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An Analysis of an Alliance: NAFTA Trucking and the US Insurance Industry[1]

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In the NAFTA, the United States agreed to phase out restrictions on the operation of Mexican trucking companies in the United States. When the deadlines came, the Clinton Administration chose to maintain the restrictions. Following a NAFTA panel ruling against the United States, the Bush Administration announced it would remove the restrictions. The decision has met with opposition from both truckers and insurers in the United States, who cite safety concerns. This article examines the economic, political and legal forces at work in this debate, as well as the relationship between the NAFTA and WTO rules on trade in services that apply.

Keywords: NAFTA; insurance; trucking; WTO

Introduction

By a 285–143 roll call, the U.S. House of Representatives voted on June 26, 2001, that it would block the Transportation Department from issuing permits that would let Mexican trucks operate throughout the United States. This vote is the result of opposition from both the Democrats and the Republicans. The Democrats were pushed hard by the truckers' lobby and the Republicans by the insurance lobby in Washington.

The U.S. trucking unions have opposed the entry of Mexican truckers into the United States to transport goods on the grounds that the Mexican truckers will not meet U.S. safety standards. Underlying this opposition is the reality that U.S. truckers are likely to lose a lot of business. Each year, about five million crossings are made, hauling about three-fourths of the $250 billion in United States–Mexico trade. Under the new NAFTA panel ruling, instead of Mexican trucks transferring their loads to U.S. truckers at the border, the Mexican truckers will be able to carry the loads to their final destinations in the U.S. Moreover, transportation of goods by Mexican truckers will cost less, as the wages earned by the Mexican drivers are a fraction of what the unionized U.S. truckers charge for their services.[2]

In February of 2001, a panel ruled that it was against the North American Free Trade Agreement for the United States to put a moratorium on free movement of trucks between the United States and Mexico. The ruling has generated a flurry of lobbying by a number of interest groups in Washington. In what follows, we analyze the history and the current situation and take a closer look at the politics and economics behind the ruling. We discuss what might be ahead.

A Bit of History

Prior to 1980, the United States granted operating authority to motor carriers for each individual route, requiring economic justification for each proposed service. It did not distinguish between United States, Mexican or Canadian applicants. However, the Interstate Commerce Commission (ICC) severely restricted new entry into the domestic market. In 1980, the Motor Carrier Act essentially eliminated regulatory barriers to entry, making it easier for motor carriers from all three countries to obtain operating authority. It did not distinguish between nationals and non-nationals. At the time, Canada already allowed reciprocal access for U.S. truckers in its domestic market, but Mexico did not. [3]

The equal treatment of U.S. and foreign applicants ended in 1982. The Bus Regulatory Reform Act imposed an initial two-year moratorium on the issuance of new motor carrier operating authority to foreign carriers. A presidential memorandum immediately lifted the moratorium with respect to Canada in response to the Brock-Gotlieb Understanding, which confirmed that U.S. carriers would have continued access to the Canadian market. The same memorandum declined to lift the moratorium with respect to Mexico, citing U.S. truckers' continued lack of access to the Mexican market. The U.S. president repeatedly extended the moratorium against Mexican truckers every two years from 1984 to 1995. The purpose of the moratorium was to encourage Mexico to lift its restrictions on market access for U.S. firms.[4]

However, there were some exceptions allowed to facilitate cross-border trade. The commercial zone of border towns exemption has permitted Mexican carriers to operate in the commercial zones associated with municipalities along the border since before 1982, provided they obtained a Certificate of Registration from the Federal Motor Carrier Safety Administration. Under this procedure, the applicant certifies that he has access to and will comply with Federal Motor Carrier Safety Regulations. Applicants are not required to submit proof of insurance, but inside the commercial zones must carry proof of insurance on board. In 1999, 8,400 Mexican firms had authority to operate in the commercial zones.[5]

A second exception relates to Mexican operators that transit through the United States to Canada, which are not affected by the moratorium. Congress has not granted the Department of Transportation the authority to require trucks transiting from Mexico to Canada to seek operating authority, so it is not required. These Mexican trucks need only comply with U.S. insurance requirements and safety regulations.

Under a third exception, "grandfathered" Mexican trucking companies that had acquired operating authority prior to 1982, when the moratorium came into effect, are not affected. Five Mexican carriers are entitled to these exemptions.[6]

Under a fourth exception, the ICC Termination Act of 1995 exempts U.S.-owned Mexican-domiciled truck companies, which number approximately 160 companies, from the operation of the moratorium. A fifth exception, which allowed Mexican carriers to lease both trucks and drivers to U.S. carriers, was allowed until January 1, 2000. The Motor Carrier Safety Improvement Act of 1999 ended the leasing exception when the United States realized that this provision could be used to sell U.S. carriers' operating authority to Mexican carriers for operations beyond the border zone.[7]

On March 1, 1994, the transportation ministers of Canada and Mexico signed three memoranda of understanding to permit truckers to operate between Canada and Mexico.[8] The cargo-exchange agreement permits Canadian truckers to enter Mexico to exchange cargoes at contracted Mexican terminals and facilities along the northern border of Mexico. The commercial driver's license reciprocity agreement lets Canadian and Mexican drivers operate in each other's country with their own licenses. The transportation training agreement allows Canada to train Mexican personnel in the areas of maritime and port management and truck-driving simulation.[9]

Under a memorandum of understanding (MOU) between the United States, Mexico and Canada, U.S. truck carriers are able to carry freight from Canada to 20 kilometers inside Mexico in a nearly barrier-free environment. Despite the MOU, the governments of the United States and Mexico have been at an impasse over permitting each other full access to their markets since 1995.

Under the NAFTA, the United States agreed to give access to Mexican trucks in 1995, but President Bill Clinton, under heavy pressure from religious, labour, environmental and other interest groups, kept the provision from taking effect, saying Mexico had to do more to address safety problems first. That year, the Mexican government, invoking NAFTA provisions, asked that a five-member panel be set up to determine whether Washington was violating the agreement. In its decision, the panel—two Americans, two Mexicans and a British chairman—unanimously ruled that the United States would be in violation if it did not begin considering applications from Mexican trucking companies. At the time, more than 160 applications were pending.

Operating authority from the Interstate Commerce Commission (ICC) was[10] required to provide interstate or cross-border truck services in the United States. Under the NAFTA, a moratorium remained in place on new grants of operating authority for persons from Mexico. However, the United States agreed to phase out the moratorium so that Mexicans would be permitted to obtain operating authority to provide cross-border truck services to or from border states (California, Arizona, New Mexico, and Texas) as of December 16, 1995. Cross-border truck services to the remainder of the United States were to start as of January 1, 2000. In addition, Mexicans were to be permitted to establish enterprises in the United States to provide truck services for the transportation of international cargo between points in the United States as of December 17, 1995. The moratorium remains in place on grants of authority for the provision of truck services by Mexicans between points in the United States for the transportation of goods other than international cargo.[11]

Recent Ruling by NAFTA Panel

The decision of the NAFTA panel requires the Department of Transportation to consider applications on individual merit and not to refuse authority across the board to all Mexican companies. In essence, the United States had argued that it could deny access to all Mexican trucking firms on a blanket basis, regardless of the individual qualifications of particular members of the Mexican industry, unless and until Mexico's domestic regulatory system meets U.S. approval. However, the law of the United States considered applications for operating authority from U.S. and Canadian carriers on an individual basis. This differential treatment of Mexicans, on the one hand, and Americans and Canadians, on the other, violated NAFTA Articles 1202 (national treatment) and 1203 (Most-Favoured-Nation treatment).[12]

Article 1202 requires that each party accord to service providers of another party treatment no less favourable than it accords, in like circumstances, to its own service providers. Article 1202 also requires that each party accord to service providers of another party treatment no less favourable than it accords, in like circumstances, to service providers of any other party or non-party.

The United States argued that the continuation of the moratorium was nevertheless justified under the general exception of Article 2101, which provides that "nothing … in

Chapter 12 (Cross-border Trade in Services) … shall be construed to prevent the adoption or enforcement by any party of measures necessary to secure compliance with laws or regulations … relating to health and safety and consumer protection." Citing GATT and WTO jurisprudence, the panel ruled that the United States had to use the least-trade-restrictive means available to address its safety concerns. The numerous exceptions the United States applied to the moratorium proved that there were less restrictive means available to achieve its safety goals with respect to Mexican truckers. Thus, the blanket ban could not be justified under Article 2101.[13]

An interesting aspect of the decision involves the nature of reservations taken under a trade agreement. The laws of each country must comply with the general rules of trade agreements that it signs, such as the non-discrimination rules of national treatment and Most-Favoured-Nation treatment. Trade agreements contain general exceptions to those rules, for example to permit environmental and safety regulations that may have an incidental effect on trade. In addition, at the time of negotiation of the trade agreement, countries may negotiate exemptions for certain industries protected from foreign competition by specific laws. That is, countries may keep certain laws in place notwithstanding their inconsistency with the general rules. However, they must be listed as reservations in the annexes of the agreement.

Reservations constitute specific instances where a country maintains laws that go against the main objective of the trade agreement, which is to liberalize trade. As such, they are often of limited duration and are interpreted strictly. When they expire, the law in question must pass muster with the general rules or fit into one of the general exceptions.

In the trucking case, the United States placed a reservation in an annex to permit the moratorium on Mexican trucks to continue, but also included dates when specific aspects of the moratorium would be phased out. Once the reservation expired, the United States had to either lift the moratorium or justify it under the general rules or exceptions. Not surprisingly, the moratorium did not pass muster. Had it been consistent with the NAFTA rules, no reservation would have been required in the first place. Thus, by using the reservation, the United States virtually admitted a violation of the rules.

The panel made clear that the United States was entitled under the NAFTA to set its own safety standards and to ensure that Mexican trucking companies meet them. Moreover, the United States is not required to treat applications from Mexican truckers in exactly the same manner as applications from the U.S. or Canadian firms, as long as they review applications on a case-by-case basis, comply with the NAFTA, and make decisions in good faith with respect to legitimate safety concerns.[14]

Following the panel decision, the Bush administration announced that it would reverse the Clinton administration policy and begin allowing Mexican trucks to haul goods throughout the United States.

Economics of Opposition

U.S. truckers are not the only industry opposing the Mexican truckers. The U.S. insurance industry is also up in arms. Why? They sell insurance to the U.S. truckers, covering not only vehicle and liability insurance, but insurance on the goods being transported. A reduction in the market share of the U.S. truckers will also reduce the market share of the U.S. companies that insure them. Mexican truckers will buy insurance from insurance companies in Mexico.[15] Of course, the U.S. insurance companies may be concerned that Mexican truckers will cause more accidents than U.S. truckers, thereby increasing payouts by insurance companies. But if the Mexican truckers are insured by Mexican insurance companies, those payments would not come out of the pockets of the U.S. insurance companies.

The American Insurance Association (AIA) said that Mexican trucks should be allowed to operate only in the border states until three programs are implemented. First, the AIA wants safety standards among the three NAFTA countries harmonized. Second, adequate enforcement of those standards must be implemented. Third, an adequate database of Mexican truck safety must be developed. The AIA proposal appears reasonable on the surface, but is in fact designed to delay the entry of Mexican truckers beyond the border states for many years.[16] Under the NAFTA, there is no requirement to harmonize safety standards, and it may be difficult to get the countries to negotiate such an agreement. Even if such an agreement were reached, corruption in Mexico means that adequate enforcement in Mexico could not be achieved for many years. Finally, the creation of a database on Mexican truck safety would be costly and time-consuming and would likely serve as further ammunition in the effort to keep Mexican trucks out of the U.S. market.

Nevertheless, some progress has been made by the Land Transportation Standards Subcommittee, which is charged with the task of implementing a work program to make standards for bus and truck operations *compatible.*[17] In 1991, Mexico became a member of the Commercial Vehicles Safety Alliance, together with the United States and Canada. The same year, Mexico and the United States adopted uniform guidelines for roadside inspections and uniform standards for commercial drivers' licenses and criteria such as knowledge and skills testing, disqualification, and physical requirements for drivers.[18]

An In-depth Look at the DOT Report

In 1998, the Department of Transportation (DOT) in the United States produced a report that sealed the fate of the Mexican truckers in the United States.[19] In the report, it is claimed that Mexican trucks do not meet U.S. safety standards. The DOT reported that 44 percent of trucks inspected did not pass the safety standards. Insurance industry trade groups argue that the U.S. government will have to spend four to seven million dollars a year to increase the number of safety inspectors at the border. Mexican trucks have been allowed to cross the border twenty miles into the United States to transfer cargo to U.S. trucks.

A closer inspection of the report produces a different picture. A much less quoted figure of the report says that although 44 percent of the Mexican trucks inspected did not pass the safety standards, 27 percent of the U.S. trucks did not pass the safety standards either (and a much lower 17 percent of the Canadian trucks did not meet the safety standards). On the face of it, it still seems that Mexican trucks have a significantly higher failure rate in meeting the safety standards. Such a presumption is false. Why?

When we examine the disaggregated data by state we find vastly different failure rates—California, 28 percent; Arizona, 42 percent; New Mexico, 37 percent; and Texas, 50 percent. (The report also quotes more recent figures, for 1998, showing that overall failure rates have become 42 percent rather than the 44 percent quoted for 1997.) Thus, it is not the same problem across different states. There should be no presumption that Mexico only sends "better trucks" across to California and "worse trucks" across to Texas! The problem lies with the process of inspection. The report acknowledges that the inspection process is not random (p. 32). If a truck "looks bad" then it is inspected more minutely. It seems that the inspection process varies substantially across states, casting doubt on the validity of the figure "44 percent bad trucks".

Dimensions of the Problem

How large is the problem? How many trucks cross the border into the United States? In many press reports the number of truck crossings cited was in the region of 4.5 million.[20] It was argued that allowing Mexican trucks on U.S. roads will pose a very large problem. For example, the Public Citizen Organization (a lobby group) declared in a highly charged article called "The Coming NAFTA Crash" that if Mexican trucks are allowed into the United States, in order to carry out simple inspections the Department of Transportation will require at least 32,000 more inspectors.[21] This will overwhelm the Department of Transportation's border inspection system. The number of trucks that actually crossed the border in 1999 was 63,000. How did the figure of 4.5 million come about? There seems to be some confusion between the number of *crossings* and the number of trucks. While it is true that there were 4.5 million crossings, the same trucks crossed the border time and again. Hence the presumed problem turns out to be a storm in a teacup!

Differing Standards

It is true that safety standards in Mexico and the United States differ in many ways: (1) The United States generally limits truck weights to 80,000 pounds, compared to Mexico's limit of 97,000 pounds. (2) The United States requires front-wheel brakes, whereas Mexico does not. (3) U.S. laws require drivers to meet licensing standards that include limits on the length of their driving shifts and drug testing, while Mexican laws do not. (4) Mexico does not require the maintenance of driving logs or other types of data that would be needed for enforcement. However, the lack of mandatory rules in these areas in Mexico would not prevent Mexican truckers from ensuring they meet U.S. standards. Indeed, trucking companies that seek to operate across the border would be wise to impose the necessary standards in-house. In fact, Mexican truck companies that applied for operation in the U.S. have pledged that they will only send the trucks that comply with "normal" U.S. standards.

With respect to insurance, U.S. trucking companies must meet minimum financial responsibility requirements to protect third-party claimants' rights of recovery. Some interstate trucking companies must also carry cargo insurance. Shippers often obtain similar coverage.

Some State Legislation

The NAFTA provisions granting Mexican trucks and buses free access to U.S. border states prompted the Texas Legislature to enact several new laws that took effect on December 5, 1995. Mexican carriers doing business beyond the Texas border commercial zones must meet the same safety and insurance requirements as U.S. and Canadian truckers. Mexican and domestic motor carriers must file proof of liability insurance coverage to the Texas Department of Transportation (TxDOT) in specific amounts ranging from US $300,000 to $5,000,000, depending on the type of vehicle and cargo.

Coverage must be with a licensed company or through a self-insurance mechanism approved by TxDOT. For-hire motor carriers of household goods must carry cargo insurance in amounts required by federal law (US $5,000 per vehicle, up to US $10,000 for aggregate loss or damage in one occurrence).

Non-U.S. insurers, through a port-of-entry law, can obtain a Texas certificate of authority to operate domestically. This law requires alien companies to establish a Texas subsidiary and comply with all Texas capital, asset, and surplus requirements. Mexico's third largest casualty insurer, Aseguradora Mexicana (ASEMEX), was the first Mexican carrier to be granted a Texas certificate of authority under the port-of-entry law. ASEMEX sought the certificate in order to sell insurance to Mexican truckers who serve U.S. border zones.[22]

Some Proposals

Cross-border trucking insurance remains a problem to be resolved. Impediments remain to "seamless" insurance coverage for carriers wishing to provide trucking services across the borders to the three NAFTA countries, that is, the ability of companies to provide insurance coverage that is effective throughout the region, without the necessity of issuing more than one policy. There are concerns regarding the financial ability of Mexican domestic insurers to pay potential claims arising in the other two countries or to issue coverage that complies with the requirements in the other jurisdictions.

Canadian and U.S. insurers use a “Managing General Agent”, or fronting concept, whereby they handle the necessary filings in each other’s jurisdiction and provide the necessary proof of insurance. However, this is not available in Mexico. Mexican insurance law requires that the entire risk be retained in Mexico and does not permit this kind of reinsurance through a U.S. or Canadian insurer. Moreover, a Canadian or U.S. insurer that wishes to act as agent in issuing the Mexican insurer’s paper must first be so authorized by the Mexican National Insurance and Banking Commission. One proposal to solve the problem is a new Mexican law that would enable Canadian- or U.S.-licensed insurers to register in Mexico for the purpose of issuing policies in Mexico to Mexican insureds for motor carrier risks outside Mexico. Another option would be to develop a NAFTA insurance card system similar to the system used in Europe.

Under international law, countries have jurisdiction to regulate activities within their territory and to regulate the acts of their citizens. Mexico therefore has jurisdiction to regulate insurance contracts between Mexican truckers and insurance companies in Mexico. The U.S. government has no jurisdiction in the matter. However, the U.S. has jurisdiction to regulate the acts of Mexican truckers operating in U.S. territory. This means that the U.S. government could legally require all trucks operating in the United States to carry insurance, and dictate the type of insurance and the nature of the coverage. But can the U.S. government require that the insurance be purchased from U.S. insurance companies? One could expect the U.S. insurance industry to lobby for such a law in order to maintain their sales of insurance to truckers, be they Mexican or American.

However, under the WTO Financial Services Agreement and NAFTA Chapter 14 on financial services, the U.S. made commitments to open up its insurance industry to foreign suppliers. More importantly, it agreed to freeze any existing restrictions on foreign insurance suppliers by listing them as reservations in schedules that have been submitted to the WTO and attached to the NAFTA. If the U.S. were to introduce a new restriction on market access, the law would risk being challenged by Mexico under the NAFTA or the WTO agreement.

Conclusion

This case illustrates how regional trade agreements, such as the NAFTA, can interact with global trade agreements, such as the WTO Agreement on Trade in Financial Services, sometimes in unanticipated ways. Opposition to free trade in trucking services was probably not expected from the American insurance industry, and the reasons for their opposition are not immediately obvious. However, their goal to ensure that trucks operating in the United States carry insurance issued by U.S. companies may be complicated by the commitments the U.S. government has made under the global Financial Services Agreement and the NAFTA.

Another complexity revealed in this case is the relationship between international agreements and national constitutional law. While the federal government of the United States has signed the NAFTA and WTO agreements, in many areas, such as insurance, state governments have the power to regulate. This limits the ability of the federal government to ensure compliance with those aspects of international agreements that fall outside its jurisdiction under its own constitution, despite its obligation to seek such compliance.

Finally, this case shows how international agreements affect the range of domestic regulatory options available to national and subnational governments and to industries that lobby those governments for regulations that may offer them protection from foreign competition. On the one hand, the NAFTA and WTO agreements allow domestic governments to set their own safety standards. On the other hand, they restrict the manner in which governments may enforce those standards. Such standards must be applied in a nondiscriminatory fashion. That is, they may not be used to create disguised trade barriers to foreign competitors.

International agreements restrict the options available to domestic industry in terms of protecting the national market from foreign competition. The trucking case shows how industry trade groups can influence the trade policy of a government by the selective use of information and by pursuing their economic interests in a way that makes it appear they are really seeking what is in the public interest. Most often, however, their goal is to protect their domestic market from foreign competitors.[23]

Endnotes

1. We would like to thank the referees for making constructive suggestions about the paper. As a result, the final product is much better (including the title). We alone are responsible for the views expressed here. They do not represent the views of our employer.
2. The average wage of a Mexican trucker is approximately 21 percent of the average wage of an American trucker.
3. In the Matter of Cross-Border Trucking Services, Secretariat File USA-MEX-98-2008-01, Final Report of the Panel, Feb. 6, 2001, available at www.nafta-sec-alena.org.
4. Ibid.
5. Ibid.
6. Ibid.
7. Ibid.

8. MOU on the Use of Terminals and Installations of Transport Companies, MOU on Transportation Technical Cooperation, and MOU on Validity of Commercial Drivers' Licenses, signed at Mexico City, March 1, 1994.
9. CANADIAN AND MEXICAN MINISTERS SIGN TRANSPORTATION AGREEMENTS, Canada NewsWire, March 3, 1994.
10. Since ICC does not exist any more, this point is of no current value (we are indebted to the reviewers for pointing this out).
11. United States, Annex I, NAFTA.
12. In the Matter of Cross-Border Trucking Services, supra, note 3.
13. Ibid.
14. Ibid.
15. It may not seem clear why a Mexican trucking company would buy an insurance policy from a Mexican company. The answer is simple. It is cheaper. Why? The cost of processing information and verification is cheaper in Mexico. This has prompted some New York based insurance companies to sell insurance in California through their Mexican subsidiary (see, Bradly Condon, Joyce Sadka and Tapen Sinha, "Emperor's New Clothes: Expansion Strategies of North American Insurance Companies," paper presented at the Annual American Risk and Insurance Association Conference in Indianapolis, August 13, 2001).
16. This was clear from the decision in the House vote referred to in the introduction.
17. In the Matter of Cross-Border Trucking Services, supra, note 3. Also see NAFTA Article 913(5)(a)(i) and Annex 913.5.a-1.
18. Ibid.
19. Office of Inspector General Audit Report, MOTOR CARRIER SAFETY PROGRAM FOR COMMERCIAL TRUCKS AT U.S. BORDERS, Office of the Secretary and Federal Highway Administration, Report Number: TR-1999-034, Date Issued: December 28, 1998, available at http://www.oig.dot.gov/audits/tr1999034.pdf
20. Suzanne Gamboa, "Feds: 63,000 Mexican Trucks Crossed" Associated Press Report, April 17, 2001.
21. "The Coming NAFTA Crash," dated February 2, 2001. http://www.citizen.org/pctrade/nafta/reports/truckstudy.htm
22. Gloria Leal, "The truck stops here: A Texas regulator's perspective", *Business Mexico,* July, 1996.
23. For a more detailed analysis of the NAFTA, WTO, and domestic rules that affect trade in insurance services, please see our forthcoming book on NAFTA, WTO, and the North American Insurance Industry.