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COMMERCE DEPARTMENT CONFERENCE ON MEXICO'S MAQUILADORA PROGRAM

STATEMENT OF
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BEFORE THE

SUBCOMMITTEE ON COMMERCE,
TRANSPORTATION, AND TOURISM
HOUSE COMMITTEE ON ENERGY AND COMMERCE

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss Commerce Department efforts to promote U.S. firms' participation in Mexico's Maquiladora program. The Maquiladora program, through which the Mexican government provides incentives to attract foreign direct investment to Mexico, was established in 1965. The Expo-Maquila'86 conference held last week in Acapulco, however, represented Commerce's first effort to stage an organized event for this program. Other than this conference, Commerce's most notable recent efforts to promote U.S. investment overseas have been conducted as part of the Caribbean Basin Initiative, an important aim of which is to increase investment in beneficiary countries.

COMMERCE PARTICIPATION IN EXPO-MAQUILA'86

A recent upsurge in U.S. business interest in the Maquiladora program served as the impetus for the Expo-Maquila'86 conference. Commerce's Foreign Commercial Service (FCS) staff at the U.S. embassy in Mexico and the staff of the Mexico desk at Commerce headquarters had been receiving a growing number of requests for information and assistance from American firms interested in establishing maquiladora plants. In response to these requests, the FCS staff, in consultation with Commerce staff at the U.S. Trade Center in Mexico City, proposed a conference on the Maquiladora program for U.S. firms. They cabled Commerce headquarters on January 24, 1986, requesting authority to hold such a conference, and Commerce headquarters cabled its approval on February 20, 1986.

Through Expo-Maquila'86, Commerce aimed to convey the benefits of the Maquiladora program and to give U.S. firms the opportunity to obtain technical information about establishing and operating maquiladora plants. In addition to presentations on the advantages of establishing maquiladora plants, the conference featured information on Mexican government regulations; site selection and plant construction; personnel search and Mexican labor policies and practices; banking, insurance, and accounting practices; and U.S. and Mexican customs regulations. The conference also included exhibits by Mexican industrial park managers, customs brokers, attorneys, Mexican and U.S. local-government officials, and companies that supply materials for maquiladora plants.

The FCS and Trade Center staffs and the Mexican public relations firm of Montenegro, Saatchi, Saatchi, Compton organized the Expo-Maquila'86 conference. The FCS staff obtained the speakers. The Trade Center staff arranged for exhibitors by contacting about 1,000 organizations in Mexico and the United States from a list which they had developed over several years. The staff sold all 90 exhibition booths available, about two-thirds to Mexican organizations and one-third to U.S. organizations. The Mexican public relations firm recruited participants for the conference by sending three mailings to a list of 39,000 prospective participants from industries that have shown the greatest interest in establishing maquiladora plants, including automotive and electronics. The list of prospective participants was compiled by Dun & Bradstreet using Standard Industrial Classification codes (i.e., codes developed by Commerce to categorize firms by industry). The public relations firm included in the third mailing a promotional brochure, which was developed by the firm and approved by the FCS and Trade Center staff in Mexico. A Trade Center official, who told us that the brochure featured the benefits of the Maquiladora program to attract participants to the conference, also said that the U.S. government officials rejected two earlier drafts and instructed the public relations firm to "tone down" the flyer's promotional aspects. As of November 26, 1986, the conference was fully reserved, with 350 participants who paid $325 each to attend, and had a waiting list of about 70 individuals. About 70 percent of the participants represented U.S. organizations.

Commerce anticipates that Expo-Maquila'86 will generate a revenue surplus. This conference was allotted $166,842 for "direct project costs" (i.e., all expenses, including the public relations firm's fee but excluding salaries of government officials[1]), as follows.

Travel and transportation	$31,238
Rent, communications, and utilities	4,197
Printing	37,880
Contract personnel	9,913
Market promotion	67,728
Design	2,497
Exhibit supplies	625
Hospitality	7,501
Exhibition installation/dismantling	3,960
Other	1,303
Total	$166,842

Commerce paid the direct project costs for the conference from an account established for its "reimbursable program." This account is financed by fees paid by exhibitors and participants in Commerce-sponsored trade shows. Anticipated gross revenues from Expo-Maquila'86 total $248,750 ($135,000 in exhibition revenues and $113,750 in participation fees). These figures may change once all expenditures and receipts have been accounted for.

Net receipts (or "profits") thus were projected at $81,908. The original arrangement between Commerce and the public relations firm called for each to receive 50 percent of the net receipts. When Commerce discontinued its participation in the conference in compliance with a restriction in the fiscal year 1987 Continuing Resolution, it turned the entire event over to the public relations firm. In line with the increased responsibilities of the firm for managing the event, Commerce

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[1]The FCS and Trade Center staff estimate that they devoted about 28 work weeks to the conference.

agreed to an new arrangement whereby the firm will receive 80 percent of the net proceeds and Commerce will receive 20 percent.

Since Expo-Maquila'86 was held just last week, we could not assess in time for this hearing the impact of the program on participants' deliberations regarding the establishment of maquiladora plants. However, in an August 1986 report on firms investing in Caribbean Basin countries, Caribbean Basin Initiative: Need for More Reliable Data on Business Activity Resulting From the Initiative (GAO/NSIAD-86-201BR), we reported that Commerce's promotional activities can influence participants' decisionmaking. Many of the firms we contacted that had been influenced by the Initiative to establish or expand operations in beneficiary countries cited the program's promotional aspects as a factor in their decisions. These promotional aspects include, among other things, trade missions and technical assistance programs.

EVOLUTION OF THE MAQUILADORA PROGRAM

Questions regarding Commerce's participation in Expo-Maquila'86 reflect, at least in part, a concern that the Maquiladora program has evolved beyond its initial objective of attracting sub-assembly operations. Due to the relatively short time frame of our inquiry for the Subcommittee, we could not conduct an exhaustive study of the Maquiladora program. Our analysis is based largely on information obtained from studies and individuals identified as highly knowledgeable about the program. We interviewed U.S. and Mexican government officials, consultants and academics knowledgeable about the program, and officials of 10 firms that have recently established maquiladora plants. We also reviewed U.S. government and private sector studies and articles on the Maquiladora program and the record of testimony on the program recently presented before the Subcommittee on Economic Stabilization, House Committee on Banking, Finance and Urban Affairs.

The Mexican government initiated the Maquiladora program in 1965 to generate economic development and employment along Mexico's economically depressed northern border by attracting sub-assembly operations. Under the program, the government permits plants to import raw materials, components, and machinery free of Mexican import duties (i.e., "in-bond"), with the stipulation that the plants export most of their output. U.S. firms with maquiladora operations also benefit from U.S. Tariff Schedules 806.3 and 807. Under these provisions, customs duties on imports of goods assembled from U.S. components are levied only on the foreign value-added (i.e., on the total value of the imports less the value of U.S.-origin parts). Starting in 1972, firms could also establish maquiladora plants in the interior of Mexico. In 1973, the Mexican government issued regulations allowing 100 percent foreign ownership of approved maquiladora plants, an exception to the general rule limiting foreign investors to 49 percent ownership of Mexican companies. In 1983, the Mexican government began permitting certain maquiladora plants to sell up to 20 percent of their output in Mexico.

The greatest increase in activity under the Maquiladora program, however, came after the devaluation of the peso in 1982 and continued with subsequent devaluations. While the pre-1982 wage differential between U.S. and Mexican labor was significant, later devaluations have made Mexican labor considerably less costly. Even after several increases in the Mexican minimum wage, the minimum wage in maquiladora plants according to information provided by the U.S. embassy in Mexico is about $4.42 a day. The per-employee annual wage differential between U.S. and Mexican employees performing the same work is reportedly $15,000 to $20,000. Firms we contacted that have recently established maquiladora plants almost unanimously cited the wage rate differential as a primary reason for their decisions to invest.

The Maquiladora program, which at the end of 1965 had only 12 operating plants employing about 3,000 workers, has become one of the most important sectors of the Mexican economy. According to the economic section of the U.S. embassy in Mexico, the Maquiladora program had grown by 1982 to 588 plants employing 122,493 workers and by 1984 to 789 plants employing 217,544 workers. This growth came largely in the automotive and electronics sectors. Value-added in maquiladora plants increased approximately 63 percent, from about $1.38 billion in 1982 to about $2.25 billion in 1984. The Maquiladora program is now second only to exports of oil and petroleum as a generator of foreign exchange for Mexico. According to information provided by the U.S. embassy in Mexico, some observers project that, if existing constraints can be overcome, the Maquiladora program could grow by 1995 to 1,500 plants employing a million workers.

There also has been a recent trend in the program toward greater sophistication of production processes and greater complexity of products, particularly in electronics and automotive plants. At first, maquiladora plants were virtually all light-industry, sub-assembly operations producing relatively simple components for export to the United States. These plants used unsophisticated assembly techniques, requiring unskilled or, at most, semi-skilled labor. Although the Maquiladora program continues to be dominated by these types of operations, some plants now use more sophisticated, and in some cases state-of-the-art, assembly processes, requiring workers with a higher level of skills. For instance, we understand that a maquiladora plant producing ceramic computer-chip carriers using non-electrolytic plating is one of the few of its kind outside Japan. Some firms have also become more vertically integrated; they conduct manufacturing (as opposed to only sub-assembly) operations, sometimes using capital-intensive production techniques. As a consequence, some plants, particularly in the automotive industry, have established heavy-industry facilities, such as metal fabrication operations. For instance, we were told that one automobile engine plant has a robot production line for preparing engine blocks, which are then completed using a more traditional labor-intensive assembly process. Reflecting these developments in the types of maquiladora plants, several now produce relatively complex components while others produce completed products ready for retail sale. We understand, however, that with very few exceptions all output from U.S.-owned maquiladora plants, including finished products, is exported to the United States.

There are constraints on the continued development of the Maquiladora program. One important constraint is the limited ability of Mexican firms to supply raw materials and inputs to maquiladora plants. While major multinational corporations routinely rely on worldwide sources of supply, smaller firms establishing vertically integrated manufacturing operations in Mexico would generally rely on local sources of supply. However, the Mexican government's "infant industry" policy of erecting high tariffs to protect domestic firms has reportedly resulted in the creation of inefficient producers. As a consequence, Mexican firms have difficulty in meeting the price, quality, and delivery requirements of maquiladora plants and currently supply less than 2 percent (mostly packaging material and janitorial supplies) of the materials used by these plants. The other important constraint is the shortage of skilled labor. Although the skill level of the Mexican work force has improved over the 21-year existence of the Maquiladora program, there continues to be a shortage of skilled Mexican labor, particularly technical and mid-level management personnel.

Infrastructure limitations also constrain the continued development of the Maquiladora program. Problems which continue to be acute in some locations include overburdened telephone and communications services, power outages, inadequate water supplies, inadequate housing, and poor transportation. Also, shipping products across the border can pose problems.

IMPACT OF FISCAL YEAR 1987 CONTINUING RESOLUTION ON COMMERCE OPERATIONS

In response to the concern raised in your letter, we assessed whether Commerce could "circumvent" the restriction contained in the fiscal year 1987 Continuing Resolution by using private sector funds. Commerce's fiscal year 1987 appropriation for the International Trade Administration (ITA) contains the following restriction.

> "none of the funds appropriated herein may be used for activities associated with conferences, trade shows, expositions, and/or seminars which feature or convey the advantages of relocating U.S. industries, manufacturing and/or assembly plants, or companies, in a foreign country" (Underscoring added.)

We read the word "herein" to mean the funds appropriated to ITA by that same paragraph of the Continuing Resolution. ITA also holds funds in a "reimbursable program" account which were not appropriated by the Continuing Resolution. Because these funds derive from private sources and are held in a separate account, they technically are not covered by the restriction. Nevertheless, we have no indication that Commerce has used or intends to use this account in a manner inconsistent with the restriction.

However, in the course of reviewing this issue, we have tentatively identified a greater concern about Commerce's use of this account. Specifically, we have reservations about Commerce's authority to maintain a separate account to receive fees obtained from the private sector. Unless an agency has specific statutory authority to establish a revolving fund, any reimbursements or payments under contracts or fees obtained from private sector sources must be turned over to the Treasury as miscellaneous receipts. As we discussed with your staff, we have not concluded our study of this matter.

We also found that a relatively narrow Commerce interpretation of the 1987 Continuing Resolution prohibition allowed Commerce staff to participate in a Caribbean Basin Initiative Conference during November 1986 that, similar to Expo-Maquila'86, appealed to U.S. firms to invest overseas. After passage of the Continuing Resolution, ITA management sought legal guidance from Commerce's Office of General Counsel on steps it should take to comply with the prohibition. Based on discussions with General Counsel staff, memoranda were issued stating that:

> "The Office of General Counsel informs us that from a program standpoint activities are considered similar [to Expo-Maquila'86] if: (1) they feature relocation of U.S. industry, manufacturing and/or assembly plants to foreign countries and, (2) [Commerce] participation and support is such that it contributes substantially to the particular event."

Based on this guidance, ITA staff participated in the Miami Conference on the Caribbean and Caribbean Basin Investment Exposition held during November 16 to 20, 1986. This conference met Commerce's guidelines. It did not feature *per se* the relocation of U.S. plants overseas. Also, this conference was staged by a private sector organization; we understand that ITA staff participation was limited to manning an exhibit booth on ITA export services, making presentations, and attending various sessions and seminars.

Commerce's interpretation of the prohibition, however, appears narrow. The provision prohibits Commerce from using appropriated funds for activities "associated with conferences that . . . feature or convey the advantages of relocating" U.S. plants overseas. (Underscoring added.) The use of the term "associated with" appears to indicate that the agency's participation need not contribute substantially to the event. In addition, the use of the term "convey" appears to indicate that the conference need not "feature" relocation of U.S. plants as a major topic to be covered by the prohibition. ITA staff acknowledge that speakers made presentations regarding establishing sub-assembly operations in Caribbean countries. These presentations included discussion of Tariff Schedules 806.3, 807, and 807(a), the latter being a special program to encourage the establishment in Caribbean countries of sub-assembly plants producing apparel from U.S.-made cloth.

We have reviewed with your staff conference materials that convey the advantages of establishing plants in the Caribbean. Brochures from represented Caribbean countries discuss the benefits of investing in Caribbean plants, such as low-cost labor, attractive investment climates, proximity to the United States, and the applicability of Tariff Schedules 806.3, 807, and 807(a). For example, one country's brochure contained a chart showing that "Total costs of manufacture or assembly in Barbados are about 30-40% of the same operation in the United States." Another brochure encourages investors to establish operations in the Caribbean as a way of "keep[ing] jobs in the United States," an argument similar to that found in promotion material for the Expo-Maquila'86 conference.

Mr. Chairman, this concludes my statement. I would be happy to respond to any questions you may have at this time.