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PREFACE

The *Industry, Trade, and Technology Review (ITTR)* is a quarterly staff publication of the Office of Industries, U.S. International Trade Commission. The opinions and conclusions it contains are those of the authors and are not the views of the Commission or of any individual Commissioner. The report is intended to provide analysis of important issues and insights into the global position of U.S. industries, the technological competitiveness of the United States, and implications of trade and policy developments.

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IMPEDIMENTS TO COMPETITIVENESS IN RUSSIA'S MINERALS AND METALS SECTOR

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The minerals and metals sector is a major part of Russia's economy, accounting for about 25 percent of exports and employing more than 1.5 million people. Russia's vast underdeveloped and rich natural resources are a leading candidate for economic development. However, most of the industries in the sector are uncompetitive, reliant on existing low-grade mines, and hampered by old equipment. In addition, Russian products face growing restraints on access to foreign markets. Many trading partners have retaliated against allegedly unfair trade of Russian products by applying added duties to Russian imports. The sector's recovery is strongly dependent on a turnaround in the Russian economy or access to world markets or to both because domestic consumption has declined dramatically and cannot support the present capacity. To compete in global markets, Russian industries need to have new technology, become more efficient and reliable suppliers, produce quality products, and price products appropriately. However, several impediments affect any prospective achievement of these goals. This article examines these impediments, focusing on the sector's current condition and restraints on imports from Russia in foreign markets.

During the mid-1980s, the former Soviet Union had the largest minerals and metals sector in the world.² Russia inherited much of this industry when the Soviet Union was dissolved in 1991,³ and has a huge natural resource base, a relatively well-educated work force with substantial industry expertise, and improvisation skills to keep plants operating that reportedly have impressed foreign observers. Nevertheless, most minerals and metals industries face a

¹The views expressed in this article are those of the author. They are not the views of the International Trade Commission or any of the Commissioners.

²The minerals and metals sector includes those industries producing ores, concentrates, unwrought metal, and semifabricated metal products (e.g., sheet, plate, bar). For the purposes of this article, the oil/gas industry is not included. Primary sources for this article include: David Dyker, ed., "Investment Opportunities in Russia and the CIS," The Royal Institute of International Affairs, (Washington, DC: The Brookings Institution), 1995; trade and economic journals, such as Natural Resources Policy and Metal Bulletin Monthly; and reports from the U.S. Geological Survey, Organisation for Economic Co-operation and Development (OECD), and the World Trade Organization. Economic and trade data is taken mainly from U.S. Geological Survey, World Bureau of Metal Statistics, and OECD reports.

³Russia is now dependent on foreign suppliers for some mineral and metal products that were produced exclusively in other ex-Soviet Republics.

number of impediments to technical development and integration in global markets. Plant facilities are old and they use obsolete technology in many cases. Many deposits that are mined currently are low-grade and near exhaustion. The amount of pollution and environmental damage is substantial. In addition, mining operations are typically in remote areas with harsh climates. The former Soviet policy of creating interdependence between regions remains prevalent in the industries' structure--in many cases, raw materials mined in one location must be transported thousands of miles to a processing plant. Products destined for export must also be transported great distances before leaving the country; the average distance from a production plant to a seaport is over 4,000 kilometers.⁴

The minerals and metals sector is a large part of the Russian economy. Employment in the metallurgical sector, which includes mining and fabrication operations, is 1.5 million, including employees in support functions such as healthcare and education.⁵ These people make a relatively significant portion of Russia's entire workforce, which is about 66 million people. Of the 1.5 million employees, approximately 900,000 are direct employees.

The most serious challenge confronting the Russian minerals and metals sector is the precipitous decline in domestic consumption during the 1990s. For example, steel consumption declined from 66 million metric tons in 1990 to approximately 18 million metric tons in 1995, a decrease of more than 70 percent.⁶ Figure 1 shows similar trends for Russian consumption of aluminum, copper, zinc, and nickel. These shrinking figures for consumption trends reflect the general contraction of the Russian economy. Real GDP declined throughout the period so that in 1997 it was just 60 percent of the GDP in 1989; capital investment was 25 percent of the 1990 level; and employment declined by 12 percent during 1990/95.⁷ Developments in the defense sector have had a large detrimental effect on minerals and metals consumption. Budget cuts implemented after dissolution and restructuring problems severely curtailed demand in the Russian defense sector.⁸

⁴"East European & CIS Metals," supplement to *Metal Bulletin Monthly*, Apr. 1997, pp. 6-19.

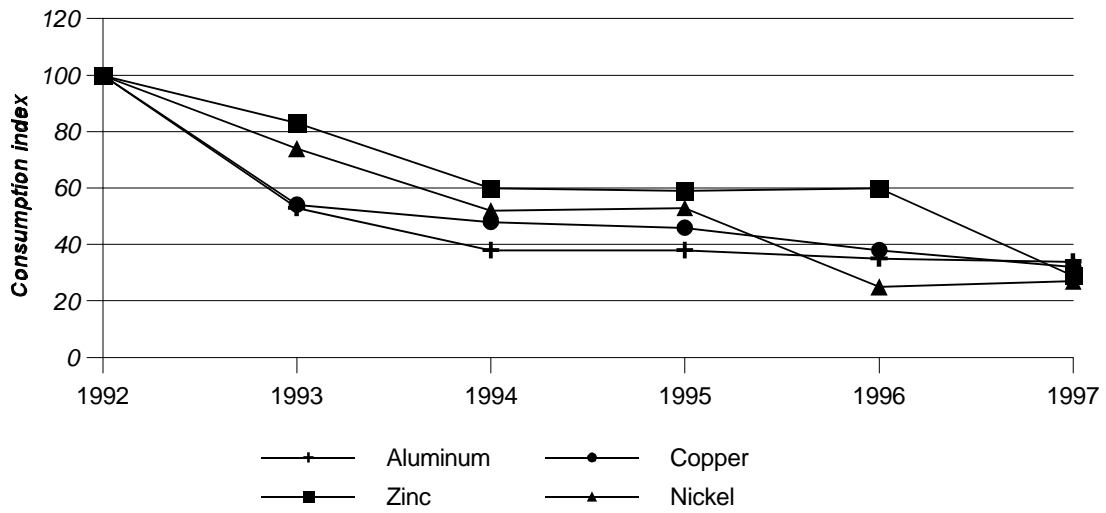
⁵World Bank, facsimile from Moscow Resident Mission, May 13, 1998. This figure does not appear to cover all types of minerals and metals operations (for example, it does not include diamond mining). Therefore, total employment in the sector is likely substantially more than this figure.

⁶World Steel Dynamics, "Russian Steel: Not to be Underestimated," Apr. 1997, p. 4.

⁷OECD Economic Surveys, 1997-98, Russian Federation, Organisation for Economic Co-operation and Development.

⁸For example, the Soviet army received almost 3,000 tanks in 1988, but the Russian army (which inherited most of the defense sector) received only 20 in 1992. David Dyker, ed., "Investment Opportunities in Russia and the CIS," The Royal Institute of International Affairs, (Washington, DC: The Brookings Institution), 1995, pp. 138-142.

Figure 1
Trends in Russian consumption of selected metals, 1992-97



Source: Based on data compiled from the World Bureau of Metals Statistics.

The decline in consumption also reflects the breakdown of commercial links between Russia and the other ex-Soviet Republics. Before dissolution, a significant portion of finished goods made in Russia using raw materials produced in Russia were shipped to other Soviet Republics. Since dissolution, the other Soviet Republics have had their own economic adjustment problems that have caused a decline in consumption of finished goods. These countries have also established customs duties for revenue purposes that have complicated commercial relations.

Largely because of the decline in domestic consumption, and despite a large increase in exports, Russian production of most mineral and metal products has substantially declined, in contrast to increasing world production.⁹ The increasing Russian production of primary refined aluminum and of refined copper (including secondary production) make exceptions to this trend. These industries have developed significant "toll" operations in which raw material from a customer is imported, processed into metal, and returned to the customer. Table 1 illustrates these relative trends in production, consumption, and exports for various mineral and metal commodities.

Despite relatively large declines in production of certain commodities, reportedly few mineral and metal plants have closed. Many plants are operating well below their rated capacity. Few workers have been discharged and these operations still maintain large social costs such as health care and education for the associated communities. The financial condition of most companies is precarious. Liquidity is a major problem--working capital is in such short supply that normal payment arrangements have broken down, and in many cases barter has become the standard method of payment.¹⁰ Companies are unable to pay suppliers or employees, and customers are unable to pay for the products they have received. In addition, companies are unable to pay taxes; arrearages are reported to be substantial.¹¹

Rising transportation and energy costs are significant problems as subsidization by the central government has been discontinued. Both the transportation and energy industries are monopolies and currently subject to little government price control.¹² Laws designed to regulate prices in the energy and transportation sector have been proposed, but no action has been taken.

⁹Based on statistics from World Bureau of Metal Statistics, World Steel Dynamics, and International Iron and Steel Institute.

¹⁰One author has estimated that 45 percent of all industrial sales was in the form of barter exchanges in 1997. James R. Millar, Director of the Institute for European, Russian, and Eurasian Studies and Professor of Economics and International Affairs, George Washington University, "Crisis in Russian Reforms," seminar presented at the U.S. International Trade Commission, July 16, 1998.

¹¹Estimated tax arrearages are 18 to 19 trillion rubles; wage arrears, 6 trillion rubles; fuel and electricity arrears, 15 trillion rubles (these figures are totals, not just for mineral and metal companies). Despite not getting paid, workers tend to remain on the job because companies typically provide other benefits, such as housing and healthcare services. Ibid.

¹²Railroads, which provide the primary mode of transport for the minerals and metals sector, are government-owned monopolies. Energy companies are mostly privately owned monopolies.

Table 1
Trends in indexes of world production and Russian production, consumption, and exports for selected commodities, 1993-97

(1992 = 100)						
Commodity	1993	1994	1995	1996	1997	Index change, 1992/97
Iron ore: ¹						
World production	103	106	111	110	114	14
Russian production	93	89	92	85	88	-12
Steel:						
World production, crude	101	101	105	104	110	10
Russian production, crude	87	73	77	74	70	-30
Russian consumption, finished steel ...	64	53	37	36	40	-60
Russian exports, finished steel	306	303	678	688	656	556
Bauxite (aluminum ore): ¹						
World production	103	101	106	110	113	13
Russian production	95	79	79	84	84	-16
Aluminum, primary refined:						
World production	101	98	102	108	111	11
Russian production ²	102	96	100	103	105	5
Russian consumption	53	38	38	35	34	-66
Russian exports	164	243	256	277	270	170
Copper ore: ¹						
World production	100	100	107	117	121	21
Russian production	83	81	87	87	87	-13
Copper, primary and secondary refined:						
World production	101	98	102	108	111	11
Russian production ²	87	89	90	93	101	1
Russian consumption	54	48	46	98	32	-68
Russian exports	319	750	1,379	1,027	1,079	979
Zinc, primary and secondary:						
World production	103	102	103	106	111	11
Russian production	109	74	90	88	88	-12
Russian consumption	83	60	59	60	29	-71
Russian exports	975	1,808	1,563	2,983	2,925	2,825
Nickel ore: ¹						
World production	90	93	104	110	109	9
Russian production	76	77	81	81	82	-18
Nickel, primary refined:						
World production	91	95	105	109	115	15
Russian production	76	77	82	77	95	-5
Russian consumption	74	52	53	25	27	-73
Russian exports	68	85	111	142	180	80
Gold ore: ¹						
World production	100	101	98	99	103	3
Russian production	101	96	89	83	83	-17

¹ Consumption and export data not available.

² Includes toll production.

Source: Based on statistics from World Bureau of Metal Statistics, World Steel Dynamics, and International Iron and Steel Institute.

Because companies are struggling financially with day-to-day operations, there are few financial resources to deal with long-term competitive and environmental problems. Reinvestment for new equipment to improve quality and reduce costs is minimal. Investment in environmental controls, which was insubstantial during the Soviet era, has declined to virtually nothing. Wasteful energy consumption and high costs could be better controlled by adopting energy conservation technology. Exploration for new reserves has declined significantly according to the latest available data, dropping 24 percent in 1994 as compared with 1993, which dropped 61 percent as compared with 1991.¹³ The Russian Geological Committee stated in 1995 that if exploration remains at such low levels, most currently mined deposits would be exhausted by the end of the century.¹⁴

The following profiles elaborate on the condition of several Russian mineral and metal industries.

Steel¹⁵

Steel is the largest minerals and metals industry in Russia. It is comprised of over 200 enterprises, including 27 mines and concentrators, 4 ferroalloy plants, 59 steelworks, 14 tube mills, 18 refractory plants, 5 coke plants, 14 wire mills, and 78 scrap processing plants. In 1995, it employed 865,000 workers, or 60 percent of the total minerals and metals industry.¹⁶ Twenty cities are either totally or largely dependent on this industry for their economic well-being.¹⁷ The industry uses 14 percent of the country's fuel, 16 percent of the electricity, and 40 percent of the raw materials. Steel products account for 30 percent of the total rail loads.

As domestic consumption collapsed, Russian steel companies developed export markets. In 1990, Russia did not export steel products; by 1995, more than one-half of steel production was exported. Some plants ship over 70 percent of their output abroad. However, plants on average are operating at only 60 percent of capacity. In addition, it is becoming more difficult to compete as rising costs have reduced profit margins. The cost of transportation and raw materials (coal, iron ore) increased from less than 16 percent of total costs in 1990 to over 50 percent by 1995.¹⁸ In 1996, three steel plants declared bankruptcy and about one-third were unprofitable.

¹³Richard Levine, "The Mineral Industry of Russia (1994 report)," U.S. Geological Survey, Reston, Va., p. 1.

¹⁴James P. Dorian and Peter S. Kort, "Joint mineral ventures in the former Soviet Union: Prospects, problems, and realities," *Natural Resources Forum*, vol. 20, No. 3, pp.199-213.

¹⁵Most of this information in this section from Alexei Mordashov, "Future of Russian Steel Industry," presented at Steel Survival Strategies XI, New York, NY, June 18, 1996; Leonid Shevelev and Alexander Gurov, "CIS Steelmakers Grapple with the New Era," *Metal Bulletin Monthly*, June 1998, pp. 12-17; and Matthew J. Sagers, "The Iron and Steel Industry in Russia and the CIS in the Mid-1990s," *Post-Soviet Geography and Economics*, vol. 37, no. 4, April 1996, pp. 195-263.

¹⁶Figure includes workers in support functions. S.Z. Afonon, "Challenges and Current Situation in Russian Steel Industry," conference paper, American Iron and Steel Institute General Meeting, May 23, 1996.

¹⁷Marcus, Peter and Kirsis, Karlis, "Russian Steel: Not to be Underestimated", *World Steel Dynamics Monitor Report*, Apr. 1997.

¹⁸Ibid.

Although the Russian steel industry has made some technological improvements, it remains reliant on obsolete technology. In 1997, open hearth furnaces accounted for 32 percent of steel production, and only 47 percent was continuously cast, compared with 50 percent and 28 percent in 1992, respectively. In contrast, no open hearth furnaces exist and continuous casting accounts for over 90 percent of production in the most developed countries, such as the United States, the European Union (EU), and Japan. Reinvestment and modernization have slowed in recent years because of increasing costs. Capital investments were 3.5 billion rubles in 1990, but less than 1 billion rubles in 1995 (using 1991 adjusted rubles).¹⁹ Some equipment purchases sit in warehouses because companies do not have the funds for installation. Despite the difficulties faced by Russian steel companies, three large companies--Severstal, Novolipetsk, and Magnitogorsk--reportedly have good long-term competitive prospects.²⁰

Aluminum²¹

A significant portion of Russia's aluminum smelters is owned by the Great Britain-based Trans-World Metals Group (TWG), which purchased shares of several companies at government auction.²² TWG restructured the plants' operations, choosing to become a large toll-smelting company using foreign alumina (the basic raw material used in primary aluminum production). Toll smelting has several advantages: it allows for hard-currency payments for the tolling service and no expenditures for the major raw materials. However, the foreign alumina imports associated with the toll-smelting operations make it more difficult for domestic alumina producers to sell their product, and they have been adversely impacted. The aluminum is exempt from export taxes and the imported alumina is exempt from a value-added tax (VAT) that applies to most imports, although the VAT exemption may be abolished by the beginning of 1999. Reports indicate that the smelters will not be profitable once the VAT is applied. This tolling arrangement has allowed the aluminum smelters to maintain production levels, unlike most of the other mineral and metal industries, but the circumstances surrounding the purchases by TWG²³ as well as concerns about whether the plants pay enough taxes, have raised questions within the Russian Government about the desirability of foreign investment.

Russia also has a bauxite (aluminum ore) mining industry that operates several underground mines in the Urals region. The bauxite from these mines is low quality, and is mined at great depths in poor conditions: two significant competitive disadvantages while most of world bauxite is produced much less expensively at surface mines. In addition, domestic consumption has declined because of the tolling arrangements used by the smelters.

¹⁹Ibid., p. 7.

²⁰Ibid., p. 1.

²¹Most of the information in this section from U.S. Geological Survey and Mining Journal.

²²TWG owns a majority of the shares of the companies that operate Russia's two largest smelters (Bratsk and Sayansk smelters), and owns shares of three other companies that operate smelters in Russia.

²³In Russia, there has been considerable controversy surrounding TWG and whether it paid too little for the shares. *Mining Journal*, CIS supplement, Nov. 14, 1997, p. 4.

Gold and diamonds²⁴

Gold and diamond deposits in Russia are typically high quality, and have attracted the attention of international mining companies. Two gold-mining companies developed with the aid of foreign investment have cash operating costs of well under \$200 per ounce, making them very low-cost producers by world standards.²⁵ By contrast, South Africa, the world's largest gold producer, has average cash costs in excess of \$290 per ounce.²⁶ The gold industry employs more than 400,000 people, many of whom are private entrepreneurial prospectors called "artels" that account for over one-half of the gold produced.

A recent presidential decree now allows Russian producers to sell their gold directly to export markets. Previously, only the central bank and licensed commercial banks were allowed to export gold. The government hopes this will stimulate investment and production in the gold industry. In addition, the government reportedly is planning to build a processing facility in the east to reduce local miners' shipping expenses; most gold is produced in the east and must be shipped to the western part of Russia for processing.

Nickel²⁷

Russian nickel deposits are rich and have the potential to form the basis for a competitive industry. Deposits now in production have mineral co- and byproducts (usually platinum-group metals and copper) that greatly aid the economics of mining and processing. The major company is Norilsk Nickel, which produces over 90 percent of Russia's nickel at two main mining and processing sites.²⁸

Norilsk reportedly is currently in poor financial condition and owes hundreds of millions of dollars to its natural gas supplier, its shipping company, and in taxes to the government. Moreover, company smelters have been the source of as much as 8 percent of all harmful emissions in Russia, which have been particularly harmful to the Scandinavian countries.²⁹ Future substantial environmental expenses by this company will likely be necessary to curtail emissions.

Export Markets and Trade Actions

²⁴Most of the information in this section from Mining Journal and interviews with industry representatives.

²⁵These companies are Omolon Gold Mining Co., in which Amax Gold Co. (United States) owns 50 percent, and Buryatzoloto, in which High River Gold Corp. (Canada) has a 23-percent equity investment.

²⁶U.S. Geological Survey, *Mineral Industry Survey--Precious Metals in Feb. 1998*, prepared by Earle B. Amey.

²⁷Most of the information in this section from U.S. Geological Survey.

²⁸Norilsk is an important world producer of nickel, palladium, and platinum, ranking in the top three for all these metals.

²⁹U.S. Geological Survey, *Russia Annual Report for 1996*, prepared by Richard Levine.

Developing markets and competition are new to Russian companies. The ability to ascertain production costs, set prices, establish business relationships with customers, assess market trends and strategy, position products in the market, and make other business decisions that are second nature to companies accustomed to operating in a market-based system are not well understood by many company officials. Product quality is typically unreliable and products are frequently not delivered on-time. Too many middlemen in the sales process make it difficult to develop adequate knowledge about customers, and profits are reduced. Nevertheless, as illustrated in table 1, Russia has been successful in finding foreign customers, and exports of many mineral and metal products increased significantly between 1993 and 1997.

In the first few years after the dissolution of the Soviet Union, as Russia made the commitment to a market-based economy and began to integrate with the global economy, countries made efforts to improve access for imports from Russia. The United States, for example, granted Russia most-favored-nation tariff treatment and also made Russia eligible for trade preferences under its Generalized System of Preferences; this allows for duty-free entry of a wide variety of mineral and metal products. The initial period of goodwill began to unravel beginning in 1993 when the quantity of Russian exports of aluminum began to alarm the world's aluminum producers. Pressure by domestic producers on their governments resulted in negotiations with Russian government officials and the creation of a Memorandum of Understanding (MOU) on Jan. 28, 1994, in which Russia agreed to cut aluminum production for a period of no more than 2 years.³⁰

Trade frictions between Russia and the rest of the world are not new. For example, in the 1960s, the United States applied antidumping duties to titanium imports from the Soviet Union (which were applied to Russian titanium exports after dissolution). However, the number of trade cases was not significant until after the 1994 MOU, coincident with large increases in exports of mineral and metal products from Russia. Other than the MOU, virtually all trade actions taken by countries against Russian exports have been antidumping actions, which have resulted in the imposition of antidumping duties and other restrictions pursuant to suspension agreements. The EU has had the most antidumping cases, reflecting the fact that the region is Russia's largest trading partner. Initially, only developed countries instituted trade restraints. However, beginning in 1996, other countries also became concerned about Russian exports and began to take trade actions. To date, 39 countries (including EU members) have or are in the process of applying trade actions to imports from

³⁰U.S. Geological Survey, Aluminum, 1994, yearbook chapter, prepared by Patricia Plunkert, 1995, p. 1. The MOU expired in early 1996.

Russia (table 2). Another country (China) is considering trade action. The largest number of cases involve steel product imports; some of the largest consuming markets (United States, EU) as well as a host of other countries, notably Canada and Mexico, currently have antidumping orders in effect on Russian steel imports.

Outlook

The minerals and metals industry could be a major factor in the potential revival of Russia's economy because of the country's well-developed technical expertise and rich mineral endowment. However, realizing this potential will be difficult considering the sector's many impediments. Domestic markets have been lost because of reduced consumption, and antidumping measures have likely contributed to reduced exports to foreign markets. Most Russian companies are now in precarious financial positions, with limited funds available for exploration, new equipment, pollution control, and environmental remediation. The best hope for the sector is for the recovery of Russian consumption, but the probability of this in the short term is not good because of the country's economic problems. Additional foreign investment is a possibility. Several major international companies are currently involved in exploration and/or feasibility studies in Russia, primarily in gold and nickel projects. These companies include Outokumpu Oy (Finland), Echo Bay (Canada), Western Pinnacle Mining (Canada), and Arian Resources (United Kingdom).

Most of the global trade actions taken to date (table 2) affecting imports from Russia have occurred during a time of relatively strong economic conditions in major consuming and producing countries, and were initiated before the full economic consequences of the Asian economic crisis (which began to surface in late 1997) were realized. Global consumption of many mineral and metal commodities has subsequently decreased, contributing to the recent decline in commodity prices (table 3). As the effects of these lower prices take their economic toll, producers may become more concerned about the state of the Russian minerals and metals sector.

Table 2
Trade actions taken or in effect during the 1990s against imports from Russia in various countries

Industry/country	Specific product	Description of action and status	Initial date	Comment
Steel:				
United States	Hot rolled sheet/strip	AD petition filed; preliminary injury determination made	September 1998	Petitioners allege dumping margins of up to 200 percent
United States	Carbon steel plate	Quota/minimum price in effect as result of suspension agreement	December 1996	Quota = 100,00 metric tons per year, minimum price = \$300 per metric ton ¹
Argentina	Flat-rolled carbon steel	AD case; status unknown	Unknown	(²)
Canada	Hot- and cold-rolled	AD petition filed	October 1998	(²)
Canada	Certain hot-rolled carbon steel and high strength low alloy plate	AD duties in effect	December 1996	25.2 percent final margin
Chile	Cold-rolled coil	AD duties in effect	October 1996	(²)
China	High-silicon carbon steel flat products	Considering initiation of AD investigation	Not applicable	(²)
European Union (EU)	Seamless pipe/tubes	AD duties in effect	April 1998	32.9 percent provisional margin
EU	Grain-oriented cold-rolled sheets/strips of silicon-electrical steel	AD duties and price/quantity restrictions in effect ³	May 1994	40.1 percent final margin
EU	Certain flat-rolled and products	longQuotas in effect	1996	1997 quota = 841,224 metric tons ⁴
EU	Hematite pig iron	AD duties in effect	January 1991	Margin is difference between selling price and minimum import price
India	Hot-rolled coils, sheets, plates	AD investigation in progress	October 1997	(²)
Indonesia	Hot-rolled coil and plate	AD duties in effect	April 1997	19 to 39 percent final margins
Indonesia	Cold-rolled coil	AD case; status unknown	Unknown	(²)
Indonesia	Wire rod	AD investigation in progress	Unknown	(²)
Korea	H-beams	AD investigation in progress	October 1996	(²)
Malaysia	Cold rolled steel	AD case; status unknown	Unknown	(²)

See footnotes at end of table.

Table 2—Continued

Trade actions taken or in effect during the 1990s against imports from Russia in various countries

Industry/country	Specific product	Description of action and status	Initial date	Comment
Steel—continued:				
Mexico	Hot-rolled sheet/strip	AD petition filed	October 1998	Petitioners allege dumping margins of 23 to 45 percent
Mexico	Hot-rolled coils	AD duties in effect	Unknown	(²)
Mexico	Plate	AD duties in effect	March 1998	(²)
Mexico	Cold-rolled steel	AD investigation in progress	June 1998	(²)
Philippines	Billet	AD case; status unknown	Unknown	(²)
Philippines	Wire rod	AD case; status unknown	Unknown	(²)
Philippines	Rebar	AD case; status unknown	Unknown	(²)
Taiwan	H-beams	AD duties in effect	July 1996	(²)
Thailand	Hot-rolled sheets	AD duties in effect	Unknown	(²)
Turkey	Billets	AD duties in effect	Unknown	(²)
Turkey	Hot and cold rolled sheets	AD case; status unknown	Unknown	(²)
Venezuela	Flat-rolled carbon steel	AD case; status unknown	Unknown	(²)
Vietnam	Round bar	AD case; status unknown	Unknown	(²)
Ferroalloys:				
United States	Ferrovandium	AD duties in effect	May 1994	3.75 to 108 percent final margins
United States	Ferrosilicon	AD duties in effect	May 1992	104.18 percent final margin
EU	Ferrochrome	AD duties in effect	1993	ECU 0.31 per kilogram final margin
EU	Ferrosiliconmanganese	AD duties revoked in 1998	October 1995	No margins
Aluminum:				
Australia, Canada, EU, Norway, United States	Primary aluminum	MOU: Russia agreed to reduce production	January 1994	Reduction of 500,000 metric tons per year for 2 years
United States	Aluminum	Industry representative predicts AD case	October 1998	No margins as yet

See footnotes at end of table.

Table 2—Continued
Trade actions taken or in effect during the 1990s against imports from Russia in various countries

Industry/country	Specific product	Description of action and status	Initial date	Comment
Magnesium:				
United States	Pure and alloy magnesium	AD duties in effect	March 1994	0.0 to 100.25 percent final margins for pure; 0.0 to 153.65 percent final margins for alloy
EU	Unwrought pure magnesium	Suspension agreement in effect	January 1994	Minimum price established
Titanium:				
United States	Titanium sponge	AD duties revoked in August 1998	1968	No margins
United States	Titanium	Industry representative predicts AD case	October 1998	No margins as yet
Uranium:				
United States	Yellowcake (U ₃ O ₈)	Suspension agreement negotiated in Oct. 1992; amended in March 1994	October 1992	Quota and matching sales provision ⁵
Zinc:				
EU	Unalloyed, unwrought zinc	AD duties in effect	April 1997	5.5 percent

¹ Quota and prices subject to adjustment by the U.S. Department of Commerce based on consumption and price trends in U.S. market.

² No other information available.

³ Quantity limitation and minimum prices agreed to by 3 Russian suppliers (AD duties do not apply to these suppliers).

⁴ Quota scheduled to increase by 5 percent in 1998, and 2.5 percent each year thereafter until 2001, after which time quotas will be removed entirely if Russia has implemented certain competition and environmental legislation.

⁵ Imports of Russian material must be matched with sales of domestic material.

Note.—Depending on type of action, initial date refers to date of antidumping petition filing or to agreement date. Month unknown in some cases.

Source: Organization for Environmental Conservation and Development, "The Situation in the NIS Area: Recent Developments," Oct. 9, 1997, document No. DSTI/SI/SC(97)31; Canadian Government; World Steel Dynamics, *Apr. 1997 Monitor Report*; *Metal Bulletin Monthly*, June 1998; press reports; *Federal Register*, Apr. 1, 1994; etc.

Table 3
Trends in prices of selected commodities, 1995-98

Commodity	1995	1996	1997	1998¹	Percentage change, 1995/98
Aluminum (<i>dollars per pound</i>)	0.82	0.68	0.73	0.59	-28
Copper (<i>dollars per pound</i>)	1.33	1.04	1.03	0.72	-46
Zinc (<i>dollars per pound</i>)	0.47	0.46	0.60	0.43	-9
Nickel (<i>dollars per pound</i>)	3.74	3.40	3.14	1.76	-53
Gold (<i>dollars per troy ounce</i>)	384.2	387.7	331.1	296.6	-23

¹ October 1998 price.

Note. Prices, except gold, are London Metal Exchange average cash settlement prices for the period. Gold price is average London fixed price for the period.

Source: World Bureau of Metal Statistics.#

NONSTORE RETAILING: ALTERNATIVE RETAILERS ATTRACTING CUSTOMERS

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The popularity of nonstore retailing is increasing as consumers seek convenient, cost-effective, and safe ways to shop. Nonstore retailing encompasses all catalog mail order, television home shopping, and Internet retailing;² vending machine sales; and direct sales, including those transacted through house-to-house canvassing, party-plans, telephone, or temporary locations such as trucks.³ Total nonstore retail sales in the United States were \$75 billion in 1997,⁴ reflecting average annual growth of 8 percent since 1987. This article examines factors contributing to the rapid growth of domestic and international nonstore retailing, advantages and challenges associated with this emerging trend, and the degree of global adoption of these new retailing methods.

Nonstore retailing comprises all shopping done beyond traditional “brick and mortar” retail outlets. Based on available sales data, shopping by catalog mail order, Internet retailing, and television are the most popular forms of nonstore retailing. Top nonstore retailers by sales volume include J.C. Penney Catalog, Gateway, Fingerhut, Spiegel, QVC Network Inc., Land’s End, Home Shopping Network, Hanover Direct, Victoria’s Secret, and Lillian Vernon.⁵

To attract and maintain consumers, many catalog companies, Internet retailers, and television home shopping firms are attempting to match store-based retailers’ generous guarantees and expedient return policies. Internet retailers are also particularly aware of the need to create an interactive, entertaining, and user-friendly environment to attract consumers. For example, to better inform and facilitate purchase decisions, Virtual Vineyards offers online advice on

¹The views expressed in this article are those of the author. They are not the views of the International Trade Commission or any of the Commissioners.

²The term “mail-order sales” includes catalog, television, and Internet sales. Total mail-order sales were \$49 billion in 1997. U.S. Department of Commerce (USDOC), Bureau of the Census, Current Business Reports, Series BR/97-RV, *Annual Benchmark Report for Retail Trade: January 1988 through December 1997*, Washington, DC, 1998.

³Vending machine sales and sales from trucks are not analyzed in this report because of their relatively small contribution to overall nonstore retailing sales. Ibid.

⁴USDOC, Bureau of the Census, Current Business Reports, Series BR/97-RV, *Annual Benchmark Report for Retail Trade: January 1988 through December 1997*.

⁵“Leading Nonstore Retailers,” *Chain Store Age*, found at Internet address <http://chainstoreage.com/>, retrieved Mar. 12, 1998.

selecting wines for certain menus,⁶ and Etoys.com reviews and recommends toys.⁷ However, nonstore retailers typically cannot offer all of the in-store features that customers find appealing. For example, nonstore consumers generally cannot physically examine goods or directly interact with sales staff. Nonstore retailers principally compensate for these shortcomings by providing consumers greater convenience, lower prices, and a safe and comfortable shopping environment.

The Advantages of Nonstore Retailing

Convenience

Convenience often attracts consumers to nonstore points-of-purchase (POP). In the United States, approximately 60 percent of families have at least two members who work, which limits the time available for shopping, household chores, and recreation.⁸ This is the principal factor that has limited the amount of time consumers are willing and able to spend in stores. This trend is identified in an industry report that indicates that the average U.S. consumer's shopping time per month declined from 4.3 hours in 1993 to 3 hours in 1996.⁹ A 1995 poll found that 21 percent of all households surveyed were shopping from home to save time.¹⁰

Lower Pricing

Nonstore retailers generally have lower operating costs, and more cost-efficient distribution centers than their store-based competitors. Instead of stocking multiple stores, nonstore retailers ship directly from warehouses or distribution centers, thereby reducing handling costs.¹¹ Nonstore retailers also can "drop ship" or sell products directly from manufacturers' inventories rather than from their own, virtually eliminating inventory costs.¹² This results in lower prices and greater product choice, since nonstore retailers can stock or have access to larger amounts of inventory. Disintermediation is particularly evident among Internet retailers. Computer manufacturers such as Dell and Gateway market computers directly to the consumer at a 10 to 20 percent discount, largely by cutting out the middleman.¹³

⁶Aaron Schavey, "Online Retailing: Today's Promise and Tomorrow's Opportunity," *Business America*, Jan. 1998, p. 41.

⁷Joel Kotkin, "The Mother of All Malls," *Forbes ASAP*, Apr. 6, 1998, p. 62.

⁸Mary Schwartz, "The Impact of Nonstore Competition on Retail Stores," *Urban Land*, July 1997, vol. 56, No. 7, p. 51.

⁹Ian P. Murphy, "Study: Apparel Shopper's Pulse Has Quickened," *Marketing News*, Apr. 14, 1997, found at Internet address <http://proquest.umi.com/>, retrieved Mar. 10, 1998.

¹⁰*Ibid.*

¹¹Raymond R. Burke, "Do You See What I See? The Future of Virtual Shopping," *Academy of Marketing Science Journal*, fall 1998, found at Internet address <http://proquest.umi.com/>, retrieved Feb. 26, 1998.

¹²"Direct Sales Use More Direct Connections," *Computer Retail Week*, Jan. 5, 1998, found at Internet address <http://proquest.umi.com/>, retrieved Mar. 25, 1998.

¹³Bill Marback, "Where to Shop," *Fortune*, Winter 1998, p. 28.

Safety

Concerns over violent crime at U.S. shopping centers have driven consumers to seek safer alternatives. A national survey reported that 48 percent of respondents will not shop in an unfamiliar area after dark, and one in four consumers is shopping closer to home as a result of crime.¹⁴ The number of nighttime shoppers has declined by 20 percent since 1990.¹⁵ Another survey found that 48 percent of consumers believe that shopping malls are less safe now than they were 2 to 3 years ago.¹⁶ Consequently, consumers are increasingly likely to purchase from nonstore retailers to avoid shopping at unsafe locations and hours.

Trends

During 1992 to 1997, nonstore retailing grew at an average annual rate of 6.3 percent, outpacing both store-based growth of 5.6 percent and GDP growth of 5.3 percent. Retailers reportedly will emphasize nonstore channels as growth continues (figure 1). In fact, such shifts are already evident. For instance, Egghead, a software and computer peripherals retailer, recently switched from store-based to nonstore retailing. The firm closed all of its traditional retail outlets, opened an Internet storefront, and changed its name to Egghead.com.¹⁷

Catalog

Catalog mail order earns the largest share of revenue in the nonstore retailing sector. In 1997, the 51 top business-to-consumer catalog firms earned \$19.4 billion.¹⁸ The most popular items include clothing, home furnishings, housewares, toys and games, and sporting goods.¹⁹ In 1996, U.S. shoppers spent \$550 per capita on mail order purchases,²⁰ with approximately 68 percent of U.S. adults making such a purchase. Most spent at least \$100. A 1996 Catalog Age survey found that people shop through catalogs primarily for their

¹⁴Elaine Santoro, "Poll Finds Consumers Afraid to Shop at Night," *Direct Marketing*, June 1996, found at Internet address <http://proquest.umi.com/>, retrieved Mar. 17, 1998.

¹⁵Richard Halverson, "Crime Steals Shoppers' Confidence," *Discount Store News*, May 6, 1996, found at Internet address <http://proquest.umi.com/>, retrieved Mar. 10, 1998.

¹⁶*Ibid.*

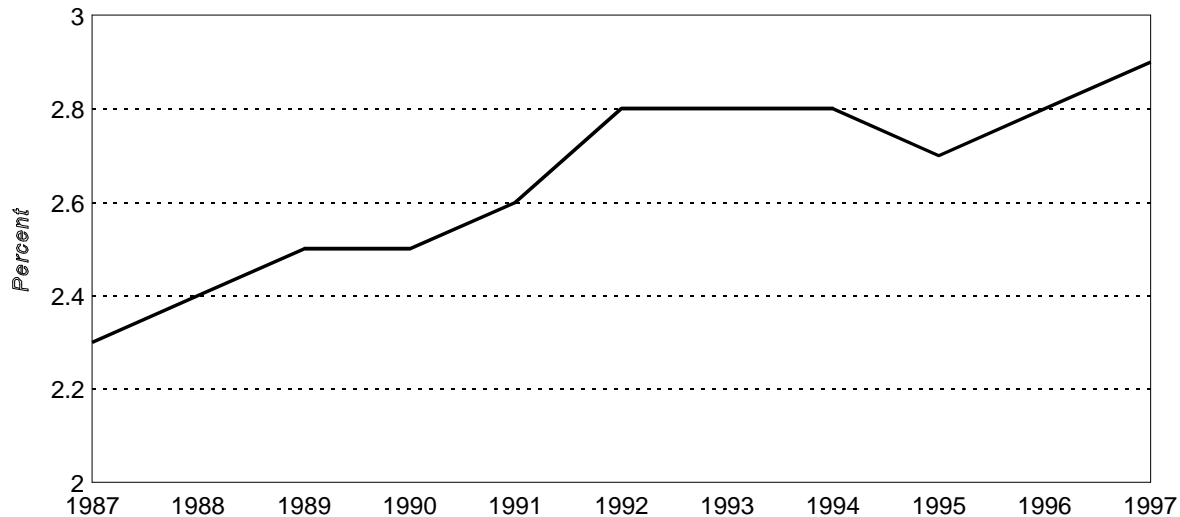
¹⁷Kristen Kennedy and Roger C. Lanctot, "Egghead's Shift Draws Shock Amid Applause," *Computer Retail Week*, Feb. 13, 1998, found at Internet address <http://www.pointcast.com/>, retrieved Feb. 13, 1998.

¹⁸*Catalog Age* ranks the top 100 business-to-business and business-to-consumer companies in the United States on an annual basis. This report focuses on business-to-consumer sales. Rama Ramaswami, "The Big Players," *Catalog Age*, Aug. 1997, found at Internet address <http://proquest.umi.com/>, retrieved Feb. 24, 1998.

¹⁹Mary Meeker and Sharon Pearson, "The Internet Retailing Report," (Morgan Stanley Dean Witter, May 28, 1997) p. 14-5, found at Internet address <http://www.ms.com/>, retrieved July 21, 1998.

²⁰Arnold Fishman, "Highlights of the 1996 Mail Order Marketplace," *Direct Marketing*, Sept. 1997, p. 35.

Figure 1
Nonstore retailing, as a percentage of total retail sales, 1987-97



Source: U.S. Bureau of the Census, *Annual Benchmark Report for Retail Trade: January 1998 through December 1997*.

convenience, and because certain products are available only through catalogs.²¹ Also, in 1996, Kurt Salmon Associates' annual Consumer Pulse Survey found that 72 percent of respondents reported they had participated in direct shopping, with most being "very satisfied" or "satisfied" with the outcome.²² The Direct Marketing Association predicts the industry's revenues will grow almost 7 percent per year through the year 2000, mainly as a result of current mail order shoppers increasing their purchases, rather than from an increase in the number of catalog shoppers.

Catalog companies face several challenges in marketing their goods, including saturated markets, look-alike catalogs, rising costs for market penetration, paper and ink costs, and distribution. Significant product return rates are also often a problem.²³ To increase revenues, many existing catalog retailers are experimenting with other forms of marketing, such as CD-ROM catalogs and Internet sites. A 1996 *Catalog Age* survey found that 59 percent of catalog retailers plan to use Internet sites as a supplemental distribution channel, making it the most popular alternative source of revenue for catalog firms.²⁴ Many catalogers have been successful Internet vendors because their distribution mechanisms are easily applied to the Internet and they can capitalize on their existing consumer database.

²¹Michael P. Niemira, "Are Nonstore Sales a Threat to Traditional Store Business?: A Look at Cyberspace and Catalog Sales," *Chain Store Age*, Sept. 1996, p. 26.

²²Murphy.

²³Ramaswami.

²⁴Meeker and Pearson, p. 14-2.

Direct Selling

Direct selling is generally an individual seller-to-consumer transaction away from a retail location. The World Federation of Direct Selling Associations estimates that U.S. direct sellers had \$20.8 billion in sales in 1996.²⁵ Approximately 71 percent of all direct sales occur in the consumers' home, followed by 14 percent in the workplace, and 8 percent over the telephone. Consumers, who often select the location and time of the transaction, consider the greatest benefits from direct selling to be receiving higher quality information and personal attention from the seller.²⁶

Virtually all direct selling occurs through one of two methods: person-to-person (78 percent) and party-plan (21 percent) selling. Prominent person-to-person direct sellers include Amway and Electrolux. With party-plan selling, consumers meet at one location, where the direct seller typically demonstrates products and invites consumers to participate. The social and entertaining atmosphere of this method of direct selling reportedly has a positive impact on sales.²⁷ The Longaberger Co., a Dresden, Ohio-based direct retailer of hand-woven baskets, switched from store-based retailing to "home shows," increasing sales from \$6 million in 1984 to more than \$600 million in 1997.²⁸ Tupperware is another prominent direct seller that uses the party-plan.

Internet Retailing

Increases in Internet access and use have contributed to Internet retailing becoming the fastest growing nonstore sector. There are more than 35,000 sites on the Internet that sell products and services, including those of major catalog companies such as Land's End, L.L. Bean, and The Sharper Image.²⁹ Internet retailing is well suited to the U.S. market because a growing number of consumers are becoming technologically sophisticated--approximately 35 million people are currently connected to the Internet³⁰ and Internet access charges are relatively inexpensive. Surveys show that convenience is the primary reason that consumers shop on the Internet. However, maintaining consumer loyalty on the Internet is difficult because the costs to switch to a competitor's Internet site are negligible. Thus price, service, ease of use, and entertainment play important roles in retaining customers. New technologies such as telephone gateways that enable consumers to connect to a live operator while online will potentially improve services and ease of use.³¹

²⁵World Federation of Direct Selling Associations, "Worldwide Direct Sales Data," Nov. 14, 1997.

²⁶Robert A. Peterson and Thomas R. Wotruba, "What Is Direct Selling? -- Definition, Perspectives, and Research Agenda," *The Journal of Personal Selling & Sales Management*, Fall 1996, found at Internet address <http://proquest.umi.com/>, retrieved on Mar. 9, 1998.

²⁷Ibid.

²⁸David Gill, "Consumers Set Product Lineup," *Home Textiles Today*, Feb. 2, 1998, found at Internet address <http://proquest.umi.com/>, retrieved May 13, 1998.

²⁹Schwartz, p. 70.

³⁰Meeker and Pearson, p. 2-1.

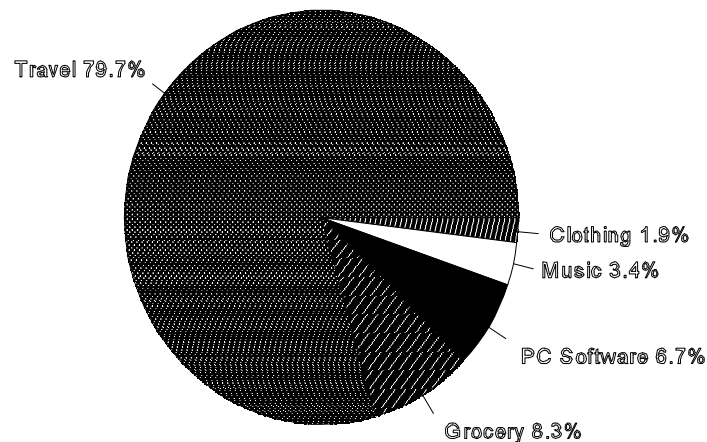
³¹Erick Schonfeld, "Efusion," *Fortune*, July 6, 1998, p. 73; Chris Bucholtz, "From Basement to Business Tool," *Telephony*, Aug. 12, 1996, found at Internet address <http://proquest.umi.com/>, retrieved Oct.

(continued...)

According to Morgan Stanley, Internet sales for 1996 were approximately \$600 million and 1998 sales are projected to be approximately \$35 billion.³² Six percent of consumers indicated they will purchase goods online in 1998, double the 1997 figure.³³ According to Media Metrix, a provider of media and digital technology measurement services, the number of Internet shopping site visitors increased 35 percent in 1997.³⁴ Jupiter Communications Inc., reported that the top revenue-generating purchases on the Internet in 1997 included travel services, groceries, PC software, music, and clothing (figure 2).³⁵ Books and intangible items such as financial services and insurance products are also highly suited to an online retail environment.

Figure 2

Top revenue-generating Internet retail sales categories by percentage, 1997



Source: Eric Flemming, "E-tailing 2002: What Will Work, What Won't," *Interactive Investor*, July 16, 1998.

³¹(...continued)

27, 1998; and "Better, Faster, Cheaper," *The Economist*, Sept. 13, 1997, p. 33.

³²Meeker and Pearson, pp. 4-3 - 4-5.

³³John A. Quelch, "The Internet and International Marketing," *Sloan Management Review*, Spring 1996, found at Internet address <http://proquest.umi.com/>, retrieved Feb. 27, 1998.

³⁴"Number of New Visitors to Shopping Websites Increases Thirty-Five Percent Since Last Year," Dec. 15, 1997, found at http://www.npd.com/corp.press/press_mm38.htm/, retrieved Mar. 27, 1998.

³⁵Eric Fleming, "E-tailing 2002: What Will Work, What Won't," *Inter@ctive Investor*, found at Internet address <http://www.zdii.com/>, retrieved July 16, 1998.

Although Internet retailing provides additional outlets for catalog and television home shopping retailers, many store-based retailers are concerned about losing sales to the new technology. However, progressive store-based retailers like Kmart, Wal-Mart, J.C. Penney, and The Gap have all created Internet sales sites. Some retailers, such as American Greetings Inc., have adjusted marketing strategies to include Internet venues which attract a young clientele.³⁶

Several issues, including privacy, transaction security, and taxation,³⁷ limit Internet commerce. Consumers are wary of providing too much personal information on the Internet, particularly if they are unsure how it will be used. The Federal Trade Commission conducted a random survey of 1,400 websites to determine if they explain how personal data is used and protected. The FTC found that 85 percent of surveyed sites collected personal information, but only 14 percent told consumers how the information would be used and only 2 percent posted a privacy policy.³⁸ Surveys indicate that for consumers to feel comfortable doing business over the Internet, they must have assurance that their personal information will remain private. The U.S. Government so far has encouraged the industry to self-regulate privacy issues.³⁹ However, the Government may face increasing pressure to intervene and impose regulations if online firms do not adequately address these issues in a timely manner.

An alternative to government or industry regulation is a trusted third-party. Companies such as TRUSTe serve as independent “watchdogs” that insure Internet sites meet minimum requirements. TRUSTe puts a “trustmark” on sites that disclose privacy policies and that have outside audits.⁴⁰ The Better Business Bureau (BBB) also helps consumers and retailers to address online security and privacy issues. BBBOnline is a certification program for Internet businesses that helps sites respond to consumer complaints and allows consumers to verify information about the business.⁴¹ WebTrust, an initiative by the American Institute of Certified Public Accountants (AICPA) and the Canadian Institute of Chartered Accountants (CICA), conducts site evaluations and audits to assure consumers that sites with the WebTrust seal meet the organizations’ standards for privacy and confidentiality.⁴²

³⁶Clinton Wilder, “Middlemen Beware?,” *Information Week*, Oct. 20, 1997, found at Internet address <http://www.proquest.umi.com/>, retrieved Feb. 24, 1998.

³⁷Raymond R. Burke, “Do You See What I See? The Future of Virtual Shopping.”

³⁸Shannon Oberndorf, “FTC Reports on Privacy,” *Catalog Age*, July 1998, found at Internet address <http://proquest.umi.com/>, retrieved Oct. 27, 1998; and U.S. Federal Trade Commission (FTC), *Privacy Online: A Report to Congress* (Washington, DC: GPO, 1998), p. iii.

³⁹“A Framework for Global Electronic Commerce,” found at Internet address <http://www.whitehouse.gov/>, retrieved Mar. 13, 1998; and USDOC, National Telecommunications and Information Administration, “Privacy and Self-Regulation in the Information Age,” June, 1997, found at Internet address <http://www.ntia.doc.gov/>, retrieved Nov. 9, 1998.

⁴⁰Heather Green, Catherine Yang, and Paul C. Judge, “A Little Privacy Please,” *Business Week*, Mar. 16, 1998, p. 98.

⁴¹Ibid; and “BBBOnline Privacy Program Created,” *Electronic Buyers’ News*, July 6, 1998, found at Internet address <http://proquest.umi.com/>, retrieved Oct. 26, 1998.

⁴²Kathy Williams, “AICPA Launches Electronic Commerce Seal,” *Management Accounting*, Oct. 1997, found at Internet address <http://proquest.umi.com/>, retrieved Oct. 26, 1998; and Sharon Machlis, “CPAs Offer Seal of Integrity,” *Computer World*, May 4, 1998, found at Internet address

(continued...)

Transaction security is another issue impeding widespread use of Internet retailing. According to a Business Week/Harris poll, 80 percent of respondents who have not purchased a product over the web worry that their credit card information could be used without their consent, and 86 percent worry that the information would be accessible to others.⁴³ However, new encryption and decryption technologies, electronic cash,⁴⁴ and personal identification numbers are being employed to help allay consumers' fears.⁴⁵ For example, an encryption technology called secure socket layer (SSL) protects credit card information during transit to the retailer. The secure electronic transfer (SET) protocol, developed by MasterCard and Visa, also encrypts credit card information, preventing it from being viewed during transit.⁴⁶ Unlike SSL, with SET, the retailer never sees the credit card data, which is transmitted directly to the retailer's bank, and decrypted using SET software. The bank receives authorization from the credit card company.⁴⁷ Other protection methods used by online merchants include "firewalls," which prevent unauthorized access to information. Firewalls include storing credit card information in a secure site that has restricted access through the Internet and developing sophisticated passwords that are frequently changed.⁴⁸

As Internet sales increase, State and Federal Governments have become interested in Internet sales as a source of tax revenue. Many are concerned that consumers will use the Internet to engage in tax-free shopping. Online retailers generally oppose Internet taxes because they do not want to stifle Internet growth or set a precedent.⁴⁹ In addition, tax opponents also note that whereas state sales taxes generally apply to tangible goods bought and sold in one State, most

⁴²(...continued)

<http://proquest.umi.com/>, retrieved Oct. 27, 1998.

⁴³Green, Yang, and Judge, "A Little Privacy Please," p. 98.

⁴⁴Electronic cash is digitized currency that can be sent over electronic networks. Steven Bonorris and Vary Coates, "Digital Money: Electronic Cash May Rise Sense," *The Futurist*, Aug./Sept. 1998, found at Internet address <http://proquest.umi.com/>, retrieved on Nov. 9, 1998.

⁴⁵Robert A. Peterson, Sridhar Balasubramanian, and Bart J. Bronnenberg, "Exploring the Implications of the Internet for Consumer Marketing," *Academy of Marketing Science Journal*, Fall 1997, found at Internet address <http://proquest.umi.com/>, retrieved Mar. 10, 1998.

⁴⁶Aaron Schavey, "Retailing Online: Today's Promise and Tomorrow's Opportunity," p. 40.

⁴⁷Alan Joch, "Safe Passage," *Inc.*, Nov. 18, 1997, found at Internet address <http://proquest.umi.com/>, retrieved Aug. 10, 1998.

⁴⁸Linda Punch, "The Real Internet Security Issue," *Credit Card Management*, Dec. 1997, found at Internet address <http://proquest.umi.com/>, retrieved Mar. 26, 1998.

⁴⁹In its Framework for Global Electronic Commerce, the Clinton administration encourages private industry to lead in the self-regulation and development of electronic commerce. To encourage businesses to extend their markets to the Internet without fear of taxes or regulations, the report also recommends "refraining from imposing any new and unnecessary regulations, bureaucratic procedures, or taxes or tariffs on commercial activities that take place on the Internet." According to the report, taxation of electronic commerce should neither "distort nor hinder" commerce. Any system set in place to tax Internet sales should be simple, capture the majority of revenues, be easy to implement, minimize burdensome record keeping and accommodate U.S. and international tax systems. "A Framework for Global Electronic Commerce."

Internet transactions involve buyers and sellers in different States. Consequently, some Internet purchases could be subject to taxation in multiple states and local tax jurisdictions.⁵⁰

The Internet Tax Freedom Act⁵¹ provides for tax-free Internet access and promotes global free trade on the Internet by calling on the administration to encourage foreign governments to keep the Internet free of taxes and tariffs on the medium itself. The act also creates a temporary commission to determine how sales and use taxes can be applied in a nondiscriminatory manner.⁵² The Internet Tax Freedom Act applies the same principle to sales and use taxes on the Internet as that for mail order sales.⁵³ In 1992, the Supreme Court ruled that States cannot impose taxes on mail order purchases unless the company has a physical presence in the state where the good was purchased.⁵⁴

Television Home Shopping

The United States has four major television home shopping companies--QVC, Home Shopping Network (HSN), ValueVision, and Shop at Home. Early attempts at television home shopping such as QUBE, and Fingerhut's "S" The Shopping Channel, reportedly foundered due to the use of complicated and cumbersome technology, the unavailability of major brand-names, and more limited consumer access to cable television.⁵⁵ Today, however, many more consumers have access to cable television, and major manufacturers, designers, and retailers have lent their names and merchandise to the medium. These changes have raised the profile of television home shopping and have attracted a wider consumer base.⁵⁶ QVC and HSN, the top companies in the segment, generated combined sales of \$2 billion in 1995, and infomercials contributed another \$1 billion to the television home shopping sector.⁵⁷ ValueVision is the third-largest home shopping network and one of the top 20 broadcasters in the United States.⁵⁸

⁵⁰Charles E. McLure Jr., "Electronic Commerce, State Sales Taxation, and Intergovernmental Fiscal Relations," *National Tax Journal*, Dec. 1997, found at Internet address <http://proquest.umi.com/>, retrieved Mar. 26, 1998; and Office of Representative Christopher Cox, "Bill Summary," The Internet Tax Freedom Act Homepage, found at Internet address <http://www.house.gov/chriscox/nettax/>, retrieved Oct. 26, 1998.

⁵¹On June 23, 1998, the United States House of Representatives passed bill H.R. 4105, the Internet Tax Freedom Act, co-authored by Christopher Cox (R-CA) and Ron Wyden (D-OR). The Senate passed its version of the bill, S. 442, on October 9, 1998. The act was integrated into the Omnibus Appropriations bill approved by Congress on October 20, 1998, and signed into law by President Clinton on October 21, 1998. U.S. Senate, *The Internet Tax Freedom Act*, 105th Cong., 2nd sess., H.R. 4105, *Congressional Record*, vol. 144, No. 83, daily ed. (June 23, 1998), H5028; and U.S. House, *Omnibus Appropriation, 1999*, 105th Cong., 2 sess., H.R. 4328, *Congressional Record*, vol. 144, No. 151, daily ed. (Oct. 21, 1998), S12741.

⁵²Office of Representative Christopher Cox, "Bill Summary;" and Charles E. McLure Jr., "Electronic Commerce, State Sales Taxation, and Intergovernmental Fiscal Relations."

⁵³Office of Representative Christopher Cox, "Bill Summary."

⁵⁴*Quill Corp. V. Heitkamp*, 504 U.S. 298 (1992).

⁵⁵"Electronic Retailing: Does It Have a Future?," *Chain Store Age*, Oct. 1995, found at Internet address <http://proquest.umi.com/>, retrieved Feb. 26, 1998.

⁵⁶*Ibid.*

⁵⁷*Ibid.*

⁵⁸Anne Torpey-Kemph, "ValueVision Tunes Out TV," *Mediaweek*, Mar. 9, 1998, found at Internet address <http://proquest.umi.com/>, retrieved Mar. 8, 1998; and Jason Hudson, "Nonstore Retailing: Paper

(continued...)

Television shopping channels inherently favor impulse buying rather than offering consumers an opportunity to shop interactively from their home. Both QVC and HSN have expanded their reach to the Internet where consumers can search for products seen on the television program or other merchandise. QVC has launched iQVC, a multi-product venue, and HSN has launched ISN to sell computer goods. In 1996, ValueVision purchased catalog retailers Montgomery Ward Direct, Beautiful Images, and Catalog Ventures in an effort to expand its product offerings and its consumer base.⁵⁹

Global Nonstore Retailing

Whereas the U.S. marketplace rapidly adapted to nonstore retailing, foreign consumers and retailers have been comparatively slow to adopt new retailing methods. Thus, U.S. nonstore retailers are poised to capitalize on their marketing and distribution experience to develop new global markets. Catalog companies were the first U.S. nonstore retailers to push into international markets and are still the most common form of nonstore retailing used by foreign consumers. Viking, an office supply cataloger, has moved aggressively into Europe and Australia. Reliable, another office supply cataloger, expanded its operations into Canada by purchasing Quill, a rival company.⁶⁰ The United States holds the largest share of the global mail order market, followed by Germany, Japan, United Kingdom, and France (figure 3).

Technological developments such as global toll-free numbers and the increased use of payment methods such as credit cards, international postal money orders, and electronic cash have made purchases from U.S. catalogs easier for foreign consumers. Also, these consumers often cite favorable exchange rates, prices, and product variety as reasons for patronizing U.S. nonstore retailers. The U.S. Postal Service developed Global Package Link (GPL) to facilitate mail order shipments to several countries. Two landmark agreements, the International Direct Mail Service Agreement and the Global Package Link Agreement

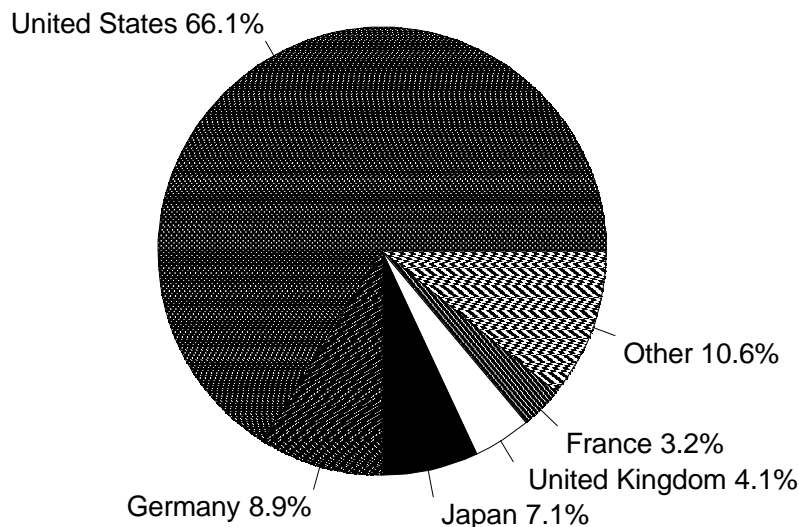
⁵⁸(...continued)

Remains King,” *Catalog Age*, Aug 25, 1995, found at Internet address <http://proquest.umi.com/>, retrieved Oct. 26, 1998.

⁵⁹Paul Miller, “Genesis of a New Era?,” *Catalog Age*, Feb. 1997, found at Internet address <http://proquest.umi.com/>, retrieved May 15, 1998; and Shannon Oberndorf, “From TV to Mailboxes,” *Catalog Age*, Feb. 1997, found at Internet address <http://proquest.umi.com/>, retrieved May 15, 1998.

⁶⁰Ramaswami.

Figure 3
Worldwide mail order sales by percentage, 1997



Source: Arnold Fishman, "The Annual Mail Order Guide," *Direct Marketing*, Sept. 1998, pp. 20 & 32; and The Japan Direct Marketing Association, "Direct Marketing in Japan for Fiscal 1997," found at Internet address <http://www.jadma.org1>, retrieved Nov. 10, 1998.

between the U.S. Postal Service and the Ministry of Post and Telecommunications of China, opened China's consumer market to U.S. mail order retailers in early 1997.⁶¹

Several obstacles could limit the growth of nonstore retailing in foreign markets. Unavailable or incomplete consumer lists are a problem in many markets and often lead to poor response rates. Privacy issues are also a concern, particularly in the European Union. Underdeveloped infrastructure and unreliable local delivery companies sometimes hamper delivery. Imprecise addressing schemes exist in over half the world's countries, creating a distribution problem for foreign mail order firms.⁶² U.S. firms have also found it necessary to alter product offerings. For example, U.S. apparel catalog companies such as Land's End have recognized that clothing sizes run smaller in Asia and have adjusted their products accordingly. J.C. Penney also has customized its catalog products to offer foreign sizes for window and bedding items.⁶³ Other

⁶¹U.S. Department of Commerce, "China-Direct Mail Marketing - ISA970901," STAT-USA Database, found at Internet address <http://domino.stat-usa.gov>, retrieved Jan. 28, 1998.

⁶²Paul Goldner, "Mail Order Marketing: A World Wide View," *Direct Marketing*, May 1996, found at Internet address <http://proquest.umi.com/>, retrieved on Feb. 9, 1998.

⁶³Carole Sloan, "JCP Bows Foreign Catalogs: United Kingdom, Mexico, Chile, and Japan Getting Home Books," *Home Textiles Today*, Nov. 11, 1996, found at Internet address <http://proquest.umi.com/>, retrieved Jan. 28, 1998.

limiting factors include customs clearance, duties, and taxes, for which consumers may be responsible.⁶⁴

The Internet may also create retail opportunities in developing countries where distribution channels are less developed, direct, or efficient.⁶⁵ U.S. Internet retailers are often able to deliver a product to a foreign customer for less than it would cost to purchase the product locally. However, outside the United States, the Internet is often prohibitively expensive or unavailable.

Canada

Canada is the primary marketing destination for many U.S. catalog firms. Overall, Canadians purchase more mail order goods than U.S. consumers.⁶⁶ U.S. firms presently hold the largest foreign share (about 16 percent) of the Canadian mail order market. However, U.S. firms expect to gain a larger share of the market due to use of better technology, more competitive prices, geographic proximity, timely delivery, cultural similarities, and improved customer service.⁶⁷ Also, Canada's consumer preferences are similar to those in the United States, providing a complementary consumer base for U.S. catalog companies.⁶⁸ Still, to attract new Canadian customers and better serve current ones, U.S. catalog companies have simplified the catalog shopping process. For example, Land's End has eliminated duty invoices and postal fees, and L.L. Bean has dropped its CDN \$5 mail system delivery fee and has established French-language telephone service.⁶⁹

European Union

The European Union, where demand is high for U.S. consumer goods, is a \$50-billion market for catalog mail order.⁷⁰ U.S. specialty catalogs generally offer better service than their European counterparts⁷¹ and cross-border distribution of goods is becoming easier as the U.S. and European postal organizations eliminate barriers. For example, U.S. catalog firms are now able to distribute their products throughout Europe from one central location. However, certain challenges exist within individual countries. For example, in France, U.S. firms reportedly must contend with frequent labor difficulties. In Germany, expensive postal rates hinder competitive pricing. In Italy, poor postal service discourages home shopping.⁷² European consumers must also pay any import duties and VAT taxes, and must collect their own tax refunds in the event of a product return. Internet retailing is not expected to be a major

⁶⁴Richard Zelade, "Roadblocks to International E-commerce," *International Business*, Jan./Feb. 1998, found at Internet address <http://proquest.umi.com/>, retrieved May 12, 1998.

⁶⁵Quelch.

⁶⁶USDOC, "Canada - Direct Marketing," Stat-USA Database, found at Internet address <http://domino.stat-usa.gov>, retrieved Oct. 23, 1998.

⁶⁷*Ibid.*

⁶⁸*Ibid.*

⁶⁹*Ibid.*

⁷⁰Cacilie Rohwedder, "U.S. Mail-Order Firms Shake Up Europe," *The Wall Street Journal*, Jan. 16, 1998, p. A13.

⁷¹*Ibid.*

⁷²Rohwedder, p. A13.

force in some of the member states until telecommunications deregulation is undertaken.⁷³ Also, the EU direct selling directive is vague on personal mail order imports, which may create uncertainty and thereby hinder sales volumes.⁷⁴

In order to remove obstacles to the free movement of data while protecting an individual's right to privacy, EU member states harmonized their data privacy legislation in line with Directive 95/46/EC, the European Union Data Privacy Directive, on October 24.⁷⁵ The directive gives citizens the right to know how data will be used and gives them a means to correct erroneous personal information about purchasing habits, credit ratings, and other characteristics.⁷⁶ The directive also prohibits the export of such information to third countries that the EU believes lack appropriate protection measures.⁷⁷

The directive reportedly could have broad implications for nonstore retailers and other companies that depend on such information to identify consumers, potentially requiring them to observe the EU directive when transmitting data to EU member states.⁷⁸ The United States is working to assure the EU that U.S. industry meets the directive's criteria in order to keep the market open to U.S. retailers.⁷⁹

Germany is second only to the United States in mail order sales, totaling over \$27 billion annually.⁸⁰ Sensing opportunity, catalog companies such as Eddie Bauer and Land's End have moved into the German market. Land's End spent a year preparing its German telephone and customer service center and training employees to handle orders, returns, and special services.⁸¹ Land's End has remained committed to the German market despite an unsuccessful attempt by a group of German retailers' to sue the company, claiming that its "lifetime guarantee" on products resulted in unfair competition.⁸²

Asia and Japan

⁷³Quelch.

⁷⁴"Cross-Channel Booze: Glug Glug," *The Economist*, Apr. 23, 1994, p. 61.

⁷⁵"Data Protection: Background Information," Aug. 3, 1998, found at Internet address <http://europa.eu.int/>, retrieved on Oct. 23, 1998.

⁷⁶Victoria Sonshine Pasher, "EU Privacy Law Dangers Cited," *National Underwriter*, Jan. 12, 1998, found at Internet address <http://proquest.umi.com/>, retrieved Oct. 23, 1998; Suzanne Perry, "Europe, U.S. Try To Head Off Privacy Trade War," Reuters News Service, Feb. 18, 1998, found at Internet address <http://www.infoseek.com>, retrieved Feb. 24, 1998; and Robert O'Harrow Jr., "Privacy Rules Send U.S. Firms Scrambling," *Washington Post*, Oct. 20, 1998, p. C1.

⁷⁷Suzanne Perry.

⁷⁸Pasher.

⁷⁹Robert O'Harrow Jr., p. C1; "A Framework for Global Electronic Commerce;" and USDOC, NTIA, "Self-Regulation in the Information Age," June 1997.

⁸⁰Shannon Oberndorf, "U.S. Mailers Blitz Germany," *Catalog Age*, Feb. 1998, found at Internet address <http://proquest.umi.com/>, retrieved Feb. 23, 1998.

⁸¹Melissa Dowling, "Germany, Meet Land's End," *Catalog Age*, Oct. 1, 1996, found at Internet address <http://proquest.umi.com/>, retrieved Feb. 11, 1998.

⁸²*Ibid*; and Rohwedder, p. A13.

In Asia, catalog purchases of foreign products are increasing as consumers find them to be an inexpensive and convenient way to shop. However, certain obstacles are faced by U.S. mail order firms. In response to language barriers, many catalog firms have created in-language catalogs, or at least in-language ordering information. Credit card use is increasing, but is still low, so firms have been flexible in accepting other forms of payment. Many firms, however, are unwilling to assume exchange rate risk by accepting payment in local currency. Restrictions exist on the distribution of consumer addresses and credit ratings, information necessary to locate potential customers. Some markets impose delivery restrictions and require nonstore retailers to have a commercial presence. China banned direct sellers in April 1998, although the ban was later modified to allow U.S. direct sellers to continue selling in China.⁸³ The modifications allow sales to Chinese consumers through Chinese sales promoters, who do not take title to the goods and who work solely on commission. However, direct sellers must also maintain retail sales outlets. Consequently, U.S. direct sellers, such as Amway, Avon, and Mary Kay, have had to significantly alter their sales strategies in China.⁸⁴

Japan is the largest market in Asia for U.S. catalog companies. Mail order imports through international catalogs reached approximately \$1 billion in 1995, 80-90 percent of which came from U.S. catalog companies.⁸⁵ Overall, foreign firms hold about 10 percent of the Japanese mail order market.⁸⁶ In Japan, catalog firms distribute their catalogs through convenience stores that charge a small fee (around 15 yen) to “purchase” a catalog. Orders are generally placed through the store, which acts as a distribution center for catalog items. The catalog companies pay store owners a commission on each sale, and the stores also benefit from increased foot traffic. This distribution channel is often difficult for foreign firms to penetrate because convenience stores generally require payment in yen, creating exchange rate risk for the foreign firm. Also, foreign catalog companies must make costly investments so their barcode systems are compatible with those of the convenience store chain.⁸⁷ As a result, some of the smaller foreign catalog firms find it necessary to take on a distribution partner. Despite these challenges, U.S. mail order firms have distinct advantages over Japanese retailers.⁸⁸ Foreign mail order firms are not subject to testing regulations for cosmetics and pharmaceuticals, because the regulations do not apply to mail-order goods purchased for personal use. Also, mailing costs for goods shipped from the United States to Japan are often cheaper than mailing costs for goods shipped across Japan, and these savings are passed on to the consumer. In addition, U.S. catalog firms offer exclusive products that are not available in Japan.

⁸³U.S. Department of State telegram No. 014472, “Foreign Direct Sellers Back in Business Under New Regulations,” prepared by U.S. Embassy, Beijing, Aug. 1998.

⁸⁴Ibid.

⁸⁵USDOC, “Japan - Catalogers in Japan - IMI960523,” Stat-USA Database, found at Internet address <http://domino.stat-usa.gov/>, retrieved Jan. 28, 1998; and USDOC, “Japan - Mail Order Business (Personal Imports) - ISA960201,” Stat-USA Database, found at Internet address <http://domino.stat-usa.gov/>, retrieved Jan. 28, 1998.

⁸⁶Joji Sakurai, “Firms Challenge Image of Japan’s Closed Markets,” *Marketing News*, July 20, 1998, found at Internet address <http://proquest.umi.com/>, retrieved Aug. 4, 1998.

⁸⁷USDOC, “Japan-Convenience Stores as Base for Catalogs - IMI970626,” Stat-USA Database, found at Internet address <http://domino.stat-usa.gov/>, retrieved Jan. 28, 1998.

⁸⁸Joji Sakurai.

Outlook

Nonstore retailing provides a convenient, low-cost shopping alternative for consumers. U.S. nonstore retailers stand to increase their share of the domestic retail market by capitalizing on their apparent advantages in terms of distribution, convenience, price, and shopper safety. Foreign market share will also likely increase due to U.S. firms' competitive advantages in applying advanced technologies to fill orders and serve customers, although privacy issues, mailing difficulties, and slower growth of nonstore mediums such as the Internet and home television shopping currently limit foreign market prospects. However, public and private sector initiatives that address security, privacy, and taxation are expected to favorably influence the fortunes of U.S. direct sellers, especially Internet retailers, both at home and abroad.#

APPAREL SOURCING STRATEGIES FOR COMPETING IN THE U.S. MARKET

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U.S. customers for apparel are driving intense competition in the apparel industry, remaking the manufacturing as well as the retail industry. Apparel consumers are demanding a greater selection of good quality at a low price as well as added convenience in readily finding merchandise. These consumer trends have led to the growth of “mega retailing” that emphasizes one-stop shopping that provides a broad assortment of goods at competitive prices.² Consumer trends have also encouraged the return of specialty stores that have consistent quality and styling in apparel, and simple, uncluttered store environments. After years of struggling to compete with imports in the U.S. apparel retail market and, more recently, meeting more stringent merchandising demands of U.S. retailers, many of the larger, successful apparel producers are now restructuring to offer retailers and customers the most cost-efficient, high-quality, fashionable combination of branded and private-label apparel. This article discusses the changing U.S. apparel retail market, the growing role of foreign sourcing by U.S. retailers and apparel producers, and the importance of such sourcing trends in the men’s dress shirt market. Competition in the U.S. apparel market is likely to increase. About one-half of U.S. consumption already consists of imported apparel, and quotas on most U.S. apparel imports will be phased out by January 1, 2005.

Current Trends in Apparel Retailing

In a U.S. retail market of more than 19 square feet of retail selling space per capita—more than a decade ago³—competition between retail establishments remains intense. The 10 largest retailers currently account for 68 percent of department, chain, discount, and specialty store sales.⁴ Large specialty stores accounted for the highest share of retail apparel sales by value in 1997, 22 percent (figure 1). These stores are regaining market share lost to the discounters, off-price stores, and other nontraditional retailers. The Limited

¹The views expressed in this article are those of the author. They are not the views of the International Trade Commission or any of the Commissioners.

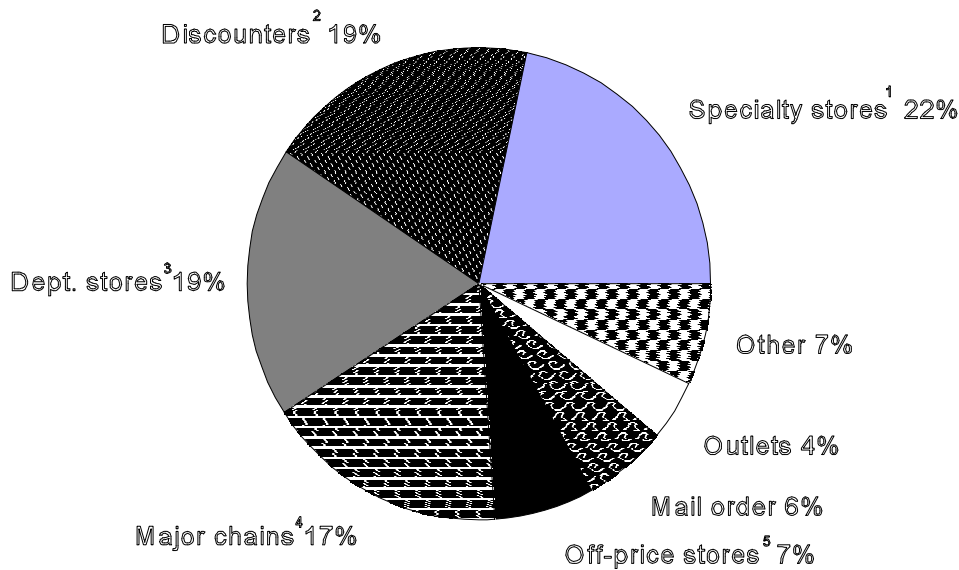
²See also the accompanying article on the growth of nonstore retailing.

³Kurt Salmon Associates (KSA), *Perspective, Soft Goods Outlook for 1998*, Nov. 1997, p. 5.

⁴Philip Black, “The X-Factor,” *The Apparel Strategist*, found at www.editor@appstrat.com.

Apparel

Figure 1
Apparel: Share of retail sales by type of outlet, 1997



¹ Includes The Limited, The Gap, and Brooks Brothers, as well as independently owned stores.
² Includes Wal-Mart, Kmart, and Target, among others.
³ Includes Nordstrom, Bloomingdale's, and Lord and Taylor, as well as regional department stores.
⁴ Includes Sears, J.C. Penneys, Wards, Kohls, and Mervyns.
⁵ Includes T.J. Maxx, Burlington Coat Factory, and Marshalls, among others.

Source: American Apparel Manufacturers Association (AAMA) Marketing Committee, "Apparel Market Monitor, Annual 1997," pp. 7-8; and Kurt Salmon Associates, *Perspective, Soft Goods Outlook for 1998*, Nov. 1997, p. 5; both sources used data provided by the National Purchase Diary (NPD) Group, Inc.

and The Gap, both large, successful apparel specialty stores, ranked among the top 10 largest specialty retailers overall. The specialty stores' recovery in 1997⁵ reflected the introduction of such new ideas as improving store environment. Consumers reportedly enjoy the orderly and simple store layout of The Gap and the atmosphere of Victoria's Secret.⁶ Successful apparel specialty stores, often within the same corporate ownership, also appear to successfully compete with other retailers by defining fairly narrow market niches.

The majority of remaining apparel sales during 1997 was fairly evenly distributed between discounters,⁷ department stores, and major chains, with each accounting for between 17 and 19

⁵Specialty store share of apparel retail sales was about 18 percent in 1994.

⁶Black.

⁷The dominance of discounters, such as Wal-Mart and Target, in the apparel retail market has lessened slightly during the past 4 years; their share dropped by almost 1 percent in 1996, and by 3 percent in 1997. These declines are attributed to the closings of weaker regional chains, leaving discounters that are

(continued...)

percent, also shown in figure 1. Large discounters and major chains selling low-to-moderate price goods dominate the list of the top 100 retailers.⁸ The top five retailers in 1997 are Wal-Mart with almost \$118.0 billion in total annual sales; Sears Roebuck & Company with \$41.5 billion; Kmart with \$32.2 billion; J.C. Penney Company, Inc. with \$30.5 billion; and Dayton Hudson (which includes primarily Target) with \$27.8 billion.⁹ The force driving the success of such stores is their ability to supply consumers with the right assortment of quality, value-priced apparel.

Department stores lost almost 3 percent of their market share in 1996, but remained at that level in 1997. Over a longer term, KSA's 1996 Consumer Pulse Study found that department stores have been fairly successful in luring back consumers since the early 1990s.¹⁰ In response to a declining market share, department stores (1) relocated themselves closer to the consumer; (2) improved customer service; and (3) introduced such new merchandise ideas as their own lines of private-label¹¹ apparel and a wider selection of branded apparel.¹² Willing to pay a little more for quality, reliable brands, and current trends, consumers are returning to shop at department stores.

Apparel Consumer Spending Habits

Consumers' time spent shopping dropped to about 3.3 hours per month in 1998, from 4.8 hours in 1993, in response to longer working hours and less time for family, household tasks, and recreation.¹³ Having limited time, and frustrated by untrained sales associates and shortages of merchandise, consumers are enjoying shopping less and are looking for retailers that help them streamline their shopping experience by providing good service, convenient locations, and varied merchandise.¹⁴

Consumers increasingly rely on nationally branded apparel for consistency in quality and style. As retailers capitalized on the branded concept and offered quality private-label apparel, the popularity of store brands or private-label merchandise increased significantly. The percentage

⁷(...continued)

“sharply focused” on market strategy. KSA, *Perspective, Soft Goods Outlook for 1998*, Nov. 1997, p. 5.

⁸David P. Schultz, “The Nations Biggest Retail Companies,” *Stores*, July 1998, found at www.stores.org, p. 1.

⁹“American Express Top 100 Retailers,” *Stores*, July 1998, found at www.stores.org.

¹⁰KSA, *Department Stores: The KSA Consumer Findings, Brand and Labels: The Issues*, June 1997, pp. 1-2.

¹¹Private-label apparel is an apparel line designed and named exclusively by a retailer. Private-label apparel is sold only by the retailer that developed the line.

¹²National brands are lines of apparel developed and produced by an apparel company, be it a manufacturer or a merchandiser. National brands are sold by more than one retail company.

¹³KSA, *KSA Perspective*, “New Consumer Demands: The Mass Merchant's Opportunity,” p. 1.

¹⁴Dick Silverman, “Consumers Are Becoming More Shopworn,” *Daily News Record*, July 6, 1998, p. 13.

of branded and private-label apparel sales together accounted for 78 percent of all retail apparel sales in 1997.¹⁵

Many consumers do not differentiate between national brands and private-label apparel, for example perceiving such private labels as The Gap, The Limited, and L.L. Bean as “nationally branded” apparel. In the Annual KSA Consumer Outlook ‘98 Survey, 67 percent of the sample indicated that it felt the quality of private-label apparel was as good as or better than that of national brands.¹⁶

Historically, brand names and designer labels have been marketing tools for retailers. With the introduction of private labels, retailers are responding to consumers’ requests for product value at competitive prices by offering lower priced alternatives to branded apparel, and at the same time, controlling the quality and prices of their product mix. Private labels also attract consumers to stores because they create a unique identity for the retailer. Two examples of successful private labels are J.C. Penney’s The Original Arizona Jean Company and Federated Department store’s I.N.C. label. J.C. Penney’s emphasizes that their private labels are a major competitive strength. Federated’s I.N.C. line competes with similar types of branded fashion or designer apparel at prices that are 20 to 30 percent lower.¹⁷ Retailers also use private labels to attract consumers to their stores in order to sell branded merchandise. Sears Roebuck & Company, for example, sells casual apparel under its Canyon River Blues private label and also sells Levi and Wrangler casual wear. In addition, because the retailer is closest to the consumer in the apparel producer/merchandiser/retailer chain, the retailer has immediate exposure to consumer purchasing habits that can be used in marketing their private labels.

U.S. retailers are likely to increase sourcing their private-label apparel overseas¹⁸ in order to save costs as they gain experience in all types of sourcing--albeit from Asia or contract production in the CBI or Mexico. According to the National Purchase Diary (NPD) in 1997, imports of branded apparel accounted for 19 percent (13 percent in 1995) of the U.S. apparel market and imports of private-label apparel accounted for 15 percent (12 percent in 1995).¹⁹ Sears, which previously had sourced its private-label apparel largely from domestic suppliers, reportedly is increasing its overseas sourcing.²⁰ Large specialty retailers such as The Gap and The Limited source their apparel worldwide. Reportedly, 30 to 40 percent of apparel sold by J.C. Penneys is imported from 60 countries²¹ and much of its overseas production has been

¹⁵The remaining apparel sales consisted of regional and/or secondary brands.

¹⁶KSA, *Consumer Outlook '98, KSA's Annual Consumer Outlook Survey Results*, 1998, p. 14.

¹⁷*Ibid.*, p. 1.

¹⁸"Convergence 2: Vertical Retail," *Apparel Industry Magazine*, found at www.aimagazine.com/archives/1097, p. 4.

¹⁹Data provided by the NPD Group, Inc., Port Washington, NY, by fax (516) 625-2839. The NPD is a large market research firm that studies on apparel consumer purchasing behavior and current retail sales activity. NPD's American Shoppers Panel (ASP) consists of 16,000 representative households nationwide.

²⁰"Convergence 2: Vertical Retail," *Apparel Industry Magazine*, found at www.aimagazine.com/archives/1097, p. 4.

²¹*Ibid.*

shifted from Asia to Central America. It also has some production-sharing operations in Mexico.²²

Restructuring by Apparel Producers and Merchandisers

Stimulated by intense competition at the retail level and growing convergence in apparel producers', merchandisers', and retailers' operations, U.S. apparel producers are undergoing extensive restructuring. There are two major aspects to their restructuring: (1) shifting from domestic manufacturing and vertical integration to foreign sourcing, in order to increase focus on consumer needs and the marketing of their products, and (2) consolidation. Such reorientation allows many larger apparel companies to offer retailers and customers the most cost-effective, high-quality, fashionable combination of branded and private-label apparel. Some companies are divesting manufacturing facilities in order to become consumer driven, to gain the flexibility to respond to consumer demands, and to develop marketing expertise. Many of the large apparel firms are also pursuing aggressive acquisition programs in order to complement their product lines. In order to compete, apparel suppliers must keep prices low so that retailers can profit, and must meet the quick response (QR) needs of retailers. Suppliers also must offer value-added services such as holding inventory for retailers and supplying floor-ready merchandise, i.e., apparel on hangers with hang tags attached, to be competitive.

Table 1 illustrates some actions undertaken by apparel companies to compete. These companies rank among the largest in the industry, with combined sales accounting for about 20 percent of the total value of sales in the U.S. apparel market in 1997²³. Their combined sales increased by almost 20 percent during 1993-97, compared with a 10-percent rate of increase for total sales in the U.S. apparel market. Most of these companies view global sourcing as a crucial competitive strategy that affords them the opportunity to meet retailer demand and, in turn, the rapidly changing needs of the consumer.

The expansion of offshore sourcing by U.S. apparel producers and retailers is part of a broader trend of globalization in apparel production. Production capacity throughout the world apparel industry continues to move from developed countries to lower cost sites of production. Intense competition in the U.S. apparel market has spurred many U.S. apparel producers to set up sewing operations in Caribbean and Central American countries and Mexico to reduce production costs.²⁴ The region offers competitively priced labor to perform labor-intensive sewing tasks, and its proximity to the United States provides U.S. firms with greater management and quality control over production, quicker turnaround, and lower transportation costs than would Asian operations.

²²Ibid.

²³Sales in the U.S. apparel market in 1997 totaled \$95.6 million and include the value of domestic shipments plus the landed duty paid value of imports, adjusted for imports made in foreign production-sharing operations less exports.

²⁴For more information on U.S. apparel production sharing operations, see USITC, *Production Sharing: Use of U.S. Components and Materials In Foreign Assembly Operations, 1993-96*, USITC publication 3077, Inv. No. 332-237, Dec. 1997.

Apparel

Table 1
Recent restructuring in the U.S. apparel industry

Company/products/brand names	Foreign sourcing	Restructuring activity
<p>VF Corp., Reading, PA</p> <p>Produces all types of apparel, such as Wrangler and Lee jeans; intimate apparel under the Vanity Fair label; knitwear; and workwear.</p>	<p>By end of 1998, offshore sourcing projected to account for 50 percent of sales.</p>	<p>Plans to increase offshore sourcing to 80 percent of sales in future. Acquired Bestform Group, a leading producer of intimate apparel, to augment offshore sourcing in Asia. Acquired Britannia Sportswear Ltd. to increase presence in mass merchandise market.</p>
<p>Sara Lee Corp., Chicago</p> <p>Produces a wide range of apparel, such as intimate apparel, underwear, and hosiery under the Hanes brand; athletic/casual wear under the Champion label.</p>	<p>In 1997, offshore sourcing accounted for 42 percent of apparel sales.</p>	<p>Recently purchased Harwood Co. with its offshore facilities in Honduras and Costa Rica. Selling off part of vertical operations, namely its U.S. knitting operations. Company's "de-verticalization" plan allows for greater focus on consumers, product development and brand marketing.</p>
<p>Fruit of the Loom, Chicago</p> <p>Leading producer of underwear and basic casual family apparel.</p>	<p>Moved most U.S. sewing operations to Mexico and Caribbean countries in the past few years. Currently has 14 company-owned offshore facilities, which account for 35 percent of its offshore sourcing.</p>	<p>Plans to have 95 percent of its production made in Mexico, Caribbean countries, and Central America in 1998. Plans to increase percent of offshore sourcing performed by 14 company-owned facilities to 60 percent and have remaining 40 percent of sewing done by offshore outside contractors.</p>
<p>Oxford Industries, Inc., Atlanta</p> <p>Produces a wide range of apparel including men's dress shirts and tailored suits. Produces such national brands and private labels as Oscar de la Renta suits, May Co. Nautica suits, J.C. Penney Stafford suits, Eddie Bauer slacks, L.L. Bean mens's slacks and shirts, and Target stores Merona blouses and pants.</p>	<p>Produces in 37 countries. In 1998, only 15 percent of its sales were made domestically; 54 percent were made in production sharing operations and 31 percent by foreign producers.</p>	<p>Plans to continue producing majority of garments offshore.</p>
<p>Kellwood Co., St. Louis</p> <p>Produces a wide range of apparel from careerwear to lingerie to men's shirts. Produces such brand names as Kathie Lee, Sag Harbor, Harve Benard, and Nautica dress shirts. Also produces numerous private labels.</p>	<p>Sources 78 percent of its apparel sales in 30 countries through a global sourcing network.</p>	<p>Plans to increase offshore sourcing to 90 percent of its apparel sales in next 5 years.</p>

Table 1—Continued
Recent restructuring in the U.S. apparel industry

Company/products/brand names	Foreign sourcing	Restructuring activity
Russell Corp., Alexander, AL Produces athletic and sports- wear under its own brand name--Russell-- professional uniforms, and licensed apparel.	Offshore sourcing accounts for 20 percent of its apparel production.	Strategic plan emphasizing consumer marketing, includes consolidation (closure of 25 global facilities out of 90) and increasing foreign sourcing to 50 percent of apparel production during next 5 years.
Salant Corp., New York Produces men's apparel brands, such as Perry Ellis, Manhattan, and John Henry; such private labels as Canyon River Blues for Sears; and licensed children's sleepwear, underwear, and sportswear.	Sources 88 percent of its apparel production offshore: 47 percent in Mexico, 18 percent in Guatemala, and 12 percent in the Dominican Republic.	Plans to continue producing majority of its apparel offshore.

Source: Compiled from various companies' annual reports and press releases, Prudential Securities monthly reports, and interviews with company officials by Commission staff obtained during field work done in August 1998.

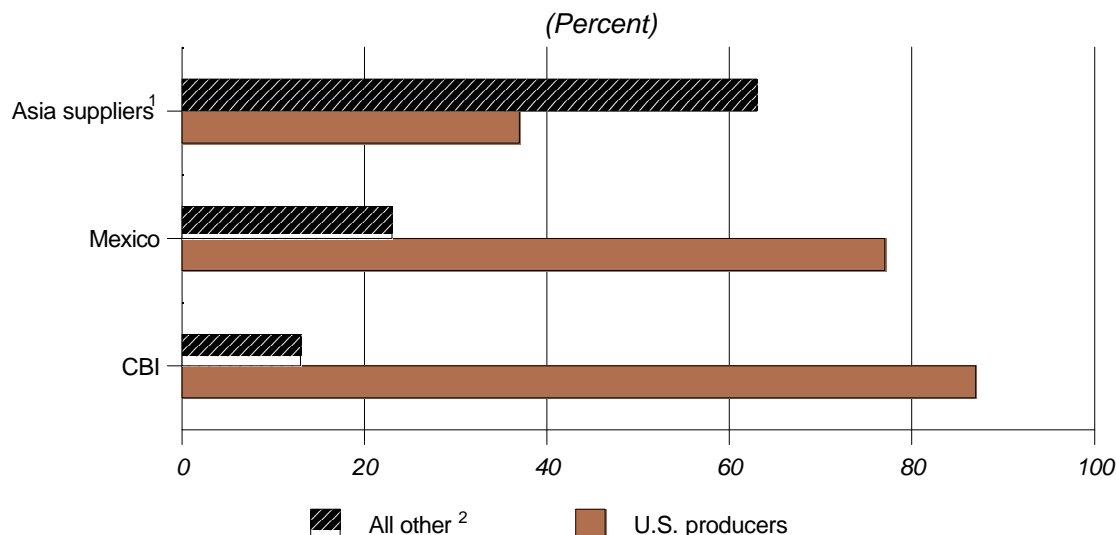
Although restructuring by the U.S. apparel industry during 1993-97 caused an estimated loss of 176,000 jobs in the domestic industry during this period, these losses occurred at the same time that U.S. apparel shipments increased by 2 percent, largely as a result of the rapid expansion of production-sharing operations with Mexico, Caribbean, and Central American countries. While the U.S. apparel wholesale market rose by 10 percent during 1993-97, domestic sales of the top 15 publicly owned apparel firms, plus Levi Strauss, which tend to source globally, increased by 27 percent, from \$27.7 billion in 1993 to \$35 billion in 1997.

Analysis: Men's Cotton Dress Shirts²⁵

One segment of the apparel industry that demonstrates the prevalence of offshore sourcing by U.S. producers and the use of private labels is men's cotton dress shirts. U.S. producers consistently were major importers of men's dress shirts in 1997, as shown in figure 2; 87 percent of the value of men's cotton dress shirt imports from CBI countries and 77 percent of the trade with Mexico reflected the use of production-sharing operations. Although the use of production sharing in CBI countries and Mexico has increased in recent years, many U.S. apparel producers still import finished goods for their product line from Asia—especially commodity-type products such as men's dress shirts. Oxford Industries reported that it imports from Asia when it is using specialty fabrics that it cannot obtain

²⁵Men's cotton dress shirts were selected for special analysis and to identify the implementation of such trends because they are imported in significant numbers as well as domestically made. In addition, sources of imports of men's cotton dress shirts are fairly evenly distributed throughout the world.

Figure 2
U.S. imports of men's cotton woven dress shirts: U.S. producers' share, by world regions, 1997



¹ Includes Hong Kong, Taiwan, Korea (South), Malaysia, Indonesia, Sri Lanka, Bangladesh, and the Philippines.

² Includes department stores, major chains, specialty stores, discounters, mail order, general importers, and merchandisers--companies which perform the design and marketing functions and contract out the actual production.

Source: Compiled by USITC staff from unpublished data of the U.S. Customs Service Net Import File.

domestically.²⁶ In addition, Oxford Industries reported that purchasing apparel or having apparel made in Asia is the least costly of all the production scenarios they utilize, including production sharing in CBI countries and Mexico, and domestic production.²⁷

The composition of the retailers' share of the men's cotton dress shirt market differed somewhat from that of all apparel, as shown in figure 3. Major chains, which tend to focus on commodity-type products, led this market segment. Specialty stores, which tend to focus more on garments with fashion appeal, ranked fourth after department stores and discounters.

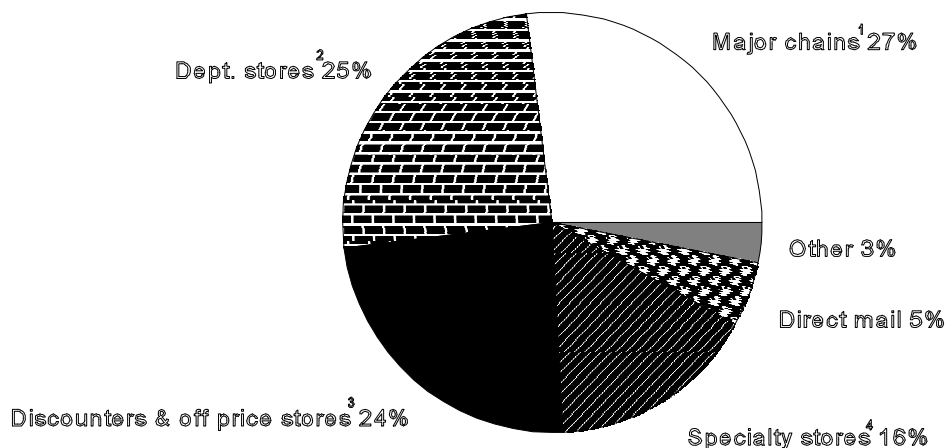
For the most part, U.S. retailers tend not to import from production sharing operations in the CBI and Mexico because they do not have the manufacturing capabilities or do not want to coordinate the production processes with U.S. manufacturers or contractors.²⁸ Most retailers prefer to import apparel directly or to purchase the "full package" from Asian firms that coordinate all the processes in manufacturing a garment. Meanwhile, those retailers without experience hire agents to coordinate all the aspects of the overseas production and

²⁶ Interview with company official of Oxford Industries by Commission staff, Aug. 1998, Atlanta and Monroe, GA.

²⁷ Ibid.

²⁸ There is a slowly growing trend for some of the larger retailers to use production sharing operations and/or contractors in the CBI and Mexico.

Figure 3
Men's dress shirts: Share of retail sales by type of outlet, 1997



¹ Includes Sears, J.C. Penneys, Wards, Kohls, and Mervyns.

² Includes Nordstrom, Bloomingdales, and Lord and Taylor, as well as regional department stores.

³ Includes Wal-Mart, Kmart, Target, T.J. Maxx, and Marshalls, among others.

⁴ Includes The Limited, The Gap, and Brooks Brothers, as well independently owned stores.

Source: American Apparel Manufacturers Association (AAMA) Marketing Committee, "Apparel Market Monitor, Annual 1997," based on data provided by the National Purchase Diary (NPD).

packaging processes.²⁹ The hiring of agents to coordinate production sharing in Mexico, including the cutting in the United States, is going on now, although this practice did not appear prevalent in the area of men's cotton dress shirts in 1997. That year retailers accounted for 38 percent of the total value of imports from Asia and for only a small share--less than 10 percent--of imports of men's dress shirts from the CBI and Mexico, together.

Outlook

The large apparel and retail companies are expected to continue to grow as consolidation moves ahead and competition weeds out the smaller companies that cannot afford the latest technology to streamline operations and deliver quality goods quickly and efficiently. However, smaller companies that develop successful market niches are likely to prosper. In today's highly competitive apparel market, increased offshore sourcing reflects the ongoing search for the most efficient global location for the production of low-cost, quality apparel. Sourcing has become one of the key elements in an apparel company's competitive strategy. Foreign sourcing is expected to increase as the roles of members of the apparel

²⁹Brenda A. Jacobs, "Have CBI Nations Found a Full Package Opportunity?" *Bobbin Magazine*, vol. 39, No. 12, p. 70.

producer/merchandiser/retailer/complex blur. In addition, competition likely will intensify with the elimination of quotas by WTO-member countries in 2005 under the Agreement On Textiles and Clothing (ATC) negotiated during the Uruguay Round of multilateral trade negotiations.³⁰ Moreover, U.S. free-trade initiatives under NAFTA and special duty and quota treatment for certain apparel assembled in Caribbean Basin countries and Mexico have greatly paved the way for growth of apparel production in these regions.#

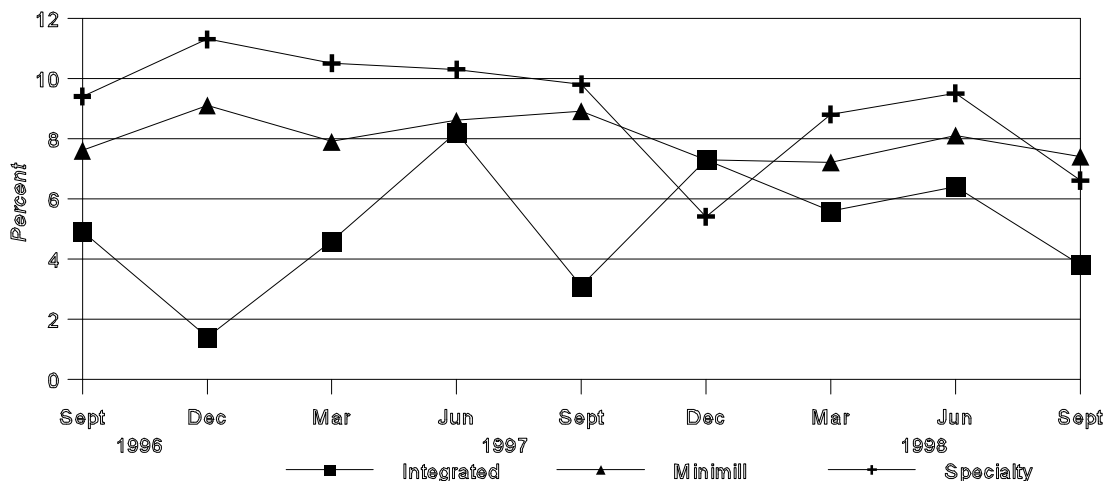
³⁰Under the ATC, WTO countries are required to phase out quotas that had been maintained under the Multifiber Arrangement on goods from other WTO countries within 10 years, beginning on Jan. 1, 1995. Sector goods are to be “integrated” into the WTO regime--that is, brought under WTO discipline and made subject to the same rules as goods of other sectors.

APPENDIX A
KEY PERFORMANCE INDICATORS OF SELECTED
INDUSTRIES

- STEEL** (Tracy Quilter, 202-205-3437/tquilter@usitc.gov)
- AUTOMOBILES** (Laura A. Polly, 202-205-3408/polly@usitc.gov)
- ALUMINUM** (Harpreet Kaur, 202-205-3120/hkaur@usitc.gov)
- FLAT GLASS** (James Lukes, 202-205-3426/lukes@usitc.gov)
- SERVICES** (Christopher Melly, 202-205-3461/melly@usitc.gov)

STEEL

Figure A-1
Steel Industry: Profitability by strategic group¹



¹Operating profit as a percent of sales. Integrated group contains 10 firms. Minimill group contains 8 firms. Specialty group contains 5 firms.

Source: Individual company financial statements.

- Profitability of all three groups of steelmakers declined in the third quarter 1998. The firms' financial reports blamed the lingering effects of the GM work stoppage, planned outages, lower realized selling prices, increased imports, and lower shipments for this decline.
- Several steel companies, including Geneva, Gulf States, Inland, Lone Star, LTV, North Star, Northwestern Steel and Wire, Nucor, Rouge, Timken, US Steel, WCI Steel, Weirton, Wheeling-Pittsburgh, and Bethlehem's Lukens plants, announced layoffs in the last few months as various mills were idled or cut back production due to a lack of orders and/or an effort to reduce costs.
- Citing weakening demand, continued high levels of imports, and softening prices, Acme Metals and Laclede Steel recently filed for bankruptcy protection under Chapter 11 of the U.S. bankruptcy code. Both companies plan to continue operations while a restructuring plan is put in place.

Table A-1
Steel mill products, all grades

Item	Q3 1998	Percentage change, Q3 1998 from Q3 1997	YTD 1998	Percentage change, YTD 1998 from YTD 1997
Producers' shipments (1,000 short tons)	24,903	-6.1	79,428	1.3
Imports (1,000 short tons)	12,279	56.3	30,518	26.8
Exports (1,000 short tons)	1,246	-22.2	4,295	-3.6
Apparent supply (1,000 short tons)	35,936	9.6	105,651	7.8
Ratio of imports to apparent supply (percent)	34.2	² 10.2	28.9	² 4.3

¹Based on unrounded numbers.

²Percentage point change.

Note.—Because of rounding, figures may not add to the totals shown.

Source: American Iron and Steel Institute.

STEEL

Table A-2
 Steel service centers

Item	Sept. 1998	Percentage change, Sept. 1998 from June 1998 ¹	Q3 1998	Q3 1997
Shipments (1,000 net tons)	2,521	-1.6	7,487	7,266
Ending inventories (1,000 net tons)	8,465	5.1	8,465	7,226
Inventories on hand (months)	3.4	(²)	3.4	2.9

¹Based on unrounded numbers.

²Not applicable.

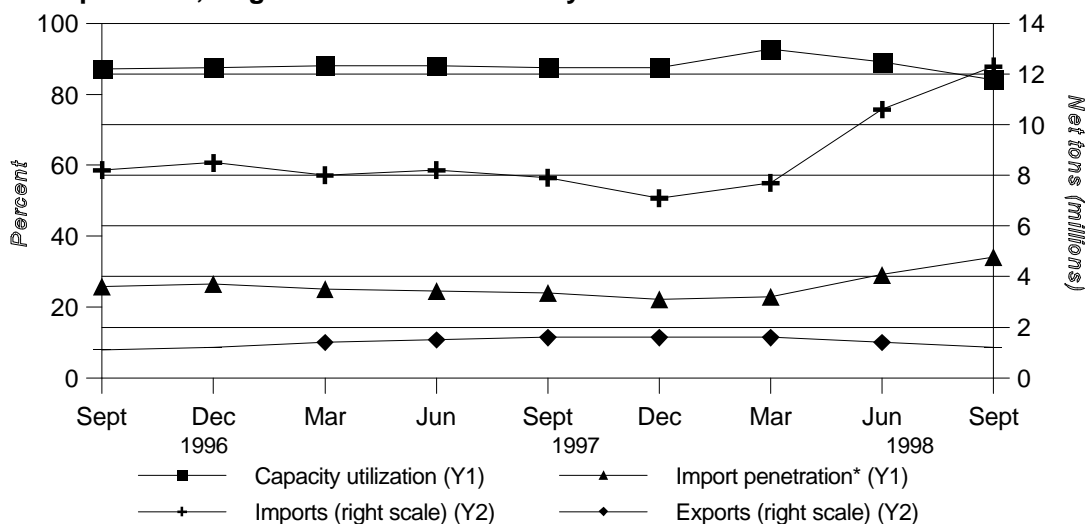
Note.—Because of rounding, figures may not add to the totals shown.

Source: Steel Service Center Institute.

- The Steel Service Center Institute (SSCI) reported a 12 percent increase in shipments for the month of September 1998 when compared with December 1997, while Q3 1998 shipments increased 3 percent from the same period last year. A majority of respondents to SSCI's November survey suggested that they expect a decrease in incoming orders in the next three months. Furthermore, SSCI anticipates a decrease in inventories during Q4 1998.¹
- Total steel imports increased 56 percent from Q3 1997 to Q3 1998, raising overall import penetration to 34 percent; imports grew 16 percent from Q2 1998 to Q3 1998. Imports of finished steel products (excluding semifinished products) increased 73 percent for the same period.
- Capacity utilization dropped 5 percentage points to an average of 84.1 percent, for Q3 1998 from Q2 1998. Capacity utilization stood at 87.6 percent for this period last year. Producers shipments for Q3 1998 decreased 6 percent compared with Q3 1997. Since the close of the quarter, several steelmakers, representing all industry segments, have reported additional production cuts.

¹SSCI, news release, "Daily Service Center Shipping Rate Tops 120,000 Tons-1st Time Since May," Oct. 23, 1998.

Figure A-2
 Steel mill products, all grades: Selected industry conditions



*Import share of apparent open market supply.
 Source: American Iron and Steel Institute.

AUTOMOBILES

Table A-3

U.S. sales of new automobiles, domestic and imported, and share of U.S. market accounted for by sales of total imports and Japanese imports, by specified periods, January 1997-September 1998

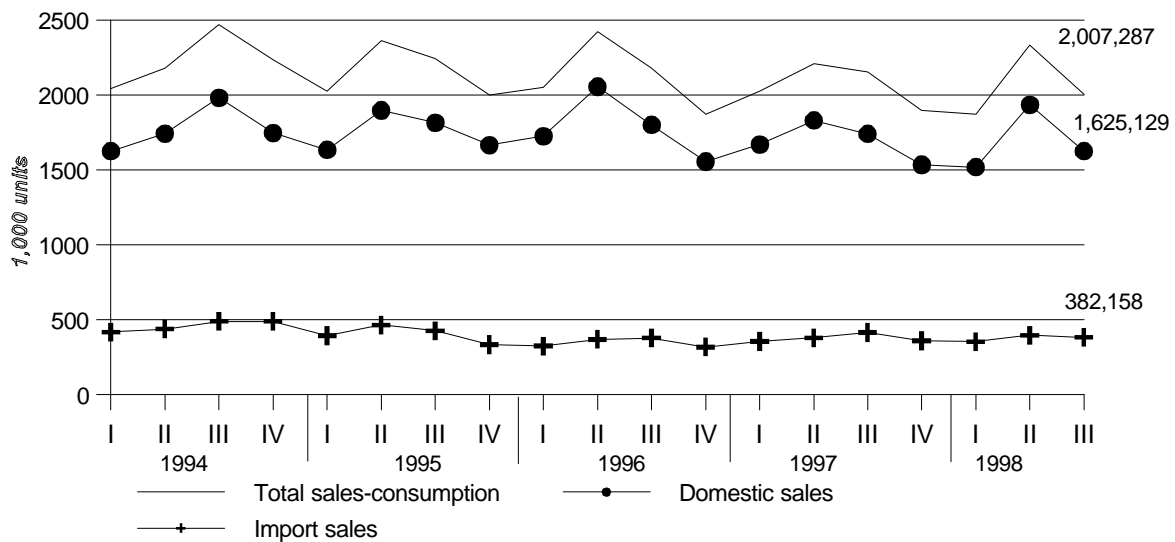
Item	Jul.-Sep. 1998	Percentage change	
		Jul.-Sep. 1998 from Apr.-Jun. 1998	Jan.-Sep. 1998 from Jan.-Sep. 1997
U.S. sales of domestic autos (1,000 units) ¹	1,625	-16.0	-4.2
U.S. sales of imported autos (1,000 units) ²	382	-3.8	3.8
Total U.S. sales (1,000 units) ^{1,2}	2,007	-13.9	-2.8
Ratio of U.S. sales of imported autos to total U.S. sales (percent) ^{1,2}	19.0	11.8	6.8
U.S. sales of Japanese imports as a share of the total U.S. market (percent) ^{1,2}	11.2	32.1	-3.1

¹ Domestic automobile sales include U.S.-, Canadian-, and Mexican-built automobiles sold in the United States.

² Does not include automobiles imported from Canada and Mexico.

Source: Compiled from data obtained from *Automotive News*.

Figure A-3
U.S. sales of new passenger automobiles, by quarter

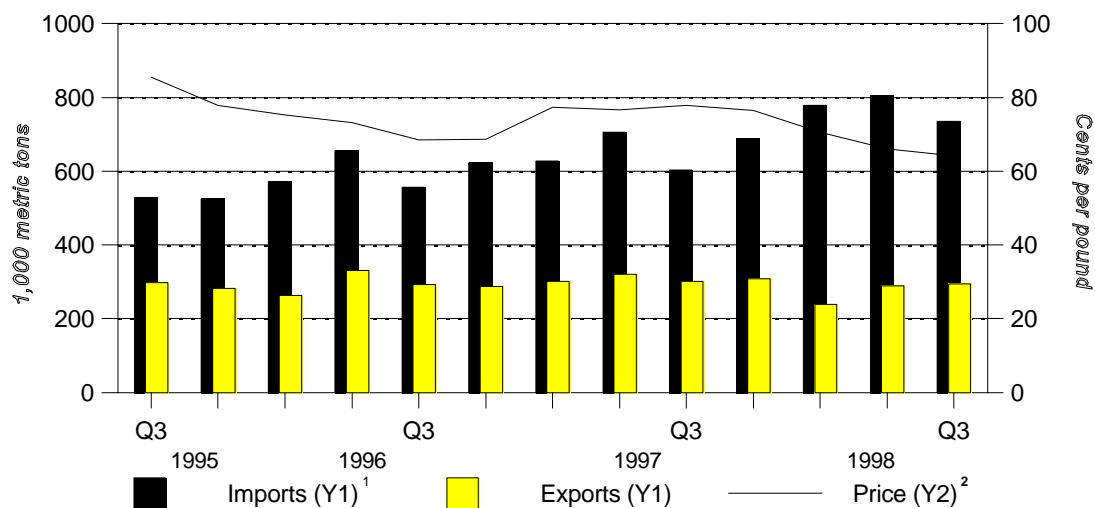


Note.--Domestic sales include all automobiles assembled in Canada and imported into the United States under the United States-Canadian automobile agreement; these same units are not included in import sales.

Source: *Automotive News*; prepared by the Office of Industries.

ALUMINUM

Figure A-4
Aluminum: U.S. imports, exports, and price



¹ Crude forms (metals and alloys) and mill products (e.g., plates, sheets, and bars) for consumption.
² Quarterly average of the monthly U.S. market price of primary aluminum ingots.

Sources: U.S. Geological Survey, World Bureau of Metal Statistics.

- Continuing strong demand for aluminum mill products in the United States and Europe, particularly in the automotive industry, helped to offset declines in consumption in Asia and other regions. An overall decrease in global production and postponement of capacity expansion plans are attributable to lower third quarter prices in 1998 (a 21.4 percent decrease compared to 1997), bad weather, and operational problems (e.g., teething problems at the Boyne Island smelter start-up in Australia).
- In the United States, increased production helped offset a 8.4 percent decrease in U.S. imports and enabled a 1.7 percent increase in U.S. exports in the third quarter of 1998, as compared to the preceding quarter. Import penetration fell from 35 percent to 32 percent from the previous quarter.
- Alcan Aluminum, Ltd., signed a ten year agreement with General Motors Corp. to supply aluminum at set prices for use in hoods, deck lids and other automotive components.

Table A-4
U.S. production, secondary recovery, imports, import penetration, exports, average nominal price, and inventory level of aluminum, by specified periods, July 1997-September 1997 and July 1998-September 1998

Item	Q3 1997	Q3 1998	Percentage change	
			Q3 1998 from Q2 1998	Q3 1998 from Q3 1997
Primary production (1,000 metric tons)	903	946	1.9	4.8
Secondary recovery (1,000 metric tons)	919	878	1.3	-4.5
Imports (1,000 metric tons)	604	736	-8.4	21.9
Import Penetration (percent)	28	32	¹ -3.0	¹ 4.0
Exports (1,000 metric tons)	302	295	1.7	-2.3
Average Nominal Price (¢/lb)	77.8	64.1	-3.0	-21.4
LME Inventory Level (1,000 metric tons)	732	513	-3.9	-29.9

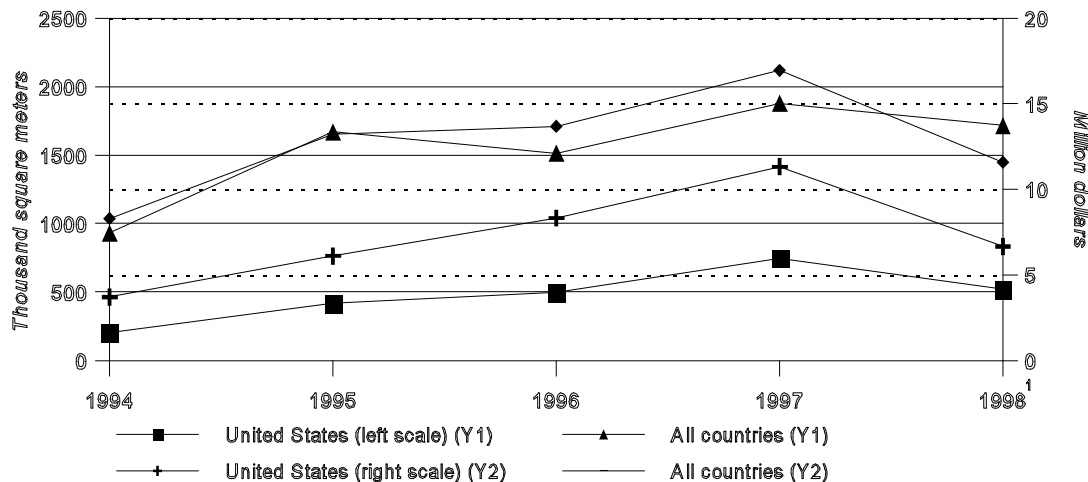
¹Percentage point change

Source: Compiled from data obtained from U.S. Geological Survey & World Bureau of Metal Statistics.

FLAT GLASS

Background

Figure A-5
Average monthly Japanese imports of flat glass, by quantity and value, from the United States and all countries, 1994-98¹



¹ Data for 1998 include Jan.-Aug.

- The U.S.-Japanese agreement on Japanese market access for imports of flat glass¹ seeks to increase access and sales of foreign flat glass in Japan through such means as increased adoption of nondiscriminatory standards and expanded promotion of safety and insulating glass.² The agreement covers the 1995-99 period.
- Japanese demand for imported glass began weakening in the second half of 1997. The Asian financial crisis and an increase in the Japanese consumption tax from 3 to 5 percent likely were contributing factors.³

Current

- Japanese demand for imported glass improved from May through August, but figures for the year remained below 1997 averages. The average monthly quantity and value of Japanese imports from all countries decreased by 9 and 32 percent for the first eight months of 1998 to 1.7 million square meters (\$11.6 million), respectively. Imports from the United States declined 30 and 41 percent to 520,000 square meters (\$6.7 million), respectively. The above-average decline in imports from the United States occurred as the U.S. dollar appreciated against the Japanese yen and was largely offset by increased imports from China.

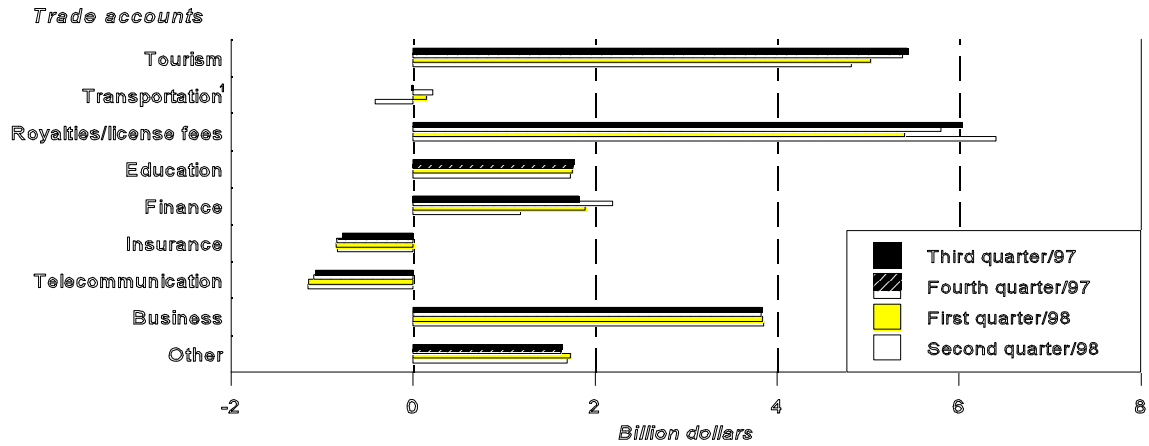
¹ Flat glass is largely unworked; safety glass (tempered or laminated) and insulating glass are also covered under the U.S.-Japanese agreement on flat glass.

² USITC, "Flat glass," *Industry, Trade, and Technology Review*, Oct. 1997, p. 42.

³ USITC, "Flat glass," *Industry, Trade, and Technology Review*, June 1998, p. 37.

SERVICES

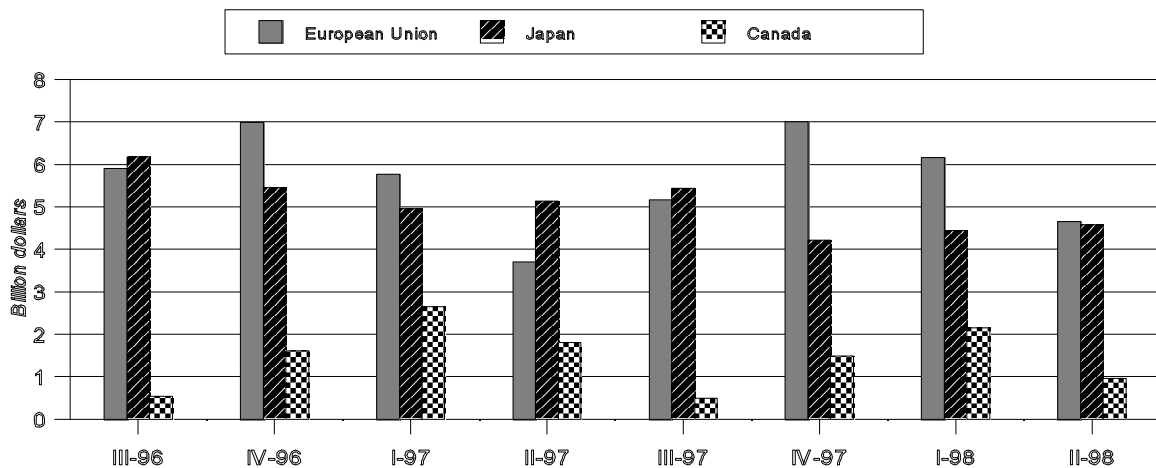
Figure A-6
 Balance on U.S. service trade accounts, third quarter 1997 through second quarter 1998



¹ Includes port fees.

Source: Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 56.

Figure A-7
 Surpluses on cross-border U.S. service transactions with selected trading partners, by selected quarters, 1996-98¹



¹ Figures reflect private-sector transactions only; military shipments and other public-sector transactions have been excluded.

Source: Bureau of Economic Analysis, *Survey of Current Business*, table 10, Oct. 1998, pp. 64-67