

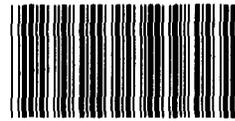
GAO

Report to the Honorable  
Louise M. Slaughter, House of  
Representatives

October 1992

# INTERNATIONAL TRADE

## Implementation of the U.S.-Canada Free Trade Agreement



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**General Government Division**

B-251023

October 27, 1992

**The Honorable Louise M. Slaughter  
House of Representatives**

Dear Ms. Slaughter:

As requested, we examined various issues regarding implementation of the U.S.-Canada Free Trade Agreement (FTA), which took effect on January 1, 1989. Specifically, our objectives were to obtain information on (1) what responsible U.S. and Canadian agencies have done to carry out the agreement; (2) how FTA has affected U.S.-Canada trade, including border-crossing concerns and differing product standards; (3) how U.S. businesses view the FTA's rules of origin and related administrative requirements; (4) how the federal agencies have coordinated their trade activities and whether there is a need to establish an Office of Free Trade Ombudsman; and (5) what other projects are underway to settle problems under FTA. Appendix V provides details on the objectives, scope, and methodology of our review.

**Background**

FTA created the world's largest bilateral free trade area, with bilateral merchandise trade of over \$160 billion in its first year of operation. FTA calls for eliminating all tariffs—in stages—by January 1, 1998, as well as progressively reducing and eliminating other barriers to trade and investment. To ensure that FTA benefits apply only to U.S. and Canadian goods, the agreement adopts rules of origin to establish which goods qualify for FTA preferences. To ease technical barriers to trade, the agreement commits the two countries to developing compatible federal standards. And, to resolve disputes, the agreement sets up panel review procedures administered by a binational secretariat. Finally, the agreement establishes the Canada-United States Trade Commission, comprised of cabinet-level representatives of both countries, to oversee FTA implementation.

The FTA's broad scope and complexity, together with the multiagency approach to formulating and carrying out U.S. trade policy, raised concerns about implementation of the FTA. These concerns focused on whether administrative problems prevented U.S. businesses from taking full advantage of FTA benefits, but also extended to a concern that such problems might recur under future agreements such as the proposed North American Free Trade Agreement between the United States, Canada, and Mexico.

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## Results in Brief

U.S. and Canadian federal agencies have undertaken various activities to implement FTA and often have cooperated with each other in helping businesses to learn about the agreement's provisions.

Because the agreement's provisions are complex and long term, the agreement's precise effect on U.S. business cannot yet be determined. But duties have been eliminated on some products and are being phased out on others, and trade has increased by more than 15 percent. Though not necessarily FTA related, there have been some problems such as delays at the border and difficulties in complying with Canadian product standards and technical requirements.

Some U.S. businesses we contacted have encountered problems in complying with the agreement's rules of origin and in completing the required Exporter's Certificate of Origin.

Efforts are underway to improve federal coordination in promoting trade, and there is some interest in establishing a single, centralized source of FTA information and assistance. Commerce's Office of Canada (OOC) has taken on part of this task by providing market information and technical assistance to U.S. businesses. However, support for establishing a governmentwide Office of Free Trade Ombudsman appears to be limited. Many of the officials we interviewed were unsure of what an ombudsman could accomplish.

The Customs Service's Project North Star Commercial has been established to coordinate implementation of FTA and related Customs commercial activities along the northern border. However, Customs has determined that for the present the project will have limited responsibilities and staff.

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## FTA Implementation Activities

U.S. and Canadian government agencies have taken several steps to help implement FTA (see app. I). Commerce's OOC, the Customs Service, and Canada Customs have conducted training and educational programs for their staffs; the trade (e.g., Customs brokers); and interested businesses both before and after the FTA's effective date. OOC, for example, has given numerous educational seminars under its "Canada First! Outreach Program." It also cooperated with Canada Customs in providing Customs procedures seminars during fiscal year 1989 for thousands of U.S. exporters.

ooc also responded to over 20,000 calls on its hot line during the agreement's first year and has prepared a wide range of publications to assist U.S. exporters.

U.S. Customs participated in educational seminars and continues, as does Canada Customs, to assist U.S. businesses by telephone. In January 1992 U.S. Customs designated FTA coordinators in Washington, D.C., and in each regional and district office to help implement FTA. Canada Customs, in addition to participating in various educational programs in the United States, had received over 260,000 calls on its toll-free FTA hot line by October 1991.

## FTA's Impact on Trade

The full impact of the agreement, which is being phased in over 10 years, cannot be measured accurately at this time. Nevertheless, trade between the United States and Canada has grown. According to Commerce, U.S. merchandise exports to Canada totaled \$85 billion in 1991, up 19 percent since 1989 when FTA went into effect (see app. II). U.S. imports from Canada had grown 12 percent, to \$91 billion in 1991. As other indicators of the FTA's success, officials cited the two rounds of accelerated tariff reductions requested by representatives from the U.S. and Canadian private sectors. Under these two rounds, tariff elimination has been accelerated on over 650 products representing trade of almost \$8 billion in 1990.

## Northern Border Concerns

Business people and local government representatives at the ports we visited, including Detroit, Michigan; Buffalo, New York; and Blaine, Washington, said that border traffic delays were a major problem. A local official in Detroit cited a study that identified inadequate staffing of primary inspection booths by the Customs and immigration agencies of both countries as the major cause of delays.<sup>1</sup> Studies in Detroit and Buffalo have suggested improvements in infrastructure and staffing that would ease traffic and cargo processing. However, traffic backups due to Canadian cross-border shoppers have affected commercial traffic in Blaine because automobiles can block access to truck lanes.

Some improvements are occurring, however. U.S. Customs and Canada Customs have expanded automated cargo-processing systems, such as the Line Release system, to prevent border delays. Under these systems, cargo

<sup>1</sup>St. Clair and Detroit Rivers International Crossings Study, Ontario Ministry of Transportation, Michigan Department of Transportation, and Transport Canada (A.T. Kearney: East Lansing, Michigan, and Toronto, Canada, 1990).

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can be released for entry in seconds when the truck driver arrives at the primary inspection booth. (See app. II.) Also, U.S. Customs has identified 10 northern border ports as its highest priority sites for making infrastructure improvements. In addition, U.S. Customs has undertaken a comprehensive review of the northern border ports, including facilities and staffing needs, to identify ways to speed cargo movement.

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## Product Standards

Private sector sources have cited differing U.S. and Canadian product standards as a hindrance to trade. A December 1990 report by the Greater Buffalo Development Foundation, for example, identified product standards as a major technical trade barrier. However, a Customs broker we interviewed said that brokers are familiar with product standards in both countries and can help to alleviate problems; other business people viewed compliance with product standards as a cost of doing business.

Chapter 6 of FTA provides that the United States and Canada, to the greatest extent possible, are to make their product standards compatible. Chapter 6 includes provisions to help ensure that each country's facilities for testing and certifying compliance with standards are treated in a nondiscriminatory manner by the other. There has been some progress, including publication of a harmonized standard on heating, ventilating, air conditioning, and refrigeration equipment. However, the absence of specific target dates for publishing other standards makes it difficult to assess progress. The President's January 1991 biennial report noted that while there had been dialogue and cooperation among interested parties in both countries, full implementation of the Chapter 6 provisions had been slow.

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## Rules of Origin Issues

The FTA provides a fairly objective test of origin for many products containing third-country materials. If such materials undergo sufficient processing in the United States or Canada to result in a designated change of tariff classification, the product qualifies for FTA preferences. However, some other products must meet a more complex test generally requiring that 50 percent of their manufacturing costs are attributable to U.S. or Canadian production processes.

Complying with FTA rules of origin and the Exporter's Certificate of Origin requirements for the latter products constitutes a major problem for certain U.S. exporters. The rules have varying effects on different businesses and products. U.S. exporters of more complex products, such

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as electronic equipment, can experience greater administrative costs and problems in verifying the components' country of origin than do exporters of products completely obtained and produced in the United States. (See app. III). OOC continues to receive many inquiries, especially from small businesses, for clarification of the rules, as businesses try to take advantage of reduced tariffs under FTA.

Both the United States and Canada have worked to resolve concerns about the rules of origin and the exporter's certificate. For example, in 1990 "blanket certification" for recurring shipments of identical goods from a single exporter was extended from 6 months to 1 year. In addition, both governments have agreed to limit the amount of information required on the certificate.

In 1991 the Binational Working Group on FTA Rules of Origin recommended additional rule changes and clarifications for various specific products and product packaging. The working group also agreed to develop a "de minimis" rule under which products containing a small percentage of third-country material could be designated as of wholly U.S. or Canadian origin.

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## Agency Coordination and the Ombudsman Concept

Several federal agencies, including OOC and the U.S. Customs Service, share responsibility for implementing FTA. While businesses may not have to deal with all of these agencies, identifying the best information source can be a problem. Although not specifically geared to Canada trade, efforts are underway to improve agency coordination generally. The U.S. Trade Promotion Coordinating Committee, established in May 1990, includes, for example, a trade information center for business. (See app. IV.)

Although there was some interest in centralizing certain FTA activities, support for establishing an Office of Free Trade Ombudsman appears to be mixed.<sup>2</sup> Most U.S. federal agency officials we spoke with as well as some private sector representatives questioned the concept, arguing that such an office would add another layer of bureaucracy.

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<sup>2</sup>Ombudsmen—officials who investigate and resolve citizen grievances against public organizations—have been used in several federal agencies. In April 1990, U.S. Customs established a trade ombudsman's office that deals with a wide range of customs issues, but does not focus specifically on FTA. Customs has also designated ombudsmen in certain districts.

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## Other Projects Underway

Another approach to facilitating FTA is the Customs Service's Project North Star, established in July 1990 by the Treasury Department and Customs in cooperation with other responsible federal agencies. North Star was charged with monitoring FTA implementation to assure uniformity, assisting in problem solving and facilitating trade, and serving as a focal point for U.S. Customs offices to work with other federal agencies, the trade community, and Canadian officials. Customs has determined that Project North Star Commercial will, for the present, remain a small activity with limited activities. In October 1992, project staff consisted of the Director, a program specialist, and an administrative assistant.

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## Agency Comments and Our Evaluation

The Commerce Department provided written comments (see app. VI) on a draft of this report and the Treasury Department and the Customs Service provided oral comments. We made revisions to the report that we deemed appropriate.

In a draft of this report we recommended that Customs evaluate Project North Star Commercial's staffing needs and establish working relationships with the Customs Trade Ombudsman and Commerce's Office of Canada.

The Customs Service commented that it has determined that current staffing of Project North Star Commercial — a director and two staff members — is adequate for its present responsibilities, which were somewhat reduced in May 1992. Customs stated that, as the function continues to evolve and responsibilities are added, further staffing needs will be determined. Customs stated that North Star Commercial has been in contact with the Customs Trade Ombudsman in various meetings and that liaison will be established with Commerce's Office of Canada in the near future. Based on these actions, we have withdrawn the recommendations.

The Commerce Department comments were supportive of the recommendations in our draft report. Commerce noted that, while Customs' natural focus is on imports, Customs could provide valuable, expert service by responding to U.S. exporters' growing demand for technical assistance on the Harmonized System and the rules-of-origin/Exporter's Certificate of Origin. Commerce also noted that OOC-Customs cooperation has been somewhat limited, in part because of Customs' staffing and budget constraints, and that more collaboration

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would greatly improve assistance to exporters seeking to benefit from the FTA.

A senior Customs official responsible for overseeing Project North Star told us during our review that he expected the project to eventually serve U.S. exporters and importers as an authoritative source of assistance and information concerning customs-related FTA questions. This congruence of Commerce's and Customs' views indicates that, as Project North Star evolves, it may provide enhanced service to U.S. exporters which may involve increased staffing.

Commerce also suggested some technical corrections which we incorporated in our report as appropriate.

Customs also provided a statement that it believes more clearly describes how foreign content costs should be accounted for in determining whether a manufactured product qualifies as being of U.S. or Canadian origin. The statement was added to appendix III.

The Treasury Department commented that, relative to rules of origin, the new change-of-tariff-classification test has been viewed as relatively simple and objective compared to origin rules in other trade laws. Treasury noted that most problems, and the potential for administrative burden on businesses, have been related to the FTA's 50-percent value-added origin test that applies to some products. We have incorporated Treasury's comments as appropriate.

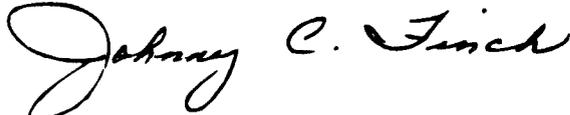
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As arranged with you, we plan no further distribution of the report until 30 days from the date of this report unless you publicly announce its contents earlier. At that time, we will send copies to the Department of the Treasury, the Department of Commerce, the U.S. Customs Service, and other interested parties. Copies will also be made available to others on request.

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Please contact me at (202) 275-4812 if you or your staff have any questions concerning this report. The major contributors to this report are listed in appendix VII.

Sincerely yours,

  
*(for)*  
Allan I. Mendelowitz, Director  
International Trade and Finance Issues



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**Abbreviations**

FTA	U.S.-Canada Free Trade Agreement
HS	Harmonized System
INS	U.S. Immigration and Naturalization Service
OOC	Office of Canada
PACE	Peace Arch Crossing Entry

# Implementation of the U.S.-Canada Free Trade Agreement: An Overview

In 1989 the U.S.-Canada Free Trade Agreement (FTA) created the world's largest bilateral free trade area. The majority of tariffs on trade between the United States and Canada had previously been eliminated, and the FTA provides for removing all remaining tariffs for U.S. and Canadian goods over 10 years. The agreement, which became effective in January 1989 as provided by the United States-Canada Free Trade Agreement Implementation Act of 1988 (P.L. 100-449), is far-reaching. It consists of 21 chapters covering a wide range of goods and services, including the removal of trade barriers in investments, financial services, agriculture, and business travel between the two countries.

The FTA's objectives are to (1) eliminate barriers to trade in goods and services between the two countries, (2) facilitate fair competition, (3) significantly liberalize conditions for investment, (4) establish effective procedures to administer the agreement and resolve disputes, and (5) lay the foundation for further bilateral and multilateral cooperation. FTA includes rules of origin to define goods entitled to FTA tariff preference and establishes mechanisms to resolve disputes. Given the complex, multifaceted nature of FTA, several U.S. and Canadian government agencies assist with implementing the agreement. We focused on four of the key participants, two U.S. and two Canadian: the Office of Canada (OOC) within the U.S. Department of Commerce, the U.S. Customs Service within the Department of the Treasury, External Affairs and International Trade Canada, and Revenue Canada (Canada Customs).

Because FTA is comprehensive and long term, it is difficult to generalize about the effectiveness and impact of FTA implementation. However, while there have been difficulties, government officials and business people we interviewed generally indicated that implementation has been adequate.

## Office of Canada Implementation Activities

Located within the Department of Commerce's International Trade Administration, the Office of Canada has the primary objectives of (1) informing American business of the opportunities provided through FTA, (2) helping solve U.S. exporters' problems, and (3) ensuring Canadian compliance with its FTA obligations so that U.S. business receives the maximum benefits. These objectives encompass both identification of exporting opportunities and education on the "nuts and bolts" of exporting, including technical assistance.

OOC has conducted various educational, trade development, and related activities to help to carry out FTA. The OOC's staff of 10, each of whom has

been assigned specific areas of expertise concerning FTA and international trade, answers inquiries regarding matters such as marketing potential by industry, FTA rules of origin, and Customs issues. In addition, OOC reaches out to business through its publications and seminars.

OOC initiated an extensive FTA educational effort through its "Canada First! Outreach Program," which began in fiscal year 1989. This program, among other things, consisted of numerous seminars, conducted in cooperation with Canada Customs. In June 1990 congressional testimony the Deputy Director of OOC stated that agency officials prepared or participated in over 100 general FTA seminars, conducted 48 Customs procedures seminars, and spoke at 89 other programs, reaching a total of more than 7,000 businesspersons during fiscal year 1989. According to an OOC official, in fiscal year 1990 staff spoke at or conducted 64 FTA-related seminars for businesses. The staff participated in a total of 63 such seminars during fiscal year 1991. During the first quarter of fiscal year 1992, OOC statistics show that OOC officials conducted about 10 seminars.

OOC has produced several informative publications for the business community covering various FTA and Canadian trade matters. OOC records show that almost 100,000 of these publications have been printed, 92 percent of which had been distributed as of November 1991. These publications included Border Crossing Procedures under the United States-Canada Free Trade Agreement; Industry Profiles; United States-Canada Free Trade Agreement Guide to Exporting Procedures; Summary of the U.S.-Canada Free Trade Agreement; and Guide to Packaging and Labeling Requirements for Canada. OOC also contributes to Business America, a biweekly Commerce publication that focuses on international trade and has devoted some issues to FTA concerns. According to OOC, more than 60,000 of the 75,000 printed copies of these Business America publications have been sent to interested parties.

Commerce officials noted, however, that because money is limited, Commerce will no longer be able to provide publications free of charge. FTA printed materials are available at Commerce's National Technical Information Service, generally at a cost of \$17 for each publication. A Business America subscription is available at an annual cost of \$53.

An OOC official said that the office responded to more than 20,000 telephone inquiries during 1989 through its Hot Line Business Counseling Service. During fiscal years 1990 and 1991 OOC handled 13,693 and 13,622 calls, respectively. Many of these inquiries dealt with the Exporter's

Certificate of Origin and the rules of origin, as well as tariff rates, trade data, and Harmonized Tariff System classification.<sup>1</sup>

ooc, along with other Commerce units, also participates in a number of other FTA-related activities.<sup>2</sup> For example, it works with Canadian officials on matters such as technical standards, accreditation and licensing standards for professionals, and border-crossing procedures. ooc also participates in the binational working groups on rules of origin and market access and Customs administration. Finally, ooc provides economic analyses of industry requests for accelerated elimination of tariffs.

ooc, with extensive information and literature on U.S. exporting, updates on the FTA, and programs and seminars, is regarded as a basic "reference point" for new exporters to Canada. It appears that ooc, although facing financial and staffing constraints, has information and expertise available to assist businesses interested in exporting to Canada.

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## **U.S. Customs Service**

Although Customs did not publish final regulations on FTA duty preference provisions until January 1992, the agency had previously developed and disseminated FTA information. For example, in May 1989 Customs issued its pamphlet U.S.-Canada Free Trade Agreement: Customs Administration. The publication, which was updated in February 1991, provides an overview of the agreement and discusses Customs requirements and how to take advantage of FTA benefits. According to a Customs official, more than 19,000 of these pamphlets have been distributed. To provide additional specific information and guidance on FTA implementation, Customs has also issued a series of 29 "fact sheets." These sheets, which review a wide range of FTA issues, including rules of origin, textile tariff rate quotas, and automotive exports, are distributed to responsible Customs personnel. Copies are also distributed to importers and Customs brokers.

In addition to participating in trade fairs and free trade panels and training its own staff, Customs personnel have provided FTA seminars and other assistance to the trade community. For example, certain Buffalo district

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<sup>1</sup>The Harmonized System (HS), a shortened term for the Harmonized Commodity Description and Coding System, was approved by the Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418). In the United States, the new Harmonized Tariff Schedule, provided for in subtitle B title I of the act, took effect on January 1, 1989. Canada adopted the HS effective January 1, 1988.

<sup>2</sup>As authorized by section 405 of the United States-Canada Free Trade Agreement Implementation Act of 1988 (P.L. 100-449), Commerce has established the U.S. section of the FTA binational secretariat. This secretariat administers panel reviews of certain cases, thus permitting quick resolution of these issues without resorting to judicial review.

office staff members offered a 2-day FTA seminar to a customs brokers' association and spent days educating local businesses to promote a thorough understanding of FTA. Customs headquarters had also provided assistance through the establishment of an FTA "hot line."

As discussed in appendix IV, a key element of the Customs Service's effort to implement FTA was the establishment of Project North Star in July 1990. Among other things, North Star was intended to coordinate and facilitate U.S.-Canada trade activities under FTA. In January 1992 Customs took a major step to enhance FTA implementation when it designated FTA coordinators in headquarters and in each regional and district office. Coordinators' responsibilities will include receiving and disseminating, within their respective offices, specific information on FTA and northern border activities such as special inspections, penalties, regulatory rulings, and so on.

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## **Canadian Government Efforts**

As in the United States, several Canadian government agencies are responsible for implementing FTA. Two of the major participating organizations include External Affairs and International Trade Canada, and Canada Customs.

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## **External Affairs and International Trade Canada**

According to Canadian officials, External Affairs and International Trade Canada's main role in FTA implementation is administering the bilateral technical working groups established under the agreement. These groups focus on topics such as rules of origin, accelerated reduction of tariffs, and agriculture issues. External Affairs, also responsible for immigration issues, administers legislation concerning FTA temporary entry provisions for business people. This agency also publishes the Canadian government's annual report on the status of FTA implementation.

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## **Canada Customs**

According to a Canadian official, Canada Customs established an FTA task force consisting of 40 people to implement the agreement formally. Its members developed a plan to train and assist both the general public and the Canada Customs staff in the 10 regional offices in which local teams carried out FTA implementation. These teams were responsible for arranging training, facilitating communication with outside entities, and outlining procedural changes. Canada Customs also conducted an

extensive public education campaign,<sup>3</sup> installed a toll-free telephone number for inquiries,<sup>4</sup> and participated in trade fairs. Moreover, it also conducted over 300 seminars in the United States and Canada, focusing on documentation requirements and exporter obligations.

Canada Customs' regional office work has increased with the heightened need to review and redetermine tariffs. As a result, staffing levels were raised in the regional offices. However, the number of commercial inspectors at the border crossings has remained fairly constant.<sup>5</sup>

## Views on FTA Implementation and Impact

FTA is a complex, long-term agreement whose impact can vary widely depending on the industry and the product affected. It is therefore difficult to generalize or to draw firm conclusions about FTA implementation and its impact at this point. There have been disappointments and difficulties, including certain auto industry rule-of-origin problems discussed in appendix III. Problems concerning trade in other products, such as beer and softwood lumber, have also strained the agreement. However, despite these problems, trade between the United States and Canada has increased since FTA implementation in January 1989. Nevertheless, it is not possible to completely isolate FTA effects from other economic variables in order to specifically identify how the agreement has affected U.S.-Canada trade. In this regard, a February 1991 study by the Royal Bank of Canada<sup>6</sup> noted that the FTA's effect may be overshadowed by other economic forces, including recession, high interest rates, and the strength of the Canadian dollar. Although unable to fully support analysis with "hard" economic data, several sources have commented on FTA implementation and its effects.

## Government Assessments Were Generally Favorable

The President's January 1991 biennial report to Congress on the status of FTA noted that implementation had "proceeded smoothly" and that U.S. and Canadian businesses were taking advantage of the many opportunities created by reducing and eliminating trade barriers. According to the report, probably the most notable trade liberalization was the accelerated elimination of duties. The report went on to say that the FTA's many

<sup>3</sup>Canada Customs published 200 tons of FTA-related literature, including a brochure on the Exporter's Certificate of Origin and a brief summary of FTA provisions.

<sup>4</sup>During the hot line's existence, Canada Customs handled over 260,000 calls.

<sup>5</sup>A Canadian official said that staffing for commercial operations at the border crossings was sufficient to handle the work load. However, the number of inspectors for passenger vehicles has lagged behind the increase in traffic owing to such factors as cross-border shopping.

<sup>6</sup>Econoscope, Royal Bank of Canada Economics Department (Montreal, Quebec: Feb. 1991).

institutional mechanisms had proven useful in avoiding serious disagreements and that when disputes did arise, FTA dispute resolution systems had worked effectively. Although generally positive, the report did point out some areas of contention, such as Canada's refusal to increase the rule-of-origin value content requirement for automotive products and the failure to reduce tariffs on certain wood products.

The President's 1990 annual report on the trade agreements program, prepared by the Office of the U.S. Trade Representative, also concluded that FTA implementation had gone well. Among other things, the report noted that the FTA dispute resolution panels and binational working groups had been operating effectively.

In addition, the U.S. International Trade Commission, in its July 1991 report on the operation of the U.S. trade agreements program, cited certain positive achievements resulting from FTA implementation, notably the accelerated tariff reductions. However, the report also mentioned certain problems, including Canadian interprovincial trade barriers. According to the report, there are hundreds of these barriers, covering areas such as government procurement policies, preferential treatment, limitations on product movements, packaging standards, and licensing. In addition to inhibiting Canadian economic integration, these barriers are "a major obstacle to the full realization of the economic benefits available from the FTA," according to the Commission's report. The Office of the U.S. Trade Representative's March 1991 foreign trade barriers report also raised questions about certain provincial trade regulation practices, including those of the provincial liquor boards.

Various Canadian organizations have conducted FTA implementation studies. Among these are the Royal Bank of Canada, which has published three annual assessments. For example, the second of these, published in February 1991, observed that FTA dispute resolution mechanisms were working effectively, while noting that interprovincial trade barriers needed to be addressed. The study also concluded that for most Canadian industries experiencing difficulties FTA had not been a major contributor and that FTA may have moderated the impact of the recession on some industries. However, there is disagreement on this point. Certain organizations, such as the Canadian Labour Congress, have attributed larger numbers of layoffs to FTA. Further, it has been argued that other economic problems, including the migration of Canadian industry, can be attributed to FTA, prompting some Canadian sources to recommend termination of the agreement.

A prominent Canadian consulting firm that analyzed FTA implementation noted in its December 1990 report to business clients that "implementation has overall been remarkably free from major problems" and that FTA dispute resolution mechanisms had worked well and been fair to both sides.<sup>7</sup> The report also called for reducing interprovincial trade barriers and pointed out that the United States had been slow to implement certain agreed-upon technical standards and tariff reductions. According to the report, while it was too early to draw firm conclusions about FTA impact, it appeared that unfavorable economic circumstances, such as high interest rates and the uncompetitive Canadian dollar, had more influence on Canada's trade problems than FTA.

In December 1991 the Canadian consulting firm reported that the FTA's direct economic impact had been small but positive and that, as planned, FTA had helped to eliminate tariffs and other barriers.<sup>8</sup> However, the report also noted that free trade would be put to the test during 1992 and that there would be "serious stresses on FTA, as vital trade disputes come to a crunch with an increasingly protectionist America."

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## **Additional Views and Observations**

Several Canadian government agency officials, including representatives of External Affairs and International Trade Canada and Revenue Canada, told us that although there may have been some problems concerning matters like rules of origin or use of the Harmonized Tariff System, overall, FTA implementation had gone well. According to a senior Canadian consular official, it is difficult to isolate FTA effects, but it appears that FTA is a success. Some of the more visible and important outcomes include increased trade and the positive attitude that has developed among many U.S. and Canadian companies about trading with each other. This official also noted that FTA dispute resolution mechanisms have worked very well, but that further steps should be taken to avoid disputes. He said that in his opinion the biggest disappointment to date is that more has not been done to deal with the subsidy issues and the related problem of countervailing duties.<sup>9</sup> Another senior consular official told us that while there have been some problems concerning product inspection and rules of origin, overall, FTA implementation on the Niagara border crossing has been excellent.

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<sup>7</sup>Year Two of the Canada-U.S. Free Trade Agreement: Making It Work, Strategico Inc. (Ottawa, Canada: Dec. 1990).

<sup>8</sup>Free Trade: Year Three: Put to the Test, Strategico Inc.(Ottawa, Canada: Dec. 1991).

<sup>9</sup>Countervailing duties are imposed to counteract foreign government subsidies for the manufacture, production, or export of goods imported into the United States.

Senior U.S. government agency officials familiar with FTA administration efforts said that generally, implementation was proceeding satisfactorily. Some of these officials pointed out, however, that there had been problems during the early stages of implementation resulting from businesses' lack of familiarity with specific FTA provisions concerning matters such as rules of origin. However, according to these officials, increased familiarity and experience with FTA has helped to ameliorate these problems to some degree. Although some state government officials mentioned problems like border-crossing delays, many of these individuals said that FTA implementation had generally gone well.

U.S. and Canadian industry association and other private business people we spoke with expressed varying opinions about FTA implementation and impact. Some of these individuals said that implementation had gone reasonably well. However, others identified certain issues, such as complying with rules of origin, as problems that have affected realization of economic benefits under FTA. Many Canadian businesses apparently have not done as well as anticipated under the agreement. According to an early 1991 survey conducted by the Canadian Federation of Independent Business, various economic situations, such as a strong Canadian dollar and interprovincial trade barriers, have limited the agreement's economic benefits. Only about 26 percent of the 2,092 small Canadian businesses surveyed said that FTA had affected them. Overall, about 25 percent of all the companies surveyed opposed the agreement, another 25 percent were uncertain, but almost 50 percent still supported FTA.

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# Trade Data, Port Profiles, and Border-Crossing Issues

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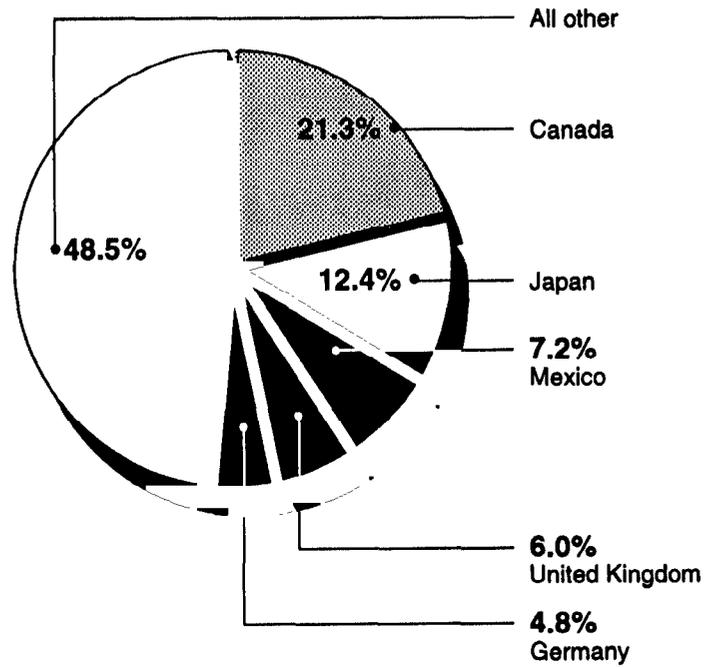
The vast majority of goods entering the United States from Canada moves through 28 Customs-designated commercial centers, along a border of approximately 5,000 miles. We visited the three largest commercial ports as measured by trade volume—Detroit, Michigan; Buffalo, New York; and Blaine, Washington—to determine what problems U.S. exporters are experiencing. Many government and private sector representatives cited traffic congestion as a major problem affecting cargo movement, and several studies have recommended improvements. U.S. Customs is taking steps to improve its operations and facilities.

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## General Trade Data

In 1990 merchandise trade between the United States and Canada, the world's largest trading partners, reached \$170 billion, or almost 20 percent of the U.S.' total trade of \$889 billion. Figures II.1 and II.2 show U.S.-Canada trade in relation to the U.S.' five largest trading partners.

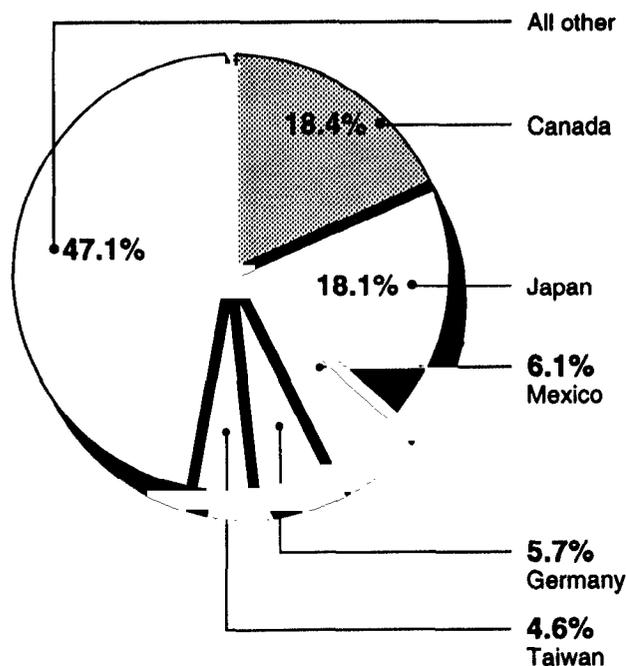
Figure II.1: Largest Trading  
Partners—U.S. Exports, 1990



Note: Percentages may not add up to 100 percent due to rounding.

Source: U.S. Department of Commerce.

Figure II.2: Largest Trading  
Partners—U.S. imports, 1990



Source: U.S. Department of Commerce.

According to the External Affairs and International Trade Canada's 1989 and 1990 FTA implementation reports, more goods have benefited from the FTA's reduced tariff rates over time. In 1989, over 65 percent of U.S. dutiable exports to Canada benefited from the FTA's tariff preferences. By the end of 1990, however, approximately 80 percent of these exports were accorded preferential duty treatment.

About 63 percent of all 1990 U.S. exports to Canada entered Canada through the ports of Detroit, Buffalo, and Seattle (Blaine), as shown in table II.1. U.S. imports from Canada through the same ports are shown in table II.2.

**Appendix II  
Trade Data, Port Profiles, and  
Border-Crossing Issues**

**Table II.1: U.S. Exports to Canada  
Through Selected Customs Districts,  
1987-1990**

Dollars in millions				
Customs District	1987	1988	1989	1990
Detroit, MI	23,255	25,440	24,192	30,141
Buffalo, NY	8,675	9,548	8,488	14,387
Seattle, WA	2,450	3,803	4,313	4,610
<b>Subtotal</b>	<b>34,380</b>	<b>38,791</b>	<b>36,993</b>	<b>49,138</b>
All other districts	22,621	29,452	37,984	29,080
<b>Total</b>	<b>57,001</b>	<b>68,243</b>	<b>74,977</b>	<b>78,218</b>

Notes: Data before 1989 are estimated. District data include all ports (land, sea, and air). Seattle district includes Blaine, Washington.

Source: U.S. Department of Commerce.

**Table II.2: U.S. Imports for  
Consumption from Canada Through  
Selected Customs Districts, 1987-1990**

Dollars in millions				
Customs District	1987	1988	1989	1990
Detroit, MI	12,152	14,428	16,331	15,547
Buffalo, NY	10,492	12,468	12,923	13,099
Seattle, WA	3,328	3,639	4,102	4,282
<b>Subtotal</b>	<b>25,972</b>	<b>30,535</b>	<b>33,356</b>	<b>32,928</b>
All other districts	44,879	50,144	54,632	58,270
<b>Total</b>	<b>70,851</b>	<b>80,679</b>	<b>87,988</b>	<b>91,198</b>

Notes: Data before 1989 are estimated. District data include all ports (land, sea, and air). Seattle district includes Blaine, Washington.

Source: U.S. Department of Commerce.

## Port Profiles

Of the 83 ports along the U.S.-Canadian border, 28 have been designated commercial centers by U.S. Customs. At these commercial centers, U.S. Customs makes staff, facilities, and equipment available 24 hours a day and provides for processing cargo through the automated Line Release system. Under this system, frequently exported low-risk cargo can be rapidly processed using personal computers and bar code technology. Table II.3 shows traffic data and staffing resources for the three largest Canadian border crossings.

**Appendix II  
Trade Data, Port Profiles, and  
Border-Crossing Issues**

**Table II.3: Selected Data on the Three  
Largest U.S.-Canada Border Crossings**

<b>Specific data<sup>a</sup></b>	<b>Detroit, MI</b>	<b>Buffalo, NY</b>	<b>Blaine, WA</b>
Type and number of crossings	2 bridges, 1 tunnel	4 bridges	5 roadways
Traffic volume			
cars	9,253,312 <sup>a</sup>	9,607,638 <sup>b</sup>	11,211,170
trucks	1,192,580	814,896 <sup>b</sup>	348,266
Number of full-time inspectors <sup>a</sup>			
INS	49	58	27
USCS	140	166	59

**Legend**

INS = U.S. Immigration and Naturalization Service.

USCS = U.S. Customs Service.

<sup>a</sup>All figures are for 1991 unless otherwise indicated.

<sup>b</sup>Represents entire district of Detroit.

<sup>c</sup>Figures are for 1990.

<sup>d</sup>Includes airport inspectors.

Source: U.S. Customs Service.

## Border-Crossing Issues

Government and business people we interviewed at the three border crossings cited traffic congestion as a major problem affecting cargo movement. These officials identified several contributing factors, including poor infrastructure, inadequate U.S. Customs staffing, and extensive vehicular traffic due to the increased number of cross-border shoppers. U.S. Customs is trying to address some of these problems.

State and local government officials, and business people in Detroit consistently cited traffic congestion and inadequate U.S. Customs staffing at the bridges and tunnel as concerns. A joint U.S.-Canadian study also concluded that Customs staffing was inadequate and the condition of the infrastructure (i.e., roads and facilities) contributed to the traffic problem. The study made a number of recommendations, such as increasing the number of staff and computers available and installing a border-crossing information system.

Improvements are underway. Construction has begun on U.S. Customs cargo facilities at the Ambassador Bridge. Further, the Detroit & Canada

Tunnel Corporation, a private organization that manages the Detroit-Windsor Tunnel, has indicated its willingness to participate in a pilot Peace Arch Crossing Entry (PACE) project, similar to the project carried out in Blaine, Washington, in June 1991. PACE is a program to expedite border crossings for frequent and low-risk travelers. Frequent border crossers who are U.S. or Canadian citizens may apply for a decal that allows them and their car to cross the border using a dedicated lane. INS is scheduled to report to Congress in September 1993 on this experiment.

At the Buffalo port, business people also cited traffic as the major problem. One exporter, for example, said that his truck drivers had to cross the border at night to avoid excessive traffic delays during the day. A consulting firm's study, based on an examination of the Niagara River Bridges, made a number of recommendations,<sup>1</sup> which included hiring more staff, improving the infrastructure, and placing signs in more visible locations. There are plans to construct a new highway at the Whirlpool Bridge, according to a U.S. Customs official. This construction would help move some of the traffic away from the two heavily used lanes. Officials also hope to establish an off-site examination area at the Lewiston/Queenston Bridge, which would expedite border crossing by diverting some of the commercial traffic away from the bridge itself. Current and projected traffic delays at the other two bridges have led U.S. Customs to identify Buffalo as one of the top 10 ports nationwide in need of facility improvements.

Government officials said that the number of Canadian cross-border shoppers has contributed to traffic congestion at the Blaine, Washington, crossing. Traffic at this port increased by almost 20 percent between 1986 and 1991, according to U.S. Customs officials. Canadians travel to the United States to shop for basic goods to take advantage of the significant price differential.

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<sup>1</sup>Niagara Frontier U.S.-Canada Bridge Study: Phase I Report, Parsons, Brinckerhoff, Quade, and Douglass, Inc., for New York State Department of Transportation, et al. (New York: 1991), pp. 3-4.

# Implementation Issues: The FTA's Rules of Origin

FTA incorporates various rules of origin to ensure that economic benefits, including reduced tariffs, accrue to U.S. and Canadian businesses only. Among other things, the rules require that goods containing third-country materials will qualify for FTA preference only if the third-country materials undergo sufficient processing in the United States and/or Canada resulting in physically and commercially significant changes. For many products, the FTA provides a relatively simple measure of such change. Products qualify if the third-country materials they contain undergo processing in the United States or Canada sufficient to result in a designated change in tariff classification. Some other products, however, will qualify only if 50 percent or more of their manufacturing costs are attributable to U.S. or Canadian materials and/or direct processing costs incurred in the United States and/or Canada. These requirements can be rather complicated and impose a costly administrative burden on some businesses. The United States and Canada have resolved certain origin problems and are trying to clarify and improve other provisions of the FTA rules.

## FTA Origin and Preference Requirements

The FTA's rules of origin differ significantly from the rules used in other trade agreements. The latter usually relied on demonstrating "substantial transformation" of goods to establish their origin and thus entitlement to preferential treatment. Generally, under these prior rules, a product containing foreign material would be considered of U.S. origin if, after domestic processing, it had a new name, character, and/or use. Substantial transformation required Customs officials to make decisions on a case-by-case basis and to use considerable subjective judgment. This subjectivity, and consequent unpredictability, has tended to promote litigation and the need for a new, more objective approach to establishing a product's origin.

The FTA's rules of origin seek to prevent foreign products that have been altered only slightly or simply placed in domestic packaging from gaining preferential tariff treatment. Eligibility for such treatment under FTA depends on whether the goods are deemed to originate in the United States and/or Canada. Specifically, the rules provide that

- goods wholly obtained or produced in the United States and/or Canada qualify for preferential treatment;
- goods containing third-country materials will qualify for preference if the foreign materials undergo processing or assembly in the United States and/or Canada sufficient (i.e., physically and commercially significant) to

result in a designated change in tariff classification under the Harmonized System (HS) of Tariff Nomenclature;

- some goods will qualify only if, in addition to a tariff classification change, at least 50 percent of their manufacturing costs are attributable to U.S. or Canadian materials and/or direct processing costs incurred in the United States and/or Canada; and
- certain goods, for which no change in tariff classification occurs between the imported components and the end product, will qualify if they meet the 50 percent criterion outlined above.

These rules apply only to those goods for which an economic benefit, such as a reduced tariff, is sought under FTA. However, most tariffs between the two countries had already been eliminated by past trade agreements. Therefore, according to U.S. Customs, these FTA reductions would only affect about 35 percent of Canadian and 20 percent of U.S. tariffs. For example, 95 percent of automotive trade has been duty free under the U.S.-Canada Automotive Products Trade Agreement of 1965.

## **Origin Certification and Verification**

Claims for preferential treatment of goods must be supported by an exporter's certification of the specific criteria or basis upon which a product's origin is determined, according to FTA Chapter 4, annex 406. The U.S. Customs Service has developed the Exporter's Certificate of Origin (form 353) for this purpose. According to industry sources, completing the certificate and developing supporting documentation and cost analyses are among the more serious issues facing FTA implementation. In order to verify an importer's claim for FTA preference, Canadian or U.S. Customs officials can ask to see the certificate of origin at any time after the cargo enters the country.

FTA requires Customs authorities in both countries to cooperate in enforcing origin rules. FTA also allows Customs officials to demand additional supporting documentation from exporters and importers and to conduct on-site audits in both countries. According to a U.S. Customs official, Customs has initiated several FTA audits. Among these is an analysis of the local or North American content of cars produced by Honda Motor Company at a plant in Canada to determine compliance with FTA origin requirements. Preliminary audit results, including certain confidential information, were disclosed by the press in June 1991. According to these accounts, Customs had determined in March 1991 that Honda had failed to meet FTA requirements and that Customs would therefore attempt to collect about \$20 million in duties. However, shortly

after a meeting between Honda and Treasury representatives, Customs advised Honda that the audit was not complete and that no final decisions had been made.

On March 2, 1992, Customs announced that its audit had determined that Honda Civics that had entered the United States between January 1, 1989, and March 30, 1990, did not qualify for FTA duty preference because these cars did not contain the necessary 50-percent North American content. The Customs auditors questioned the application of direct cost of processing and the use of a concept called "roll-up" as it applied to intermediate materials in the production process. According to a Customs official, "roll-up" allows foreign costs which have been converted to North American costs by the legitimate application of the 50-percent value content test to be used to qualify additional foreign costs. The FTA allows a company to carry forward or "roll-up" the qualified material to another stage of production. Customs stated that one interpretation suggests that use of "roll-up" is unlimited, but Customs' attorneys studying the FTA found specific language addressing how to determine the value of the qualified materials. Customs' attorneys said that the language precludes the multiplier effect; that under the test of the agreement, the cost of North American parts used at stage one cannot be used to qualify additional foreign parts.

According to Customs, a 2.5-percent duty rate applies to those cars. Although Customs did not disclose the amount owed, press accounts placed the figure at almost \$17 million. Honda can protest the decision through Customs' administrative process. If the protest is denied, Honda will have to pay the duties but can file suit in the U.S. Court of International Trade. The issue could also be examined by a binational dispute resolution panel.

Canada Customs officials told us that they have audited about 15 U.S. companies concerning FTA preference and origin matters. Further, Canada Customs has required some U.S. businesses to provide additional information supporting their FTA preference claims by completing the agency's comprehensive "Origin Determination-Territorial Content Questionnaire."

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## **Effects of the FTA's Rules of Origin Have Varied**

Depending on factors such as industry and product type, interpreting and applying the FTA's rules of origin can be a relatively simple task if only the change in tariff classification test is required. However, satisfying the 50-percent value-added test can be a time-consuming, costly undertaking.

As a result of these factors, opinions on the rules and their implementation vary. Further, given the absence of specific, reliable data it is virtually impossible to accurately assess the rules' economic impact.

The President's January 1991 biennial report, among other things, concluded that there was broad agreement among U.S. and Canada Customs agencies and private sector sources that the rules are predictable and transparent. The report also noted that sensitive industries like textiles, apparel, and steel seem to be satisfied that the rules are helping to prevent third countries' goods from gaining domestic origin status by transshipment. The report, however, did point out certain continuing problems such as questions on how some interest costs would be treated in calculating 50-percent value content, and why the Canadian government rejected a U.S. proposal to increase the domestic content rule for automotive products to 60 percent.

Another study, a May 1991 U.S. International Trade Commission report on the Caribbean Basin Economic Recovery Act, examined various origin issues, including those relating to FTA. According to the report, it is difficult to assess FTA rules because the agreement is so new that the resulting body of rulings and interpretations is limited. However, the Commission concluded that in cases involving a clear change in tariff classification, and when there is no value-added criterion, the rules appear to be relatively easy to apply. They are also likely to provide a higher degree of predictability and uniformity than traditional case-by-case decisions based on substantial transformation. Treasury, in its input to the report, said that problems have arisen from the use of a value-added content criterion for certain products. Overall, however, Treasury found that, according to U.S. and Canadian sources, the change in tariff classification approach seems to be working fairly well and providing a transparent, predictable, and consistent methodology.

In a March 1991 letter to the Commission, the Customs Service observed that while the FTA's rules provide more predictability and certainty, there have been some problems. For example, implementing the rules had proven more complex and difficult than originally envisioned. To some extent this difficulty was attributed to businesses' lack of experience with the new rules. According to Customs, not all brokers and importers fully understood the change in tariff classification rules, thereby causing administrative difficulties for Customs personnel who had to reclassify certain products and reassess duties. Customs went on to say that use of the 50-percent value-added content test, although applicable only to some

products, "has caused the most difficult problems" in administering the agreement. Finally, Customs noted that it believes the problems associated with applying FTA rules of origin will diminish as the trading community and Customs gain more experience with FTA origin requirements and HS.

A November 1991 International Trade Commission report focusing on the automotive industry also commented on various aspects of FTA rules of origin. Among other things, the report concluded that the rules pose various problems, including the use of 50-percent value-added standards and the need for costly, time-consuming audits. The report also pointed out that certain FTA language is ambiguous and that Customs had not always provided clear, timely guidance. An industry official indicated that the rules were so complicated that many exporters and importers simply did not use the program. However, despite the problems, interested parties expressed support for including FTA-type value-added origin standards in a North American Free Trade Agreement, according to the report.

We discussed the FTA's rules of origin and their implementation with over 60 private sector and government officials. Several of these individuals did not view the rules or the exporter's certificate as major problems. According to a Customs broker, for example, the quality of the certificates has improved over the last 2 years, and exporters and Customs brokers have become better at preparing these documents. He added that the FTA's rules of origin have yielded more predictable results.

However, many of the exporters, Customs brokers, and association officials we interviewed said that there were problems with the rules, which in certain cases have prevented or discouraged companies from taking advantage of FTA tariff reductions. For example, a trade association representative argued that the rules impose a costly administrative burden on certain domestic manufacturers that at times threatens to compromise the economic advantages they are intended to promote. It is often impossible to separate and account for product ingredients that are purchased from both domestic and foreign sources. According to a major exporter, the rules are too restrictive and burdensome, and the requirement to identify each ingredient/component of a product threatens the confidentiality of the formula. Identifying multiple suppliers of numerous ingredients and having the suppliers provide origin information are very time consuming and not always successful. Also, some ingredients obtained from both domestic and foreign suppliers are commingled.

Some private sector representatives cited the documentation needed to support the certificate of origin as a major problem, pointing out that in certain cases exporters are simply not willing or able to do the certificate of origin paperwork. For example, a Customs broker told us that preparing the certificate can be especially complicated in such industries as high-tech electronics, chemicals, and plastics. This broker said that a recent analysis of 100 certificates in his files showed that 86 contained some type of error.

As alluded to previously, the 50-percent value-added requirement is among the most significant and frequently cited problems relating to the FTA's rules of origin. According to a large trade association, determining origin when there is no change in tariff classification, thus requiring use of the value-added criterion, has prevented many companies, both large and small, from taking advantage of FTA. These companies are not able to process and provide the information at a reasonable cost. A Chamber of Commerce official described the 50-percent value-added criterion as a "nightmare." Further, a corporate official told us that his company had not taken advantage of about \$1 million in potential FTA tariff reductions for a particular product, due to the administrative costs involved. That is, according to the official, it would be too expensive to track the origin of the hundreds of domestic and foreign ingredients used in the product. Although some experts told us that concerns about the complexity of the rules of origin and the cost of compliance had prevented or discouraged companies from taking advantage of FTA, the overall economic impact of the rules, in this context, cannot be measured accurately.

Finally, we discussed this issue with the Treasury Department official who developed the FTA's rules of origin. This individual said that the 50-percent value-added criterion, which had originally been included to facilitate origin determinations, has actually contributed to practically all the major rule of origin problems experienced to date. According to this official, the 50-percent criterion should be clarified and simplified significantly, or eliminated entirely as soon as possible.

It should be noted that some of the origin problems may well diminish over time as the trade community and Customs administrations become more familiar with the rules and their implementation. However, the problems will persist to some extent. We were told that U.S. and Canada Customs officials are beginning to enforce the rules more stringently. Moreover, companies new to trade between the United States and Canada may encounter some of these origin problems for the first time.

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## **Changes to the FTA's Rules of Origin**

The United States and Canada have made changes in response to complaints and suggestions from the trade community about rules of origin and the exporter's certificate. Beginning in late 1990, for example, exporters no longer had to list all consignees' names or identify the actual producer of the export product on the certificate. Earlier in the year, the "blanket" Exporter's Certificate of Origin (used for recurring shipments of identical products whose FTA eligibility does not change) had been extended from 6 to 12 months.

Furthermore, during the summer of 1991, the Binational Working Group on FTA Rules of Origin recommended several changes and clarifications that the United States and Canada will pursue concerning matters such as specific products and packaging. Another change that the working group members agreed to explore is a "de minimis" rule (or provision) allowing a product to be deemed as wholly of U.S. or Canadian origin even if it contains a small percentage, by value (e.g., 5 to 10 percent), of foreign material. Such a change could help to avoid the extensive administrative burden associated with establishing origin even when products contain only small amounts of nonqualifying material. For example, a chair consisting of domestic wood, fabric, padding, nails, and glue, but also containing foreign-made staples could, under a de minimis rule, be considered wholly of U.S. origin because of the low value of the staples relative to the chair's total cost.

A senior Treasury official told us that efforts were made to implement these changes by incorporating them into the North American Free Trade Agreement.

# Federal Agency Coordination and the Ombudsman Concept

Given the multiagency nature of the federal trade policy and the number of agencies involved in export promotion, obtaining specific FTA information or assistance can be challenging, particularly for small, first-time exporters. We examined the need for and the feasibility of establishing a centralized free trade ombudsman (facilitator) to deal with various issues and questions concerning U.S.-Canada trade and FTA implementation.

There is some interest in establishing a single, centralized source of FTA information and assistance. However, we found that support for creating an official U.S.-Canada FTA ombudsman was mixed. Some experts questioned the need for an additional layer of bureaucracy. Further, several public and private sector sources indicated that existing organizations, such as the Department of Commerce's OOC, were already carrying out some ombudsman-type functions. Also, some steps are being taken to improve overall coordination of federal trade policy and export promotion activities.

Ombudsmen have been used by several federal agencies, including the U.S. Customs Service, which has established an ombudsman's office at its headquarters in Washington, D.C., and designated ombudsmen in certain district offices. A Customs official told us that although the headquarters and district ombudsmen do not focus specifically on FTA, they do try to facilitate trade and cargo movement. Customs has also established Project North Star Commercial, a potentially important mechanism for coordinating commercial activities along the U.S.-Canada border. However, project staff has been limited, and North Star Commercial's mission and specific objectives were still evolving as of October 1992.

## Federal Trade Activities and Coordination

Numerous independent agencies and specialized units within several federal departments, including Customs, Commerce, and the Office of the U.S. Trade Representative, share responsibility for implementing FTA. In addition, export promotion activities are carried out by an extensive network of agencies that may specialize according to industry sector, export function, or country of destination. Among these are Commerce's OOC and the U.S. and Foreign Commercial Service, and the Small Business Administration's Office of International Trade.

Although it is unlikely that the average small exporter will have to deal with all of these trade policy/export promotion agencies, trying to find a specific source of information can be difficult. Efforts are underway, however, to improve coordination and availability of services. In May 1990

the President announced the establishment of the Trade Promotion Coordinating Committee, which is intended to streamline and integrate trade promotion activities of 18 federal agencies. Key components of this initiative include export promotion conferences and the Trade Information Center, which is intended to be a full-service, comprehensive, one-stop information source for small- and medium-sized companies. The center uses a nationwide toll-free number, 1-800-USA-TRADE, and can access various computerized data bases in order to provide specific information on such matters as foreign markets. The system can also transfer calls directly to other appropriate offices within Commerce (such as OOC) or to other federal agencies.

Though not limited to Canada, another potentially useful initiative is being implemented by the U.S. Trade Representative, the Small Business Administration's Office of International Trade, and various trade association representatives. This joint industry and government effort expects to identify ways to improve the "export infrastructure" for small business. More specifically, the effort plans to examine (1) obstacles confronted by exporters, (2) access to federal programs, and (3) ways to improve agency coordination.

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## **The Ombudsman Concept**

An ombudsman investigates citizens' complaints, recommends solutions, if needed, and acts as a troubleshooter, but generally does not have the authority to impose a solution, according to the Administrative Conference of the United States. To be effective, the ombudsman should be evenhanded and independent of an agency in order to persuade the parties involved to follow his or her recommendations. The position of ombudsman, a Swedish word meaning "agent" or "representative," has been used with varying degrees of success in several federal agencies, including the U.S. Customs Service.

One U.S. Congresswoman, in response to concerns brought to her attention by various sources including local business leaders, proposed the establishment of a free trade ombudsman. Among other things, this ombudsman would seek to improve coordination among U.S. and Canadian agencies responsible for FTA implementation, help to resolve technical disputes, and serve as a single point of contact for businesses needing information and assistance.

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## **Views on the Free Trade Ombudsman Proposal**

Several of the government and private sector representatives we spoke with were not familiar with the ombudsman proposal. Some officials told

us they had not studied the concept nor taken a formal position. Overall, our interviews showed that opinions varied regarding the need for and practicality of establishing an FTA ombudsman. Several state government officials and private businessmen, including Customs brokers, favored the establishment of an ombudsman. A representative of a major binational business organization told us that having an ombudsman is a good idea because members of his organization sometimes get different answers to trade questions from various government agencies. He favors a truly knowledgeable ombudsman who could help both U.S. and Canadian businesses.

Representatives of a large international trade association said that conceptually, at least, they favored a central contact point, or ombudsman. However, not having studied the issue, they could not say how such an office should function in terms of authority and its location within the government. Another trade association official observed that an ombudsman would be a good idea if the office had real authority over all trade issues and over the various trade agencies, which do not always coordinate with each other. Thus, the ombudsman would be similar to the foreign trade offices in other countries, which are responsible for international trade matters.

Other officials said that companies often do not know whom to contact and that it would be helpful if they had one number to call concerning trade questions. According to a trade association representative, a bilateral ombudsman with some authority on both sides of the border would be helpful because U.S. and Canadian exporters have no access to policymakers when problems arise.

Some government and industry officials supported the idea of local ombudsmen along the northern border. For example, one expert stated that truckers who encounter problems at the border could benefit from the services of a local ombudsman, especially if there were a toll-free number to call. The truckers could use this service to avoid unnecessary delays.

However, most U.S. and Canadian government officials and many business officials we interviewed questioned the need for an ombudsman, arguing, among other things, that such an office would add another layer of bureaucracy. According to a Department of Commerce official, for example, agencies designed to help small businesses are already fractured, and adding an ombudsman's office might well duplicate or dilute current

efforts further. A senior International Trade Commission official told us that although the ombudsman concept appears attractive, certain questions exist. For example, where specifically in the federal bureaucracy would such an office be located, and exactly what power would it have?

Some business and government officials said that the complex structure of the federal trade policy and export promotion bureaucracy might make the ombudsman position unworkable. For example, a business association representative said that while his organization favors the idea of a Department of Trade and International Investment, it does not support the ombudsman concept because it does not go far enough in addressing existing bureaucratic problems. Further, a Commerce Department official noted that trade issues have become so complex that an ombudsman could not provide "one-stop shopping" assistance for business. Finally, some government officials observed that Commerce's ooc provides technical assistance, promotes trade with Canada under FTA, and carries out some of the previously described functions of the proposed ombudsman.

Dispute resolution was also seen as a potential role for the ombudsman. However, FTA incorporates certain bilateral institutional mechanisms for dispute resolution, which, according to some experts, are working well. Chapters 18 and 19 of FTA, for example, establish panel review processes to resolve disputes on FTA provisions and antidumping or countervailing duty cases, respectively.<sup>1</sup> Two of the three Chapter 18 disputes regarding FTA interpretations have been resolved. Of the 23 Chapter 19 cases filed as of March 1992, 9 had gone through the panel process to completion, and 5 were under review. The remaining cases had either been consolidated or terminated. FTA also established a number of binational working groups which, among other things, seek to facilitate FTA implementation.

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## The U.S. Customs Service

To improve relations with the foreign trade community and to help resolve Customs-related trade issues, the Customs Commissioner appointed a trade ombudsman in April 1990. The ombudsman's office has a staff of seven that interacts with the trade community and deals with a wide range of customs and trade matters. Among the office's primary concerns is ensuring operational consistency among Customs districts. According to a Customs official, most of the problems are handled by phone because international trading requires a timely response. In addition,

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<sup>1</sup>Antidumping duties are imposed to counteract the injury caused by the import of goods for sale in the United States below the amount charged for the same goods in the home market.

representatives from the Office of the Ombudsman regularly visit Customs offices along the northern border. However, while the office responds to U.S. and Canadian trade questions, it does not focus specifically on the northern border. According to the headquarters ombudsman's office, four Customs districts—Nogales, Arizona; Houston and El Paso, Texas; and San Diego, California—have established ombudsmen. District ombudsmen can function as a liaison, assist the local trade community in complying with applicable laws and regulations, and make recommendations to the District Director to improve local Customs operations. According to the Nogales District Ombudsman, her specific duties include attending border and trade meetings, facilitating use of Customs' Line Release program, educating the trade community on how to avoid delays at the U.S. border, and assisting in resolving minor disputes. The Nogales District Ombudsman, the District Director, and a representative of the headquarters ombudsman's office told us that the ombudsman approach has been very helpful. The District Director said that having an ombudsman is cost-effective, since he or she can cut through red tape and shorten the time it takes to get goods across the border.

Reactions from Customs officials on the northern border to the district ombudsman proposal were mixed, however. One port official said that an ombudsman would have very little work to do in his district, since U.S. Customs and local Customs brokers communicate regularly. An official in another northern district said that the ombudsman approach might be useful if it entails an additional, funded position and not one taken from current staff.

## **Project North Star**

Recognizing the need to focus and coordinate law enforcement and commercial trade activities more effectively along the Canadian border, Treasury and Customs, in cooperation with other responsible federal agencies, established Project North Star in July 1990. Of potential use in facilitating trade and implementing FTA, North Star's responsibilities are continuing to evolve.

Physically located in Buffalo, New York, North Star Commercial<sup>2</sup> was charged with monitoring FTA implementation to assure uniformity, assisting in problem solving and facilitating trade while increasing fraud enforcement, upgrading border station facilities, improving cooperation, and increasing federal border workforce efficiency. Other responsibilities

<sup>2</sup>North Star actually consists of two major functions—Enforcement and Commercial. Our review focused on the latter.

included establishing an "east-west" and a "north-south" dialogue along the entire border and collecting and routing information to interested parties within the Customs agencies as well as private business. North Star established a free trade data base which, together with a Customs E-mail (electronic mail) system, allows North Star to coordinate and disseminate FTA and selected information regarding such matters as the validity of FTA tariff preference claims.

Another North Star objective involved the organization of a Northern Border Trade Alliance to be comprised of representatives of U.S. and Canadian border entities, including economic development corporations, chambers of commerce, trade associations, individual companies, and governmental agencies. The alliance's primary objectives would have included assuring continued trade growth, integrating U.S. and Canadian interests in a cooperative effort, and providing unified leadership and an effective forum focused on border issues. There is some support for a border trade organization among local private sector and government officials, and it appears that such an alliance on the Mexican border has been active in addressing border problems. However, North Star has apparently played a limited role, and a northern alliance has not been established. At the time of our review, a senior Customs official told us that while participating in the border alliance would be acceptable, the agency no longer regarded actually organizing or establishing such a group as an appropriate North Star activity.

Despite its objectives of facilitating and coordinating trade activities, North Star Commercial staffing has been limited. Customs had not formally evaluated staffing needs at the time of our review, and the project never had more than four staff members, including administrative support. The individual who had served as director since its inception left North Star in October 1991. Subsequently, the Director's position was filled on a temporary or acting basis. The position was officially advertised in early February 1992, when the entire North Star Commercial staff consisted of one full-time trade operations specialist, one clerical staff member, and two part-time employees, who shared the Director's position. The position announcement was subsequently cancelled, and the position was filled in early May by an individual transferred from another Customs office.

A senior Customs official told us that there is a need to improve coordination within Customs and among various federal agencies in order to facilitate trade and to "generally make life easier for U.S. exporters and importers." This official supports the designation of a central U.S.-Canada

trade facilitator who would be identified as the primary, or perhaps sole, Customs contact point. The office's major responsibility would be to direct people with questions or problems to the most appropriate source of information within Customs or elsewhere. Senior Treasury Department and Customs Service officials supported assigning these responsibilities to North Star.

At the time of our review, Customs was identifying specific North Star Commercial objectives, roles, and responsibilities. It appeared that North Star might well be assigned a major role in FTA implementation. For example, according to a December 1991 internal memorandum from the Assistant Commissioner, Office of Commercial Operations, North Star's responsibilities were to include

- establishing and maintaining an FTA data base and electronic bulletin board to facilitate the flow of relevant information,
- assembling FTA data from district coordinators,
- creating an FTA newsletter,
- monitoring FTA training and regulatory rulings,
- conducting seminars, and
- serving as a clearinghouse and focal point for questions and disseminating FTA information to the industry and Customs personnel.

According to a senior Customs official responsible for overseeing North Star, the project's specific roles relative to U.S. exporters have not been fully defined, and the roles may continue to evolve and change over time. However, the official said that he expects North Star to become a central, authoritative source of assistance and accurate, consistent information for exporters and importers concerning Customs-related FTA and U.S.-Canada trade questions.

# Objectives, Scope, and Methodology

At the request of Representative Louise M. Slaughter, we examined various issues regarding implementation of the U.S.-Canada Free Trade Agreement, which took effect on January 1, 1989. Specifically, our objectives were to obtain information on (1) what responsible agencies have done to carry out the agreement; (2) how FTA has affected U.S.-Canada trade, including how the agreement has dealt with border-crossing concerns and differing product standards; and (3) how U.S. businesses view the FTA's rules of origin and related administrative requirements; (4) how the federal agencies have coordinated their trade activities, and whether there is a need to establish an Office of Free Trade Ombudsman; and (5) what other projects are underway to settle problems under FTA. The report also presents general U.S.-Canada trade data and information about the three largest border crossings, by trade volume. Although the agreement includes provisions concerning trade in goods and services, agriculture, and business travel, as agreed this report focuses on trade in manufactured goods.

Much of the information presented in this report is based on interviews, documents, and statistics provided by officials of various units within the U.S. government. These entities included the Office of Canada and the Bureau of the Census within the Department of Commerce; the U.S. Customs Service and other relevant offices within the Department of the Treasury; the Office of the U.S. Trade Representative; the U.S. International Trade Commission; the Small Business Administration; the Department of State; the Immigration and Naturalization Service of the Department of Justice; and the Animal and Plant Health Inspection Service of the Department of Agriculture.

In addition to our interviews with federal agency officials in Washington, D.C., we met with U.S. Customs officials in Detroit, Michigan; Buffalo, New York; and Seattle and Blaine, Washington, as well as with Commerce district office staff in Detroit and Seattle. Among other things, these officials provided us with information about the land border ports we visited: Detroit, Buffalo, and Blaine.

We reviewed published material, including congressional hearings and reports. We also analyzed relevant academic and periodical literature and reports prepared by various sources, including industry and trade associations, private consultants, and U.S. and Canadian government agencies.

We obtained information about and views on FTA implementation and U.S.-Canada trade issues from academic experts, individual company representatives, Customs brokers, and officials of industry and trade organizations. Additionally, we interviewed numerous state and local government officials to get their opinions on various FTA issues.

We obtained information on FTA issues in group meetings with exporters, trade association representatives, and state and local officials in Rochester and Buffalo, New York; Detroit, Michigan; and Seattle (Blaine) Washington—three of the largest ports, by trade volume, along the Canadian border. The meetings, with a total of 73 participants, were arranged with the help of various private and public organizations. The views of the local exporters we met with are not necessarily representative of the views of all exporters.

To obtain Canadian views on the implementation of the agreement, we reviewed pertinent reports and other documentation. In addition, we met with officials of External Affairs and International Trade Canada in Ottawa. We also discussed FTA issues with representatives of Revenue Canada Customs and Excise in Ottawa, Fort Erie, Windsor, and Vancouver, Canada, and reviewed documentation provided by these officials. We toured Revenue Canada facilities in Fort Erie and attended a U.S.-Canada Trade Fair in Hamilton, Ontario. In addition, we discussed FTA issues with Canadian Customs brokers and their representatives and reviewed documents provided by these individuals.

We did our review from March 1991 through May 1992 in accordance with generally accepted government auditing standards.

# Comments From the Department of Commerce



UNITED STATES DEPARTMENT OF COMMERCE  
Chief Financial Officer  
Assistant Secretary for Administration  
Washington, D.C. 20230

21 OCT 1992

Mr. Richard L. Fogel  
Assistant Comptroller General  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Fogel:

Thank you for your letter requesting comments on the draft report entitled, "International Trade: Implementation of the U.S.-Canada Trade Agreement."

We have reviewed the enclosed comments of the Under Secretary for International Trade and believe they are responsive to the matters discussed in the report.

Sincerely,

  
Preston Moore

Enclosure

Appendix VI  
Comments From the Department of  
Commerce



UNITED STATES DEPARTMENT OF COMMERCE  
The Under Secretary for International Trade  
Washington, D.C. 20230

OCT 09 1992

Mr. Richard L. Fogel  
Assistant Comptroller General  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Fogel:

Thank you for your letter requesting the Department's comments on the draft General Accounting Office report entitled "International Trade: Implementation of the U.S.-Canada Free Trade Agreement."

The report accurately reflects the Office of Canada's (OOC) efforts to implement the U.S.-Canada Free Trade Agreement (CFTA). A few inaccuracies are noted, most notably the confusion between the tariff removal schedule and accelerated tariff removal. In addition, since completion of the report, some of the issues, such as a "de minimis" rule, have been prospectively resolved in the North American Free Trade Agreement (NAFTA). Specific comments to correct and update the report are attached.

Based on our reading of the report, we believe the recommendations assume the U.S. Customs Service assists U.S. exporters as well as importers. Naturally, Customs focus is on imports. Both recommendations, therefore, leave out a vital segment of the American business community. Comments on the recommendations follow:

RECOMMENDATION I "Fully evaluate Project North Star Commercial's staffing needs and assign staff accordingly."

We recommend North Star consider including technical assistance to U.S. exporters on the Harmonized System and the rules-of-origin/Exporter's Certificate of Origin. To the extent that North Star is operating, it currently serves U.S. Customs agents, customs brokers, and importers, not exporters. Exporters continue to seek HS numbers and other CFTA technical customs procedures information from OOC. The demand will expand significantly if NAFTA is approved and implemented, and we believe Customs may be in a better technical position to provide this information.



Appendix VI  
Comments From the Department of  
Commerce

GAO note: Technical corrections suggested by the Department of Commerce have been omitted.

RECOMMENDATION II "Specify the relationship between North Star and other relevant entities such as the Customs Trade Ombudsman and Commerce's Office of Canada."

We strongly support this recommendation. Since 1989, OOC-U.S. Customs cooperation to help U.S. exporters has been somewhat limited, in part because of Customs' staffing and budget constraints. More collaboration would greatly improve assistance to exporters seeking to benefit from tariff removal under the CFTA and under NAFTA.

We appreciate this opportunity to comment on the draft report.

Sincerely,



Timothy J. Hauser, Acting

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