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Briefing Report to the Chairman, Subcommittee on Commerce, Consumer Protection, and Competitiveness, Committee on Energy and Commerce, House of Representatives

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INTERNATIONAL TRADE

Commerce Department Conference on Mexico's Maquiladora Program

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National Security and
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April 3, 1987

The Honorable James J. Florio
Chairman, Subcommittee on Commerce,
Consumer Protection, and Competitiveness
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

In response to your request and subsequent discussions with your representative, we reviewed Commerce Department participation in the Expo-Maquila '86 conference. This event aimed to promote U.S. firms' participation in Mexico's Maquiladora investment program. Due to concern about the appropriateness of Commerce sponsorship of this conference, Congress placed in the 1987 Continuing Resolution (P.L. 99-591) a provision which, according to the Joint Explanatory Statement of the Conference Committee, aims to prohibit Commerce participation in this and similar events. We earlier provided you with testimony on this matter on December 10, 1986.

Although Mexico established the Maquiladora program in 1965, the Expo-Maquila '86 conference held December 3 to 5, 1986, represented Commerce's first effort to stage an organized event to promote participation in this program. The Mexican government initiated the Maquiladora program 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.

Commerce's decision to stage this event resulted from a recent upsurge in U.S. business interest in the program. 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. The Expo-Maquila '86 conference was organized by Commerce's Foreign Commercial Service and Trade Center staffs at the U.S. embassy in Mexico and a Mexican public relations firm. The Foreign Commercial Service staff obtained the speakers; the Trade Center staff arranged for exhibitors; and the Mexican public relations firm recruited participants by sending three mailings to a list of about 39,000 individuals from industries that have shown the greatest interest in establishing maquiladora plants.

Commerce alloted $166,842 for direct project costs (i.e., all expenses, including the public relations firm's fee but excluding salaries of government officials) for Expo-Maquila '86. Commerce paid these costs from an account established for its "reimbursable program," which is financed by fees paid by exhibitors and participants at Commerce-sponsored trade shows and by firms for Commerce export services. Other costs, such as salaries for Commerce staff, were paid using appropriated funds. Commerce anticipates that Expo-Maquila '86 will generate a revenue surplus. However, when Commerce turned the event over to the public relations firm to comply with the fiscal year 1987 Continuing Resolution prohibition, Commerce's proceeds from the event were reduced.

Questions regarding Commerce's participation in Expo-Maquila '86 reflect concerns about the development of the Maquiladora program. We found that the program has grown substantially in recent years and has evolved beyond its initial objective of attracting sub-assembly operations. The devaluation of the peso in 1982, which greatly reduced the U.S. dollar-cost of Mexican labor, caused a substantial increase in activity under the Maquiladora program. At the end of 1965, the program had only 12 operating plants employing about 3,000 workers; by 1982 the program had grown to 588 plants employing over 122,000 workers and by 1985 to 789 plants with about 217,000 workers. As of February 1986, about 68 percent of maquiladora plants reportedly were entirely or majority U.S.-owned.

With this increased activity has come the recent trend 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. 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. Reflecting these developments, several maquiladora plants now produce relatively complex components while others produce completed products ready for retail sale.

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. 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. Another important constraint is the shortage of skilled labor. Infrastructure limitations, such as overburdened telephone and communications services and power outages, also constrain the continued development of the Maquiladora program. Also, shipping products across the border can pose problems.

At your request, we also assessed whether Commerce could "circumvent" the fiscal year 1987 Continuing Resolution prohibition by using private sector funds. The funds held by Commerce's International Trade Administration in its "reimbursable program" account 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 found no indication that Commerce has used or intends to use funds from this account in a manner inconsistent with the restriction.[1]

We also found that a relatively narrow Commerce interpretation of the 1987 Continuing Resolution prohibition resulted in Commerce staff participation in a Caribbean Basin Initiative conference during November 1986 that, similar to Expo-Maquila '86, appealed to U.S. firms to invest overseas. Commerce officials acknowledge that speakers made presentations regarding establishing sub-assembly operations in Caribbean countries. Also, materials were made available that convey the advantages of establishing plants in the Caribbean.

Appendix I contains more detailed information on the results of our work and our objectives, scope, and methodology for conducting this review.

[1] 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 As agreed with your representative, we will report to you on this matter at a later date.

In response to your request that we expedite issuance of this report, we did not request agency comments. However, Commerce officials have informally informed us that our December 10, 1986 testimony, which serves as the basis for this report, presented a generally fair and accurate description of Commerce participation in Expo-Maquila '86 and the evolution of the Maquiladora program.

Unless you publicly announce its contents earlier, we plan no further distribution of this briefing report until 7 days from the date it is issued. At that time, we will send copies to the Secretary of Commerce, various congressional committees, and other interested parties and make copies available to others upon request. If we can be of any further assistance, please call me on 275-4812.

Sincerely yours,

Allan I. Mendelowitz
Senior Associate Director

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Abbreviations

FCS	Foreign Commercial Service
ITA	International Trade Administration

Commerce Department Conference on Mexico's Maquiladora Program

During January 1986, the Department of Commerce took steps toward staging a conference in December—Expo-Maquila '86—to promote U.S. firms' participation in Mexico's Maquiladora program. Through this program, the Mexican government provides incentives to attract foreign direct investment to Mexico. Due to concern about the appropriateness of Commerce sponsorship of this conference, Congress placed in the "Joint Resolution Making Continuing Appropriations for the Fiscal Year 1987, and Other Purposes" (P.L. 99-591) a provision which, according to the Joint Explanatory Statement of the Conference Committee, aims to prohibit Commerce participation in this and similar events.

Objectives, Scope, and Methodology

We made this review at the request of the Chairman, Subcommittee on Commerce, Transportation, and Tourism,[1] House Committee on Energy and Commerce, to assess Commerce Department participation in the Expo-Maquila '86 conference, provide information on the Maquiladora program, and review Commerce compliance with the 1987 Continuing Resolution prohibition.

In assessing Commerce participation in the Expo-Maquila '86 conference and compliance with the Continuing Resolution prohibition, we interviewed (1) Commerce headquarters officials from its Office of Export Promotion Services and Caribbean Basin Initiative Information Office and (2) Trade Center officials at the U.S. embassy in Mexico. We reviewed materials related to the Expo-Maquila '86 conference, including recruitment material sent to prospective participants, lists of attendees and exhibitors, budget analyses, and a final report on the conference. We also reviewed materials related to (1) Commerce efforts to comply with the fiscal year 1987 Continuing Resolution prohibition and (2) other conferences in which Commerce planned to participate during fiscal year 1987, particularly a Caribbean Basin Initiative conference held November 16 to 20, 1986.

In assessing the evolution of the Maquiladora program, we relied largely on information obtained from studies and individuals identified as 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

[1] As a result of a January 1987 reorganization of the House Energy and Commerce Committee, the Subcommittee on Commerce, Transportation, and Tourism was renamed the Subcommittee on Commerce, Consumer Protection, and Competitiveness

sector studies and articles on the Maquiladora program and the record of testimony on the program presented on November 25, 1986, before the Subcommittee on Economic Stabilization, House Committee on Banking, Finance and Urban Affairs; and on December 10, 1986, before the Subcommittee on Commerce, Transportation, and Tourism, House Committee on Energy and Commerce.

This review was conducted in accordance with generally accepted government auditing standards.

Commerce Participation in Expo-Maquila '86

The Expo-Maquila '86 conference, held December 3 to 5, 1986, in Acapulco, Mexico, represented Commerce's first effort to stage an organized event for the Maquiladora program. Commerce's decision to stage this event resulted from a recent upsurge in U.S. business interest in the program. 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 such 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, S.A. organized the Expo-Maquila '86 conference. The FCS staff obtained the speakers. The Trade Center staff arranged for exhibitors by contacting 1,443 organizations in Mexico and the United States. The staff sold all 92 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 about 39,000 prospective participants from industries that have shown the greatest interest in establishing maquiladora plants. To generate this list, the public relations firm used, among other things, a list of firms in the automotive and electronics industries compiled by Dun & Bradstreet using Standard Industrial Classification codes (i.e., codes developed by Commerce to categorize firms by industry) and U.S. Trade Center recruitment lists. 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 staffs in Mexico. The conference was fully reserved, with about 400 participants who paid $325 each to attend. About 70 percent of the participants represented U.S. organizations.

Commerce anticipates that Expo-Maquila '86 will generate a revenue surplus. According to Commerce officials, final accounting for such events normally does not occur for months after their completion. 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[2]), as follows.

Table I.1: Expo-Maquila '86 Direct Pro ect Costs

Type of Expenditure	Cost
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 at Commerce-sponsored trade shows and by firms for Commerce export services, such as credit checks on foreign firms and notices of export opportunities. Gross

[2]The FCS and Trade Center staffs estimate that they devoted about 28 workweeks to the conference

revenues from Expo-Maquila '86 originally were estimated at $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") originally 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 agreed to a new arrangement whereby the firm will receive 80 percent of the net proceeds and Commerce will receive 20 percent. This action also caused an increase in expenses associated with the conference. Of greatest importance, because the conference was being staged by a Mexican firm, rather than a U.S. government facility not subject to Mexican taxation, it became subject to about $40,000 in Mexican value-added tax, almost halving the projected net receipts.

Based on previous work, we believe this program could have an influence on the decisionmaking of the participants. 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 concerns that the Maquiladora program has grown substantially in recent years and has evolved beyond its initial objective of attracting sub-assembly operations. 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 reduced considerably the U.S.-dollar cost of Mexican labor. Even after several increases in the Mexican minimum wage, the minimum wage in maquiladora plants on January 1, 1986, according to information provided by the U.S. embassy in Mexico, averaged 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. A devaluation of the peso in early 1987 likely will result in a further decrease in the U.S.-dollar cost of Mexican labor. Firms we contacted that have recently established maquiladora plants most often 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 over 122,000 workers and by 1985 to 789 plants with about 217,000 workers. This growth came largely in the automotive and electronics sectors. As of February 1986, about 68 percent of maquiladora plants reportedly were entirely or majority U.S.-owned. Value-added in maquiladora plants increased approximately 53 percent, from about $828.2 million in 1983 to about $1.265 billion in 1985. The Maquiladora program is now second only to exports of 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 22-year existence of the 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 Prohibition on Commerce Operations

In response to the concern raised in your letter, we assessed whether Commerce could "circumvent" the prohibition contained in the fiscal year 1987 Continuing Resolution by using private sector funds. Commerce's fiscal year 1987 appropriation for its 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 found no indication that Commerce has used or intends to use funds from this account in a manner inconsistent with the restriction.

After passage of the Continuing Resolution, Commerce used appropriated funds in implementing its decision to turn the conference over to the public relations firm. In an effort to transfer responsibility in an orderly manner, Commerce needed to continue performing certain administrative functions, such as receiving payments, which could not be readily discontinued. We believe these activities were consistent with the intent of the restriction.

However, in the course of reviewing this issue, we have tentatively identified a greater concern with Commerce's use of this account. Specifically, we have reservations about whether the Mutual Education and Cultural Exchange Act of 1961, as amended (22 U.S.C. 2451 et seq.), under which Commerce operates its "reimbursable program," authorizes it to maintain reimbursements or payments from private sector sources. Unless an agency has specific statutory authority to establish a revolving fund, by statute (31 U.S.C. 3302), any reimbursements or payments under contracts or fees it receives must be turned over to the Treasury as miscellaneous receipts.

We also found that a relatively narrow Commerce interpretation of the 1987 Continuing Resolution prohibition resulted in Commerce staff participation 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, ITA management issued memoranda 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 <u>feature</u> relocation of U.S. industry, manufacturing and/or assembly plants to foreign countries and, (2) [Commerce] <u>participation</u> and <u>support</u> is such that it <u>contributes substantially</u> to the particular event."

Based on this guidance, ITA staff, using appropriated funds, participated in the Miami Conference on the Caribbean and Caribbean Basin Investment Exposition held November 16 to 20, 1986. This conference appears to have met Commerce guidelines. It did not feature <u>per se</u> 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 "<u>associated with</u> conferences . . . which feature <u>or convey the advantages of</u> 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 discussions 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 and cut cloth. Also, materials were available at the conference that conveyed the advantages of establishing plants in the Caribbean. Brochures from represented Caribbean countries discussed 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 encouraged investors to establish operations in the Caribbean as a way of "keeping jobs in the United States," an argument similar to that used in support of the Maquiladora program.

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