameliorate those potential problems to the degree, in your judgment, those problems would otherwise occur.

Mr. Opie, or Mr. Van Heuven?

Mr. OPIE. Mr. Chairman, I think it is very important to keep the perspective on a full international basis, looking at the problem. This is why I have avoided going into any specific issue with Mexico.

What I would like to say, before the Mexican Government had officially announced that it was going to negotiate with GATT for injury, I had been running a personal campaign for Mexican entry into GATT and to my Mexican friends in this town a month ago, just about a month ago, I said—speaking as a naturalized Mexican—I think that we ought to take, as a country, full responsibility in every international organization.

Now, at present, as members of the GATT, we are receiving from the United States most-favored-nation treatment. Let us call a spade a spade. It is not dignified for a great country like Mexico to receive charity. It ought to be receiving most-favored-nation treatment as a right as a member of the GATT. And my private sector friends who were there nodded their heads in agreement.

To me, the more general you can keep the basis of argument, the more you are going to achieve. What has happened today is exactly the same discussions we had 40 years ago when we began the Anglo-American discussions for the brave new world. We started during the war, during the neutrality period, to discuss exactly the same things we are discussing today on a full international basis.

In 1940, it was when Secretary Wells went to England and came back in secret discussions, given to negotiate with the U.S. Government for the preparation of a freer world system after the war, which at that time, the United States never expected to enter, but they were going to be at the peace table.

I stress that the continuity of these problems are overlooked, and you will see in the paper I put in the record the continuity in the approach to problems that must be stressed. If we do not do that—and I will finish with this sentence—if we do not do that, we will not have any way to resist the extreme demands of the Third World.

Senator BAUCUS. You do not agree with the backwash theory?

Mr. OPIE. No; that is why I wanted to put it into a broad perspective.

Senator BAUCUS. Mr. Van Heuven?

Mr. VAN HEUVEN. I agree.

Senator BAUCUS. Mr. O'Connel?

As I listened to you, Mr. O'Connel, you seemed to think in the interests of Canadian sovereignty and autonomy that you would be very concerned about almost any effort to reduce trade barriers between Canada and the United States. I am wondering what merit you might see in Mr. Weintraub's and Mr. Currie's analysis that a lot of the political problems are really resolvable, that many of the benefits of trade barrier reductions could be very helpful to Canada and Mexico and not reduce the political sovereignty.

Mr. O'CONNEL. Mr. Chairman, I am not worried about proceeding toward freer trade. In fact, Canada was a pretty full participant in the GATT negotiations which have resulted in lower trade barriers internationally and certainly for us in Canada.

I just persist in the belief that we have so much restructuring to do that it is not likely to take place along acceptable lines under bilateral free trade arrangements by sector or generally, but we should go slowly on anything. In addition to GATT, we have a lot to do with just the GATT arrangements coming through in the next 10 or so years.

Senator BAUCUS. Do you agree with the general thesis that in the longer term freer trade is beneficial to all parties?

Mr. O'CONNEL. I really do not know how anybody easily can answer that question. The term is so wide. Who knows what the impact of free trade is.

I assume that free trade was adopted by Britain because it was going to benefit Britain. If it benefitted the economy, well and good, but how did it benefit them? They became peripheral economies to the British economy.

Perhaps that is our big example of a free trade system, and English Canada has been involved. We, in turn, resist that.

As far as the sovereignty question goes, I would define it as the capacity to choose among a wide range of options and if one rejuices those options by bilateral arrangements, it is an exercise in sovereignty, but it limits the exercise for the future.

For example, it would be very difficult, I would think, in the free trade arrangements in the United States to pursue certain regional development policies in Canada, certain investment incentives, industrialization in the West. The desire to process those resources, all those exercises in sovereignty which would have been restrained and, in our cases, with rather profound unity constraints, unity strains, that rise in part from the feelings of the various economic regions that they are not able to reach their full potential economically, in part because of national policies, and the need to change those national policies, perhaps deliberately, from internal or domestic development and domestic unities.

I feel locking ourselves into more external arrangements are going to reduce the meaningfulness of the Canadian Federal Government to many important regions, and therefore add to our difficulties.

Senator BAUCUS. As I listen to you, perhaps part of the Canadian concerns are rooted in the political and management difficulties raised by increased autonomy of Canadian Provinces. Is that a part of your problem?

Mr. O'CONNEL. I think it is a factor. It is hard to assess. But free trade would rejuice the inter-regional linkages in Canada and lead to greater interests in north-south linkages, and therefore I think you could extend that to the point that provincial autonomies, if not greater, certainly would not be reduced. But the main thing would be that the federal, or central government, would have tied its hands somewhat, in my view, and would have lost meaning in the face of the Provinces, which would increasingly look at north-south.

Senator BAUCUS. What if the United States tends to significantly reduce trade barriers with Mexico and other Latin American countries? What would the Canadian reaction be? Perhaps Canada may find itself in even a more disadvantageous position in that circumstance. Canada might be left out cold, as it were.

Mr. O'CONNEL. We will face that when it comes.

Canada has always favored a multilateral approach and we will face any bilateral arrangements, I would think, when they emerge. I think those are rather hypothetical situations, very difficult to answer.

The people here have been stressing let the private sector work it all out and the governments will follow. In the Canadian case, the private sector is already dominant by decisions made in another country in head offices.

I think it is not unnatural that we would look with some apprehension if governments were counseled to stand aside and let the private sector work it out. And that is essentially what the C. D. Howe Institute is saying: Reduce government involvement in the economy. Make an association with that country that already dominates in the private sector and the market forces will solve it all for you in the long term.

I do not think that the country was built that way. Some say it is an exercise against nature. Well it is a country, and it works and I think that we have to be rather careful.

Senator BAUCUS. I want to thank the panel very much.

Before we conclude, though, I will give individual members a chance to make any observations they may want to make based on what transpired this morning and this afternoon.

Do any of the panelists have any final burning statements to make?

Mr. OPIE. I think, Mr. Chairman, that it is important to stress that what Mr. O'Connel is talking about is free trade, as though that is the end. What we are doing is moving further and further toward that end, which I know we will never reach. It is very important to have the direction. It is freer trade that we are working for all the time.

Unless we keep this ideal—this is the ideal. It is a practical ideal.

We will not give ourselves the right direction unless we stress the fact that for 30 years the GATT has done a very good job in freeing trade. It could have done a better job for certain reasons. It did not do a better job.

We have got to analyze the reasons why it did not do a better job, and we are making that next step forward under the new multilateral trade agreement in a big way.

If you asked me 30 years ago, 35 years ago when I was involved with these things in an official capacity, on this progress, institutionalizing and reducing the nontariff barriers, I would have said no.

Of course, I did not expect to live so long.

Senator BAUCUS. Thank you so much. You have been most helpful.

I want to particularly thank those of you who have come great distances.

[The prepared statements of the preceding panel follow:]

PREPARED STATEMENT OF DR. REDVERS OPIE

Mr. Chairman and honorable members of the subcommittee, I gladly accepted your invitation to testify in your hearings today because an examination of North American Area Interdependence over the next ten years interests me very much. More than two years ago, in January 1977, I introduced the subject of regional economic integration into my oral testimony on the Mexican economic system before the subcommittee on Inter-American Economic Relationships of the Joint Economic Committee.

I said to that subcommittee: "If contiguous areas exist in which the economic characteristics of the constituent countries make them a fit subject for economic integration, the North-American Continent is surely one such area. Canada, the United States and Mexico are in many respects complementary (rather than competing) economies, and perhaps especially Mexico and the United States. These two countries have mutuality of interest in pursuing harmonious development together".

This statement might be interpreted as indicating that I was an advocate of regional common markets. Let me say emphatically that I neither was nor am. In the early 1950's I believed and wrote that regional groupings of countries, with a common tariff and other trade barriers against the outer world, were a derogation from a higher ideal of the full internationalization of efforts to reduce tariff and non-tariff barriers. This was the purpose for which the GATT was established and it has done an excellent job in pursuing the ideal.

A historical perspective on current problems is essential if we are not to repeat the errors of the past. It is therefore relevant to recall that when the U.S. Congress 30 years ago was establishing the Economic Cooperation Administration to implement the Marshall Plan for economic reconstruction, economic "integration" or "unification" was being urged on Europe, by some members of Congress and many other Americans, as the most rational solution of its problems. Eventually, in 1960 under the Treaty of Rome, the regional common market that is known as the European Economic Community (EEC) emerged from their advice. The EEC began with six countries and is still a long way from embracing the whole of Europe.

It is relevant also to recall that thirty years ago the United States encouraged and supported European union on non-economic grounds. It was thought that economic integration (even though the concept was left undefined) could be a back door to political agreement or even union. This was putting the cart before the horse, because political union must precede many types of unified economic action. For example, as the efforts to achieve European monetary union have shown, a single Federal-Reserve-like banking system for Europe is an impossible aim, except under the sovereign authority of one state.

I believe that most, if not all, of what the EEC has done for its members could have been achieved through the GATT, with greater benefit to the rest of the world, and perhaps to the members of the EEC themselves. The same can be said, but even more strongly, of the Latin American Free Trade Association (LAFTA) and other less plausible attempts at regional common markets. It may be, however, judging with hindsight, that the mission of these exercises in "integration", and especially in Latin America, was to force countries into communicating with one another as they had never done before.

The support for "common markets", or economic integration, was and still is based on a misunderstanding, or a confusion, regarding the means of cooperation amongst sovereign states. The age-long method of cooperation—and really the only practical method—is that of association by treaty, either bilaterally or multilaterally. The sole acceptable alternative is a voluntary organic act of union.

But most organic unions of states have been accomplished through outright conquest or the threat of it. The union voluntarily created by the 13 American States is rare, if not unique, in history. It partook of the miraculous. But even that organic act of union was performed under the shadow of a revolutionary war and threats of further military action.

The confusion has not ended, for the treaty form of association is still a source of misunderstanding, and of apprehension, because it may involve "loss" or "surrender" of sovereignty. The truth is of course that adherence to a treaty, far from being a surrender of sovereignty, is an expression of the exercise of sovereign power to act, or to refrain from acting, in the common interest of all the signatories to the treaty.

So in my view, the title of the subcommittee hearings has been well chosen. With its stress on interdependence, a concept that includes all nations, it warns off supporters of regional isolationism. It also avoids the temptation to think of "creating" an integrated area in the form of a common market, which raises the spectre of surrendering sovereignty by some organic act of union.

As is the case in other groups of contiguous countries, however, the North American group may have special interests among themselves, which give rise to a deeper and more intimate state of interdependency than they have with the rest of the world. Propinquity has indeed already in practice produced a profound depth of interdependency in the North-American area. Over the next ten years it is sure to increase. But it will be increasing within the wider context of increasing world interdependence.

The degree of area interdependence compared to interdependence with the outside world, is not ths same for each country in the North American Area. In 1976, the most recent year for which figures are published, of the $9,018 million total of Mexico's merchandise trade (imports plus exports), 62% was with the United States and 2% was with Canada. Probably more than 80% of Mexico's total international transactions, including capital and other financial transactions and services, was with the United States. While the importance of Mexico in total U.S. international transactions is growing, it is far from reaching this level. Mexico can be said to be more deeply interdependent than the United States within the area. But this greater degree of interdependence is not justifiably called dependence in the pejorative sense, which some Mexicans (not to speak of other nationalities) are inclined to do. The different degrees of interdependence within the area are free to change; and they are certainly not inherently an obstacle to growing interdependence of individual countries with the outside world.

From the foregoing, it should be obvious that whatever special common interests among some or all the countries in North America are to be promoted on an area basis, the instrument to be used must be the treaty method of association. It should be clearly understood and accepted, however, that the special area arrangements must not conflict with existing or future measures for promoting full international interdependence; and that the special area measures are being used because the desired ends could not be appropriately sought, or attained, through full international agreements.

As I have indicated, international economic interdependence goes far beyond trade. In describing interdependence in world trade, the GATT uses the metaphor of a network, a criss-cross of trade transactions and balances among countries. It is a realistic metaphor. And it can be used with equal realism to enhance our understanding of the rest of the international economic system. That system comprises three other networks: the network of lenders and borrowers of loan capital; the network of transfers of equity capital, known as foreign direct investment; and finally the network of transfers of technology and managerial or organizational know-how. I submit that these four networks realistically conceptualize the nature of the international economic system, with emphasis on the state of interdependence among the countries operating within the networks.

All four networks have an outstanding common characteristic: the bulk of the transactions within them take place among the developed industrial countries themselves. And two of the networks have a still more striking common characteristic: namely, that the transfers of equity capital and of technology are virtually exclusively made by multinational (or transnational) corporations. These vehicles for transfer are at present overwhelmingly indigenous to the developed industrial countries. But they have begun to be formed by the developing countries, of which Mexico is an example, though of course in this respect far behind the United States and Canada.

In my testimony in 1977, I offered the opinion that in these two thickening networks of equity capital and technological transfers we are witnessing a historical process of more fully internationalizing world production, for which the transnationals are the instrument. It would be unrealistic and impracticable to try to stop this process. As the developing countries become more developed they will have a greater share of world production. But they can only develop by getting more deeply into the four networks; and especially the last two, which they can do only through the transnationals. This fact must condition the attitudes of area countries to intra-North American action relating to interdependence.

When and if the developing countries come to recognize that in order to develop they must inevitably get deeper into the networks, they should also recognize that the long-run enlightened self interests of all countries in the international economic system are the same, despite apparent or actual short-term divergences, because economic interdependence is worldwide. They should then cease to magnify their differences with the developed countries, and their demands for a New International Economic Order should become less strident.

The practical significance of these networks for area interdependence, and for the relation of area to world interdependence, should be obvious. Moreover, the notable absence of a network of labor transfers is especially significant for area interdependence. Obstacles to the movement of people on a world scale are too great for the network metaphor to describe realistically the thin streams of moving people. They are not yet the object of fully international agreements.

Migration of people is probably the most important aspect of North American interdependence that is likely to be the subject of bilateral or multilateral treaty arrangements over the next ten years. This particular reflection of area interdependence is already a problem, of course, between Mexico (and to a lesser extent the Caribbean) and the United States.

As regards achieving greater freedom in the movement of factors of production within North America. I have considerable hope of seeing the fairly rapid breaking down of the prejudices in the capital and technology receiving countries against the transnationals, which is one of the reasons that these countries are reluctant to accept productive resources offered to them at worldmarket-determined prices (which, ironically, the developed countries are lapping up!). If I am right, movements of equity capital and the other productive factors that go with it, will become freer and thus deepen area interdependence.

I have less hope of getting the labor-receiving countries as rapidly to recognize the advantages of the freer migration of people. So the obstacles to the movement of labor will continue to put stricter limits to the growth of area interdependence than those that arise from restrictions on capital movements.

Labor mrigration is clearly a very proper subject for agreement by treaty on a purely local basis. Bilateral agreements already exist. It remains to be seen whether any advantages would ensue if the issue could be dealt with by the necessarily more complicaed multilateral arrangements.

The United States is the largest receiver of illegal immigrants. Recently, Mr. Douglas S. Massey, a demographer at Princeton University, has stated that the "best demographic evidence suggests that there may be about four million illegal aliens living in the United States at any time. Furthermore, recent work indicates that this population has not greatly increased since the early 1970". Most of these "illegal aliens" (officially designated "undocumented workers" by Mexico) are said to be from Mexico and the Caribbean.

Without wishing to detract from the political seriousness of the problem, if the estimate of four million illegal aliens rather than 12 million is nearer the mark; if the number has remained fairly constant for nine years; if most of them pay taxes; and if they are "very unlikely to use the social services", and therefore far from being a burden on the economy they are "more likely to be subsidizing it"; then I submit that these facts diminish substantially the economic basis of the political problem. (All the passages quoted above are from Mr. Massey's letter in The New York Times of May 31, 1979.) And that should make the political problem more amenable to solution, and encourage a determined attempt during the next ten years to put intra-North American movements of labor on a more rational basis.

Mr. Chairman, given my long and more than usually varied experience in international economic and political affairs, I decided that the most useful contribution I could make to your Committee's deliberations would be to explain the philosophical background—I hesitate to say theoretical because that word is frequently read as the opposite of practical—of the state of interdependency and of action to deepen it. If I have succeeded, it will be clear that we should be especially concerned with freeing still further the movements of capital and of people. Greater mobility of these factors of production would increase interdependency and productivity, which would make for greater political stability in the North American area.

Statement of Sidney Weintraub, Senior Fellow, The Brookings Institution

(The views presented in this testimony are those of the author and should not be attributed to the Brookings Institution, to its trustees, officers, or other staff members, or to the organizations that support its research.)

GREATER TRADE INTEGRATION IN NORTH AMERICA: KEY ECONOMIC ISSUES

The case for seeking further integration in trading relations among Canada, Mexico, and the United States (or between the United states and any one of the other two) must be (1) that this would be a natural process to raise incomes and improve effeciency, and (2) that each of the three parties would benefit without imposing a great cost on other countries.

Current interaction in North America

Interaction between the United States and each of the other two countries already is substantial. The United States is the first trading partner for each country. In 1977, both Canada and Mexico sent in excess of 60 percent of the value of their exports to the United States. Canada is far and away the first foreign market for U.S. merchandise, accounting in recent years for more than 20 percent of U.S. exports. Mexico is the fifth largest export market for U.S. goods, taking 4 percent of the total in 1977. Trading relations between Canada and Mexico are less significant: in 1977, Mexico sent 1 percent of its exports to Canada and Canada sent only one half of 1 percent of its exports to Mexico.

Another indicator of the interaction between the United States and each of the other two countries is the number of people who enter the United States legally from each of them. In the year ended September 30, 1977, there were more than 100 million entries of aliens across the Mexican border, plus 56 million by United States citizens. There were about 50 million entries of aliens across the Canadian border plus 36 million by U.S. citizens. The Commission of Immigration and Naturalization, Leonel Castillo, has pointed out that many cities in the United States have low populations each night and high populations each day as they are swelled by persons who legally work and shop in them. The fact that many other Mexicans enter the United States each year without documentation is an indication that the two economies arer not easily separable despite the legal existence of a boundary.

There is no doubt that contiguity makes for natural interaction and that because of this the United States is more important economically to Canada and Mexico than is any other country and what happens in Canada and Mexico is more likely to affect the United States, for good or bad, than what happens in more distant countries. Prosperity in either of them would be reflected in the United States throught trade, and turbulence in either nation would find its reflection in the United States.

The more difficult question to answer is whether each of the three countries would benefit from official steps to further integrate their trade, and if the answer is yes, how the three would share in the benefits. I will direct most of my remarks to this question.

What is meant by trade integration?

However, there is a prior issue, namely, to define what is meant by greater trade integration. What is usually meant by those advocating this is a market without tariff or non-tariff barriers, such as now exists within each of the three countries. The larger, barrier-free market, could involve substantially all trade, or it could be confined to particular sectors. There is an important difference between the two conceptions. The automotive agreement between Canada and the United States is an example (although not a pure one, since Canada still maintains some restrictions on its automotive imports from the United States) of sectoral free trade and the European Economic Community is an example of a more comprehensive customs union. Sectoral free trade may bring benefits to the parties but it is a limited conception. I will discuss the question of general free trade since it subsumes the sectoral approach. The elimination of barriers in particular sectors need not be a prelude to more complete integration. The U.S.-Canada automotive agreement, born out of special circumstances of the industry in the two countries, has not expanded to other sectors. Or it can be a prelude to greater integration, as the European Coal and Steel Community was.

There is also a legal point worth making as between sectoral and general free trade. The United States, as a contracting party to the General Agreement on Tariffs and Trade, would need a waiver from the Contracting Parties to enter into sectoral free-trade agreements with only Canada and Mexico. A movement towards general free trade among the three countries, on the other hand, would be enitrely consistent with the articles of agreement of the GATT.

A general arrangement to free trade could take the form of a customs union, under which each of the countries moves to a common tariff towards the rest of the world, or a free-trade area, under which each country maintains its own external tariff. The former is clearly a more comprehensive arrangement. it also would be much more difficult to achieve because of the different levels of development between the United states and Mexico particularly. A common tariff would require either that the U.S. tariff go up part of the way to the level of the Mexican tariff, which would be a retrograde step in the international trading system and one which undoubtedly would invite retaliation; or that the Mexican tariff come all the way down to the level of the U.S. tariff, for which Mexico might not feel prepared until its own industry is more competitive. For this reason, I suspect that examination of the issues surrounding prospective movement towards free trade among the three countries should focus on the idea of a free-trade area.

Those who advocate free trade among the three countries would not expect this to happen suddenly, but rather to take place over a transition period to allow time for adjustment in each country. The adjustment period can be relatively short (12 years was the contemplated time in the European Economic Community, although the customs union was achieved in less time than that), or it can be relatively long. For example, the association agreement between the EEC and Turkey contemplated elimination of duties over 22 years, although the plan was not put into effect. My own expectation is that if one were to move towards free trade among countries with economic structures as disparate as those in North America, the time should be longer rather than shorter, say in the Turkish-EEC time frame. Or, it might be that the United States would agree to remove its tariffs for imports from Mexico and Canada in, say, 20 years, and they in turn would do so in 25 years. The exact period is not the vital issue, but rather that there be sufficient lead time so that adjustment can be gradual.

One final preliminary point might be made. Article XXVIII of the GATT requires that barriers to trade in a free-trade area must be removed on "substantially" all trade, i.e., some exceptions are possible.

The economic issues

I do not have the answers to the key economic questions that would be raised in each of the three countries if there were a proposal to move gradually to free trade among them, but I would like to raise issues that need analysis.

The most pervasive misgiving that would arise both in Canada and particularly in Mexico is that there would be what Gunnar Myrdal many years ago called a "backwash" effect or what more recent economic literature refers to as polarization. This argument is that when there is free trade between generally well-developed and more backward areas, either within countries or internationally, the investment in growing industries goes mostly to the more developed region or country. The reason for this, or so the argument goes, is that the infrastructure exists in the richer area and does not to the same extent in the poorer area. Sophisticated industries need complementary industries to provide intermediate goods and other industries to which its goods are inputs. Skilled labor is needed. Transportation systems must exist. Knowledge must be diffused. All of these are more available in developed than in backward places. The polarization or backwash contention is that the rich areas get richer and the poor areas would be forced to concentrate on raw material production or on simple industry that is inherently labor intensive.

It is this argument that, in essence, lies behind the infant industry argument for industrial protection. For many years, there was a polarization effect in the United States under which the North produced manufactured goods, which it protected against external competition, and the South produced raw materials. The argument that was raised in Canada some years ago when a proposal was made for a free-trade area between the United States and Canada was that this would make Canadians hewers of wood and drawers of water. Both Canada and Mexico have highly protected industries and they would have to be convinced that removal of this protection, even over time, would not destroy their industries.

There have been many efforts since World War II to form free-trade areas or customs unions among less-developed countries. These generally have failed. The main reason for the failures was the inability to work out schemes for equiable distribution of new industrial investment. The Latin American Free Trade Association, the Central American Common Market, the Andean Common Market, the East African Common Market, all had schemes to try to avoid the polarization effect, and in none of them has it really worked.

However, there is another side to this argument. It used to be taken for granted that the North in the United States had and would continue to attract dynamic industries and that the South would continue to be more backward in this respect. In recent years, these earlier assumptions turned out to be wrong. At a certain level of development, economies may become integrated rather than polarized. As the South attracted industries, this created employment and wages increased. It is possible that in a gradual movement towards free trade, Mexico would be to the United States what the South has been to the North. Industry could be attracted to

Mexico by lower wages, particularly those industries in which U.S. productivity is not great, rather than there being more polarization.

Mexico's most serious economic problem today is the inability of the economy to create sufficient employment to meet the need. About 700,000 Mexicans enter the labor force each year whereas job creation is less than half of this. About 40 percent of Mexico's economically active population is now either unemployed or underemployed. Since about half of Mexico's population is under 15 years of age, its most serious employment problems may be ahead. What I am saying is that Mexico's past development model, while it did bring high rates of overall economic growth to the country, has not succeeded in creating sufficient jobs and it may be in Mexico's own interest to alter its development model of protected industrialization.

The European Economic Community has had some and will soon have more experience with trade integration of economies with disparate levels of per capita income. In no case has the disparity been as great as that between the United States and Mexico (which was 7.8 to 1 in 1977), but the disparity in income between Germany and Italy in 1977 was 2.4 to 1, Germany and Ireland 2.8 to 1, and Germany and Portugal (which is expected to enter the Community) 4.4 to 1. This has not prevented satisfactory economic growth in Ireland, one of whose main engines has been its export sector, or in Italy.

The European Community also built into its structure mechanisms under which the richer countries help the poorer ones through financial assistance. A free-trade area in North America undoubtedly would also require techniques for special assistance to the poorer areas.

For the most part, the gradual elimination of tariffs in the European Community did not lead to great disruption. It is not clear what would happen if this were allowed to take place in North America. The apparel industry might well move mostly to Mexico, where wages are the lowest of the three countries. It is by no means clear how the steel industry, just to cite one complex industry, would eventually shake down if there were free trade throughout all of North America. What I am speculating about is in a sense the reverse of the polarization argument. Many industries now highly protected in the United States might be seriously affected as they lost their protection. Or, they might survive in stronger shape as a consequence of having to face up to competition.

I would like to add a few words about agriculture. In most integration schemes, agriculture has been treated differently from industry. Some of the most sensitive trade problems today between the United States and Mexico relate to agriculture, for example, those relating to U.S. imports of tomatoes and other winter vegetables from Mexico. If comparative advantage were allowed to function, and free trade implies that this would be the case, there could be some losers among the winter vegetable growers in the United Sates who now have a protected market.

I would like to summarize the economic issues. I wish to repeat that I am not attempting here to provide answers, but rather to raise questions.

The most important question revolves around the division of benefits. Will the richer areas gain at the expense of the poorer or would the poorer areas gain by attracting investment to take advantage of lower wages? Can some of the potential adverse effects, particularly in the poorer areas, be compensated by financial transfers from the richer areas? Are the producers and the workers, and the people who represent them, prepared to let comparative advantage decide the outcome of who produces and exports what?

The politics of integration

I will not dwell on the probable political opposition to greater trade integration. In both Mexico and Canada, a formal U.S. proposal for a North American free-trade area would be seen as a U.S. attempt to gain greater economic domination over the whole area. In each country, voices would be raised that industries can survive only through protection. In Mexico and Canada, this would be based primarily on the infant industry argument; in the United States, it would be based on the assertion that high U.S. wages would make it impossible to compete in many activities with Mexico. In both Mexico and Canada, nationalistic sentiment would be aroused against the economic colossus to the north or the south, as the case may be. It may prove impossible to get by the initial political opposition.

My recemmenation would be to get on with the economic analysis regardless of political arguments. The economic analysis might show that the political opposition is justified or it might show the reverse.

Statement of the Chamber of Commerce of the United States

(By William G. Phillips)[1]

The Chamber of Commerce of the United States appreciates the opportunity to comment on North American interpendence. This statement will concentrate on the U.S. relationship with Canada and will cover three areas: (1) the proposed amendment to Section 612 of the 1974 Trade Act, which is the occasion for these hearings; (2) where North America should be heading in the next decade, especially in view of the recently concluded round of multilateral trade negotiations; and (3) the state of current and prospective United States-Canada bilateral issues.

Underpinning this statement is a fundamental policy of the Chamber. That is, the United States has a vital stake in promoting measures to achieve the greatest possible relaxation of discriminatory and restrictive trade and investment practices which reduce the flow of goods and services and the volume of international payments and which obstruct production, distribution and economic growth. Chamber policy has therefore been that of urging the United States government to promote these goals, consistent with the national interest which requires the maintenance of a healthy, competitive enterprise economy at home.

The importance the National Chamber attaches to relations with Canada is reflected in the fact that in 1933, in cooperation with the Canadian Chamber of Commerce, we formed the Canada-United States Committee, a group whose membership is composed of selected corporate officers representing a cross section of United States and Canadian leadership. The Committee is dedicated to strengthening the economic relationship between Canada and the United States. Early in its history, it was active in bringing about the 1935 Reciprocal Trade Agreement between the two countries. Later, it produced one of the first sets of voluntary guidelines for international corporate conduct. Since its inception, the Committee has worked to foster greater public understanding of Canada-United States relations and to develop timely and useful policy responses to issues of importance to both countries.

Section 612 of the 1974 Trade Act

The first item in this statement concerns the proposed amendment to Section 612 of the Trade Act of 1974 which differs from the original Section 612 in four ways:

It omits the phrase "free trade" and, instead, instructs the president to "initiate negotiations" in an attempt to "simplify and harmonize the laws" to increase trade;

It extends the region beyond the United States and Canada to include Mexico and the Caribbean;

It is more specific in that it refers to sectors, such as agriculture and energy, in which "competitive opportunities for U.S. exports" should be "equivalent to the competitive opportunities afforded in U.S. markets to the importation of like or similar products," taking into account all tariff and nontariff barriers; and

It is more concerned with the domestic impact of trade liberalization, stating that the attempts to increase trade must be subject to a "careful evaluation of the implications such agreement may have for domestic affairs of the United States" including, very specifically, "immigration patterns, agricultural production and the availability of energy supplies."

The National Chamber supports the spirit of this amendment. The Chamber of Commerce of the United States welcomes the avowed intent of regional groupings to further the integration of economies and the expansion of world trade. We recommend, however, efforts to prevent divisive regional groupings and emphasize that regional arrangements entered into should be consistent with continued efforts to develop and expand the world economy and should not preclude broader multilateral arrangements.

The difficult question is how do we get beyond the rhetoric of calling for freer trade? Certainly not with cosmic theories and grand designs, however attractive they might seem on the surface. While we are not against an occasional bold stroke, it is generally more feasible to proceed cautiously, searching out and building upon areas of concentric interests with Canada and Mexico. Grand schemes can be counterproductive, not only because they can overwhelm us, but also because they can intimidate our neighbors who are already somewhat wary about sharing a continent with the U.S. giant.

[1] William G. Phillips, Chairman of the Board and Chief Executive Officer, International Multifoods, and Chairman, U.S. Section, Canada-United States Committee, Chamber of Commerce of the United States.

We sometimes forget that national sensitivities on the part of Canada and Mexico are as great as in other parts of the world, and in many ways greater, given the disparity in size between these nations and the United States. A recent example of a lack of U.S. sensitivity can be found in this year's Senate Resolution 165, which calls for the establishment of a North American Continental Trade Commission. Though this might be a good idea, the Senate Resolution calling for the Commission continually refers to Canada as the "Republic of Canada." Canada is, of course, a parliamentary democracy with a monarch (Queen Elizabeth II) as head of state and a prime minister (Joe Clark) as head of government. One of the most irritating forms of insensitivity is giving the impression to other nations that we do not care enough about them to learn their ways.

A final point concerning a healthy caution about grand theories: we got where we are today in an evolutionary and rather natural fashion. Our present degree of North American interdependence is primarily the result of the relatively free play of market forces rather than government initiatives. We see this in investment, trade, business cycle relationships, capital markets, exchange-rate linkages, and so on. There are, of course, successful exceptions to this, such as the Automotive Pact between the United States and Canada but, in general, our integrated North American system, unlike the European experience in integration, has not been consciously planned and organized.

In short, we support the spirit of the proposed amendment because it sensibly searches for specific areas in which comprehensive trade liberalization might be usefully attempted, while keeping a judicious eye on the domestic impact of such liberalization. We have two recommendations at this point, both of which concern the future procedures of the Subcommittee.

First, we respectfully urge the Subcommittee to hold hearings in different regions of the United States. Any proposal for trade liberalization must take into account the very real and differing interests of all sections of this country. These regional voices, including those states sharing borders with Mexico, must be heard and duly considered.

Second, we respectfully urge the Subcommittee to bring together all the testimony from these hearings in the form of a published task force report, perhaps similar to the Jones Task Force on Japan (Subcommittee on Trade of the House Ways and Means Committee). In discussing United States-Canadian concerns, we seem to be continually re-inventing the wheel, going over the same vague proposals and issues again and again. A synthesis of the testimony, with specific recommendations in the form of a task force report, would serve as a reference point of current thought, which could be revisited in future years to check our progress.

North America and the 1980's

The second item in this statement concerns the direction the North American relationship should take over the next decade. Canada and Mexico have been of tremendous importance to U.S. interests, and their importance will increase as we move into the 1980s. Some of our best international economic opportunities can be found closest to home.

We will not present the usual litany of economic and strategic imperatives that bind North America together; that is not necessary. No matter how one might want to characterize our North American relationship, and particularly our relationship with Canada, it is unique. Moreover, this uniqueness should not only be nurtured, but expanded. Especially now.

As we look beyond the current round of multilateral trade negotiations, there are several reasons why a review of our North American trade options is especially important at this time.

No nation was able to achieve all that it sought in the multilateral trade negotiations, so there is a need to try to obtain freer access to markets through bilateral discussions in the years ahead. Moreover, it is clear that it will be years before new multilateral trade negotiations are undertaken, and even longer before such negotiations can be expected to yield positive results. This belief reinforces the point that progress toward removing or at least reducing existing trade barriers, particularly nontariff barriers, can proceed only on the basis of new initiatives. An approach toward comprehensive North American trade liberalization is one such initiative which is permitted by the General Agreement on Tariffs and Trade (GATT) rules as long as the parties to such an arrangement follow certain specified standards. And, of course, both the United States and Canada are fully committed to freer trade through the instrument of GATT.

In short, freer North American trade is an especially important topic to explore in view of the challenges facing our North American countries over the decade of the 1980s. In a general sense, further trade liberalization in the North American context would be expected to increase interdependence and the gains that can be derived for all parties. At the same time, it would subordinate parochial interests that can be significant barriers to increased economic well-being and collective security. Moreover, freer North American trade can be a significant tool to maintain or even enhance the international competitive strength of the nations involved. It would follow then, that the political and strategic strength of the Atlantic community would be increased, and this, after all, has been a cornerstone of U.S. foreign policy throughout the post-war period.

To be more specific, it is widely assumed that there would be significant economic benefits for all parties, but particularly for Canada and Mexico, with a freer trade approach. In addition, there would be sizable political gains for the United States if an approach toward freer trade were adopted, for example, in terms of enhanced North American political stability. Economic matters loom large for Canada and Mexico. Certainly, Canada needs and welcomes the freest possible access to world markets for primary, semi-manufactured and manufactured products, given its dependence on trade for economic prosperity. Expansion of its foreign markets would provide Canadian industry further gains from specialization and economies of scale, since many Canadian industries, particularly those that are highly innovative, need wider markets to become fully competitive.

One of the major problems in an approach toward further North American trade liberalization is that, whole the economic benefits appear to significantly outweigh the costs, the impediments to freer trade are probably more political and cultural than they are economic. In fact, over the present decade, both Canada and Mexico have been deliberately attempting to reduce their dependence on the United States and to obtain greater freedom of action for their national policies without sacrificing much, if any, of the benefits of economic integration with the United States. It is questionable whether such an approach will be successful in the long run. To allay the concerns of our neighbors, one need only look at the success of the Canada-United States Automotive Agreement of 1965. Despite the economic and political issues that surface from time to time, the agreement illustrates that a cautious approach to freer trade on a bilateral basis can work for the economic benefit of all parties while recognizing national sensitivities. Also, freer trade would give impetus to attempts by our countries to enter into joint projects, such as those in the energy area, which would, in turn, greatly reduce the economic costs and political problems that arise from pursuing counterproductive nationalistic strategies.

We should take a fresh look at North American interdependence as we approach the 1980's, systematically searching for and analyzing those areas in which there are mutual advantages, based upon a realistic assessment of our respective national interests. What would comprehensive trade liberalization specifically mean to U.S. economic, political and strategic interests? What would it mean for Canada and Mexico? Beyond the general assessment, a more thorough study is needed—a need which is being taken seriously by private and public groups. For example, the National Chamber's Canada-United States Committee is holding discussions on this crucial subject, from which more specific recommendations are likely to emerge in the near future.

It is premature at this point to comment on the precise shape North American trade liberalization should take in the next decade. However, the National Chamber is fully committed to comprehensive trade liberalization and we do have two precedural recommendations as to how we might proceed along the path.

First, we respectfully suggest that a small, high-level tripartite group be established to investigate the potential for and consequences of comprehensive North American trade liberalization in the 1980's. This would not be a problem-solving group preoccupied with the resolution of current issues. Instead, it would be an ongoing study group consisting of government officials and private sector representatives from the United States, Canada and Mexico, that would make formal recommendations to their respective governments. The latter voice is especially relevant, given the importance of the role of the private sector in our North American interchange. The services of our Canada-United States Committee are available in assisting such a group.

This recommendation is somewhat different from, but not contradictory to, Senate Resolution 165, noted earlier, which instructs the president to establish a North American Continental Trade Commission. We assume from the Resolution's wording that the intent is to form a tripartite body composed solely of government officials who, to quote the sponsor of the Resolution would constitute a "forum for the quiet resolution of those thorny little problems" that divide our three countries on trade matters.

Second, we respectfully suggest that the governments of the United States, Canada and Mexico hold high-level consultations to review the future of North American relations in the 1980s in the search for greater areas of cooperation. This could be complemented by increased exchanges between the legislators of the three countries.

United States-Canada Bilateral Issues

Finally, in discussing bilateral problems, one must not lose sight of the forest for the trees, in that most issues are structural in nature. That is. they are generated by the interdependent nature of our two nations. There will always be issues or irritants. This is not to dismiss the importance of current issues, but rather to emphasize the importance of effective means of issue resolution. And here we are fortunate, for the bilateral relationship has an honorable and effective tradition of settling its disputes, whether it be through a bilateral organization like the International Joint Commission, or through deliberations by highly competent United States and Canadian Government officials.

At present, there is no shortage of issues to resolve. For example, it is our understanding that Secretary of State Cyrus Vance's briefing book for his November 1978 meeting in Ottawa contained no less than 46 separate agenda items. Currently, the following issues appear to be more active: energy, including the Northern tier supply problems; maritime boundaries and fisheries negotiations; environmental pollution issues; exchange of information on antitrust cases; the United States-Canadian Automotive Agreement; U.S. tax law on foreign coventions and its linkage with the Canadian TV advertising case; and the joint vessel traffic scheme for Puget Sound.

Quite apart from current bilateral issues, there are more general factors affecting both countries that are worthy of serious attention by this Subcommittee as we approach the 1980s. These include: the Canadian debate about freer trade versus technological sovereignty; Canadian and U.S. investment incentive policies used by federal, state/provincial and local governments; MTN issues affecting United States-Canada trade; regional interactions in the bilateral relationship including the roles of states and provinces; and the possible impact of recent U.S. developments with Mexico on United States-Canada energy relations. And, of course, internal economic and political developments in Canada, including the question of national unity, remain of concern to Canadians and Americans. All of these current and potential factors take on added significance when viewed in the context of the momentous challenges facing the international economic order.

Conclusion

As we approach the decade of the 1980's, the Chamber of Commerce applauds the efforts of this Subcommittee to investigate avenues of cooperation between our North American nations. We appreciate the opportunity to share our views at this early stage in the hearing, and we look forward to providing you with additional thoughts as we probe more deeply into the opportunities for greater degrees of North American interdependence.

Senator BAUCUS. That concludes the hearing.

[Whereupon, at 1:55 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

THE FOUNDATION OF
THE SOUTHWESTERN GRADUATE SCHOOL OF BANKING
AT SOUTHERN METHODIST UNIVERSITY,
Dallas, Tex., June 5, 1979.

Mr. MICHAEL STERN,
Staff Director, Senate Committee on Finance,
Dirksen Senate Office Building, Washington, D.C.

DEAR MR. STERN: I am enclosing for inclusion in the record of the hearings on North American Economic Interdependence of the Finance Subcommittee on International Trade the text of a talk by Jose Pintado Rivera, Director General of the Multibanco Comermex, S.A., Mexico, D.F. on "Mexico and the U.S. in the 1980s." The talk was presented before the 35th Assembly for Bank Directors on April 7, 1979 at the Fairmont Hotel, San Francisco, California.

Mr. Pintado's remarks on the issue of the U.S.-Mexican relations in the next decade should, I think, be of interest to the Subcommittee.

Please let me know if I may provide you with further information.
Sincerely,

MARGARET LYLE,
Public Relations Officer.

Enclosure.

MEXICO AND THE UNITED STATES IN THE 1980'S

(By Lic. Jose Pintado Rivera, Director General, Multibanco Comermex, S.A., Mexico, D.F.)

Geography has placed the United States and Mexico in the position of sharing an immense border that extends some 1,900 miles. Our respective histories—as a consequence of geographic destiny—have joined us intimately, and there can be no doubt that we must learn to live together. Ethnic and economic differences in the composition of our nations have created grave situations for both countries in the past. We have strived to resolve these situations throughout our histories with a curious blend of painful experiences and promising realities.

I speak before you today on the subject of Mexico and the United States in the 1980s, as I see it from my perspective.

It is, perhaps a professional requirement of all bankers to be less than eager when it comes to playing the prophet. I am no different. It is always easier for me to interpret the present, and I inevitably hesitate when I have to look into the future. However, I also am oriented towards planning and conscious of the necessity this implies to try to forecast the future—if I am to be able to develop solid programs—and rationally to accept as unavoidable the risk of being wrong.

In this light I understood when I received the invitation to give this talk that I must remove myself from our traditional affinity for the precise and concrete and let my imagination take wing as much as possible—directed as far as possible by the facts and realities of our present situation. The basic elements of our future can be found, without any doubt, within arm's reach.

In a global analysis of United States and Mexican relations there are before us various pressing issues whose management will be definitive in the direction of our future neighbors. In wide, general terms there are essentially four current critical issues.

The first is a need for improved international trade relations.—In 1978 the value of Mexican exports to the U.S. market amounted to $3.5 billion. This figure represents 60 percent of the total exports of merchandise for that year and places Mexico in sixth among foreign suppliers to the United States. Mexican imports of capital and consumer goods from the United States amounted, in turn, to $4.5 billion—nearly 55 percent of the total imports made by the country in 1978. In this regard Mexico ranked in fifth place among the principal foreign clients to the United States.

Those figures—in spite of several problems such as restrictions on the part of U.S. authorities on exports of a wide range of manufactured goods, and in spite of the recent Mexican economic recession of 1975-77—represent a solid base for the future growth of our trade relations.

Mexico is looking—both bilaterally with the United States and multilaterally through negotiations with GATT—for increased and freer trade with her current major partner, the United States, and is exploring possibilities for new future partners.

The second critical issue is the U.S. need for and the convenience for both countries of natural gas exports from Mexico to the United States.—Negotiations that had been suspended by Mexico in February 1977—after a rather unfortunate mishandling by Mr. Schlesinger—are in the process of being resumed, with the purpose of meeting these needs and conveniences to the satisfaction of both parties.

The third is the problem of illegal aliens. -Which involves a need by Mexican labor and the ease of travel between our two countries. A select committee is to be named by your government to study this very difficult problem—with input from Mexico. Recommendations are to be forthcoming within one year.

The fourth area concerns the question of international maturity through improved political relations.—Mexico is initiating her integration into world affairs. However, the United States has yet to recognize fully and appreciate either the monumental effort and successes that Mexico has sustained in her economic development for the last twenty-five years—which by the way were attained without significant supplies of petroleum—or Mexico's almost unique political stability which she has maintained for over forty years.

Mexico must have the recognition of the United States—as well as the other industrialized countries of the world—as a new and equal member in the community of world nations—nations who communicate in an atmosphere of open negotiations, not of pressure and nations who recognize the political and economic self-determination of their sister nations.

In the area of these four critical issues, what is the outlook for the 1980's?

Trade relations

Whether Mexico joins GATT or not, her trade relations will continue to increase. "Infant Industry" protective import tariffs already are being phased out. On the other side, Mexico's need of industrial inputs and capital goods for carrying on the National Industry Development Plan now in progress are enormous. In the energy field alone—oil, petrochemical, and electricity—it is estimated that Mexico will require twenty-two billion dollars in imports for the next ten years.

Exports to the United States will increase with the help of revised trade agreements. Cooperation and understanding of the new realities of both countries are essential for the materialization of these perspectives.

Natural gas

With respect to the question of Mexico's exports of natural gas, oil, and other petroleum products to the United States, Mexico still will recognize the United States as her "natural market," and the United States will recognize Mexico as her "natural and secure supplier" and deal openly—as any other customer must—in an open and competitive market, accepting the reality that Mexico will develop her petroleum resources and sell them at her convenience and at a just price.

Illegal Aliens

By the end of the 1980s employment and living conditions will be greatly improved in Mexico—especially on the northern border. This will diminish the magnitude of the problem of illegal immigration into the United States. Meanwhile, it will be necessary to find ways to recognize and regulate these realities according to the basic principles of human rights.

There are principally three factors in the decline of illegals, our National Industrial Development Plan, and the in-bound plants on the border—the P.I.D.E.R.: programs for border development, increased employment, and expectations of even harsher treatment of illegals in the United States.

Political Relations

Mexican and United States political relations already have begun a new era with apparent recognition of a bilateral need for cooperation. To improve intergovernmental communications and understanding the existing consultative presidential commission is being reinforced—as are many of other already existing commissions on technology, energy, etc. We may expect greater mutual understanding as Mexico and the United states strive for wider global answers to her joint problems and prospects.

Future Business Climate

Beyond these current issues with which we all are so familiar other tendencies in our respective governments and economies can be identified which allow us to speculate about or future business and economic climates and comment on their implications.

For the U.S. domestic economy in the 1980s business is seen to be confronting several problems; e.g., a slow growth of the GDP, a high and fluctuating inflation, a decline in real productivity, and energy shortages.

On the international scene, a major factor which will gain influence in the 1980's will be increased foreign government subsidies which will undermine competition in international markets and increase protectionism.

The Mexican Scenario

As for Mexico's future, in wide, general terms we see high but closely controlled declining inflation. Real productivity will rise slowly at a sustained rate. The credit market not only will be maintained, but also will be amplified by government innovation. The real growth rate of Mexico's GDP will be moderately high and sustained.

What will the government's role be in controlling inflation? The Central Bank deliberately will follow a policy of increasing the money supply in strict accordance with the growth rate of the GDP, and it will encourage the expansion of the private sector in its attempt to eradicate unemployment, decreasing the public sector's presence in the economy. Trade barriers and tariffs will continue to be lowered—

implying lower import prices and increased efficiency in Mexican industry. The strongest economic factor in Mexico's control over inflation will be a stable and strong peso in international exchange markets.

In the area of real productivity the government is giving strong incentives to the private sector for productive investment, including broadening credit markets with a new financial tool—commercial paper—and a wide variety of tax incentives. Again, the impact of lowered protective barriers will force higher industrial productivity.

Economic and social factors which will affect real productivity wil be increased capitalization of industry and increased productivity through the accrued training and experience of Mexico's abundant labor force.

Another significant factor in Mexico's future is its pragmatic national energy policy. What does this energy policy imply? Mexico will be internally self-sufficient in terms of petroleum resources; its domestic energy prices will be stable; and it will generate substantial petroleum export income, reaching US$4 billion this year and almost US$8 billion by 1982—including petrochemical and refined gasoline sales.

In Mexico's future international economic relations several trends can be postulated. She will develop both mature industrial trade relationships and a wider domestic market. Government incentives for import substitution and export development will lead to an adaptation of the most feasible available technology for a more competitive international position. Mexico's maintenance of its traditionally friendly political and economic relations will be demonstrated by increased cooperation with the rest of Latin America, Asia, and the industrialized world.

The stability of the peso and international pressure on the dollar will help Mexico to attract a substantial increase in U.S. tourism with its very favorable influence on our balance of payments and employment. If in 1978 tourism income in Mexico amounted to $2.8 billion, it is estimated that by 1989 these figures will have reached a level of $13 billion.

What then may we say of the expectations of the Mexican economy and business climate in the 1980's.

High and sustained real economic growth; controlled and diminishing inflation; stable and increasing productivity; pro-business attitude by government; increased availability of credit; stable and increasing profitability; increased private sector dynamism; pragmatic and effective government economic policy; and continuing political stability.

What are the implications of these developments in the 1980's? To answer this question I would like first of all to mention a key result of a recent survey by Stanford Research with a direct quote:

"Investment and business opportunities will continue to grow in the developing countries, but multinational corporations will be much more selective than previously in directing their efforts to certain areas. Countries rating higher marks in the selection process will have several important characteristics—political stability, lower costs, and a plentiful supply of labor—and they will be relatively open to foreign capital."

These characteristics in many ways fit Mexico like a glove—with the very important addition that we also are self-sufficient with respect to energy resources, including petroleum.

In round numbers, Mexico currently has a population of over 63 million inhabitants, a GDP of $90 billion, and a per-capita income of $1,400. We expect that by 1990 these figures will increase to a population of 90 million inhabitants, a GDP of $250 billion constant, and a per-capita income of $2,800 at 1978 prices and exchange rates. This is similar to the per-capita income of Israel or Italy in 1975.

However, the more important aspect of Mexico's greater maturity in the future will be its continued dedication not only to economic growth, but also to political, economic, and financial freedom and self-determination.

Mexico will have followed its own course—with a free market economy—in search of social justice. She will have a strong public sector with ample economic resources dedicated to the active development of the social and economic infrastructure of the nation. Its function will be to guide and give stimulus to the economy, complementing the private sector as the need arises.

What kind of support will the private sector be able to count on?

A modern and complete infrastructure; a stable framework of social legislation; a balanced tax system which will allow for just profits and promote reinvestment; and a constant, rational, and practical financial system.

We may anticipate a 7.5 percent growth rate of the GDP this year and an 8 percent to 10 percent increase in the gross domestic product during the decade of the 1980s.

What will generate this growth?

First will be development of the petroleum industry. By the end of 1980 Mexico will be able to export 1,100,000 barrels of petroleum daily. This alone will earn approximately $7 billion annually. Natural gas production will reach 3.6 billion cubic feet annually.

Petroleum is not, of course, a panacea for Mexico's problems. Nevertheless, the GDP and the federal budget will increase dramatically, and our balance of payments will become strengthened, bringing us closer to a state of financial self-sufficiency. These resources, in turn, logically will widen Mexico's internal demand. The expansion of petroleum and petrochemicals alone will substantially decrease our unemployment.

By the year 2000 Mexico should be receiving over 15 million tourists annually—in comparison to the 3.5 million we now receive. The growth of this very labor-intensive industry will help considerably in the creation of new jobs, of which some 800,000 are required yearly.

In the agricultural sector, the first phase of the agrarian reform will be completed with all available land already distributed. The second phase—that of increased productivity—will be well underway, raising the quality of life of the Mexican farmer and increasing the produce needed to feed the Mexican population. The fishing industry will realize the ancient dream of getting from the sea more of the proteins that our growing population needs.

The sector that will have to carry the most weight in Mexico's development will be, of course, industry. Its capacity must increase not only to satisfy the internal needs of a growing domestic market, but also to supply the international demands of the future. A vigorous development of industry will be the only satisfactory method of absorbing the idle labor force in the rural areas of Mexico.

In Mexico—as in the rest of the world—the constant threat to the realization of these accomplishments will be runaway inflation. If the resources of Mexico are to be intensively developed, only the most productive spending can be tolerated.

Some people may say that this future projection is optimistic, but these facts seem to suggest clearly that national and international business investment opportunities in Mexico are practically limitless.

One other salient feature is that, of the top growth industries in the 1980's, banking and finance appear among the top five in the world. Mexico is not an exception. Total banking resources—as a percentage of GDP—will increase from 48.2 percent in 1977 to 61 percent in 1990 and 72 percent in the year 2000. Bank financing will grow from 34 percent of GDP in 1977 to 48 percent in the year 2000, and private and mixed banks will manage 67 percent of this amount.

With these perspectives and the expected increase in foreign exchange from petroleum and tourism income we expect the Bank of Mexico to diminish slowly its active dominant role in the economy to allow more of the total banking resources to be controlled by the private banks. This will tend to diminish our legal reserve requirement and convert it to primarily a monetary policy tool, rather than a development tool, in the hands of the government.

Hand-in-hand with this internal expansion will be Mexico's international financial expansion in all areas of banking endeavors, as Mexico continues its integration into world affairs.

Conclusion

If we consider the trends that are developing in the United States and in Mexico, it becomes clear that the investment climate in Mexico offers a wide variety of business opportunities, many of which are lacking in the United States. With the proper spirit of cooperation on both parts, the 1980s can be both constructive for Mexico and profitable for the United States.

Mexico today is like a giant that suddenly awakens to discover that it has immense petroleum wealth, vast natural resources, and an emerging economy growing at one of the most rapid rates in the world. If the United States and Mexico act as friends—and partners—business opportunities between the two nations are surely among the most promising that can be found anywhere.

AIR TRANSPORT ASSOCIATION OF AMERICA,
Washington, D.C., June 13, 1979.

Hon. MAX BAUCUS,
Subcommittee on International Trade, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR BAUCUS: On behalf of the Air Transport Association, which represents virtually all U.S. scheduled carriers, we were pleased to learn of the hearings on North American economic interdependence which you chaired on 6 June 1979. The nation's airlines have a direct interest in this subject.

For many years, the Air Transport Association's Facilitation Committee has sponsored conferences with government officials of Canada and the United States to discuss air transportation matters of mutual interest, particularly those aspects dealing with border-crossing. A number of meetings have also been held with Mexico and one conference with both countries to allow joint discussion of common air transportation problems.

It is interesting to note that the Chairman of the 1976 joint meeting with Canada, in his opening remarks, stated: ". . . to achieve our common objective . . . one answer . . . may be the virtual elimination of borders between certain countries. Canada and the United States stimulate that type of thinking. The coordination of our respective Immigration entry requirements could be achieved by work and legislation. Customs and commercial involvement gets more complicated; but if we can arrange for a man to take a shot of golf on the moon, must those problems remain mountainous?"

Some of these earlier conferences were instumental in paving the way, for example, for the implementation of preclearance of travelers flying to the United States from Canada. Preclearance is a procedure whereby U.S. Customs, Immigration, and, where appropriate, Agriculture officials conduct their government inspections prior to departure in a foreign country, rather than on arrival here. So successful has this facilitation procedure been in Canada, that it has been extended to Bermuda and the Bahama Islands. In addition to current preclearance operations in Canada at Montreal, Toronto, Winnipeg, Calgary, and Vancouver, another Canadian city, Edmonton, should have the procedure operational later this year.

The advantages of a possible United States and Canada free trade area have been discussed in an informal manner from time to time at these ATA conferences as well as the possibility of eliminating visitor travel border control for Immigration purposes between the two countries. The latter would be accomplished by Canadian Immigration officials doing U.S. inspection requirements for travelers planning to enter the United States after first visiting Canada. The reciprocal service would be provided by U.S. officials.

For these reasons, member airlines of the Air Transport Association of America endorse the concept of North American economic interdependence, and urge that the greatest freedom of movement for travel and trade within this area be pursued. Although today Customs duties are not assessed on half of the merchandise moving between the United States and Canada, the ultimate objective would be the removal of tariffs to the fullest extent possible on all goods between the United States, Mexico, Canada, and countries of the Caribbean; and the removal of all Immigration restrictions on the movement of business and pleasure travelers between these countries. However, in the interest of effective progress it may be desirable to explore such objectives on a bilateral basis first, rather than attempting to do it multilaterally.

It would be appreciated if you would include this letter in the record of the hearings chaired by you.

Sincerely,

NORMAN J. PHILION,
Executive Vice President.

PREPARED STATEMENT OF JOSEPH HORTON, REGARDING FINANCING NORTH AMERICAN ECONOMIC COOPERATION

SPONSORSHIP

The Committee on Public Issues of the Association for Social Economics is pleased to have this opportunity to sponsor testimony regarding North American Economic Interdependence. The Association does not take organizational stands. Sponsorship, therefore, does not mean that the views expressed are those of the membership of the Association. Sponsorship by the Committee on Public Issues does, however, indicate that the Committee regards a witness's views as worthy of serious consideration by those concerned with public issues.

BIOGRAPHICAL NOTE

Joseph Horton is professor of economics and finance at Slippery Rock State College, where he joined the faculty as chairman in 1971. He earned his Ph.D. from Southern Methodist University in 1968. He has been a financial economist at the Federal Deposit Insurance Corporation and Federal Home Loan Bank Board. He has been a postdoctoral research fellow at Harvard University and has taught at the University of Maryland and the George Washington University. Dr. Horton is the author of more than fifty articles, reviews, papers and monographs.

ADDRESS AND TELEPHONE DATA

Further information regarding the views expressed in this statement can be obtained by writing Professor Horton at the Department of Economics and Business, Slippery Rock State College, Slippery Rock, Pennsylvania, 16057, or by calling him at (412) 794-7324.

DISCLAIMER

The views expressed in this statement do not necessarily reflect the views of any organization with which the author is associated.

INTRODUCTION

The economic interdependence of North America is structured around five components. These are raw materials and energy, people, education, technology, and capital. This statement considers each of these but places particular emphasis upon the capital required to finance effective cooperation among the people of North America. The theme of the presentation is that North America economic unity is a viable alternative to the formation of regional groupings within North America such as the Central American Common Market, the Caribbean Common Market, and the Eastern Caribbean Common Market.

RAW MATERIALS AND ENERGY

The traditional relationship between the United States and the rest of North America has been that the United States absorbs the raw material exports of the other countries and supplies them with manufactured goods. This has been changing, especially with regard to Canada and Mexico, in the last decade. These two countries are increasingly industrial and competitive with the United States in manufactured goods. There is every reason to believe that there will continue to be rapid development of the industrial sectors of their economies. This is especially true for Mexico, which has the potential for extraordinarily rapid economic growth financed at least in part through the export of petroleum.

The nations of Central America and the Caribbean should begin to move into the stage which Mexico currently occupies. They will make progress in lessening their dependence on raw materials and tourism. Oil refining is already a major industry in the Caribbean. Reduced dependence on raw materials exports will, however, depend critically on stable governments and a favorable attitude toward foreign investment. The economies of these nations are too small to be individually viable. Even existing common market agreements represent areas too small to allow the development of efficient domestic industrialization. International investment is particularly important to these nations. The most important single difference between most of these nations and Mexico is lack of a stable government. For many of these nations, especially the Spanish speaking ones, Mexico represents a more reliable guide to development than does the United States. Mexico is, moreover, in a particularly strong position to exercise a leadership role in this area.

Two Caribbean nations deserve special consideration. One is Cuba. There is potential for a great expansion of trade between the United States and Cuba. Such trade would be beneficial to the economies of both nations although it would be relatively much more important to Cuba because of the small size of its economy compared to the trade which would develop. Expanded trade with Cuba would be to a considerable extent at the expense of other Caribbean nations. These are, therefore, complex international relations considerations which may be more important than strictly economic factors in resolving this question.

The Bahamas is the second nation to warrant special consideration. Although technically not a Caribbean nation it is part of the North American economic unit and fits in with the Caribbean better than with other subareas. The Bahamas' special importance is as a regional, indeed a world, financial center. This special position is almost entirely an artificial creation resulting from excessive regulation of banking and finance in the United States. The continued success of the Bahamas as a financial center depends as much upon the continuation of that excessive regulation as it does on anything the Bahamas itself may do or fail to do.

PEOPLE

Except for Canada and the United States a large and rapidly growing population characterizes North America (as defined to include Central America and the Caribbean). The rapid growth of population is generally regarded as a problem. Illegal immigration from Mexico to the United States has at times strained relations between the two nations. An important part of any program to encourage the economic integration and development of North America must be some means of recognizing people as an asset rather than as a liability.

A first step in the efficient and humane treatment of people throughout North America is to allow greater freedom of movement by individuals seeking economic opportunities. Tom Johnson has demonstrated, in a paper presented last December in Mexico City to the North American Economic Studies Association, that even the illegal Mexican immigration to the United States has had a net favorable effect on the economies of both countries. Many of the other nations of North America, as defined by the Subcommittee, could also provide workers to the United States to the benefit of both nations as well as the workers themselves. The United States is, however, far from being alone in imposing excessive restrictions on the employment of foreigners. All nations in the area would benefit from the mutual relaxation of such restrictions. The restrictions themselves are based on outmoded ideas and fears of unemployment which recent economic research has shown to be invalid.

EDUCATION

One way in which a rapidly growing population is an advantage is that it provides an opportunity to raise the average level of education of a nation's people very rapidly. It is essential, of course, that education be provided to the young for this policy to work. Education improves the productivity as well as the quality of life of those who receive it. It also confers substantial external benefits ranging from a more productive and flexible work force to people more capable of democratic government.

In the United States education is considered so important to all of society that it is treated as a public good. This means that it should receive substantial public support. It does not mean that it must be provided by the government. On the contrary, diversity of educational institutions including church (with both a capital and a small c), secular private, and government schools are probably desirable at the present time. Public financial support should be provided to students attending each of these, but public regulation should be restricted to government owned institutions. Ideally government owned institutions would act as a backup system to insure that any students not served by other schools receive a quality education.

If North America is to be a single economic unit, the public good nature of education means that the education of children who happen to live in the other nations of North America is important to citizens of the United States. Moreover, the United States is in a position to perform an important service in the educational field. It has the most highly developed educational system in North America. Moreover, it, unlike Mexico, Central America, and the Caribbean islands, has a declining school population.

The United States together with the other nations of North America should encourage adequate financing of schools and freedom of movement of both students and teachers to maximize the educational opportunities available to all of the children of North America.

At the college and graduate school level the United States, and to an increasing degree Canada and Mexico, provide leadership to the area. The United States seems to have a natural advantage at the present time as declining enrollments provide the capacity to educate substantial numbers of students at a time when institutions to the south have excessive enrollments. The cost to the United States of educating additional students is very small. The benefits to all of us in North America are great. A special effort should be made to make college education available to the brightest students from throughout North America regardless of their financial means. The opportunity to study in the United States should be limited only by intellectual ability, not financial ability.

Greater opportunities should be provided for United States professors to teach in other nations at salaries competitive with those of United States colleges and universities. The public good benefits of higher education argue for this just as much as for assisting students from other nations to study in the United States. The advantages to the United States of having professors who have lived and taught in the other nations of North America are even greater. More adequate funding, by a factor of ten or more, should be provided for Fulbright and similar programs directed to North America. Special emphasis should be placed upon the English speaking southern nations, since the preponderance of United States faculty members would be most effective there. Financial support for international meetings of associations interested in the economic interdependence of North America would be an important contribution to research and understanding to achieve the goal set by this Subcommittee.

TECHNOLOGY

The transfer of technology is largely the result of education combined with the new plant and equipment required to use the latest technology. The current relatively low state of industrialization in most of southern North America and the youth of its population can be turned to advantage. Any plant built there can embody the latest technology. As young people are educated they will learn the latest technology. The average state of technology in these countries is likely to be higher than that of the United States as they expand their industrial base.

The free flow of goods and ideas is as important as freedom of movement of individuals if the full economic potential of our southern neighbors is to be realized. Present United States policy, like that of other nations in the area, is a substantial barrier to the industrialization of the smaller nations of North America. Restrictive and unpredictable tariffs and quotas impede progress in these nations.

Productivity is limited by the extent of the market. Workers and businesses in these nations must have access to a large market like that of the United States if they are to make the best use of modern technology and raise their standards of living. Our current programs which allow reduced tariffs or duty free imports only until a firm becomes successful is an impediment to the economic development of other nations. It is like standing in the doorway tempting a hungry man with a piece of steak and then slamming the door on his hand if he succeeds in grasping the steak.

A less restrictive trade policy will help United States consumers through lower prices and greater competition. Opposition to imports seems to stem from antiquated ideas about the causes of unemployment. Economic analysis clearly shows that the net benefits from unimpeded trade are positive. We should no longer allow special interest groups to stand in the way of a better life for consumers and workers throughout North America.

CAPITAL AND FINANCE

In addition to greater freedom of movement for people and ideas capital must be free to move where it is most productive to maximize the standard of living of the people of North America. Businessmen have a strong incentive to invest where investments are most productive because this tends to be where they are most profitable. Restrictions on investment by citizens of other nations, limitations on currency convertibility, and similar policies inhibit investment in many nations. The United States could usefully work with other nations to reduce these impediments to economic development.

Greater reliance on private business rather than government or international agencies in financing economic development would be likely to make more effective use of capital. The highly developed financial institutions and markets of the United States are particularly well suited to serve the needs of the entire North American area. Securities and Exchange regulations which inhibit the use of United States financial markets and excessive regulation of banking should be modified to accommodate foreign business practices.

Government financing should be limited to projects which clearly exhibit externalities. Education is probably the most important such investment. Imperfections in the capital market make it difficult for an individual to finance his education through debt, especially when he is attending school in a foreign country.

A North American Educational Free Trade Area could be a first step in this direction. Every citizen of a North American nation would have the same rights as a citizen of the nation (province or state) in which he attends school. He would be eligible for the same financial aid as such citizens. Federal government financing would be required to make this a viable system. Ideally cooperative agreements would be worked out with other nations. However, unilateral action by the United States would be preferable to no action.

SUMMARY

There are great opportunities to improve the standard of living of the people of North America. The smaller nations of the area especially stand to gain from these opportunities. The essential requirements are to improve productivity by increasing the size of the market, to encourage investment where it is most productive, and to facilitate the movement of workers to productive employment. The achievement of each of these goals requires that governments reduce the barriers which they have established to inhibit the free movement of people, capital, and ideas among the nations of North America. The United States has a special opportunity to play a leadership role in education and in financing the development of the area.

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July 12, 1979

Mr. Michael Stern, Staff Director
SENATE COMMITTEE ON FINANCE
Room 2227
Dirksen Senate Office Building
Washington
DC 20510

Dear Mr. Stern,

With respect to the recently held hearings under Sen. Max Baucus on North American Interdependence, the enclosed paper on World Competition for the U.S. 806/807 Market may be of use.

I am aware that it is late, but believe the contents merit attention.

Very truly yours,

Richard L. Bolin
Director

Enclosure
rlb/bjb

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THE PURPOSE OF THE FLAGSTAFF INSTITUTE - A NON-PROFIT CORPORATION

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Editor: Jon D. Ozmun

WORLD COMPETITION FOR THE U.S. 806/807 MARKET

By Richard L. Bolin

An estimated 90,000 new factory jobs were created in less developed countries (LDC's) in 1978 to serve the U. S. market for labor-intensive goods produced with United States components under sections 806.30/807 of the U.S. Tariff as LDC exports of dutiable value increased by $450 million to $2176 million.

The economic and political effects of these new jobs are significant in the LDC's. The economic effect is that each new direct job in manufacturing creates about $5000 per year of new exports and $10,000 per year of new gross national product, and results in about two additional indirect jobs for each factory job. The political effect is that three jobs are created, primarily among the unskilled population where unemployment is highest and the need for spreading wealth is greatest. The politicians who can claim to have created these three jobs expect a return at the ballot box.

Among those less developed countries which realize how the process works, competition is now intensifying, even while the US market for such labor inputs grows by leaps and bounds. The purpose of this article is to show through statistics from the Flagstaff Institute Databank the market share and growth rates of LDC's involved in the competition during 1972-1978, and to show further the product line competition which is occurring among Western Hemisphere LDC's supplying the US market.

DEFINITIONS

Under 806.30, U.S. metal components may be shipped abroad for further processing, and when the article is returned to the United States, the value of the components shipped out is deducted from the value of the product on its return in calculating Dutiable Value. The only restriction is that further processing must occur in the United States after the goods are returned.

Under Article 807, U.S. components may be shipped abroad for assembly and on their return the value of the U.S. components is deducted from the value of the finished products in calculating Dutiable Value. The steps permitted in assembly are carefully defined and controlled by U.S. Customs under Article 807, but no further processing in the U.S. after the goods are returned is required.

Under 806/807, "Dutiable Value" is carefully defined and has a narrow meaning, but in economists terms, "Dutiable Value" means "value added abroad."

MARKET SHARE AND GROWTH BY WORLD AREA

The United States purchased $2.5 billion of dutiable value under 806/807 from the rest of the world in 1972. By 1978, this figure had risen to $7.2 billion, growing at an average rate of 19% per year.

Advanced Nations

The advanced industrial nations of the Western world, 26 in number (including Japan), sold us $2.0 billion in 1972, and $5.0 billion in 1978, growing at an average rate of 16% per year. In 1978, the advanced nations sold us ten dollars of dutiable value for each dollar of U.S. components they used under 806/807, reflecting the high proportion of foreign automobiles entering the U.S. market from Germany, Japan, Sweden, France, and Italy, to which United States-made tires are assembled.

Less Developed Countries

The less developed countries of the world supplied $0.5 billion of dutiable value in 1972, and $2.2 billion in 1978, growing at an average rate of 26% per year. The LDC's use about one dollar of U.S. components for each dollar of dutiable value they supply, and thus consume ten times the value of U.S.-made products per unit of dutiable value supplied as do the advanced nations. Furthermore, LDC's are growing 10% per year faster than the advanced nations in their purchase of US components.

Among the less developed countries, those in Asia supplied 53% of the 1978 dutiable value, while Western LDC's accounted for 45%. Since 1972, Asian LDC's have grown at an average of 23% per year, while Western LDC's have grown at 31%.

AREA	LDC MARKET SHARE DUTIABLE VALUE 1978		AVERAGE GROWTH RATE 1972-1978 % PER YR.
	$ million	%	
ASIA	1147	53	23
Taiwan	393	18	16
Singapore	193	9	19
Malaysia	188	9	90
Hogg Kong	182	8	16
Korea	118	5	31
Philippines	73	3	52
WESTERN	977	45	31
Mexico	715	33	27
Brazil	123	6	77
Caribbean	66	3	25
Haiti	29	1	33
Central America	64	3	66
El Salvador	44	2	119
Northern South America	9	-	50
OTHER	52	2	61
TOTAL	2176	100	26

COMPETITION AMONG NEARBY WESTERN HEMISPHERE LDC'S

Those nearby Western Hemisphere LDC's which have advantages of geographical position, low labor cost, suitable infrastructure, and the initiative to do something about development are actively participating in the U.S. 806/807 market.

Brazil, while a significant supplier of 806/807 dutiable value, behaves more like an advanced nation than a less developed country, supplying in 1978 $6.50 of dutiable value for each dollar of U.S. components, and exporting primarily radios, televisions, and automobiles. The remaining LDC's active in the market are all north of the equator and exhibit a one to one ratio between dutiable value and U.S. value. These are the countries in which unskilled labor is being made available to supply the U.S. market under 806/807. We have eliminated Brazil from this analysis and will concentrate only on the nearby countries north of the equator in the Western Hemisphere.

The top fourteen countries' dutiable value exports are analyzed by major product group for the years 1972 and 1978 in Table I; the top eight countries' market share in 1972 and 1978 is also shown.

MEXICO

Mexico clearly dominates the market in all sectors. During the last six years, however, its overall market share has declined from 89% to 84%. It has lost market share to El Salvador, the Dominican Republic, and Colombia, while Haiti, Costa Rica, and Barbados have maintained their 1972 positions. On the other hand, Jamaica dropped from 4% of the overall market in 1972 to 1% in 1978.

Mexico held its strong position in electrical/electronics products which quintupled during the period, but lost 14% of the overall textiles/garments market, principally to the Dominican Republic, Haiti, Costa Rica, and El Salvador. Admittedly, U.S. garment quotas have interfered with free development in this industry. But even in the much smaller market of sporting goods, games and toys, where no U.S. quota system exists, Mexico lost market share to Haiti.

Mexico's domination of the northern half of the Western Hemisphere is so great that it is the logical target for the competition. Its proximity to the United States has given Mexico great advantage in point of use of lower cost truck transportation and frequency of service. It has been in the 806/807 business longer than others, and can exploit its proximity as well as its existing infrastructure of 806/807 plants to grow at overall competitive costs. The wages along the Mexican border are in the neighborhood of $1.20 to $1.50 per hour actually worked including fringes for unskilled labor, and are thus relatively high with respect to the other LDC's in the northern part of the Western Hemisphere. However, Mexico is attempting to develop more business in its interior where the wages are considerably lower and quite competitive with those of the higher cost competition such as Barbados and the Dominican Republic.

The outlook for Mexico is continued growth of border industries at a very high rate and somewhat slower development of the interior provided that Mexico improves its infrastructure, maintains relatively low wage rates, and stays

TABLE I

LDC SUPPLIERS OF 806/807 DUTIABLE VALUE IN THE NORTHERN HALF OF THE WESTERN HEMISPHERE, DUTIABLE VALUE AND MARKET SHARE BY MAJOR PRODUCT GROUP

DUTIABLE VALUE $ MILLION	TEXTILES/ GARMENTS		ELECTRICAL/ ELECTRONICS		SPORTING GOODS GAMES, TOYS		OTHER		TOTAL		AVERAGE GROWTH RATE 1972-1978, % PER YR.
	1972	1978	1972	1978	1972	1978	1972	1978	1972	1978	
MEXICO	14.1	46.1	102.1	467.9	14.9	20.9	39.8	180.4	171.0	715.3	27
EL SALVADOR	0.4	8.8	0	32.1	0	0.5	0	2.9	0.4	44.4	119
HAITI	1.5	11.0	5.0	5.8	2.5	8.5	0.7	3.4	5.2	28.7	33
DOMINICAN REPUBLIC	-	14.8	0.2	4.3	0	0.5	-	0.5	0.3	20.0	97
COSTA RICA	1.4	10.1	0.3	2.0	0	0	-	0.2	1.7	12.3	39
BARBADOS	0.7	4.2	1.1	5.7	0.1	0	0.5	0.9	2.3	10.8	29
COLOMBIA	0.8	7.9	-	-	0	0.3	-	-	0.8	8.2	47
JAMAICA	5.3	4.0	0.8	0	0.7	-	0.9	0.3	7.0	4.2	(-)
NICARAGUA	0.1	3.1	0	0	0	0.4	0	-	0.1	3.5	81
BELIZE	0.6	2.4	0	0	0	0	0	0	0.6	2.4	26
HONDURAS	0.3	1.0	-	0.1	-	0.1	0	0.1	0.3	1.3	28
GUYANA	0	0.9	0	0	0	0	0	-	0	0.9	(+)
TRINIDAD	0.7	0.5	0.4	-	0	0	0	0	1.2	0.5	(-)
ST LUCIA	0	0.2	0	0.1	0	0	0	0.2	0	0.5	(+)
OTHER CARIBBEAN	-	0.3	1.4	0.4	0.2	0	0.8	-	1.5	0.7	(-)
TOTAL	25.9	115.3	111.3	518.4	18.4	31.2	42.7	188.9	192.4	853.7	28
MARKET SHARE, PER CENT OF AREA EXPORTS OF DUTIABLE VALUE											
MEXICO	54	40	92	90	81	67	93	96	89	84	27
EL SALVADOR	2	8	0	6	0	2	0	2	-	5	119
HAITI	6	10	4	1	14	27	2	2	3	3	33
DOMINICAN REPUBLIC	-	13	-	1	0	2	-	-	-	2	97
COSTA RICA	5	9	-	-	0	0	-	-	1	1	39
BARBADOS	3	4	1	1	1	0	1	-	1	1	29
COLOMBIA	3	7	-	-	0	1	-	-	-	1	47
JAMAICA	20	3	1	0	4	-	2	-	4	-	(-)
ALL OTHER	7	6	2	1	1	2	2	-	2	3	(-)
TOTAL	100	100	100	100	101	101	100	100	100	100	

competitive in its incentives.*

CENTRAL AMERICA

The seven Central American countries supplied only 3% of total LDC dutiable value sold to the United States in 1978, but the area has grown rapidly at 66% per year during the past six years. Table II shows the changes in dutiable value and market share which have occurred. Market share is shown as percentage of total Central America exports of dutiable value in order to magnify the changes.

El Salvador

El Salvador has dominated Central American growth during the last six years, achieving 69% of regional exports to the U.S. of 806/807 dutiable value of 1978. Most of its growth has come in the electrical/electronics field in semiconductors, although it has also increased its market share in textiles/garments. With a minimum wage of about $0.60 per hour actually worked, El Salvador has been highly competitive in recent years. About 9,000 new jobs have been created in export industries since 1972, and there is a very large supply of unemployed young workers available.

Costa Rica

Costa Rica grew at 39% per year during the last six years but lost market share from 55% in 1972 down to 19% in 1978 due to the successful development of El Salvador. While it more-or-less held its market position in textiles and garments, Costa Rica lost considerably in the electrical/electronics field. Its labor force is abundant and competitively priced with that of El Salvador.

Others

Nicaragua, Belize, and Honduras, are all very small suppliers of 806/807 dutiable value, while Panama and Guatemala are not yet active.

THE CARIBBEAN

There are nineteen entities among the Caribbean Islands which have the potential to supply 806/807 dutiable value to the U.S. Market. Of these, only three are important, as shown in Table III. Haiti, the Dominican Republic, and Barbados, among them accounted for 92% of all 1978 exports of dutiable value from the Caribbean. The area as a whole grew at 25% per year from 1972 to 1978, and achieved total exports at the end of the period roughly equal to those of Central America (about 3% of total LDC exports to the United States of Dutiable Value).

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* for further detail on Mexico's in-bond assembly programs prospects, see Mr. Bolin's other paper "Mexico Forecast: Outlook for In-bond Assembly Programs" beginning on page 11 of this issue.

TABLE II

CENTRAL AMERICA, 806/807 DUTIABLE VALUE AND MARKET SHARE, 1972-1978

DUTIABLE VALUE $ MILLION	TEXTILES/ GARMENTS		ELECTRICAL/ ELECTRONICS		SPORTING GOODS GAMES, TOYS		OTHER		TOTAL		AVERAGE GROWTH RATE 1972-1978, % PER YR.
	1972	1978	1972	1978	1972	1978	1972	1978	1972	1978	
EL SALVADOR	0.4	8.8	0	32.1	0	0.5	0	2.9	0.4	44.4	119
COSTA RICA	1.4	10.1	0.3	2.0	0	0	-	0.2	1.7	12.3	39
NICARAGUA	0.1	3.1	0	0	0	0.4	0	-	0.1	3.5	81
BELIZE	0.6	2.4	0	0	0	0	0	0	0.6	2.4	26
HONDURAS	0.3	1.0	-	0.1	-	0.1	0	0.1	0.3	1.3	28
PANAMA	-	-	0	0	0	0	0	0	-	-	-
GUATEMALA	-	-	0	0	0	0	0	0	-	-	-
TOTAL	2.8	25.5	0.3	34.2	0	1.0	-	3.3	3.1	63.9	66

MARKET SHARE, PER CENT OF CENTRAL AMERICAN 806/807 EXPORTS OF DUTIABLE VALUE	TEXTILES/ GARMENTS 1972	TEXTILES/ GARMENTS 1978	ELECTRICAL/ ELECTRONICS 1972	ELECTRICAL/ ELECTRONICS 1978	SPORTING GOODS GAMES, TOYS 1972	SPORTING GOODS GAMES, TOYS 1978	OTHER 1972	OTHER 1978	TOTAL 1972	TOTAL 1978
EL SALVADOR	15	35	1	94	0	55			14	69
COSTA RICA	50	40	97	6	0	-			55	19
NICARAGUA	3	12	0	0	0	36			3	5
BELIZE	21	9	0	0	0	0			18	4
HONDURAS	10	4	2	-	0	9			9	2
PANAMA	0	-	0	0	0	0			-	-
GUATEMALA	0	-	0	0	0	0			-	-
TOTAL	99	100	100	100	0	100			99	99

TABLE III

THE CARIBBEAN, 806/807 DUTIABLE VALUE AND MARKET SHARE, 1972 - 1978

DUTIABLE VALUE $ MILLION	TEXTILES/ GARMENTS		ELECTRICAL/ ELECTRONICS		SPORTING GOODS GAMES, TOYS		OTHER		TOTAL		AVERAGE GROWTH RATE 1972-1978, % PER YR.
	1972	1978	1972	1978	1972	1978	1972	1978	1972	1978	
HAITI	1.5	11.0	5.0	5.8	2.5	8.5	0.7	3.4	5.2	28.7	33
DOMINICAN REPUBLIC	-	14.8	0.2	4.3	0	0.5	-	0.5	0.3	20.0	97
BARBADOS	0.7	4.2	1.1	5.7	0.1	0	0.5	0.9	2.3	10.8	29
JAMAICA	5.3	4.0	0.8	0	0.7	-	0.9	0.3	7.0	4.2	(-)
TRINIDAD	0.7	0.5	0.4	-	0	0	0	0	1.2	0.5	(-)
ST LUCIA	0	0.2	0	0.1	0	0	0	0.2	0	0.5	(+)
12 OTHERS	-	0.3	1.4	0.4	0.2	0	0.8	-	1.5	0.7	(-)
TOTAL	8.3	34.9	4.5	16.5	3.5	9.0	2	5.2	17.5	65.5	25

MARKET SHARE, PER CENT OF CARIBBEAN 806/807 EXPORTS OF DUTIABLE VALUE	TEXTILES/ GARMENTS 1972	TEXTILES/ GARMENTS 1978	ELECTRICAL/ ELECTRONICS 1972	ELECTRICAL/ ELECTRONICS 1978	SPORTING GOODS 1972	SPORTING GOODS 1978	OTHER 1972	OTHER 1978	TOTAL 1972	TOTAL 1978
HAITI	18	31	11	36	73	95			29	44
DOMINICAN REPUBLIC	1	42	5	26	-	5			2	31
BARBADOS	8	12	24	35	2	0			13	17
JAMAICA	64	11	18	0	20	-			40	6
TRINIDAD	9	1	10	-	0	0			7	1
ST LUCIA	0	-	-	1	0	0			0	1
OTHERS	-	1	31	2	5	0			9	1
TOTAL	100	98	99	100	100	100			100	101

Haiti

Haiti, with a 1979 wage rate of $0.21 per hour actually worked including fringe benefits for unskilled labor in garments and $0.27 per hour in the electronics industry, increased its Market Share from 29% to 44% of Caribbean exports during the 1972-1978 period. Growth was balanced in all of the product groups studied, and overall growth was 33% per year. Because of Haiti's extremely low wage rate and its relative stability, it is expected to continue at a high rate of growth in the near term.

Dominican Republic

In point of growth rate, the Dominican Republic, at 97% per year, was the star performer, In 1978 it enjoyed 31% of the overall market, having made most of its gain in textiles/garments. The current minimum industrial wage, including fringes, is $0.70 per hour actually worked, which is comparable with the very lowest wages in the interior of Mexico and should assure continued growth to the Dominican Republic in its present markets.

Barbados

Barbados exhibited moderate growth of 29% per year during the period 1972-1978 and increased its market share from 13% to 17%. Barbados is strong in the electrical/electronics industry and competitive in textiles/garments. Its current minimum wage is $0.89 per hour actually worked including fringes, which is somewhat higher than most of the other Caribbean suppliers. However, it has a continuous 20-year record of attracting industry and a sophisticated industrial development organization aiming for higher technology industries. Barbados' stability and general tourist attractiveness should permit it to sustain its recent growth rate.

Jamaica, Trinidad, St. Lucia

Jamaica has experienced a significant loss of market share during 1972-78, from 40% of the market to 6%. Trinidad, never an important factor, is now only a very small supplier of 806/807 dutiable value. St. Lucia is an example of a country entering the 806/807 market and achieving a modest market share. The potential for other islands in the Caribbean to emulate St. Lucia in the coming decade is considerable but the present share of all other islands put together is only 1% of the Caribbean dutiable value output.

NORTHERN TIER SOUTH AMERICA

The five countries which form the "top" of South America are only beginning to enter the 806/807 Dutiable Value market. They currently supply only 0.4% of the total LDC supply of dutiable value to the U.S., and almost all of this comes from Colombia in the form of textiles/garments as shown in Table IV. Guyana entered the market in a modest way during the 1972-1978 period, but the remaining countries have yet to do so. Colombia's wages are about $0.40 per hour actually worked, which should make it an effective competitor. It is handicapped by being somewhat more distant from the United States, as are the others in this group. While Venezuela continues to have unemployment, its wage rates are related to its petroleum economy and perhaps non-competitive with the others for this reason. The remaining areas are all potential participants in the competition for the U.S. 806/807 market during the next decade.

CONCLUSIONS

As expected growth of the U.S. market continues, the nearby countries in the northern half of the Western Hemisphere have an outstanding opportunity during the next ten years to increase their export of dutiable value under 806/807 to the United States. Mexico has shown the way during the past decade, followed by the examples of El Salvador, Haiti, and the Dominican Republic.

Some 18 entities in the region have not yet begun to participate in the market and another 7 , taken together, account for only 2%. Only 7 countries are presently active and these account for 98% of dutiable value exports from the region.

All LDC's in the region will face high unemployment and lack foreign exchange during the 1980's. The outlook is for continued competition to export dutiable value to the U.S. under 806/807.