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A free trade agreement between Chile and the MERCOSUR countries (Argentina, Brazil, Paraguay, and Uruguay) becomes operative on October 1, 1996. This agreement is MERCOSUR's first effort to create an enlarged South American free-trade area; it is also Chile's second operational free-trade agreement.	
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INTERNATIONAL ECONOMIC COMPARISONS

Summary of U.S. Economic Conditions

U.S. labor productivity (as measured by output per hour) rose at a slower rate in the second quarter than in the first quarter despite strong output gains in the business and nonfarm business sectors. Rising employment (as measured by hours worked by all persons) reduced productivity gains in the second quarter. Hourly compensation rose, but real hourly compensation remained either unchanged or fell from the level of the first quarter. Unit labor costs, which reflect changes in hourly compensation and productivity, rose in the second quarter over those of the first quarter. Manufactures productivity grew by less than one-half of first quarter's growth rate, and most of the increase was concentrated in the durable goods sector.

In addition, long-term data on output growth by industry show a shift in industry contribution to GDP growth from manufactures to services. Goods-producing industries' share of GDP has been declining, and the services-producing share of GDP has been rising. The trend has its implications because services productivity is notoriously low and output is difficult to quantify in most cases. Hence, as the services share in GDP grows, it is becoming increasingly difficult to measure accurately that large part of economic activity.

(Changes in the following sections are seasonally adjusted annual rates.)

Productivity and Costs

The U.S. Department of Labor reported that U.S. labor productivity—as measured by output per hour of all persons—grew in the second quarter by 1.1 percent in the business sector, and by 0.5 percent in the nonfarm business sector (table 1). Productivity in the first quarter increased by 2.0 percent in the business sector and by 1.8 percent in the nonfarm business sector. The modest second-quarter productivity gains resulted from strong growth in employment measured in “hours worked.”

In manufacturing, productivity grew in the second quarter by 2.2 percent, following productivity gains of 5.6 percent in the first quarter. The second-quarter increase in manufacturing productivity was concentrated in durable goods industries, where a 3.9-percent productivity gain reflected a 10.9-percent increase in output and a 6.8-percent rise in hours worked. Productivity rose by 0.5 percent in nondurable goods industries.

Output in the business sector increased in the second quarter by 5.2 percent and “hours worked of all persons” increased by 4.0 percent. These were the largest increases in both series since the second quarter of 1994, when output and hours worked grew by 6.9 percent and by 6.3 percent, respectively. Hourly compensation (which includes wages and salaries, supplements, employer contributions to employee benefit plans, and taxes), increased by 4.0 percent in the second quarter, following a 3.0-percent rise in the first quarter. Real hourly compensation, however, increased by 0.2 percent after falling by 0.2 percent in the first quarter. Unit labor costs grew by 2.9 percent during the second quarter, compared with a 1.0-percent rise in the first quarter.

Output in the nonfarm business sector increased by 4.9 percent, and hours worked by all persons increased by 4.4 percent. This compares with gains of 2.7 percent in output and 1.0 percent in hours worked during the first quarter of 1996. Hourly compensation in the nonfarm business sector increased by 3.7 percent in the second quarter, compared with a 3.3-percent increase one quarter earlier. However, real hourly compensation fell by 0.1 percent after remaining unchanged in the first quarter. Unit labor costs rose by 3.2 percent during the second quarter of 1996, compared with a 1.5-percent rise in the first quarter.

Output in manufacturing increased by 6.4 percent and “hours worked of all persons” increased by 4.1 percent. Hourly compensation of all manufacturing workers increased by 5.8 percent during the second quarter, the largest gain since the second quarter of 1990. Real hourly compensation in the manufacturing sector rose by 1.9 percent, and unit labor costs rose by 3.6 percent in the second quarter. During the first

quarter, real hourly compensation fell by 2.8 percent, and manufacturing unit labor costs fell by 4.9 percent.

In durable goods manufacturing, output increased in the second quarter by 10.9 percent and hours worked of all persons rose by 6.8 percent. Unit labor costs increased by 2.8 percent in the second quarter of 1996, after falling by 9.3 percent in the first quarter. Hourly compensation grew by 6.8 percent in the durable goods industries, compared with a 3.9-percent increase in nondurable goods industries. Table 1 shows changes in productivity and cost measures in the second quarter and from the second quarter a year ago.

Industry Contribution to GDP growth

Long-term data on manufactures output reveal a declining trend in manufacture contribution to economic growth. Industry data of gross product (value added by industry) released by the Department of Commerce show shifts in sector contributions to gross domestic product (GDP), particularly away from manufactures and towards services (figure 1).

From 1977 to 1994, wholesale trade, "agriculture, forestry, and fishing," and services were the major industry groups with the fastest growth in industry gross product, as measured by each industry's value added. Real gross product in wholesale trade increased at an average annual rate of 5.0 percent in 1977-94, nearly double the 2.6-percent GDP increase. In "agriculture, forestry, and fishing," real industry gross product increased by 3.9 percent; and in services, real gross product increased by 3.4 percent. Other major industry groups whose growth in real industry gross product exceeded that of GDP were "transportation and public utilities" (3.1 percent), retail trade (2.9 percent), and "finance, insurance, and real estate" (2.8 percent).

The slowest growth among the major industry groups during the 1977-94 period was in mining (0.9 percent); construction (1.0 percent); and government (1.2 percent). The 2.3 percent growth rate of manufacture was below the GDP growth rate (table 2).

Industry shares of GDP

The private goods-producing industries and the private services-producing industries together with the government (Federal and local) are the main industry groups that contribute to GDP growth. The private services-producing industries' share of current-dollar GDP increased from 51.9 percent in 1977 to 62.0 percent in 1994 (table 3). These industries consist of "transportation and public utilities," wholesale trade, retail trade, "finance, insurance, and real estate," and

services. Of these industry groups, services share of GDP increased the most, from 12.5 percent in 1977 to 19.4 percent in 1994; and the "finance, insurance, and real estate" share in GDP increased from 14.0 percent to 18.4 percent.

In contrast, the private goods-producing industries' share of current-dollar GDP decreased from 32.8 percent in 1977 to 24.2 percent in 1994. These industries consist of "agriculture, forestry, and fishing," mining, construction, and manufacturing. Of these industry groups, manufacturing's share of GDP fell the most, from 22.6 percent in 1977 to 17.3 percent in 1994; and the government share of GDP decreased from 14.5 percent in 1977 to 13.4 percent in 1994.

U.S. Economic Performance Relative to other Group of Seven (G-7) Members

Economic growth

U.S. real GDP—the output of goods and services produced in the United States measured in 1992 chain-type prices¹—grew at a revised annual rate of 2.3 percent in the third quarter of 1996, following an increase of 2.0 percent in the first quarter.

The annualized rates of real GDP growth in the second quarter of 1996 were 1.3 percent in Canada, -1.4 percent in France, 6.1 percent in Germany, -1.6 percent in Italy, -2.9 percent in Japan, and 2.3 percent in the United Kingdom.

Industrial production

The Federal Reserve Board reported that industrial production increased by 0.2 percent in September 1996, following a gain of 0.4 percent in August in the United States. Manufacturing output increased by 0.2 percent in September. Total industrial production in September was 3.5 percent higher than it was in September 1995. In the third quarter industrial production growth slowed down to a 4.4-percent annual rate from a 6.7-percent increase in the second quarter. Total industrial capacity utilization edged down by 0.1 percentage point, to 83.3 percent, and was 3.5 percent higher than in September 1995.

¹ A chain-type price index uses the price weights of adjacent years to calculate real GNP instead of price weights fixed to a specific year. The chain-type method had the advantage of allowing for the effects of changes in relative prices and changes in the composition of output over time in contrast to the fixed-weighted measures which use a single set of weights over the entire period. For fuller discussion of the two methodologies, see the *IER*, October 1995.

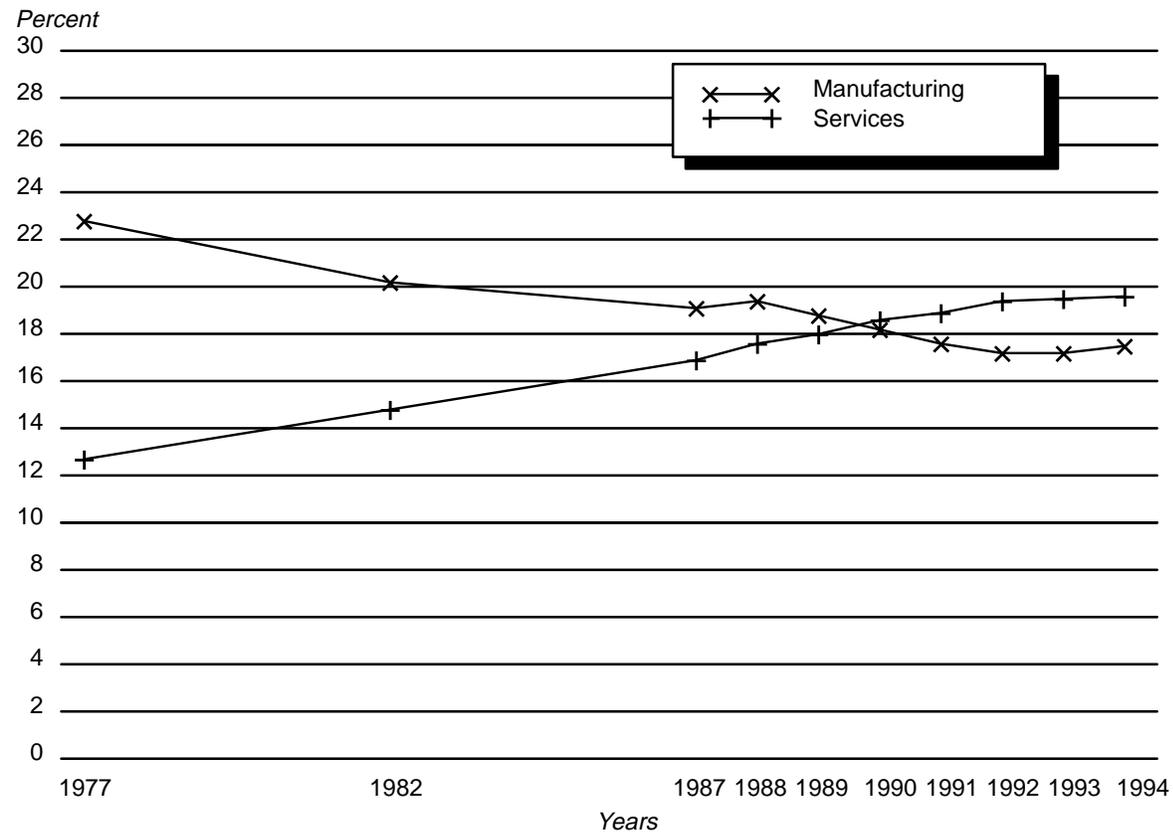
Table 1
Productivity and costs: Revised second-quarter 1996 measures of change, by seasonally adjusted annual rates

(Percent)

Sector	Output per hour	Output	Hours	Hourly compensation	Real hourly compensation	Unit labor costs
	Change from preceding quarter					
Business	1.1	5.2	4.0	4.0	0.2	2.9
Nonfarm business	0.5	4.9	4.4	3.7	-0.1	3.2
Manufacturing	2.2	6.4	4.1	5.8	1.9	3.6
Durable	3.9	10.9	6.8	6.8	2.8	2.8
Nondurable	0.5	0.9	0.4	3.9	0.0	3.4
Change from same quarter a year ago						
Business	1.1	3.3	2.3	3.8	0.9	2.8
Nonfarm business	0.8	3.2	2.4	3.8	0.9	2.9
Manufacturing	4.2	3.2	-0.9	3.8	0.9	-0.3
Durable	5.6	6.2	0.6	3.3	0.4	-2.1
Nondurable	2.6	-0.6	-3.1	4.4	1.5	1.7

Note.—Although productivity measures describe the relationship between real output and labor hours involved in production, these measures do not describe the specific contributions of labor, capital, or any other factor of production. They reflect the joint effects of all factors engaged in production, including technological changes, managerial skills, etc.

Figure 1
Gross product by manufacturing and services in current dollars as a percentage of gross domestic product (GDP), 1977-94



Source: Gross product by industry, 1977-94, U.S. Department of Commerce BEA 96-26, August 8, 1996.

Table 2
Quantity indexes for Gross Domestic Product by industry, selected years (1992=100)
(Percent)

	1977	1982	1987	1988	1989	1990	1991	1992	1993	1994	Growth rates 1977/94
Gross domestic product	68.5	74.0	90.5	93.9	97.1	98.3	97.3	100.0	102.2	105.8	2.60
Private industries	66.5	72.3	90.1	93.7	97.0	98.2	96.9	100.9	102.6	106.7	2.82
Agriculture, forestry, and fishing	53.9	69.9	77.9	71.8	78.5	90.3	89.8	100.0	91.9	102.9	3.90
Mining	89.3	85.4	93.6	113.2	100.6	105.0	105.6	100.0	98.3	104.8	0.90
Construction	93.1	75.2	104.3	108.3	109.7	107.8	99.7	100.0	102.8	110.2	1.00
Manufacturing	74.9	76.2	97.9	104.4	104.0	102.5	98.8	100.0	103.0	109.8	2.30
Durable goods	75.9	74.6	98.6	107.4	106.9	104.8	99.1	100.0	104.8	114.7	2.40
Industrial machinery & equipment	44.0	54.4	84.1	97.7	103.4	104.3	95.4	100.0	106.6	117.4	5.94
Motor vehicles & equipment	151.3	88.5	132.3	140.5	121.5	107.6	88.5	100.0	114.6	137.7	-0.01
Nondurable goods	73.8	78.8	97.5	100.9	100.5	99.8	98.4	100.0	100.8	104.1	2.00
Transportation & public utilities	66.2	72.5	86.7	89.4	90.7	93.5	97.3	100.0	105.1	110.7	3.10
Wholesale trade	49.5	60.7	79.4	84.6	90.1	88.7	93.8	100.0	103.0	110.7	5.00
Retail trade	67.0	71.3	93.6	98.8	101.7	100.4	98.1	100.0	103.5	109.4	2.90
Finance, insurance, & real estate	64.7	76.3	88.5	93.2	96.0	96.6	96.3	100.0	101.0	103.8	2.80
Services	99.3	69.8	86.7	91.5	95.7	98.4	97.8	100.0	101.8	104.1	3.40
Government	82.1	85.7	92.7	94.9	97.0	99.2	100.0	100.0	100.2	100.3	1.20
Federal	90.6	91.2	99.2	99.9	100.7	102.1	102.4	100.0	97.4	93.6	0.20
State & local	77.1	82.3	89.5	92.5	95.3	97.7	98.8	100.0	101.5	103.4	1.74

Source: U.S. Department of Commerce, BEA 96-26.

Table 3
Gross product by industry group in current dollars as a percentage of Gross Domestic Product, selected years
(Percent)

	1977	1982	1987	1988	1989	1990	1991	1992	1993	1994
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Private industries	85.5	85.8	86.1	86.2	86.4	86.2	85.8	86.0	86.3	86.6
Agriculture, forestry, and fishing	2.7	2.4	1.9	1.8	1.9	1.9	1.7	1.8	1.6	1.7
Mining	2.7	4.6	1.9	2.0	1.8	2.0	1.7	1.5	1.4	1.3
Construction	5.6	4.0	4.6	4.6	4.5	4.3	3.9	3.7	3.7	3.9
Manufacturing	22.6	20.0	18.9	19.2	18.6	18.0	17.4	17.0	17.0	17.3
Durable goods	13.7	11.6	10.9	11.0	10.6	10.0	9.4	9.2	9.3	9.7
Nondurable goods	9.1	8.4	8.0	8.2	8.1	8.0	7.9	7.9	7.7	7.6
Transportation and public utilities	8.9	9.0	9.0	8.8	8.5	8.4	8.7	8.5	8.6	8.7
Wholesale trade	7.0	6.8	6.4	6.7	6.6	6.4	6.6	6.5	6.5	6.7
Retail trade	9.4	8.9	9.3	9.1	9.0	8.8	8.7	8.7	8.7	8.8
Finance, insurance, and real estate	14.0	15.6	17.7	17.7	17.7	17.8	18.3	18.4	18.5	18.4
Services	12.5	14.6	16.7	17.4	17.8	18.4	18.7	19.2	19.3	19.4
Government	14.5	14.2	13.9	13.8	13.6	13.8	14.2	14.0	13.7	13.4
Addenda:										
Private goods-producing industries	32.8	31.0	27.3	27.6	26.8	26.2	24.7	24.0	23.7	24.2
Private services-producing industries	51.9	54.9	59.1	59.7	59.6	59.8	51.0	61.3	61.6	62.0

Source: U.S. Department of Commerce, BEA 96-26.

The output of consumer goods was little changed in September as substantial declines in the production of automotive products and other durable goods were offset by advances in the production of nondurable goods. As in August, the output of business equipment advanced by 0.8 percent; the increase was concentrated in production of information-processing equipment.

Other Group of Seven (G-7) member countries reported the following growth rates of industrial production. For the year ending August 1996, Germany reported a 2.0-percent increase, Italy reported a 11.3-percent decrease, Japan reported a 2.2-percent increase, and the United Kingdom reported a 0.0 increase. For the year ending July 1996, Canada reported a 2.1-percent increase, and France reported a 0.5-percent decrease.

Prices

The seasonally adjusted U.S. Consumer Price Index (CPI) rose by 0.3 percent in September 1996 following a 0.2-percent increase in July. For the 12-month period ended in August 1996, the CPI increased by 3.0 percent.

During the 1-year period ending September 1996, prices increased by 1.4 percent in Canada, 1.6 percent in France, 1.4 percent in Germany, 3.4 percent in Italy, 0.2 percent in Japan and 2.1 percent in the United Kingdom.

Employment

The Bureau of Labor Statistics reported that the unemployment rate rose to 5.2 percent in September 1996 from 5.1 percent in August. Payroll employment fell in manufacturing and local government in September, and growth slowed in several other major industries.

Manufacturing employment declined by 57,000 in September; industry losses now total 331,000 since the most recent peak in March 1995. Job losses were widespread, with the largest declines occurring in industrial machinery and transportation equipment. Within nondurable goods, job losses continued in several industries, including food and kindred products, printing and publishing, and apparel.

Employment growth in services slowed in September, increasing by 54,000, which was just under one-half of the average monthly gain recorded in the first one-half of the year. Employment growth in September was weak in business and private educational services. Employment in health services grew by 30,000, following 3 months of sluggishness. Retail trade added only 22,000 jobs in September, half

the average monthly gain of the past year. Employment declined in general merchandise and apparel stores, and it grew moderately in eating and drinking establishments. Although the pace of job growth in wholesale trade has slowed considerably since March, the September increase of 5,000 was especially small.

Employment in finance, insurance, and real estate increased modestly in September. Employment growth accelerated in insurance, but employment in finance and real estate was little changed over the month. Gains in transportation and public utilities employment were relatively small for the third consecutive month. Within transportation, there was a small increase in air transportation, but employment in trucking and warehousing was flat over the month and has shown no net growth since late last year.

In other G-7 countries, the latest available unemployment rates in 1996 were 9.9 percent in Canada, 12.6 percent in France, 10.1 percent in Germany, 12.2 percent in Italy, 3.3 percent in Japan, and 7.4 percent in the United Kingdom.

Forecasts

Forecasters expect real growth in the United States to average around 2.2 percent (annual rate) in the third quarter of 1996 and then to accelerate to an average of 2.5 percent in the fourth quarter. In the first half of 1997, growth is expected to range between 2.1 and 2.3 percent. Factors that might restrain growth in the third and fourth quarters of 1996 include slowing consumer spending due to the rising consumer debt burden, a slow-down in consumer and producers' demand for new goods and a resulting slowdown in industrial output and factory employment, and the contractionary impact of the decline in government spending and investment if unaccompanied by monetary policy easing. Table 4 shows macroeconomic projections by six major forecasters for the U.S. economy from July 1996 to June 1997, and the simple average of these forecasts. Forecasts of all the economic indicators, except unemployment, are presented as percentage changes over the preceding quarter, on an annualized basis. The forecasts of the unemployment rate are averages for the quarter.

The average of the forecasts points to an unemployment rate of 5.3 percent in 1996. Inflation (as measured by the GDP deflator) is expected to remain subdued at an average rate of about 2.5 to 2.6 percent. The expected slowdown in general economic activity during the second half of 1996, the Federal Reserve's tight monetary policy, and the rising foreign exchange value of the U.S. dollar are expected to keep inflation at bay.

Table 4
Projected changes of selected U.S. economic indicators, by quarter, July 96-June 97

(Percent)

Period	Confer- ence Board	E.I. Dupont	UCLA Business Forecasting Project	Merrill Lynch Capital Markets	Data Resources Inc. (D.R.I.)	Wharton WEFA Group	Mean of 6 fore- casts
GDP current dollars							
1996:							
July-Sept.	5.1	5.3	4.6	4.1	5.5	3.5	4.7
Oct.-Dec.	7.9	5.0	5.1	4.1	4.6	4.4	5.2
1997:							
Jan.-Mar.	6.7	4.8	5.1	3.7	4.4	4.7	4.9
Apr.-June	5.7	4.8	4.5	4.1	3.8	4.3	4.5
GDP constant (chained 1992) dollars							
1996:							
July-Sept.	2.3	2.5	2.0	2.0	2.9	1.4	2.2
Oct.-Dec.	4.7	2.3	2.0	1.9	2.4	2.0	2.5
1997:							
Jan.-Mar.	3.4	2.2	2.3	1.6	2.0	2.2	2.3
Apr.-June	2.6	2.2	2.0	1.9	1.6	2.0	2.1
GDP deflator index							
1996:							
July-Sept.	2.7	2.7	2.5	2.1	2.6	2.2	2.5
Oct.-Dec.	3.0	2.6	3.0	2.2	2.2	2.4	2.6
1997:							
Jan.-Mar.	3.2	2.5	2.8	2.0	2.4	2.5	2.6
Apr.-June	3.0	2.5	2.5	2.2	2.1	2.2	2.4
Unemployment, average rate							
1996:							
July-Sept.	5.2	5.3	5.4	5.3	5.3	5.3	5.3
Oct.-Dec.	5.2	5.5	5.3	5.3	5.3	5.4	5.3
1997:							
Jan.-Mar.	5.0	5.6	5.2	5.4	5.3	5.5	5.3
Apr.-June	4.9	5.7	5.3	5.4	5.4	5.6	5.4

Note.—Except for the unemployment rate, percentage changes in the forecast represent annualized rates of change from preceding period. Quarterly data are seasonally adjusted. Date of forecasts: Oct. 1996.

Source: Compiled from data provided by the Conference Board. Used with permission.

U.S. International Transactions

U.S. Current Account

The U.S. current-account deficit widened in the second quarter of 1996, according to data released by the U.S. Department of Commerce. A rise in the foreign exchange value of the dollar and stagnant economic growth in Europe constrained U.S. exports and increased imports. As a result, the deficit on goods increased and the surplus on investment income turned into a deficit. Table 5 shows a summary of U.S. international transactions.

In the second quarter of 1996, the deficit on the current account increased to \$38.8 billion from \$34.9 billion in the first quarter. The deficit on goods increased to \$46.8 billion from \$42.7 billion in the first quarter. Goods exports increased to \$153.3 billion from \$150.0 billion. Most of the increase was accounted for by a rise in nonagricultural exports. Goods imports, however, increased to \$200.1 billion from \$192.8 billion.

The deficit on goods and services increased to \$27.9 billion, from \$24.2 billion. The surplus on services increased to \$19.0 billion in the second quarter from \$18.5 billion in the first. Services receipts increased to \$56.0 billion from \$55.1 billion. Increases

Table 5
Summary of U.S. international transactions Jan. 1995- June 1996

(Million dollars)

	1995	1995 Jan.-Mar.	1995 Apr.-June	1996 Jan.-Mar.	1996 Apr.-June
Exports of goods	575,940	138,551	142,983	150,028	153,316
Imports of goods	-749,364	-183,474	-190,910	-192,758	-200,146
Balance on goods	-173,424	-44,923	-47,927	-42,730	-46,830
Exports of services	210,590	50,435	51,735	55,122	56,005
Imports of services	-142,230	-35,027	-35,632	-36,619	-37,050
Balance on services	68,360	15,408	16,103	18,503	18,955
Balance on goods and services	-105,064	-29,515	-31,824	-24,227	-27,875
Income receipts on U.S. assets abroad	182,659	44,100	46,779	47,497	48,195
Income payments on foreign assets in					
the United States	-190,674	-45,000	-47,641	-47,235	-49,799
Balance on investment income	-8,016	-900	-862	262	-1,604
Balance on goods, services, & income	-113,079	-30,415	-32,686	-23,965	-29,479
Unilateral transfers, net	-35,075	-8,639	-8,290	-10,904	-9,300
Balance on current account	-148,154	-39,054	-40,976	-34,869	-38,779
U.S. assets abroad, net (increase/ capital outflow (-))	-307,856	-61,747	-108,299	-68,750	-49,165
U.S. private assets, net	-297,834	-56,275	-105,398	-68,615	-48,213
Direct investment	-95,509	-15,053	-18,247	-23,202	-22,983
Foreign securities	-98,960	-7,571	-23,011	-34,420	-20,081
Foreign assets in the United States, net(increase/capital inflow (+))	424,462	90,995	115,421	99,471	80,315
Foreign Official assets in the United States, net	109,757	21,822	37,380	52,021	13,197
Direct investment	60,236	10,788	9,692	28,690	10,733
Net capital inflows	116,606	29,248	7,122	30,721	31,150
Net capital inflows for foreign direct investment in the United States	60,235	10,788	9,692	28,690	10,733
Net capital outflows for U.S. direct investment abroad	-95,509	-15,053	-18,247	-23,202	-22,983

Source: U.S. Department of Commerce, Bureau of Economic Analysis BEA 96-30.

in transfers under U.S. military agency sales contracts, "other" private services, and "other" transportation were partly offset by a decrease in travel. Service payments increased to \$37.1 billion from \$36.6 billion. Increases in "other" private services and "other" transportation were partly offset by decreases in travel and in passenger fares.

Investment income

Investment income shifted to a deficit of \$1.6 billion in the second quarter from a surplus of \$0.3 billion in the first. Income receipts on U.S. assets abroad increased to \$48.2 billion from \$47.5 billion, due to the increase in direct investment and "other" private receipts. Income payments on foreign assets in the United States increased to \$49.8 billion from \$47.2 billion. Much of the income payment increase resulted from a relative surge in earnings on direct foreign investment in the United States, because of relatively higher rates of growth. "Other" private payments and U.S. Government payments also increased. Net unilateral transfers declined to \$9.3 billion in the second quarter, from \$10.9 billion in the first, due to the decline in U.S. Government grants.

U.S. Capital account

Net recorded capital inflows were \$31.2 billion in the second quarter, compared with \$30.7 billion in the first. Acquisitions of foreign assets by U.S. residents and acquisitions of U.S. assets by foreign residents slowed by nearly equal amounts.

U.S. assets abroad

U.S. assets abroad increased by \$49.2 billion in the second quarter, compared with an increase of \$68.8 billion in the first. U.S. claims on foreigners reported by U.S. banks increased \$5.1 billion, in contrast to a decrease of \$1.7 billion in the first quarter. The increase was accounted for by lending to home offices abroad by foreign-owned banks in the United States

and lending to unaffiliated banks abroad by U.S. securities brokers and dealers.

Net U.S. purchases of foreign securities were \$20.1 billion in the second quarter, down from \$34.4 billion in the first. Net U.S. purchases of foreign stocks and foreign bonds decreased.

Net capital outflows for U.S. direct investment abroad were \$23.0 billion in the second quarter, little changed from \$23.2 billion in the first.

Foreign assets in the United States

Foreign assets in the United States increased by \$80.3 billion in the second quarter, compared with an increase of \$99.5 billion in the first quarter.

U.S. liabilities to foreigners reported by U.S. banks, excluding U.S. Treasury securities, decreased by \$3.9 billion in the second quarter, following a decrease of \$35.6 billion in the first. The second-quarter decrease reflected, in part, weak growth in domestic (U.S.) bank lending and an increase in U.S. banks' deposits that combined to reduce the need for funds from abroad.

Net private foreign purchases of U.S. Treasury securities were \$31.7 billion in the second quarter, up from \$11.8 billion in the first. The stepup was more than accounted for by a shift to net purchases by investment funds in the Caribbean.

Net foreign purchases of U.S. securities other than U.S. Treasury securities were \$28.6 billion in the second quarter, down from \$36.0 billion in the first. Net foreign purchases of U.S. bonds decreased, whereas net foreign purchases of U.S. stocks increased.

Net capital inflows for foreign direct investment in the United States were \$10.7 billion in the second quarter, down from \$28.7 billion in the first.

Foreign official assets in the United States increased by \$13.2 billion in the second quarter, following an increase of \$52.0 billion in the first quarter. Foreign industrialized countries sharply slowed their accumulation of dollar assets, and nonindustrial countries other than OPEC members sold dollar assets.

U.S. TRADE DEVELOPMENTS

Seasonally adjusted U.S. trade in goods and services in billions of dollars as reported by the U.S. Department of Commerce is shown in table 6. The U.S. Department of Commerce reported that seasonally adjusted exports of goods and services of \$69.3 billion and imports of \$80.1 billion in August 1996 resulted in a goods and services trade deficit of \$10.8 billion, \$800 million less than the \$11.6 billion deficit in July. The August 1996 deficit was approximately \$3.4 billion more than the deficit registered in August 1995 (\$7.4 billion) and \$2.7 billion more than the average monthly deficit registered during the previous 12 months (\$8.1 billion).

The August 1996 trade deficit on goods was \$17.0 billion, approximately \$500 million lower than the July

deficit (\$17.5 billion). The August 1996 services surplus was \$6.2 billion, \$258 million higher than the July services surplus (\$5.9 billion).

In the January-August period, total U.S. exports of goods and services increased by \$36.0 billion over the corresponding period of previous year, to a record of \$550.9 billion. Total imports increased by roughly \$32.0 billion to \$625.6 billion.

Nominal export changes and trade balances for specific major commodity sectors are shown in table 7. U.S. exports and imports of goods with major trading partners on a monthly and year-to-date basis are shown in table 8, and U.S. trade in services by major category is shown in table 9.

Table 6
U.S. trade in goods and services, seasonally adjusted, Aug.-July 1996
(Billion dollars)

Item	Exports		Imports		Trade balance	
	Aug. 96	July 96	Aug. 96	July 96	Aug. 96	July 96
Trade in goods (BOP basis)						
Current dollars—						
Including oil	50.7	48.8	67.7	66.3	-17.0	-17.5
Excluding oil	51.3	49.5	61.3	59.9	-10.0	-10.3
Trade in services						
Current dollars	18.6	18.5	12.5	12.6	6.2	5.9
Trade in goods and services						
Current dollars	69.3	67.3	80.1	78.9	-10.8	-11.6
Trade in goods (Census basis)						
1992 dollars	54.5	52.5	69.3	68.3	-14.8	-15.8
Advanced-technology products (not seasonally adjusted)	12.7	11.9	10.5	10.6	2.2	1.3

Note.—Data on goods trade are presented on a Balance-of-Payments (BOP) basis that reflects adjustments for timing, coverage, and valuation of data compiled by the Census Bureau. The major adjustments on BOP basis exclude military trade but include nonmonetary gold transactions, and estimates of inland freight in Canada and Mexico, not included in the Census Bureau data.

Source: U.S. Department of Commerce News (FT 900), Oct. 18, 1996.

Table 7
Nominal U.S. exports and trade balances, of agriculture and specified manufacturing sectors, Jan. 1995-Aug. 1996

Sector	Exports		Aug. 1996 over July 1996	Change		Trade balances, Jan.- Aug. 1996
	Aug. 1996	Jan.- Aug. 1996		Jan.- Aug. 1996 over Jan.- Aug. 1995	Share of total, Jan.- Aug. 1996	
	<i>Billion dollars</i>			<i>Percent</i>			Billion dollars
ADP equipment & office machinery	3.1	26.0	6.9	15.6	6.4	-16.6
Airplanes	1.8	11.7	12.5	19.4	2.9	9.1
Airplane parts	1.1	7.7	22.2	14.9	1.9	5.5
Electrical machinery	4.7	37.5	6.8	9.3	9.2	-12.8
General industrial machinery	2.2	17.6	0	10.0	4.3	0.4
Iron & steel mill products .....	.4	3.3	0	0	0.8	-5.3
Inorganic chemicals .....	.4	3.0	0	0	0.7	-0.2
Organic chemicals	1.2	9.9	9.1	-9.2	2.4	-0.2
Power-generating machinery	1.9	14.4	18.7	2.1	3.5	-0.5
Scientific instruments	1.8	13.6	12.5	12.4	3.3	5.6
Specialized industrial machinery	2.1	17.1	0	12.5	4.2	-4.6
TVs, VCRs, etc	1.6	12.7	0	4.1	3.1	-8.4
Textile yarns, fabrics and articles .....	.7	5.1	16.7	6.2	1.2	-1.6
Vehicle parts	3.8	32.1	26.7	0	7.8	-36.0
Manufactured exports not included above	13.2	106.7	3.1	8.2	26.1	-56.0
Total manufactures	40.0	318.4	7.5	7.7	77.8	-112.4
Agriculture	4.5	39.0	2.3	12.1	9.5	17.2
Other exports not included above	6.6	52.0	6.5	1.6	12.7	-11.1
Total exports of goods	51.1	409.4	6.9	7.3	100.0	-106.3

Note.—Because of rounding, figures may not add to the totals shown. Data are presented on a Census basis.

Source: U.S. Department of Commerce News (FT 900), Oct. 18, 1996.

Table 8
U.S. exports and imports of goods with major trading partners, Jan. 1995-June 1996
(Billion dollars)

Country/area	Exports			Imports		
	Aug. 96	Jan.-Aug. 96	Jan.-Aug. 95	Aug. 96	Jan.-Aug. 96	Jan.-Aug. 95
North America	15.5	123.5	114.3	19.6	150.4	135.1
Canada	10.7	87.5	84.2	13.4	103.1	95.0
Mexico	4.8	36.0	30.1	6.4	47.3	40.2
Western Europe	11.1	93.8	87.7	12.7	103.4	96.2
European Union (EU-15)	10.0	84.4	80.1	11.5	93.7	87.2
Germany	1.8	15.5	14.3	3.4	25.5	24.6
European Free-Trade Association (EFTA) ¹	0.8	7.0	5.3	0.9	8.0	7.3
Former Soviet Union/Eastern Europe ...	0.7	4.7	3.5	0.7	4.2	5.0
Former Soviet Union	0.6	3.3	2.3	0.5	2.8	3.6
Russia	0.3	2.3	1.8	0.3	2.1	3.0
Pacific Rim Countries	15.4	124.8	117.7	25.5	188.1	189.8
Australia	1.1	8.0	7.1	0.3	2.4	2.2
China	0.8	7.4	7.4	5.5	31.7	29.2
Japan	5.7	45.6	41.8	9.5	75.9	84.3
NICs ²	6.4	50.1	48.9	6.9	54.5	52.2
South/Central America	4.6	33.6	32.8	4.1	31.6	28.0
Argentina	0.4	2.9	2.7	0.2	1.4	1.2
Brazil	1.2	7.9	7.6	0.9	5.8	5.8
OPEC	1.9	14.4	12.9	3.3	26.7	23.4
Total	51.1	409.4	381.6	67.8	515.7	489.5

¹ EFTA includes Iceland, Liechtenstein, Norway, and Switzerland.

² The newly industrializing countries (NICs) include Hong Kong, the Republic of Korea, Singapore, and Taiwan.

Note.—Country/area figures may not add to the totals shown because of rounding. Exports of certain grains, oilseeds and satellites are excluded from country/area exports but included in total export table. Also some countries are included in more than one area. Data are presented on a Census Bureau basis.

Source: U.S. Department of Commerce News (FT 900), Oct. 18 1996.

Table 9
Nominal U.S. exports and trade balances of services, by sectors, Jan. 1995-Aug. 1996, seasonally adjusted

	Exports		Change Jan.- Aug. 96 over Jan.- Aug. 95	Trade balances	
	Jan.- Aug. 96	Jan.- Aug. 95		Jan.- Aug. 96	Jan.- Aug. 95
	<i>Billion dollars</i>		<i>Percent</i>	<i>Billion dollars</i>	
Travel	42.8	39.9	7.3	10.6	9.4
Passenger fares	13.0	12.1	7.4	3.6	2.6
Other transportation	18.9	18.4	2.7	0.1	-1.2
Royalties and license fees	19.1	17.6	8.5	14.3	13.5
Other private services ¹	44.7	40.7	9.8	20.0	18.2
Transfers under U.S.					
military sales contracts	9.0	8.9	1.1	1.9	2.3
U.S. Govt. miscellaneous services ...	0.7	0.5	40.0	-1.2	-1.3
Total	148.3	138.0	7.3	49.3	43.5

¹ "Other private services" consists of transactions with affiliated and unaffiliated foreigners. These transactions include educational, financial, insurance, telecommunications, and such technical services as business, advertising, computer and data processing, and other information services, such as engineering, consulting, etc.

Note.—Services trade data are on a Balance-of-Payments (BOP) basis. Numbers may not add to totals because of seasonal adjustment and rounding.

Source: U.S. Department of Commerce News (FT 900), Oct. 18, 1996.

INTERNATIONAL TRADE DEVELOPMENTS

U.S. Trade Deficit With China: Statistical Quirks

From 1988 through 1992, at the same time the United States was reporting a trade deficit with China, China reported a trade deficit with the United States. For the past 3 years, the United States has reported imports from China that are nearly double what China reports for its exports to the United States, and the ratio was even higher in previous years. In June, August, and September 1996, the U.S. bilateral trade deficit with China exceeded the deficit with Japan, leading some to claim that China was surpassing Japan as the no. 1 threat to American jobs.

What do all of these phenomena have in common? The ways that trade statistics are gathered and recorded by both the United States and China contribute to distorted pictures in both cases. Standard rules for recording the country of origin of imports and the country of destination of exports combined with the realities of the increasing globalization of commerce and direct investment are responsible for the bulk of the distortion. The role of Hong Kong in U.S.-China trade is the largest factor contributing to the distortions in the trade picture. More than 75 percent of U.S. imports from China passes through Hong Kong. Twenty-five percent of U.S. exports to China passes through intermediaries, mostly through Hong Kong.

What can be drawn from the above statements in light of knowledge about statistical reporting and the realities of U.S.-China trade? Contrary to Chinese reports, China did indeed run a trade deficit with the United States over the years 1988-92, as well as in subsequent years, but the deficit has been about one-half to two-thirds of what the U.S. Department of Commerce has reported. For the past 3 years, U.S. imports from China have probably been around 1.5 times the level of exports to the United States reported by China. While the U.S. bilateral trade deficit with China is large and is second only to that with Japan, its composition is fundamentally different from the U.S. deficit with Japan and the U.S. balance with most other countries; and, to the extent that bilateral trade deficits have any detrimental effect on U.S. jobs, the deficit

with China has much less effect than deficits of comparable size with most other countries.

Nicholas Lardy, a China scholar at the Brookings Institution, has conducted ongoing research on the U.S.-China trade balance, and the U.S. Bureau of the Census, in conjunction with China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC), has produced a report examining the discrepancy between official U.S. and Chinese trade statistics. Both Lardy and the Census Bureau emphasize the role of Hong Kong as an intermediary in China's trade with other countries.

A portion of China's trade that flows through Hong Kong is simply transshipped, that is, no one in Hong Kong takes ownership of the goods. But the bulk of Chinese exports through Hong Kong are sold to Hong Kong companies that re-export the products, often after performing additional operations, and almost always after adding a mark-up for services rendered by the Hong Kong re-shipper. Several complications arise from the practice of re-exporting.

China follows United Nations (UN) guidelines that call for exports to be recorded by the country of destination known at the time goods leave a country. Since a large proportion of Chinese goods ultimately flowing to the United States are first sold to Hong Kong firms, such exports are recorded as going to Hong Kong rather than the United States. The United States follows the same practice for goods sold to Hong Kong firms that may be re-exported to China, but this occurs on a much smaller scale.

On the other hand, the United States, also following UN guidelines, records most of the goods re-exported by Hong Kong as exports from China. In general, for nonpreferential trade the United States considers the country of origin to be the last country where a "substantial transformation" took place, regardless of the portion of the final import value of the product that is added by processing that takes place in other countries after the "substantial transformation." (Preferential trading arrangements, such as NAFTA and GSP, have specific value-added requirements. U.S. trade with China and Hong Kong is on a nonpreferential basis. The textiles and apparel sector has its own special rules.) Adherence to

reporting guidelines in the case of Hong Kong re-exports leads to a substantial gap between what the United States reports as its imports from China and what China reports as its exports to the United States. Large discrepancies in bilateral trade balances reported by the two countries also result, as can be seen in table 10.

In addition, there are substantial markups on goods that pass through Hong Kong as re-exports from China. Using data that Hong Kong collects on re-exports of merchandise, Lardy and his recent collaborator, Scott Kennedy, have estimated the value of U.S. trade with China, adjusted for trade that passes through Hong Kong, shown in table 10 as "adjusted trade." These estimates are lower than the official U.S. figure for imports from China and higher than the official U.S. figure for exports to China. These figures subtract an estimate of the value added to Chinese goods in Hong Kong from official U.S. import statistics, and add an estimate to official U.S. export statistics of the value of U.S. goods officially exported to Hong Kong that are subsequently re-exported to China. Lardy and Kennedy used general statistics on re-export margins for Chinese-origin goods and non-Chinese-origin goods in making their estimates of U.S.-China trade. Census Bureau estimates of the Hong Kong re-export margin for Chinese-origin goods based on more detailed statistics suggest that the adjusted value of U.S. imports from China should be lower than what Lardy and Kennedy report.

The fact that such a large portion of China's exports to the United States are re-exported through Hong Kong accounts for the anomaly of China's reporting a deficit in its trade with the United States at the same time that the United States reports a deficit in its trade with China in the 1988-92 period. The same phenomenon, combined with the Hong Kong value added on re-exported Chinese goods, accounts for the likely value of U.S. imports from China being roughly 1.5 times the value of reported Chinese exports to the United States in recent years rather than being nearly double, as might be inferred from official statistics.

While the U.S. trade deficit with China has undoubtedly grown in recent years, the adjusted deficit, when the Hong Kong value-added in re-exports is taken into account, is roughly two-thirds the size of the deficit officially reported by the United States. Even this lower estimate of the deficit overstates its effect on the U.S. economy. First, much of the increase in Chinese exports to the United States represents a shift in production from Hong Kong, Taiwan, and other Asian countries to China as manufacturers have taken advantage of low Chinese labor costs and Chinese incentives to invest in processing and assembly operations in China. As wages have risen in these countries, some of the most labor-intensive operations

have been shifted to China. At the same time that Chinese exports to the United States have risen, exports from these countries to the United States have fallen, or risen at a decreased rate.

Second, even after the Hong Kong value of re-exports is accounted for, much of the import value attributed to China by the United States is actually of non-Chinese origin. Of the major categories of products exported to the United States—footwear, apparel, toys and dolls, and consumer electronic products—all involve the processing and assembly in China of parts and materials from other countries, even the United States. Included in the major categories of products exported by the United States to China are cotton, electronic and computer parts, plastics, fibers, and raw leather, all used in the processing and assembly of major Chinese export products. The *Los Angeles Times* reported recently that a Barbie doll labeled "Made in China" that sells for \$9.99 in the United States consisted of about 35 cents in Chinese value added out of a customs value (the value at the port from which it was shipped to the United States) of \$2. The rest constituted transoceanic shipping costs and U.S. marketing costs and profits. Problems in accounting for the value added from different countries are not unique to China, but are more pronounced than for such mature industrial countries as Japan because of the vast extent of processing and assembly operations in China. In a world where national statistics administrators assign a single country of origin to goods for record-keeping purposes, these problems will always occur, regardless of the relevance of the resulting numbers for trade analysis.

EU To Resume Information Technology Negotiations

After months of EU backsliding, U.S. and European Union (EU) officials recently agreed to resume negotiations to liberalize trade in information technology products through an Information Technology Agreement (ITA). The logjam was broken on September 28, on the sidelines of the Quadrilateral meeting in Seattle, WA, where U.S., EU, Japanese, and Canadian trade ministers met to assess preparations for the first WTO ministerial meeting in December in Singapore. (See separate article on the WTO Ministerial in this issue.) The settlement resulted when the United States and Japan agreed to delay meetings scheduled under the U.S.-Japan Semiconductor Arrangement until March, permitting the EU to participate if the ITA has been concluded, as is planned.

Table 10
Merchandise trade between the United States and China, 1988-95

Billion dollars

Year	Reported by China			Reported by the United States			Adjusted Trade		
	Exports to U.S.	Imports from U.S.	Balance	Exports to China	Imports from China	Balance	U.S. exports to China	U.S. imports from China	Balance
1988	3.382	6.668	-3.286	5.033	8.512	-3.479	6.089	7.626	-1.536
1989	4.410	7.863	-3.453	5.807	11.989	-6.182	6.952	10.381	-3.430
1990	5.179	6.588	-1.409	4.807	15.224	-10.417	5.978	13.400	-7.422
1991	6.194	8.008	-1.814	6.287	18.976	-12.689	7.480	16.234	-8.394
1992	8.594	8.900	-0.306	7.470	25.676	-18.206	9.600	21.535	-11.935
1993	16.964	10.688	6.276	8.767	31.535	-22.768	11.699	25.856	-14.157
1994	21.461	13.970	7.491	9.287	38.781	-29.494	12.784	32.472	-19.688
1995	24.700	16.100	8.600	11.748	45.555	-33.807	16.451	38.737	-22.285

Source: Nicholas Lardy and Scott Kennedy, personal communication, Brookings Institution, Washington, DC, Oct. 4, 1996.

Negotiation of an ITA was formally launched at the U.S.-EU summit in Madrid in December 1995. The initiative was just one of a large number of economic, political, and security measures announced in the New Trans-Atlantic Agenda to reinvigorate the trans-Atlantic partnership (see *IER*, Feb./Mar. 1996). Building on the recommendations of U.S. and EU business, the two sides committed to seek an agreement eliminating tariffs on information technology products by the year 2000. The products covered by such an agreement would include computer hardware, semiconductors and integrated circuits, computer software, telecommunications equipment, parts for these products, and other information technology equipment.

At the April 1996 Quad meeting in Kobe, Japan, trade ministers from the United States, EU, Japan, and Canada endorsed the ITA and agreed to complete negotiations before the December 1996 WTO Ministerial with a view to initiating tariff reductions on ITA products in 1997. Ministers also agreed that as many countries as possible outside the Quad should participate in the ITA, particularly APEC members such as Korea, Taiwan, Malaysia, Indonesia, Thailand, the Philippines, Singapore, and China. Quad ministers tasked negotiators to work on product coverage.

However, at the same time, the EU stalled progress on the ITA by requesting a "balanced" agreement and by linking negotiations with other nontariff matters. The EU was especially concerned that the ITA would require the EU to grant more significant tariff concessions than the other Quad members. For example, whereas the United States and Japan agreed in 1985 to apply zero rates on semiconductors, EU tariffs on semiconductors today range from 0 to 7 percent. As a result, the EU demanded that the ITA be a "balanced agreement" and grant "mutual benefits" by including tariff cuts in other sectors. Southern EU-member states in particular withheld support for the ITA unless they would be compensated for tariff concessions.

EU efforts to link ITA progress to other activities focused on EU participation in the U.S.-Japan Semiconductor Arrangement. The EU stated that the only acceptable result from the semiconductor negotiations would be "the establishment of future industry-to-industry and government-to-government cooperation on a tri- or plurilateral basis from the very start, without any form of conditionality...." According to EU officials, EU semiconductor manufacturers strongly supported the linkage so that they could not be excluded from the benefits of the agreement. The EU also tried to link ITA support with progress on negotiations to conclude Mutual Recognition Agreements (MRAs) in a number of sectors.

Despite these demands, the United States insisted that the ITA was a separate, simple tariff exercise and concluded a semiconductor agreement with Japan on August 2 (see *IER*, September 1996). In addition to a global government forum, the U.S.-Japan Semiconductor Arrangement established an industry-level Semiconductor Council to promote cooperative activities, (for example, standardization, environmental protection, etc.), discuss market access concerns, and expand international cooperation. Also, the semiconductor industries were tasked to collect and analyze market and trade flow data. Participation in the Semiconductor Council is open to industry organizations in any country provided the country has either eliminated semiconductor tariffs, committed to eliminate tariffs expeditiously, or suspended tariffs pending their formal elimination. Governments whose national industry associations have joined the Council may join government-level consultations that will review the reports and activities of the Council. It was anticipated that the EU would quickly meet the condition for participating in the Council through compliance with the ITA.

Following conclusion of the semiconductor arrangement, U.S. and EU officials committed to explore how the EU could join the semiconductor accord while making a commitment to conclude an ITA. Progress was difficult, as some EU member states continued to object to the ITA. The United States was determined, however, not to move forward without EU support. Otherwise, tariff cuts on a most-favored-nation (MFN) basis under an ITA would permit the EU to be a free rider.

A resolution was finally agreed, which allowed Quad ministers to formally endorse the ITA at their meeting September 27-28, 1996. Under the recent Quad settlement, the first meeting of the Semiconductor Council will be delayed until March 1997 to ensure that the ITA has been concluded and thus, that the EU can participate. The first government-to-government level consultations on semiconductors will follow. However, the EU will not be able to participate in data exchanges and preparations for the March meetings until the ITA is concluded. Quad ministers pledged to "work together urgently to conclude the ITA by the Singapore Conference." Soon after the Quad meeting, the EU-member states offered their support and granted the EU Commission a mandate to negotiate the ITA. APEC ministers meeting in Manila in mid-October, meanwhile, went on record as broadly supporting the ITA.

U.S. officials are currently participating in an intensive schedule of meetings with Quad partners and bilaterals with others. Although progress on the ITA was commended at the November 8-9 meeting of the

Trans-Atlantic Business Dialog (TABD), the mechanism for U.S. and EU private-sector involvement in the New Trans-Atlantic Agenda, much remains to be accomplished. The next milestone is to gain participation from APEC members in time to announce an agreement at the APEC Ministerial scheduled in late November. To date, although APEC members have offered broad support for an ITA, product coverage and tariff phaseout periods are still matters of concern. Now, the United States is urging individual APEC economies to clearly identify their issues and concerns with particular product areas. Quad ministers then hope the ITA will “serve as a centerpiece for a broader market access package to be agreed at Singapore.” According to U.S. officials, making substantive progress on the ITA is critical to the future of the WTO, whose success depends on continuously moving forward as well as such important initiatives as the Global Information Infrastructure.

WTO Singapore Ministerial Conference

The first ministerial-level review of the Uruguay Round Agreements (URA) will take place in Singapore on December 9-13, 1996. Although the agenda is still being finalized, the Singapore Ministerial Conference (SMC) is likely to involve at least five major issue areas—

- Implementation of the URA;
- The WTO “built-in” agenda which includes ongoing negotiations in such areas as services;
- The report and recommendations of the Committee on Trade and Environment;
- Further trade liberalization; and
- Issues to add to the WTO work program.

Implementation of the URA

The members of the World Trade Organization (WTO) largely concur that the top priority for the conference is ensuring the proper implementation of the URA, a vast undertaking covering goods, services, and intellectual property rights. The newer and the developing country members of the WTO have found that carrying out all the commitments embodied in the URA is a weighty task. The WTO Director-General, for example, remarked in his December 1995 annual report that there were some 215 WTO notification requirements in the URA, 175 notifications in the goods areas and another 40 in the areas of services and intellectual property rights.

More recently, at the 29th meeting of the so-called quadrilateral or “Quad” member countries (Canada, the EU, Japan, and the United States) in Seattle, WA on September 27-28, 1996, the Quad ministers said that the quality and quantity of notifications under many WTO agreements must be improved. They also identified other areas where greater effort was needed, such as updating national legislation and implementing regulations to translate WTO members’ commitments into action. The Quad singled out cases involving auto regimes and trade-related investment incentives as being of particular concern because certain WTO members were not meeting their legal obligations. Thus, the smooth functioning of notification requirements and similar implementation questions are likely to occupy a major position on the agenda of the December 1996 SMC.

Built-in Agenda

The “built-in” agenda comprises the numerous provisions for reviews and further negotiations that are embedded in the individual UR agreements. The “built-in” agenda is the term often used to refer to the “unfinished business” of the URA, that is, the extended negotiations regarding trade in services. However, it also includes the periodic review of provisions found in the individual agreements which include grandfather clause exemptions (such as that covering the U.S. Jones Act of 1920), as well as areas such as agriculture, where new negotiations are to begin on a date certain for the purpose of attaining additional liberalization. In 1997, for example, the URA called for completion of work on harmonization of rules of origin, a review of the provisions of the Preshipment Inspection agreement, a review of the provisions of the TRIPs agreement concerning geographical indications, the start of negotiations under the GATS on government procurement of services, the end of negotiations under the GATS on safeguards provisions for services, as well as the end of the interim agreement under the GATS on financial services. (See *IER*, Sept. 1996 for details on the timeline of Uruguay Round commitments).

Extended services negotiations were foreseen at the end of the Uruguay Round for—

- Financial services,
- Movement of natural persons,
- Basic telecommunications services, and
- Maritime transport services.

Also foreseen were periodic reviews of certain air-transport services and discussions on professional services, the latter beginning with the field of accounting.

Financial Services

Extended negotiations were to conclude on June 30, 1995, and did conclude on July 28, 1995, with an interim agreement on financial services. The interim agreement went into effect on August 1, 1996, after acceptance by all members concerned, and is to continue through December 31, 1997. On November 1, 1997—60 days before the end of the interim agreement—participants may modify, change, or withdraw their offers, in effect, initiating new negotiations on financial services. Under the interim agreement, the United States took its MFN exemption in financial services, which applies to new investment in the field of financial services. In September 1996, the quadrilateral ministers said they would urge resumption of financial services negotiations in early 1997 with the aim of achieving significantly improved commitments. The United States has been urging improvements by Asian countries in particular, many of whom are unwilling to commit to retain existing levels of foreign access.

Movement of Natural Persons

Extended negotiations paralleled the financial services negotiations, concluding July 28, 1995. Participants agreed that the temporary entry of personnel involved in supplying services in no way impinges on a country's right to govern the employment market or citizenship through domestic laws.

Basic Telecommunications Services

Extended negotiations were to conclude on April 30, 1996, but were further extended, until February 15, 1997. On January 15, 1997—30 days before the newly scheduled conclusion of negotiations—participants will review their offers in an effort to reach an agreement. A major aim of the negotiations is to liberalize market access and national treatment restrictions based on "procompetitive" regulatory principles that include—

- Competitive safeguards, including prohibition of cross-subsidization;
- Transparent and nondiscriminatory interconnection with essential telecommunications facilities;
- Transparent and timely licensing procedures;
- Regulatory authorities that are independent of any basic telecommunication services supplier; and
- Transparent, published, and justifiable international accounting rates.

In September 1996, the quadrilateral member countries restated their commitment to conclude the basic telecommunications negotiations by the February 1997 deadline. To that end, the United States and the EU expected to announce improved telecommunications offers prior to the SMC in the hope that a critical mass of countries would come forward and reciprocate these offers.

Maritime Transport Services

Extended negotiations were scheduled to conclude June 30, 1996, but are now to resume in 4 years time, in 2000. The United States had announced shortly before the June 1996 deadline that it would not submit an offer after concluding that the offers presented by the other 23 participants were not or were not likely to be sufficiently forthcoming.

On a separate but related matter, implementation of the OECD Shipbuilding Agreement also reached an impasse in 1996 with the failure of the U.S. Congress to pass legislation that would allow the United States to ratify the agreement. The agreement—the Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry—was reached in July 1994, signed in December 1994, and expected to enter into force January 1, 1996—a target date that was extended to July 15, 1996, at the end of last year to allow Congress more time to enact the necessary implementing legislation. It was primarily designed to eliminate shipbuilding subsidies in signatory countries—Japan, the EU, Norway, South Korea, and the United States—which account for 80 percent of global shipbuilding. Legislation that would have enabled U.S. ratification of the agreement was approved in the House and Senate committees responsible for this matter in March and May 1996, respectively. However, amendments to this legislation were subsequently approved in the House that were inconsistent with the agreement, and efforts in the Senate to reverse this situation were not successful. Whereas all other parties to the agreement have completed their legislative and ratification requirements, the United States will now enter anew into consultations with its industry, Congress, and U.S. trading partners to assess the options available. The agreement will not enter into force until all parties—including the United States—ratify it.

Professional Services

A WTO Working Party on Professional Services was established in 1995 to examine the disciplines necessary to ensure that qualification requirements and procedures, technical standards, and licensing requirements for professional services do not constitute unnecessary barriers to trade. At their April 1996

meeting in Kobe, Japan, the Quad ministers expressed the desirability that the first sector under examination—accounting—be completed by the SMC. At their September 1996 meeting, they agreed to endeavor to complete the work on accountancy as early as possible in 1997. The quadrilateral countries also said development of generic rules that could be applied to several professions would be desirable.

Committee on Trade and Environment

The Committee on Trade and Environment (CTE), mandated by the Decision on Trade and Environment in April 1994 at the Marrakesh Ministerial Conference, is to report and make recommendations to the SMC. The committee's terms of reference are—

1. To identify the relation between trade and environmental measures in order to promote sustainable development;
2. To recommend modifications to the multilateral trading system that retain its open, equitable, and nondiscriminatory nature and—
 - A. To promote sustainable development in the interaction of trade and environmental measures;
 - B. To avoid protectionist trade measures while ensuring that the multilateral trading system adheres to Agenda 21 [the concept of “sustainable development”] and the Rio Declaration, in particular Principle 12 [the concept of international consensus to take environmental measures that address transboundary or global environmental problems];
 - C. To monitor trade measures used for environmental purposes and environmental measures with significant trade effects.

The decision also set out a work program to address the following points. The Committee has since added item no. 8—

1. The relationship between the provisions of the multilateral trading system and trade measures for environmental purposes, including those pursuant to multilateral environmental agreements (MEAs);
2. The relationship between environmental policies relevant to trade and environmental measures with significant trade effects and the provisions of the multilateral trading system;
3. The relationship between the provisions of the multilateral trading system and requirements

for environmental purposes relating to products, including standards and technical regulations, packaging, labeling and recycling;

4. The provisions of the multilateral trading system with respect to the transparency of trade measures used for environmental purposes and environmental measures and requirements that have significant trade effects;
5. The relationship between the dispute settlement mechanisms in the multilateral trading system and those found in multilateral environmental agreements;
6. The effect of environmental measures on market access, especially in relation to developing countries, in particular to the least developed among them, and environmental benefits of removing trade restrictions and distortions;
7. The issue of exports of domestically prohibited goods; and
8. The relationship between the environment and trade-related intellectual property rights (TRIPs).

In Singapore, WTO ministers will review the work and terms of reference of the CTE in light of its report and recommendations. The quadrilateral ministers announced in April 1996, that they would recommend making the CTE permanent despite still widely divergent views within the committee on different approaches to justifying trade actions taken in support of environmental measures. The committee expects to report the problems (as well as the debates) it has had under consideration, but in August 1996 the chairman was not sanguine about whether or not it would be possible to make recommendations to the December SMC.

Market Access Initiatives

At their April 1996 meeting, the Quad strongly supported the negotiation of an Information Technology Agreement (ITA). (See separate article on an ITA in this issue.) If successful, an ITA would essentially lead to mutual tariff elimination in goods such as computer hardware, semiconductors and integrated circuits, computer software, telecommunications equipment, parts for these products, and other information technology equipment.

At their September 1996 meeting, Quad ministers said they “recognized that expanding market access opportunities in industrial products would be an important contribution to the package for Singapore.” They pledged to provide the necessary leadership to

complete the ITA, working together “urgently to conclude the ITA by the Singapore Conference.” They announced a further expansion of the already agreed pharmaceuticals zero-for-zero initiative that would be implemented by the beginning of April 1997.

New Trade Issues

The final area for discussion on the agenda of the SMC is likely to encompass “new” trade issues. New issues represent any topic that a WTO member considers should be raised for future discussion under the WTO work program. At the Marrakesh Ministerial Conference in April 1994, initialing the Final Act of the URA, the following topics were possible additions to the future work program—

1. The relation between the trade system and internationally recognized labor standards;
2. The relation between immigration policies and international trade;
3. Trade and competition policy, including export financing rules and restrictive business practices;
4. Trade and investment;
5. Regionalism;
6. The interaction between trade policies and policies relating to financial and monetary matters, including debt and commodity markets;
7. International trade and company law;
8. The establishment of a mechanism for compensation for the erosion of preferences;
9. The link between trade, development, political stability and the alleviation of poverty;
10. Unilateral or extra-territorial trade measures.

At the December SMC, other areas may also be raised for discussion and inclusion as part of the WTO work program. U.S. efforts to encourage transparency, openness, and due process in the area of public procurement is one example. Press reports suggest that ASEAN countries such as Malaysia and Indonesia are particularly opposed to raising any new issues at the SMC that they consider not to be trade related, such as bribery, labor, competition, and investment.

OECD New Trade Agenda Issues

The member countries of the Organization for Economic Cooperation and Development (OECD) have been examining the relation of trade to a number of subjects that are often considered key candidates for

discussion under the WTO work program. This OECD “new trade agenda” began at the outset in 1991 and 1992 with an examination of the policies and programs involved in trade and environment, trade and investment, and trade and competition policy. A fourth area—trade and core labor standards—was added later in 1994 at the request of the United States and France.

Trade and Environment

The OECD Joint Experts Group on Trade and the Environment was formed in 1992 to examine trade and environment issues. In 1993, the group developed procedural guidelines in the following four areas—

- Transparency and consultation;
- Trade and environmental examinations, reviews, and followup;
- International environmental cooperation; and
- Dispute settlement.

The Joint Experts Group presently monitors implementation of the guidelines and, in 1995, began to examine the transportation sector. However, OECD work on trade and the environment has deferred in large measure to the WTO Committee on Trade and Environment since its establishment in January 1995 and its work program.

Trade and Investment

Following preliminary discussions begun in 1991, OECD members agreed in May 1995 to negotiate a multilateral agreement on investment (MAI). The agreement would be open to all OECD members and the EU, and to accession by non-OECD member countries as well. The agreement is meant to build on existing OECD investment instruments by consolidating the results achieved, creating new disciplines, and providing comprehensive framework for international investment. A MAI is to set high standards for investment liberalization and protection, and contain dispute settlement procedures. The OECD Negotiating Group on a Multilateral Agreement on Investment has been working since September 1995 toward submitting an agreement to OECD ministers by spring 1997.

The Negotiating Group has set up several drafting and expert groups to treat various topics as follows:

- *Drafting Group 1 on Investment Protection*—general standard of treatment, expropriation, compensation, transfers, protection from strife, and subrogation.
- *Drafting Group 2 on Treatment of Investors and Investment*—national treatment, most favored nation (MFN) treatment, transparency, general exceptions, and standstill and rollback.

- *Expert Group 1 on Dispute Settlement and Geographic Scope*—the role of a signatories' group to address application and interpretation, how to structure state to state dispute settlement, draft decisions, binding decisions, and remedies, enforcement, aspects of investor to state dispute settlement, and territorial scope of application.
- *Expert Group 2 on Taxation Issues*—Expropriatory taxation.
- *Expert Group 3 on Special Topics*—Key personnel, performance requirements, investment incentives.
- *Expert Group 4 on Institutional Matters*.
- *Expert Group 5 on Financial Matters for the MAI*—Definition of investors, definition of investment, transparency, recognition and harmonization arrangements, access to clearance and settlement systems without conferring access to lender-or-last-resort facilities, access to self-regulatory bodies, including stock exchanges, new financial services.

The EU is keen to raise the issue of investment in the WTO and may ask at the December SMC for the establishment of a WTO Working Party on investment. Its goal is not to undermine the OECD MAI negotiations but rather to begin the process of integrating developing countries and investment issues into the multilateral trading system. Although the U.S. priority is to focus on the OECD MAI negotiations, the United States would be willing to join a consensus to begin a limited educational effort within the WTO on trade and investment. However, some developing countries are leery of tackling new trade issues that could result in additional multilateral disciplines.

Trade and Competition

Discussions in the OECD on trade and competition policy (antitrust) have been underway since 1992. The OECD Trade Committee and Committee of Competition Law and Policy (CLP) issued a joint report in 1993 that identified generic issues raised by the interaction of trade and competition policies. The two committees are focused presently on examining the trade difficulties arising from gaps in coverage and enforcement of competition policies. In June 1996, the two committees agreed to form a Joint Group on Trade and Competition Policy.

In a recent report regarding this subject, the EC Commission proposed a stronger international framework that could help national governments deal more effectively with cartels and other anticompetitive

practices that restrict access to foreign markets. The report calls for countries to adopt national legislation based on a core of common principles that would help control mergers, prevent monopoly power abuse, and address other restrictive agreements. The report considers that "horizontal" restraints should be addressed first—such as price fixing, market sharing, bid rigging, group boycotts, and export cartels—and that principles covering "vertical" restraints—such as monopolies and exclusive supply and distribution agreements—might take longer to work out. However, the EU is more likely to favor a "building-block" approach toward such a framework, rather than the creation of any sort of international competition authority.

The EU favors having the issue of trade and competition policy added to the WTO work program at the December SMC. However, the United States finds that the time is not ripe for launching any kind of negotiation in the WTO to establish a comprehensive framework of rules. The United States would be willing to join a consensus to begin a limited educational effort within the WTO concerning trade and competition policy, but also recognizes the resistance of some developing countries.

Trade and Labor

At the WTO Marrakesh Ministerial Conference in April 1994, the United States unsuccessfully sought to include the issue of trade and labor standards as part of the WTO work program. Other participants, many of whom are developing countries, were vehemently opposed to development of multilateral rules that might undermine their comparative labor advantage in world trade. As an initial alternative, the United States and France succeeded in having the issue of trade and labor added to the OECD's "new trade agenda." The United States is mandated under its Uruguay Round implementing legislation to seek the establishment of a WTO working party to examine the relationship between trade and labor standards. Few countries other than Belgium, France, and Norway, have been supportive of this move. The U.S. aim is to raise living standards worldwide, thereby improving market access, through the more effective observation of the following core labor standards that are already widely endorsed in the International Labor Organization and elsewhere—

- Freedom of association;
- The right to organize and bargain collectively;
- End to child labor exploitation;
- Prohibition of forced labor;
- Nondiscrimination in employment.

Interim Agreement on Government Procurement

At the SMC, the quadrilateral member countries expect to propose an Interim Agreement on Government Procurement that will lessen the opportunity for corrupt practices in the area of government procurement, without directly drafting multilateral rules to combat bribery and corruption. Meeting in April 1996 at Kobe, Japan, the Quad noted the anticorruption efforts made in the OECD² and stated that, as a first step to help reduce corruption as an impediment to trade, they would initiate work on an interim arrangement that would include the three main elements of (1) transparency, (2) openness, and (3) due process, in government procurement practices.

The Quad proposal would begin negotiations after the SMC and would aim to conclude an interim arrangement on government procurement practices by the end of 1997, based on the elements of transparency, openness, and due process. The negotiations would likely merge with negotiations concerning government procurement of services as called for under GATS article XIII:2. The Quad members are also encouraging WTO members to join the GPA on its own merits and will work toward making the GPA a comprehensive WTO agreement at some later date. Whereas the Quad members would consider it desirable to simply "multilateralize" the current plurilateral WTO Agreement on Government Procurement (GPA)—that is, make the GPA applicable to all WTO members rather than as it currently exists, applicable to only its present 10 signatories—they also realize that the GPA requirements are often seen as highly rigid and administratively burdensome, especially by developing country WTO members.

Prospects

The SMC will set the agenda for WTO work over the coming 2 years. There seems to be general consensus that its first priority should be ensuring full implementation of the URA and successfully completing items on the WTO's "built-in agenda,"

² Following several years of study initiated largely at U.S. request, members of the have recently approved the following two items in the field of anticorruption measures: (1) the May 1994 Recommendation on Bribery in International Business Transactions, and (2) the April 1996 Recommendation on the Tax Deductibility of Bribes to Foreign Public Officials. A review of the 1994 recommendation will be presented at the 1997 OECD ministerial meeting. The 1996 recommendation was approved by the OECD Council in April 1996 with the intention of outlawing the deductibility of such bribes and criminalizing bribery of foreign public officials.

notably outstanding services negotiations. It is also likely that further liberalization of market access for industrial goods will be announced. An ITA involving both the Quad members and APEC countries is a top U.S. priority; lowering tariffs on chemicals and on alcoholic beverages (such as white spirits) may prove possible as well.

Adding items to the WTO's work program is more problematic. Although various countries support the inclusion of different new issues—the United States for example seeking inclusion of trade/labor and government procurement issues, the EU hoping for progress on trade/investment and trade/competition policy issues, Japan looking for movement on issues regarding regionalism—a consensus to move forward in these areas may well prove elusive, particularly given the tendency of a number of these issues to provoke intense reaction in many developed and developing countries.

Chile-MERCOSUR Union Creates Enlarged South American Free-Trade Area

A free-trade agreement (FTA) between Chile and the Southern Common Market (MERCOSUR) countries became operative on October 1, 1996. MERCOSUR is a customs union joining the economies of Argentina, Brazil, Paraguay, and Uruguay. The agreement with Chile is MERCOSUR's first effort to create an enlarged South American free-trade area; the MERCOSUR partners are already exploring additional FTAs with Bolivia, Peru, and other Latin American countries. The MERCOSUR accord is Chile's second fully operational FTA; a bilateral Chile-Mexico FTA has been operative since 1992. Chile also has bilateral FTAs with Bolivia, Colombia, Ecuador, and Venezuela that are scheduled to become fully operative January 1, 1997, and is negotiating FTAs with Peru, Canada, and the Central American countries.

This article outlines key provisions of MERCOSUR and the Chile-MERCOSUR trade agreement. It also summarizes the current status of the rapidly growing network of FTAs centered on MERCOSUR and Chile. (For additional discussion of MERCOSUR and the status of Chile-MERCOSUR negotiations, see *IER*, "Free-Trade Area for the Americas: Chile Is Linchpin," Nov. 1995, p. 11.)

MERCOSUR

Created in March 1991, the MERCOSUR customs union liberalizes trade in goods by reducing or eliminating tariffs and some quantitative restrictions on

trade among Argentina, Brazil, Paraguay, and Uruguay. The four-country MERCOSUR economic market comprises more than 200 million inhabitants and has a combined economic output of over \$1 trillion, compared with the NAFTA market of 360 million inhabitants with combined economic output of over \$8 trillion.

The MERCOSUR countries have a separate reciprocal investment promotion and protection agreement (the January 1994 Colonia Protocol) that guarantees nondiscriminatory treatment, prohibits performance criteria such as minimum exports or local inputs, bans restrictions on capital repatriation and profit remittances, and prohibits expropriation. While the Colonia Protocol offers limited internal market opening in telecommunications, restrictions remain on foreign investment in the MERCOSUR region. The original MERCOSUR text does not address intellectual property rights (IPR); however, an August 1995 protocol provides limited common terms of reference on IPR (all of the MERCOSUR members have accepted the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) negotiated as part of the Uruguay Round). Although the founding treaty of MERCOSUR mentions trade in services, no fixed schedule exists for liberalization in this area. The MERCOSUR countries have established a working group to study ways to harmonize standards-related measures, including phytosanitary regulations. MERCOSUR does not cover government procurement, notably because government procurement in Brazil is regulated under that country's Constitution, and an agreement in this area would require a Brazilian Constitutional amendment.

MERCOSUR has two components—an FTA and a common external tariff (CET). The FTA eliminates tariffs on eligible products traded among the MERCOSUR countries. Even before the FTA became operative, bilateral trade among MERCOSUR countries was conducted on a preferential basis—tariffs were as much as 22 percent below the *ad valorem* tariff generally applied to other countries—under provisions of the Latin American Integration Association (LAIA, commonly referred to by the Spanish acronym ALADI; in addition to the four MERCOSUR countries, other members of ALADI are Bolivia, Colombia, Ecuador, Mexico, and Venezuela).

A transition period for the FTA lasted from July 1991 through December 1994, during which time MERCOSUR members reduced tariffs immediately to 47 percent below the generally-applied *ad valorem* tariff, followed by progressive and automatic tariff reductions of 7 percent every 6 months; remaining duties were eliminated at the end of the transition phase. The FTA became fully operative January 1, 1995. However, each country maintains a list of

import-sensitive products for which tariffs remain in effect. Argentina has 222 such sensitive items listed, primarily steel, textile, footwear, and paper products. Brazil has 29 items listed, primarily rubber and textile products. Paraguay has 436 items listed, and Uruguay has 492 items listed; for both countries, the lists include textile, food, and paper products. Tariffs on these import-sensitive items are scheduled to be reduced automatically by 25 percent each year beginning January 1, 1995 (for Argentina and Brazil) and January 1, 1996 (for Paraguay and Uruguay), with the goal of complete tariff elimination for these items by January 1, 2006. However, with prior notice, any country can restart the tariff reduction timetable at the original 1995 or 1996 tariff level.

MERCOSUR rules of origin extend from those established under ALADI. Products eligible for MERCOSUR treatment must be entirely made within the MERCOSUR region or, if made of non-MERCOSUR components, generally must (1) undergo a change of tariff classification through processing or transformation within the MERCOSUR region (certain products also must be of no more than 40 percent of non-MERCOSUR components) or (2) have foreign inputs account for no more than 40 percent of the FOB value of the good (ALADI requires 50 percent).

Under the CET, all MERCOSUR members apply a common tariff, ranging from 0 to 20 percent *ad valorem*, to articles imported into the MERCOSUR region from all countries outside the region. The CET became operative January 1, 1995, immediately covering approximately 88 percent of the MERCOSUR region's combined tariff schedule. The remaining 12 percent was made up of products with a longer phase-in timetable or products subject to special tariff regimes. According to sources, the CET established an average *ad valorem* tariff of approximately 12 percent for products entering the MERCOSUR region.

Each member maintains a list of import-sensitive items subject to a longer phase-in to the CET. Argentina, Brazil, and Uruguay have 300 items listed each; tariffs on these items are to be phased out by the year 2000; Paraguay has 399 items listed, subject to tariff elimination by 2006. Tariffs on these import-sensitive goods are permitted to be as high as 35 percent *ad valorem* except for Brazil, which is permitted to apply a top tariff of 70 percent for imports of automobiles. Capital goods are subject to a special CET implementation timetable—each country's tariffs are to converge to a common tariff of 14 percent *ad valorem* by 2001 (for Argentina and Brazil) or by 2006 (for Paraguay and Uruguay). Tariffs on computer systems and telecommunications products are scheduled to converge to a common rate of 16 percent

ad valorem by 2006. Special tariff regimes also apply to sugar (members are allowed to exclude sugar from both the FTA and the CET until 2001) and automobiles. Argentina and Brazil, the largest regional producers of motor vehicles, are approaching trade in automobiles on a bilateral basis, rather than as part of MERCOSUR and have signed a quota-sharing agreement to last through the year 1999; after 1999, automobiles are to be subject to a common tariff of 20 percent *ad valorem*.

The institutional arrangements of MERCOSUR continue to evolve. MERCOSUR is an intergovernmental arrangement with no autonomous or supranational bodies such those of the EU. A dispute settlement mechanism was established by the December 1991 Brasilia Protocol that builds on ALADI trade consultation mechanisms, although ALADI has no dispute settlement procedure as such. Under MERCOSUR, trade disputes undergo an initial 15-day period of direct negotiations between the affect parties; if no settlement is reached, the next step is a 30-day period of review by the MERCOSUR Common Market Group, made up of four representatives from each country; the final avenue for resolution is an arbitration panel. There are no provisions for companies and individuals to bring complaints before this dispute settlement mechanism; consequently, commercial disputes are resolved through bilateral consultations.

Chile-MERCOSUR Association Agreement

Chile's association agreement with the MERCOSUR countries entered into force October 1, 1996. With the addition of Chile, the extended MERCOSUR market now comprises 216 million inhabitants with combined economic output of nearly \$1.3 trillion. Associate member status in MERCOSUR was necessary because Chile participates in the FTA, but not in the CET. Chile has a flat 11 percent *ad valorem* tariff with almost no peak duties on sensitive sectors or products. To participate in the CET, Chile effectively would have had to raise tariffs—something the Chilean Government has long pledged not to do—to the prevailing CET level on many items from non-MERCOSUR countries. Nevertheless, the inclusion of Chile—by far, Latin America's most stable and most successful economy—gives added importance and momentum to MERCOSUR as a vehicle for enlarged hemispheric economic integration.

Like the original MERCOSUR text, the Chile-MERCOSUR agreement does not cover government procurement and sets no fixed schedule for liberalization of investment and trade in services. The

agreement broadly covers three categories of traded goods—those not already subject to bilateral ALADI preferential trade arrangements, those subject to ALADI preferential trade, and import-sensitive items. Rules of origin requirements are similar to those of the original MERCOSUR text.

Eligible products must be entirely made within the Chile-MERCOSUR region or, if made of foreign components, generally must either undergo a change of tariff classification through processing within the region or have foreign inputs account for no more than 40 percent of the final value of the product.

Under the Chile-MERCOSUR FTA, tariffs on goods not already subject to preferential trade arrangements (an estimated 65 percent of traded goods) were reduced by 40 percent effective October 1, 1996; these tariffs are scheduled to be reduced in equal annual percentages until tariffs reach zero by 2004. The agreement also replaced, and made multilateral preexisting bilateral ALADI preferential tariff agreements signed between Chile and each of the MERCOSUR members. Tariffs on these items were eliminated effective October 1, 1996. Included in this category were 500 products of MERCOSUR countries imported by Chile (such as seafood, corned beef, tea, cacao, certain nonmetallic minerals, pigments and dyes, chemical products, cotton, aluminum, and agricultural machinery), and 1,000 Chilean products imported by MERCOSUR countries (including dairy products, salmon and other fish, crustaceans, chemicals, wood products, certain copper, and certain manufactured products). Tariffs on import-sensitive (primarily agricultural) products (an estimated 19 percent of traded goods) were reduced by 30 percent when the agreement entered into force, and are scheduled to decline to zero by 2006 through equal annual reductions; Chile listed 209 MERCOSUR products, while MERCOSUR listed 311 Chilean products subject to this schedule.

Tariffs on certain "special sensitive" products, including 193 items listed by Chile and 208 items listed by MERCOSUR, will undergo no tariff reductions until 1999, when they then will begin annual reductions to decline to zero by 2006. A shorter list of items will undergo the longest tariff-reduction schedule. Included on Chile's list are 151 MERCOSUR products such as motor vehicles, sugar, wheat, wheat flour, beef, rice, edible oils, and wine; the MERCOSUR list includes 139 imports from Chile such as fruit, wine, and motor vehicles. Tariffs will remain unchanged until 2006, at which time they will undergo staged annual reductions to be eliminated by 2011 (most items), 2012 (sugar), or 2014 (wheat and wheat flour).

Upon entry into force of the agreement on October 1, 1996, it was estimated that tariffs were eliminated

for 15 percent of Chilean imports from MERCOSUR and approximately 20 percent of Chilean exports to MERCOSUR. By January 1, 2004, it is estimated that nearly 60 percent of Chilean imports from MERCOSUR and more than 52 percent of Chilean exports to MERCOSUR will be duty-free. By January 1, 2006, estimates are that more than 76 percent of Chilean imports from MERCOSUR and more than 87 percent of Chilean exports to MERCOSUR will be duty-free.

In negotiations with MERCOSUR, Chile agreed to phase out tariffs on traditional-crop agriculture—namely grains, sugar beets, oilseeds, and dairy products. Unlike the country's free-market and globally competitive agricultural export sector, Chile's traditional farming sector has long received Government support and import protection. Under the agreement, Chile also committed not to expand the use of price bands to other products. Price bands are an import protection system under which minimum and maximum prices, related to a moving average of representative international prices, are set for imports. Chile applies price bands to imports of edible oils, sugar, wheat, and wheat flour—an issue of concern in U.S. trade relations with Chile. The Chilean Government has long contended that price bands do not constitute price-support mechanisms, but rather correct for alleged artificial distortions in global markets.

Under the Chile-MERCOSUR agreement, members are to bring their domestic trade laws and regulations into conformity with commitments made during the Uruguay Round. They also agreed to inform one another should any member impose antidumping or countervailing duty remedies on imports originating outside of the FTA, so that the offending imports can be monitored by all members; there are provisions for consultations should another member permit such imports to occur. Trade disputes among members are to be handled by an Administrative Committee, although specific procedures are not specified. Like the original MERCOSUR text, the Chile-MERCOSUR agreement permits the accession of other ALADI countries.

Other MERCOSUR Agreements

Also during 1996, MERCOSUR countries have held talks for possible FTAs with Bolivia, Peru, and the Andean Group (Bolivia, Colombia, Ecuador, Peru, and Venezuela). Furthest along is an agreement with Bolivia scheduled to enter into force January 1, 1997. Like Chile, Bolivia will be an associate MERCOSUR member in order to retain its current tariff structure—5 percent *ad valorem* for imports of capital goods and 10 percent *ad valorem* for other imports—which is lower

than that of the CET. Also as was the case with Chile, the Bolivia-MERCOSUR FTA involved the multilateralization of Bolivia's bilateral ALADI preferential trade arrangements with each of the MERCOSUR countries. According to press reports, effective January 1, 1997, tariffs on goods traded between Bolivia and the original MERCOSUR countries will be reduced by 30 percent; through annual staged tariff reductions, an estimated 80 percent of trade will be duty-free. Other aspects of the agreement most likely will closely resemble the MERCOSUR-Chile FTA, with allowances made in the phase-in schedule for Bolivia's relatively less developed economy. The enlarged MERCOSUR market, including both the Bolivia and Chile FTAs, will comprise 224 million inhabitants and have a combined economic output of just over \$1.3 trillion.

Recent press reports indicate that Mexico and the MERCOSUR have expressed a mutual interest in launching FTA negotiations, perhaps during 1997. Efforts to fold existing bilateral ALADI preferential trade agreements between Mexico and each of the MERCOSUR countries into a single agreement between Mexico and the four MERCOSUR countries collectively were under way during October 1996; it is possible that this new agreement could become the basis for a future Mexico-MERCOSUR FTA. In addition to tariffs, Mexico and MERCOSUR have agreed to hold discussions on such issues as dispute resolution, subsidies and illegal trade practices, phytosanitary measures, technical standards, and safeguard measures.

Other Chilean Agreements

A bilateral Chile-Mexico free-trade agreement entered into force on January 1, 1992. Under the agreement, both countries reduced tariffs to 10 percent *ad valorem* on approximately 95 percent of eligible items, with further equal reductions annually, until reaching zero on January 1, 1996. Tariff reductions on 100 sensitive items (including poultry, eggs, grapes, tobacco, acids, dyes, paints, essential oils, chemicals, plastics, resins, wood products, synthetic yarns, glassware, and ceramics) were delayed until January 1, 1996; duties on these items are now being reduced in annual increments, and are scheduled to reach zero by January 1, 1998. Effective January 1, 1996, vans, buses, and trucks have been traded tariff- and quota-free; a tariff-elimination scheme for passenger cars became operative January 1, 1996, with duties to be phased out by January 1, 1998; some quantitative limits will remain thereafter. Nontariff barriers were eliminated on January 1, 1991, unless otherwise protected under ALADI. The Chile-Mexico FTA also provides for nondiscriminatory treatment in government procurement and foreign investment,

provides for “adequate” protection for intellectual and industrial property, uses ALADI rules of origin (no more than 50 percent foreign content), and permits other ALADI members to accede. The agreement sets forth procedures authorizing safeguards for up to one year for balance of payments disequilibrium or damage to domestic production as a result of imports under the agreement, and provides for the establishment of a binational panel to resolve disputes involving interpretation of or compliance with the FTA; however, it sets up no specific mechanisms for resolution of issues related to unfair trade practices such as dumping and subsidies (in such cases, antidumping or countervailing duties may be applied pursuant to the respective domestic laws when proof is provided of serious injury or threat thereof to domestic production).

Chile has also signed bilateral FTAs with Colombia (1993), Ecuador (1994), and Venezuela (1993). (For additional discussion of Chile’s other trade agreements, see *IER* “Chile’s Trade Agreements With Latin American Partners,” Nov. 1994, p. 11.) Tariff reduction schedules were implemented under these agreements, with tariffs on most eligible products scheduled to fall to zero effective January 1, 1997 (1998 for the agreement with Ecuador) or by January 1, 1999 (2000 for the agreement with Ecuador) for import-sensitive products. Products excluded from these agreements include: cut lumber, certain manufactured copper items, and petroleum (excluded by Colombia), petroleum (excluded by Ecuador), and agricultural products subject to Chile’s price bands. The agreements are similar in content to the Chile-Mexico FTA, with nearly identical language on rules of origin, safeguards, unfair trade practices, and provisions for nondiscriminatory treatment in government procurement and foreign investment. In 1993, Chile signed a bilateral trade agreement to provide

nonreciprocal tariff reductions to certain products of Bolivia; this agreement could form the basis of an eventual Chile-Bolivia FTA, despite a longstanding and unresolved territorial dispute between the two countries over landlocked Bolivia’s lack of access to the Pacific Ocean. Chile also has launched FTA negotiations with Peru (begun in 1995) and the Central American Common Market countries of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama (begun in July 1996).

Chile and Canada signed a bilateral FTA on November 18, 1996. Negotiations began in January 1996 after negotiations for Chilean accession to NAFTA stalled in 1995 when it became apparent that the U.S. administration would be unable to secure fast-track negotiating authority in the near term. Chilean and Canadian officials have long stated that their bilateral agreement would be structured to be compatible with NAFTA. Once approved by the two countries’ respective legislative bodies, the agreement will immediately eliminate tariffs on 75 of bilateral trade; tariffs on more sensitive products, including meats and grains, will be phased out over periods of up to 15 years. One key stumbling block to the negotiations was Canada’s desire for Chile to eliminate a requirement that foreign investors deposit 30 percent of their capital with Chile’s central bank (Chile instituted this measure, known as the *encaje*, in 1991 to prevent short-term speculative foreign capital inflows of the type that contributed to Mexico’s 1994-95 “peso crisis”); the FTA does not change this Chilean investment requirement. The Chile-Canada FTA also provides for the eventual elimination of antidumping regulations on a bilateral basis; the two countries reportedly will use existing domestic laws, such as antitrust legislation, to curtail dumping.

STATISTICAL TABLES

Indexes of industrial production, by selected countries and by specified periods, Jan. 1993-Sept. 1996
(Total Industrial production, 1991=100)

Country	1993	1994	1995	1995	1996								
				IV	I	II	III	Apr.	May	June	July	Aug.	Sept.
United States ¹	112.0	118.1	122.3	122.6	123.3	125.1	126.7	124.4	125.3	126.4	126.4	126.8	127.1
Japan	92.0	93.1	96.0	98.0	96.9	96.0	(²)	97.0	93.2	97.8	103.2	(²)	(²)
Canada ³	101.4	105.5	107.6	108.2	105.0	108.7	(²)	106.8	108.5	110.9	(²)	(²)	(²)
Germany	92.8	93.9	95.9	99.4	94.0	95.0	(²)	94.7	93.5	96.7	92.7	(²)	(²)
United Kingdom	98.4	103.3	105.9	110.4	111.8	104.5	(²)	104.3	107.5	101.7	(²)	(²)	(²)
France	93.9	97.5	99.0	102.0	103.9	100.2	(²)	101.6	98.2	100.7	(²)	(²)	(²)
Italy	95.7	102.2	107.8	113.0	110.1	(²)	(²)	108.4	110.5	(²)	(²)	(²)	(²)

¹ 1987=100.

² Not available.

³ Real domestic product in industry at factor cost and 1986 prices.

Source: *Main Economic Indicators*, Organization for Economic Cooperation and Development, September 1996, *Federal Reserve Statistical Release*, October 17, 1996.

Consumer prices, by selected countries and by specified periods, Jan. 1993-Aug. 1996
(Percentage change from same period of previous year)

Country	1993	1994	1995	1995	1996									
				IV	I	II	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.
United States	3.0	2.6	2.8	2.7	2.7	2.9	2.7	2.7	2.8	2.9	2.9	2.8	3.0	2.9
Japan	1.3	0.7	-0.1	-0.5	-0.2	0.4	-0.4	-0.2	0.1	0.4	0.3	0.0	0.4	0.2
Canada	1.8	0.2	1.7	2.1	1.4	1.4	1.6	1.3	1.4	1.4	1.5	1.4	1.2	1.4
Germany	4.2	3.0	1.7	1.5	1.4	1.3	1.4	1.4	1.4	1.3	1.5	1.2	1.3	1.4
United Kingdom	1.6	2.5	3.4	3.2	2.8	2.4	2.9	2.7	2.7	2.4	2.2	2.1	2.2	2.1
France	2.0	1.7	1.7	1.9	2.1	2.4	2.0	2.0	2.3	2.4	2.4	2.3	2.3	1.6
Italy	4.4	1.0	5.2	5.6	5.0	4.5	5.4	5.0	4.5	4.5	4.3	3.9	3.6	3.3

Source: *Consumer Price Indexes, Nine Countries*, U.S. Department of Labor, October 1996.

Unemployment rates (civilian labor force basis)¹, by selected countries and by specified periods, Jan. 1993-Aug. 1996

Country	1993	1994	1995	1995			1996									
				IV	Nov.	Dec.	I	II	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.
United States	6.8	6.1	5.6	5.5	5.6	5.6	5.6	5.4	5.8	5.5	5.6	5.4	5.6	5.3	5.4	5.1
Japan	2.5	2.9	3.2	3.4	3.4	3.4	3.3	3.5	3.4	3.3	3.1	3.5	3.6	3.6	3.4	3.4
Canada	11.2	10.4	9.5	9.4	9.4	9.4	9.5	9.6	9.6	9.6	9.3	9.4	9.4	10.0	9.8	9.4
Germany	5.8	6.5	6.5	6.7	6.7	6.8	7.0	7.1	7.0	7.0	7.1	(²)	7.1	7.1	7.1	7.2
United Kingdom	10.4	9.6	8.8	8.6	8.6	8.6	8.4	8.3	8.5	8.5	8.3	8.3	8.3	8.6	8.1	8.1
France	11.3	12.3	12.3	12.3	(²)	12.4	12.5	(³)	12.5	12.6	12.6	(²)	12.1	12.2	12.2	(²)
Italy	10.3	11.4	12.0	12.0	(³)	(³)	12.0	12.5	12.0	(^{3})	(^{3})	(^{3})	(^{3})	(³)	11.9	(³)

¹ Seasonally adjusted; rates of foreign countries adjusted to be comparable with the U.S. rate.

² Not available.

³ Italian unemployment surveys are conducted only once a quarter, in the first month of the quarter.

Source: *Unemployment Rates in Nine Countries*, U.S. Department of Labor, October 1996.

Money-market interest rates,¹ by selected countries and by specified periods, Jan. 1993-Sept. 1996
(Percentage, annual rates)

Country	1993	1994	1995	1995	1996			Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.
				IV	I	II	III									
United States	3.2	4.6	5.8	5.6	5.2	5.3	5.5	5.2	5.1	5.2	5.3	5.3	5.4	5.5	5.5	5.5
Japan	2.9	2.2	1.2	0.5	0.6	0.6	(2)	0.5	0.6	0.6	0.6	0.6	0.5	0.6	0.6	(2)
Canada	5.1	5.5	7.1	6.1	5.3	4.9	(2)	5.5	5.2	5.2	5.0	4.8	4.8	4.7	4.3	(2)
Germany	7.1	5.2	4.4	3.9	3.3	3.2	(2)	3.5	3.2	3.2	3.2	3.1	3.2	3.2	3.2	(2)
United Kingdom	5.8	5.4	6.6	6.5	6.2	5.9	(2)	6.3	6.1	6.0	5.9	6.0	5.8	5.6	5.7	(2)
France	8.3	5.7	6.4	5.9	4.3	3.8	(2)	4.5	4.2	4.1	3.8	3.7	3.8	3.7	3.8	(2)
Italy	10.0	8.4	10.4	10.6	9.9	9.0	(2)	10.0	9.9	9.8	9.6	8.8	8.7	8.7	8.7	(2)

¹ 90-day certificate of deposit.

² Not available.

Source: *Federal Reserve Statistical Release*, October 15, 1996; *Federal Reserve Bulletin*, October 1996.

Effective exchange rate of the U.S. dollar, by specified periods, Jan. 1993-Sept. 1996
(Percentage change from previous period)

Item	1993	1994	1995	1995	1996			Mar.	Apr.	May	June	July	Aug.	Sept.
				IV	I	II	III							
Unadjusted:														
Index ¹	100.1	98.5	92.9	94.3	96.4	97.6	97.4	96.5	97.2	97.6	98.0	97.5	96.9	97.8
Percentage change ..	3.1	-1.6	-5.6	.9	1.6	1.2	-.2	-.1	.7	.4	.4	-.5	-.6	.9
Adjusted:														
Index ¹	104.2	101.5	93.9	95.2	97.9	100.3	100.7	98.6	99.5	100.2	100.8	100.5	100.1	101.3
Percentage change ..	3.3	-2.7	-7.4	2.9	2.7	2.4	.4	.5	.9	.7	.6	-.3	-.4	1.1

¹ 1990 average=100.

Note.—The foreign-currency value of the U.S. dollar is a trade-weighted average in terms of the currencies of 18 other major nations. The inflation-adjusted measure shows the change in the dollar's value after adjusting for the inflation rates in the United States and in other nations; thus, a decline in this measure suggests an increase in U.S. price competitiveness.

Source: Morgan Guaranty Trust Co. of New York, October 1996.

Merchandise trade balances, by selected countries and by specified periods, Jan. 1993-Aug. 1996
(In billions of U.S. dollars, exports less imports [f.o.b - c.i.f.], at an annual rate)

Country	1993	1994	1995	1995		1996		Feb.	Mar.	Apr.	May	June	July	Aug.
				IV	I	II								
United States ¹	-115.7	-150.6	-159.6	-138.9	-153.8	-161.1	-139.3	-147.9	-157.1	-172.9	-154.3	-187.4	-178.2	
Japan	120.3	121.2	106.0	90.3	67.4	54.4	51.3	82.4	30.1	57.7	75.6	(2)	(2)	
Canada ³	13.4	17.0	27.8	34.2	28.0	33.8	22.3	29.6	30.2	38.6	32.7	(2)	(2)	
Germany	35.8	45.6	63.6	66.3	63.7	(2)	78.6	60.9	68.5	66.4	(2)	(2)	(2)	
United Kingdom	-25.5	-22.5	-22.4	-24.8	-26.6	-28.5	-28.9	-21.4	-30.1	-27.7	-27.7	(2)	(2)	
France ³	15.6	14.7	20.0	21.7	23.1	18.7	23.4	27.1	7.4	26.0	22.5	(2)	(2)	
Italy	20.6	22.0	27.6	21.0	37.5	(2)	53.2	42.1	43.0	(2)	(2)	(2)	(2)	

¹ Figures are adjusted to reflect change in U.S. Department of Commerce reporting of imports at customs value, seasonally adjusted, rather than c.i.f. value.

² Not available.

³ Imports are f.o.b.

Source: *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, October 18, 1996; *Main Economic Indicators*; Organization for Economic Cooperation and Development, September 1996.

U.S. trade balance,¹ by major commodity categories and by specified periods, Jan. 1993-Aug. 1996
(In billions of dollars)

Country	1993	1994	1995	1995		1996		Feb.	Mar.	Apr.	May	June	July	Aug.
				IV	I	II								
Commodity categories:														
Agriculture	17.8	19.0	25.6	8.0	7.9	5.6	2.6	2.5	2.0	1.9	1.7	1.6	1.8	
Petroleum and selected product— (unadjusted)	-45.7	-47.5	-48.8	-11.3	-12.4	-15.6	-3.7	-4.1	-5.2	-5.4	-5.0	-5.5	-5.1	
Manufactured goods	-115.3	-155.7	-173.5	-44.9	-30.5	-36.9	-10.0	-7.8	-11.7	-12.7	-12.5	-18.5	-16.7	
Selected countries:														
Western Europe	-1.4	-12.5	-10.6	-2.8	-1.6	-1.9	-4	-2	-4	-8	-7	-4.2	-1.5	
Canada	-18.6	-25.1	-31.6	-5.6	-4.4	-6.5	-1.2	-1.3	-1.6	-2.5	-2.4	-1.8	-2.5	
Japan	-60.1	-66.4	-61.4	-12.2	-11.7	-10.3	-3.8	-4.1	-4.0	-3.1	-3.2	-4.3	-3.7	
OPEC (unadjusted)	-11.6	-13.8	-15.7	-3.7	-3.8	-4.9	-1.2	-9	-1.6	-1.9	-1.4	-1.7	-1.7	
Unit value of U.S. imports of petroleum and selected products (unadjusted)	\$15.13	\$14.22	\$15.83	\$15.41	\$16.65	\$18.76	\$16.18	\$17.33	\$19.33	\$18.95	\$18.02	\$18.24	\$18.65	

¹ Exports, f.a.s. value, unadjusted. Imports, customs value, unadjusted.

Source: *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, October 18, 1996.