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INTERNATIONAL ECONOMIC COMPARISONS

Summary of U.S. Economic Conditions

Several economic indicators advanced, signalling that the recession might be bottoming out. However, the recovery is expected to be lethargic due to the sluggish growth in consumer and business spending.

Data released by the U.S. Department of Commerce suggest that the recession might be bottoming out. Commerce reported that retail sales increased by 1.0 percent in May 1991 and personal spending on goods and services fell in April by a mere 0.1 percent at an annual rate compared with a fall of 1.3 percent in the first quarter of 1991, signalling an improvement in consumer confidence and spending. Moreover, the Federal Reserve reported that the nation's total industrial output rose by 0.5 percent in May 1991. The rise was seemingly caused by the strengthening of demand for manufactures. Latest data released by Commerce show that factory orders climbed by 1.8 percent and factory shipments rose by 2.6 percent in April 1991, the first increases since October 1990. Orders for durable goods jumped 3.0 percent, and orders for capital goods rose a hefty 10.1 percent in April 1991. In addition, new home sales increased by 1.2 percent in April 1991, and job surveys indicate increases in business payrolls in the remainder of 1991.

Nevertheless, while consumer spending seems to be rising, albeit sluggishly, business spending for 1991 is projected to increase far below the 1990 level. A report released by Commerce shows that U.S. business spending on new plant and equipment is projected to increase by just 2.7 percent in 1991 compared with an increase of 5.0 percent in 1990. Real business spending is expected to increase by 3.0 percent, based in part on a projected decrease of 0.3 percent in the implicit price deflator for plant and equipment. Tight credit, high interest and tax rates, and the high level of consumer and business indebtedness are likely to continue constraining consumer and business spending.

The U.S. economic recovery, however, is expected to be boosted by the improvement in industrial countries' economic conditions. Foreign demand for U.S. exports is expected to rise as prospects for recovery in the industrialized countries improve. The Organization for Economic Cooperation and Development (OECD) forecast that the annual growth rate for industrial countries will climb to 2.4 percent in the second half of 1991, up from the paltry 0.3 percent in the first half. The OECD expects growth to climb to a 2.9-percent annual rate in 1992. For the United States, the OECD forecasts that GNP is likely to fall by 0.2 percent in 1991 and to grow by 3.1 percent in 1992; inflation as measured by the GNP deflator is expected to fall to 3.6 percent in 1992.

The U.S. Current Account

The U.S. current account recorded a surplus in the first quarter of 1991 for the first time since the second quarter of 1982. Commerce revised statistics on the U.S. current account showed a surplus of $10.2 billion in the first quarter of 1991 compared with a deficit of $23.4 billion in the previous quarter. The surplus resulted from two factors: (1) a $26.2 billion shift from net payments to net receipts reflecting cash contributions from the coalition partners in Operation Desert Storm, and (2) a $7.4 billion decline in the deficit on goods and services and income. The deficit on merchandise trade declined by $9.4 billion to $18.4 billion in the first quarter, as imports declined to $119.3 billion and exports stabilized at $100.9 billion. The surplus on the services account declined slightly to $7.0 billion in the first quarter from $7.5 billion in the fourth quarter of 1990. The loss on the surplus was mainly due to a decline in travel and other transportation receipts. The balance on investment income decreased $1.5 billion in the first quarter of 1991. The $6.1 billion surplus from the previous quarter was thus reduced to $4.7 billion. Receipts of income on U.S. assets abroad were $33.0 billion and payments of income on foreign assets in the United States were $28.3 billion.

The following tabulation shows a summary of the U.S. current account in the first quarter of 1991 in billions of dollars:

Exports of merchandise	$100.9	
Imports of merchandise	-119.2	
Merchandise trade deficit		-18.4
Exports of services	33.8	
Imports of services	-26.8	
Services trade surplus		+7.0
Income receipts on U.S. assets abroad	33.0	
Income payments on foreign assets in the United States	-28.3	
Surplus on income		+4.7
Unilateral transfers, net		+17.0
Current account surplus		$10.3

U.S. International Investment Position, Revalued

In addition to the historical cost method, the U.S. Department of Commerce has recently completed a revaluation of the U.S. international investment position using the current cost, and the market value methods of evaluation. The historical cost method has been criticized as misleading since much of the U.S. investment abroad took place a long time before foreign investment in the United States was made, and therefore, it is argued, the historical cost method does not reflect changes in inflation. Most of the changes, however, apply to direct investment data. The historical cost valuation method estimates the value of tangible assets at their acquisition prices. The current cost method estimates reflect the current cost of replacing U.S. and foreign parents' shares of affiliates investment in tangible assets (property,

plant, equipment and inventory). The market-value method estimates reflect the current stock market value of U.S. and foreign parents' shares of equity in foreign affiliates—including not only tangible assets but also intangible assets (patents, trade marks, management, goodwill, name and changes in the general economic outlook of the industry). Table 1 shows Commerce data on foreign investment in billions of dollars at the end of 1989. The U.S. net direct investment position shows positive balances when the current cost and market value methods of valuation are used. Market value revaluations show that U.S. direct investment abroad exceeded foreign investment in the United States by $261 billion, compared to a deficit of $27 billion when the historical cost method is employed. The U.S. net debtor position as valued by the current cost and the market value methods was lower than that determined by the historical cost method. However, at the end of 1989, the U.S. net position was still negative, amounting to $464 billion measured in current cost and $281 billion measured in market value. While the U.S. negative balances represent obligations on the United States to foreign countries, they are in fact a source of international liquidity provided by the United States in its capacity as the world banker to the world economy. Without such infusions of dollar liquidity in the form of U.S. current account deficits, the international financial system might face extremely high interest rates and dollar scarcity.

Economic Growth

Real economic activity in the United States in the first quarter of 1991 fell at a revised rate of 2.6 percent on an annual basis. The growth rate in the fourth quarter of 1990 was revised to -1.6 percent from the -2.1-percent earlier estimate. The real growth rate was 1.4 percent in the third quarter, 0.4 percent in the second quarter, and 1.7 percent in the first quarter of 1990. The real growth rate for all of 1990 was 0.9 percent. The annualized rate of real economic growth in the first quarter of 1991 was -2.4 percent in the United Kingdom, 9.7 percent in Germany, 11.2 percent in Japan, and -0.1 percent in France. The annualized real growth rate in the fourth quarter of 1990 was -4.0 percent in Canada, and 0.7 percent in Italy.

Industrial Production

U.S. industrial production increased by 0.5 percent in May 1991 after an upwardly revised gain of 0.3 percent in April 1991. The May rise was a result of an increase in the output of motor vehicles and parts. The May 1991 index was 3.3-percent lower than it was in May 1990. Capacity utilization in manufacturing, mining, and utilities increased in May by 0.2 percent to 78.7 percent, after increasing by 0.1 percent in April 1991.

Other major industrial countries reported the following annual rates of growth in industrial production: for the year ending April 1991, Germany reported an increase of 5.7 percent and Japan reported an increase of 3.7 percent; for the year ending March 1991, France reported an increase of 1.9 percent, whereas the United Kingdom reported a decrease of 3.5 percent, Canada reported a decrease of 7.4 percent, and Italy reported a decrease of 2.9 percent.

Prices

The seasonally adjusted U.S. Consumer Price Index rose by 0.3 percent in May 1991. The consumer price index rose by 5.0 percent during the year ending May 1991.

During the 1-year period ending May 1991, consumer prices increased by 6.8 percent in Italy and 3.0 percent in Germany. During the 1-year period ending April 1991 consumer prices increased 6.4 percent in the United Kingdom, 3.2 percent in France, 6.3 percent in Canada, and 3.7 percent in Japan.

Employment

The seasonally adjusted rate of unemployment in the United States rose to 6.8 percent in May from 6.5 percent in April 1991. In May 1991, Germany reported 6.3-percent unemployment, and Canada reported 10.3-percent; in April 1991, Japan reported 2.1-percent, the United Kingdom reported 7.6-percent, Italy reported 9.7-percent, and France reported 9.4-percent unemployment. (For foreign unemployment rates adjusted to U.S. statistical concepts, see the tables at the end of this issue.)

Table 1
U.S international investment positions, using alternative methods of valuation, at yearend 1989, in billions of dollars.

	Historical cost	*Current cost*	*Market value*
U.S. assets abroad	1,412.5	1,669.0	1,937.7
Foreign assets in the United States	2,076.3	2,133.0	2,219.1
International investment, net	-663.7	-464.0	-281.4
U.S. direct investment abroad	373.4	535.9	804.5
Foreign direct investment in the United States	400.8	457.6	543.7
Direct investment, net	-27.4	78.3	260.8

Source: U.S. Department of Commerce, Bureau of Economic Analysis

Forecasts

Table 2 shows macroeconomic projections for the U.S. economy for April- December 1991, by four major forecasters, 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 forecasts point to a moderate rebound in GNP nominal and real growth rates starting in the third quarter of 1991 and continuing throughout the remainder of the year. There are many possible reasons for the slowness of the recovery in 1991: the general slowdown in the world economy, particularly in the industrialized countries; the sluggish rise in consumer spending, the increase in excise taxes introduced in the new U.S. budget plan, and the high level of consumer indebtedness; the expected low level of investment spending because of reduced business expectations; and the reduction in available credit as a result of the Savings and Loan crisis. However, several dynamics appear to be working in favor of stronger future growth: the decline in interest and inflation rates in the first half of 1991 that might encourage a rise in consumer and business spending; the expected surge in export growth as a result of the anticipated improvement in industrial countries' economic conditions that will increase foreign demand for U.S. exports; and the low level of inventories held by businesses that could prompt a buildup of business inventories once a recovery starts. The average of the forecasts predicts an increase in the unemployment rate in the second and third quarters of 1991 and a decline afterwards. Inflation (measured by the GNP deflator index) is expected to dip in the remainder of 1991.

U.S. TRADE DEVELOPMENTS

The U.S. merchandise trade deficit increased in April 1991 due to the accelerated rise in imports over the rise in exports of industrial commodities. Seasonally adjusted U.S. merchandise trade in billions of dollars as reported by the U.S. Department of Commerce is shown in table 3.

Table 2
Projected quarterly percentage changes of selected U.S. economic indicators, 1991
(In Percent)

Quarter	*UCLA Business Fore-casting Project*	*Merrill Lynch Capital Markets*	*Data Resources Inc.*	*Wharton E.F.A. Inc.*	*Mean of 4 fore-casts*
GNP Current Dollars:					
1991:					
April-June	2.1	4.3	3.5	2.9	3.2
July-September	4.0	5.2	6.1	4.5	5.0
October-December	5.9	8.4	6.1	5.8	6.5
GNP Constant (1982) Dollars:					
1991:					
April-June	-0.6	-0.4	0.5	0.9	0.1
July-September	1.9	0.9	3.0	2.5	2.1
October-December	3.6	4.6	3.2	3.5	3.7
GNP deflator index:					
1991:					
April-June	2.7	4.7	2.9	1.9	3.0
July-September	2.1	4.2	2.9	2.0	2.8
October-December	2.2	3.6	2.8	2.2	2.7
Unemployment, average rate:					
1991:					
April-June	6.5	6.7	6.8	6.7	6.6
July-September	6.7	7.0	7.0	6.8	6.9
October-December	6.5	6.9	6.9	6.7	6.7

Date of Forecasts: June, 1991.

Note.—Except for the unemployment rate, percentage changes in the forecast represent compounded annual rates of change from preceding period. Quarterly data are seasonally adjusted.

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

Table 3
U.S. merchandise trade in specified cateogries, March, April 1991
(Billions of dollars)

	Exports		*Imports*		*Trade balance*	
	March 91	*April 91*	*March 91*	*April 91*	*March 91*	*April 91*
Current dollars:						
Including oil	34.0	35.6	38.1	40.3	-4.1	-4.8
Excluding oil	34.0	35.6	35.3	37.5	-1.3	-1.9
1987 dollars	31.7	33.1	35.1	37.4	-3.3	-4.3
3-month-moving average	33.9	34.4	39.6	39.2	-5.6	-4.8
Advanced-technology products (not seasonally adjusted)	9.0	8.5	5.3	5.1	+3.6	+3.4

Source: U.S. Department of Commerce (FT 900), June 1991.

When oil is included, the seasonally adjusted U.S. merchandise trade deficit in current dollars increased by 17.1 percent in April 1991 to $4.8 billion from $4.1 billion in March 1991. The April 1991 deficit was 37.7- percent lower than the $7.7 billion average monthly deficit registered during the previous 12-month period, and 36.9-percent lower than the $7.6 billion deficit registered in April 1990. When oil is excluded, the April 1991 merchandise trade deficit increased by 46.1 percent over the previous month.

In April 1991, both exports and imports increased but imports increased faster. Including oil, seasonally adjusted exports in current dollars rose by $1.6 billion in April to $35.6 billion while imports increased by a $2.2 billion to $40.3 billion. Excluding oil, U.S. imports rose by $2.2 billion to $37.5 billion in April from March 1991. The U.S. oil import bill stabilized at $2.8 billion in April 1991.

In seasonally adjusted constant dollars, the April 1991 trade deficit rose by $936 million from March 1991. The trade surplus in advanced-technology products dropped to $3.4 billion in April 1991 from $3.6 billion in March 1991. (Advanced-technology products as defined by the U.S. Department of Commerce include about 500 products from recognized high-technology fields—for example, biotechnology—out of a universe of some 22,000 commodity classification codes.)

Nominal export changes in April 1991 for specified major exporting sectors are shown in table 4. The sectors that recorded the most export increases in April 1991 include electrical machinery, airplanes, automatic data processing and office machinery, the "other manufactured goods" category, general industrial machinery, specialized industrial machinery, power-generating machinery, vehicle parts and scientific instruments.

The U.S. agricultural trade surplus declined to $1.03 billion in April from $1.64 billion in March 1991.

U.S. bilateral trade balances on a monthly and year-to-date basis with major trading partners are shown in table 5. The United States experienced improvements in bilateral merchandise trade balances in April 1991 with Japan, Canada, and Germany and small deficit increases with the Newly Industrializing Countries (NICs), OPEC, and China. The U.S. trade surpluses with the EC, Western Europe, and the U.S.S.R. declined slightly. The deficit with Japan declined by $220 million, and with Canada by $120 million, and the deficit with Germany by $440 million. The deficit with the NICs rose $530 million; the deficit with OPEC increased slightly, and the deficit with China rose $170 million. The surplus with the EC almost declined by $710 million to $2.01 billion, and the surplus with Western Europe declined to $2.11 billion. The surplus with the U.S.S.R. declined by $140 million. On a cumulative year-to-date basis the United States experienced improvements in its bilateral trade balances from a year earlier with almost all trading partners except Canada and China.

Table 4
U.S. exports, not seasonally adjusted, of specified sectors, by specified periods, January 1990-April 1991.

Sector	Exports: January-April 1991	Exports: April 1991	Change: January-April 1991 over January-April 1990	Change: April 1991 over March 1991	Share of total: January-April 1991	Share of total: April 1991
	Billion dollars		Percent			
Manufactures						
ADP equipment &office machinery	8.79	2.17	7.6	-15.5	6.3	6.0
Airplanes	7.0	2.23	6.9	12.6	5.0	6.2
Airplane parts	3.27	0.82	1.5	0	2.4	2.3
Electrical machinery	9.92	2.56	7.9	-3.8	7.2	7.1
General industrial machinery	5.51	1.57	4.7	7.5	4.0	4.4
Iron and steel milll products	1.35	0.38	36.4	26.7	1.0	1.1
Inorganic chemicals	1.33	0.38	13.7	15.1	1.0	1.1
Organic chemicals	4.10	0.99	16.1	-11.6	3.0	2.7
Power generating machinery	5.43	1.46	2.6	3.5	3.9	4.1
Scientific instruments	4.39	1.10	10.9	-8.3	3.2	3.0
Specialized industrial machinery	5.48	1.53	6.6	6.2	3.9	4.3
Telecommunications	3.06	0.77	8.5	-9.4	.2	2.1
Textile yarns, fabrics and articles	1.74	0.47	6.1	2.2	1.2	1.3
Vehicle parts	4.32	1.23	-8.3	10.8	3.1	3.4
Other manufactured goods[1]	7.99	2.12	9.6	3.9	5.8	5.9
Other manufactured exports not included above	32.23	8.69	10.0	4.8	23.2	24.1
Total manufactures	105.91	28.47	7.8	1.5	76.4	79.1
Agriculture	13.26	3.08	-8.4	-14.0	9.6	8.5
Other exports	19.49	4.48	11.2	-13.5	14.0	12.4
Total exports	138.66	36.03	6.5	-2.1	100.0	100.0

[1] This is an official U.S. Department of Commerce commodity grouping.

Note: Detail lines may not add to totals because of rounding.

Source: U.S. Department of Commerce News (FT 900), June 1991.

Table 5
U.S. merchandise trade deficits (-), surpluses (+) in billions of dollars, not seasonally adjusted, with specified areas, January 1990-April 91.

Area and country	April 1991	March 1991	April 1990	January-April 1991	January-April 1990
Japan	-3.35	-3.57	-4.04	-13.54	-13.59
Canada	-0.29	-0.41	-0.10	-1.66	-0.85
Fed. Republic of Germany	-0.01	-0.45	-0.66	-1.45	-2.98
EC	+2.01	+2.82	+1.33	+7.59	+3.50
Western Europe	+2.11	+3.18	+1.21	+7.75	+2.52
NICs[1]	-0.76	-0.23	-1.50	-2.55	-5.54
U.S.S.R.	+0.25	+0.39	+0.38	+1.11	+1.31
China	-0.67	-0.50	-0.65	-2.86	-2.51
OPEC	-0.98	-0.97	-1.47	-5.29	-7.96
Total trade balance[2]	-3.69	-1.87	-6.53	-16.92	-28.68

[1] NICs include Singapore, Hong Kong, Taiwan, and the Republic of Korea.

[2] The difference between trade balances shown in total exports table and those shown in the above (country/area) table represents exports of certain grains, oilseeds, and satellites that are not included in the country/area exports.

Source: U.S. Department of Commerce News (FT 900), June 1991.

The Human Rights Issue and the MFN Status of China

Making his already known intention official, President Bush recommended to the Congress on May 29 the renewal of China's most-favored-nation (MFN) status for another year. The President's recommendation to continue the MFN tariff treatment of imports from a nonmarket economy country normally results in an automatic extension through July 2 of the following year, but this year his position on MFN for China has triggered a formidable challenge from the Congress.

MFN status was granted to China in 1980 and has been extended annually since that time under the President's general authority to waive full compliance with the freedom-of-emigration requirement (Jackson-Vanik amendment) of section 402 of the Trade Act of 1974. The continuation of the waiver for China has been controversial, however, since the violent military crackdown on student-led prodemocracy demonstrators in June 1989. Again in 1991, as he has since mid-1989, the President is facing strong opposition from many Members of Congress concerned about the Chinese Government's continuing suppression of human rights. Although this remains the primary issue, this year's congressional efforts to impose conditions on the extension or to deny outright MFN status for China are in addition fueled by other concerns, including recent reports of Chinese missile sales to Pakistan and nuclear cooperation with Algeria, the widespread piracy of trademarks and patents in China, and the use of prison labor in the production of goods for export. Yet another issue is the growing U.S. trade deficit with China, which has been increasing since 1984 (when it registered $51.9 million) and in 1990 alone grew by 70 percent, from $6.2 billion in 1989 to $10.3 billion.

In making his decision on whether to continue MFN status for China, the President was not required—and, in fact, he is not authorized under current law—to consider any of these issues. Since MFN status was granted to China under the President's general authority to waive full compliance with the freedom-of-emigration requirement of the 1974 Trade Act. Thus he must determine only that a further 12-month extension of the existing waiver applicable to China will substantially promote the objectives of this provision. In transmitting this determination to the Congress, the President reported that 16,751 U.S. immigrant visas were issued in China during fiscal year 1990, the number that fully met the U.S. numerical limitation for immigrants from China. "The principal restraint on increased emigration," he concluded, "continues to be the capacity and willingness of other nations to absorb Chinese immigrants, not Chinese policy." President Bush also reported to the Congress that he has "serious concerns about the human rights situation in China," but he contends that maintaining MFN "gives China an incentive to stay engaged on issues of vital concern to the United States." He particularly emphasized the adverse impact that withdrawing MFN could have on bilateral trade relations and U.S. investment in China, on the free-enterprise Hong Kong economy, and on the progress of reforms in China, particularly in the coastal Provinces that have gone the farthest in introducing market-oriented policies and practices.

Two procedures are available to the Congress in challenging the President's position on MFN status for China. The Trade Act of 1974, as amended by the Customs and Trade Act of 1990, provides for the enactment of legislation disapproving a President's recommendation to continue a Jackson-Vanik waiver under a specific "fast-track" procedure. The 1990 amendment changed this congressional disapproval procedure from a one-House resolution that was of

doubtful constitutionality (since it was, in effect, a legislative veto) to a joint resolution that was clearly constitutional (since it must be sent to the President for his signature or veto). Outside this procedure, the Congress can enact a law through the regular legislative procedure to change China's MFN status in any way.

Two "fast-track" resolutions disapproving the waiver extension were introduced in the House immediately following the President's May 29 recommendation to Congress to continue China's MFN status for another year (H.J. Res. 262 and 263), and a third joint resolution of disapproval was introduced in the Senate (S.J. Res. 153). To provide for speedy legislative action, the operative language of such resolutions is prescribed by law, and strict time restrictions and other conditions apply. Only one of the resolutions can be enacted, and it must be adopted by both Houses and transmitted to the President within 60 days after the previous waiver expires; i.e., during the period beginning on July 3 and ending on August 31 of each year. If Congress succeeds in passing one of the disapproval resolutions introduced this year, President Bush is expected to veto it. After receiving the veto message, the Congress will then have 15 days during which both the House and the Senate are in session to override the veto. If the Congress is successful, the resolution of disapproval would become effective (and China's MFN status would be terminated) on the 61st day after its enactment. A joint resolution disapproving the extension of the waiver for China in 1990 (H.J. Res. 647) was passed in the House by a vote of 247 to 174, falling short of the two-thirds majority needed to override a Presidential veto. It was not voted on by the Senate prior to the statutory deadline.

The bills relating to China's MFN status that have been introduced in the 102d Congress for consideration under the regular legislative process fall essentially into the following three categories:

1. Those that require the President to withdraw China's MFN status and prohibit its reinstatement. These bills include S. 38 (Moynihan); H. R. 2188 (Solomon); H.R. 2381 (Frank); and S. 1167 (De Concini).

2. Those that impose specified conditions that China must meet for continuation of its MFN status. S. 1020 (Helms) would make a waiver of the Jackson-Vanik amendment for China subject to the President certifying that specified conditions relating to human rights and other matters have been met; and S. 1084 (Mitchell) would require the President to withdraw the MFN treatment of imports from China 180 days after enactment of the law if certain conditions have not been met.

3. Those that impose conditions on the renewal of MFN status for China in 1992. A second bill introduced by Senator Mitchell (S. 1367) and bills introduced in the House earlier this year by Representatives Pelosi (H.R. 2212) and Pease (H.R. 2468) state that the President may not recommend the continuation of the waiver in 1992 unless China meets certain conditions outright and has also made significant progress in other areas of behavior relating mainly to the human rights situation in China. A bill establishing other objectives (in addition to free emigration) that the President would have been required to take into account when deciding whether to extend the waiver for China in 1991 was introduced by Representative Pease in 1990 (H.R. 4939). It was passed in the House by a vote of 384 to 30, but was not voted on by the Senate prior to adjournment of the 101st Congress.

In late June, two "fast-track" joint resolutions disapproving President Bush's May 29 extension of the Jackson-Vanik waiver for China and two of the bills imposing conditions on the renewal of China's MFN status in 1992 moved to the floor of the Congress. In the House, the Committee on Ways and Means reported H.J. Res. 263, the resolution introduced by Representative Solomon, and H.R. 2212, the Pelosi bill, to which more conditions for renewal of MFN were added during markup in committee. In the Senate, The Committee on Finance reported S.J. Res. 153, the Cranston resolution, and S. 1367, the most recent Mitchell bill. Both the House and Senate are expected to take up these measures soon after the July 4 recess.

Beer in North America: Trouble Is Brewing

The brewing industry was expressly excluded from the reduction of barriers to trade accorded other alcoholic beverages under the United States-Canada Free-Trade Agreement (FTA), signed in 1987 and implemented at the start of 1989. The one specific mention of "beer and malt containing beverages" occurs in chapter 12 and consists of a grandfathering clause that recognizes existing practices governing the internal sale and distribution of beer. This provision allows the State and Provincial controls that were already in place at the time of the signing of the agreement to remain intact. The agreement, however, did commit both sides to refrain from introducing any further discriminatory practices. Now, 3 years into the bilateral agreement, procedures involving the sale of beer have become the focus of a number of acrimonious disputes on both sides of the border. Attempts to resolve the disputes have stretched from Ottawa, to Washington, and even to Geneva, as the GATT has been brought into the process.

U.S. claims re Canadian beer

In Canada, Provincial liquor boards have exclusive control over the listing, distribution, pricing, and sale of all alcoholic beverages. The procedures and requirements vary from Province to Province. In addi-

tion, the Provincial boards determine whether imported wines and beer may be sold in outlets other than Provincial liquor stores. The United States maintains that Canadian Provincial liquor boards discriminate against U.S. beer in regard to listing, distribution, and pricing. A "listing" is the term given to a particular alcoholic beverage product that is available for purchase. Provincial boards require U.S. producers to apply for a separate listing for every product sold in the Province. For example, a manufacturer that brews four different brands of beer must receive a different listing for each brand, as well as a separate listing for each type of container in which the beers are sold. (For example, bottles and cans require separate listings; different size containers also require separate listings.)

The locations where foreign beer may be sold are controlled by the liquor control boards. Although almost all Canadian beers are sold through private retail outlets, the sale of imported beer is generally restricted to Government-owned stores.

In September 1990, the Liquor Control Board of Ontario instituted a new policy that established minimum prices below which it will not buy beer. The United States maintains that such a policy could prevent certain U.S. brands from competing on the basis of price in the Ontario market.

In October 1990, Saskatchewan removed the last prohibition on the sale of U.S. beers at the Provincial level. Only four U.S. brands were allowed, and these had to be priced within a specific range. The range varied by between $4 and $6 per dozen for the same products sold in the Province of Alberta. While the Saskatchewan markup on U.S. beer was the same as for domestic products, U.S. beer was subject to an additional surcharge of over $3.50 per dozen to cover storage and shipping.

Canada has yet to bring its import regime into compliance with the findings of a 1988 GATT dispute settlement panel report. That report was the result of a successful EC complaint against Canadian Provincial liquor board restrictions. The panel found that certain Provincial practices were inconsistent with certain articles of the GATT.

As a result of these ongoing concerns, the United States initiated a section 301 investigation in June 1990. The investigation followed receipt of a complaint from U.S. breweries (G. Heileman Brewing Co. and Stroh Brewery Co.). The U.S. industry complained that Canada had not implemented the recommendations of the 1988 GATT panel, and that new discriminatory practices had been introduced in some Provinces. Among the new practices were discriminatory cost-of-service methodology and price determination, minimum import price requirements, discriminatory assessment of environmental taxes, discriminatory markups on draft beer, and failure to advertise new legal requirements. Since existing beer distribution restrictions were grandfathered in the United States-Canada FTA, the United States Trade Representative declined to pursue the U.S. industry's complaint via the bilateral pact dispute settlement mechanism. Instead, the matter was pursued in the GATT through its normal dispute settlement process, with bilateral consultations, and then the formation of a panel in February of this year. The GATT panel's report is due to be issued in August.

Canadian claims re U.S. beer

While the United States was pursuing the matter of unfair trade practices by Canadian Provincial liquor boards in the GATT, the Canadian Government initiated a dumping investigation against Heileman, Stroh, and the Pabst Brewing Co. in March 1991. The Canadian case was initiated by a complaint jointly filed by Labatt Breweries, Molson Breweries, and Pacific Brewing Co. These three companies account for about 98 percent of the beer produced in the Province of British Columbia, and have seen the market share of the three U.S. producers increase in the Province from 6.8 to 9.2 percent since 1988. The dumping case is currently at a point where Revenue Canada and the Canadian International Trade Tribunal (CITT) have each made preliminary determinations and found that imports from the United States are dumped and are likely to be causing injury to Canadian beer producers in British Columbia. A final determination by Revenue Canada is due in September, and the CITT is expected to make its final determination in October.

Another Canadian complaint concerns the special tax treatment accorded certain U.S. beer producers. The U.S. Federal excise tax on beer provides for reduced tax treatment on beers made by small U.S. producers, with no comparable treatment for foreign competitors. Canada maintains that the tax treatment discriminates against small Canadian producers.

In February 1991, while the United States was calling for the formation of a GATT panel to explore a variety of Canadian Provincial practices that limited U.S. beer, the Canadians, citing their problems with U.S. Federal and State regulations and practices, called for GATT consultations as well. The Government of Canada had also compiled a list of State practices that it considers to be discriminatory in the treatment of Canadian beer. (As an example of State practices, the Canadians cited tax exemptions provided for in-State brewers in eight States and preferential treatment afforded beer with less than 4% alcohol content in some States. Most Canadian beers contain 5%, and are thus not eligible for the preferential tax treatment.) Consultations are a preliminary step in the GATT to formal dispute resolution proceedings and panel formation. In May 1991 the United States agreed to the formation of a panel in the GATT to examine the Canadian complaints. The Canadian request for a panel review of its complaint is supported by Australia, the European Community, New Zealand, and Venezuela—all exporters of beer to the United States.

Conclusion

The beer disputes are continuing in the GATT and both will be examined by panels; eventually reports will be made as to the allegations and their compliance with GATT rules. The fact that similar complaints on the same product are being hurled on both sides of the border indicates that a significant amount of unfinished business remains to be addressed. Indeed, a number of issues were not fully resolved in the United States-Canada FTA, pending, among other things, the outcome of the Uruguay Round. One of the underlying tensions in the Round is how to handle subnational obligations (e.g. at the State or Provincial level). This is an issue in the government procurement and standards negotiations.

Canada has in fact been pursuing the issue of inter-Provincial barriers and their effect on domestic commerce. An inter-Provincial agreement addressing barriers to trade in beer within Canada, completed last year, does not address the principal concerns of the United States.

While the recently inaugurated negotiations toward a North American Free-Trade Agreement (NAFTA), that would include Mexico, Canada, and the United States, are not intended to reopen discussions of elements of the already concluded United States-Canada pact, the ongoing disputes involving imported beer sales might prove to be the catalyst for trilateral attention to the brewing industry. U.S. brewers have already signalled their desire to have Mexico's distribution of beer addressed in the NAFTA talks.

OECD Ministers Endorse Early Uruguay Round Conclusion

Highlights

Economics and trade Ministers from the 24 industrialized nations composing the Organization for Economic Cooperation and Development (OECD) met in Paris, France, on June 4 and 5, 1991 for their annual Council meeting. At the meeting, Ministers called an early conclusion of the Uruguay Round of multilateral trade negotiations a "top priority." A second highlight was the launching of the "Partners in Transition" programme to assist Czechoslovakia, Hungary, and Poland.

The ministers reiterated their support for policies aimed at smoothing structural adjustment and expanding international trade. They also signalled their intention to pursue work on the links between trade and the environment as well as domestic competition policies and their effect on trade. Industrial subsidies were also an area slated for future OECD work and possible disciplines. Disagreement over tied-aid export credits precluded final action on this issue, but a revised arrangement is expected by yearend.

In light of the recent economic slowdown, the Ministers affirmed their intention to pursue macroeconomic policies that support noninflationary growth. They stressed in addition the importance of ensuring that those policies actively promote structural change. The Ministers agreed that policies that meet this test will expand supply, increase employment opportunities, and permit the sustained growth with price stability that helps support both the OECD economies as well as those of nonmember states.

The Uruguay Round

In the area of international trade, the Ministers said the highest priority on the global economic agenda was an early conclusion of the Uruguay Round, preferably by the end of 1991. The Ministers recognized that to successfully finish the Round by yearend, all participants would need to make political decisions that would allow for intensive negotiations that yield substantial progress by the end of the summer. In endorsing the OECD Trade Committee report prepared for them, the Ministers further stated their resolve to conclude a substantial and wide-ranging global agreement in the Uruguay Round, rather than a smaller, less ambitious package of trade measures. The Ministers reaffirmed their Governments' "standstill" commitments to not take trade actions contrary to their obligations under the General Agreement on Tariffs and Trade (GATT), and rejected movement toward policies of managed trade, unilateralism, bilateralism, and sectoralism.

In the field of agriculture reform and disciplines, the Ministers acknowledged that limited progress has been made since defining their initial reform principles in 1987 and 1988. However, they reaffirmed their commitment to achieve substantial progressive reductions in agricultural support and protection, and to agricultural reform, particularly in the context of the Uruguay Round. They noted that participants in the Round have now agreed to conduct negotiations to achieve specific binding commitments in each of the three main areas under discussion: (1) domestic support, (2) market access barriers, and (3) export subsidies. This was also the first official confirmation by the European Community (EC) that it has accepted specific binding commitments in each of these areas as the aim of the Round's agriculture talks. This condition was worked out informally by GATT Director-General Arthur Dunkel and accepted by the EC in February 1991 and underpins the agreement by other countries to the resumption of the overall Uruguay Round talks (see May 1991 *IER*).

Emerging Trade Issues

The OECD has often served as a forum for initiating reviews of issues that lead later to negotiations over policies perceived as having an impact on international trade and investment. Its preparatory work in the early 1980s on agricultural reform, for example, has been instrumental to the Uruguay Round's efforts to craft solutions to recurring agricultural trade disputes. Work in the OECD on subjects such

as services and intellectual property laid similar foundations for Uruguay Round negotiations on services and trade-related aspects of intellectual property rights (TRIPs).

The Ministers touched upon trade issues emerging in the 1990s beyond the Uruguay Round, addressing the need for a more global perspective on aspects of various issues that traditionally have been considered largely domestic policy concerns. The Ministers stressed the need to expand consideration of trade policy issues to include links and interactions with competition, technology, investment, and environment policies. The Ministers also asked the OECD to continue to watch developments in the area of regional integration to ensure that such integration stimulates and strengthens multilateral liberalization efforts.

The Ministers highlighted several issues in the area of competition policy. They asked the OECD to continue its work on the interaction of competition policies with trade and industrial policies in an effort to strengthen policy convergence among member states. The Ministers marked the growing use of technology as a means of enhancing national competitiveness and encouraged further OECD examination of the relationship between competition policies and technology-related issues, particularly in the field of communications.

The Ministers restated their view that industrial subsidies typically hinder rather than improve structural adjustment and lead to trade-distorting effects and increased fiscal pressures. The Ministers invited the OECD to systematically monitor the use of industrial subsidies with a view towards the eventual definition of commonly accepted OECD guidelines on the use of industrial subsidies. Underlying this common approach is the concern of Ministers to address all industrial sectors in an integrated fashion under a single framework. Thus, the Ministers committed their Governments to provide the OECD Industry Committee with the necessary information to fashion internationally comparable data that would allow for negotiations, as in the previous OECD examination of agricultural support that underpinned current negotiations in the Uruguay Round. These common guidelines would permit a comprehensive approach to industrial competition disciplines to avoid the piecemeal arrangements by industrial sector, such as in shipbuilding or steel, that can be undermined by weaker disciplines elsewhere.

In the environment field, the Ministers drew attention to the progress made toward integrating economic and environmental decision making at the January 1991 meeting of the OECD Environment Committee. The Ministers endorsed the report prepared jointly by the OECD Trade and Environment Committees that identifies major connections between the areas of trade and environment policies. The joint report outlines a preliminary work program that the Ministers expect will lead to multilateral guidelines to cooperate and minimize possible conflicts in protecting both the environment and the open world trade system. They called for continued work to be reported at next year's OECD Ministerial meeting as well as possibly at the United Nations Conference on Environment and Development (UNCED) in June 1992.

Co-operation with Central and Eastern Europe

The Ministers indicated that the common values of pluralist democracy and market economies, which have proven a lasting basis for long-term economic and social development among OECD countries, are being increasingly pursued by non-member countries in central and Eastern Europe. As a consequence of the historical importance of their move away from authoritarian and centrally planned regimes toward more democratic and market-oriented states, the Ministers offered the expertise of the OECD to these countries in the field of technical aid on Government policy formulation that could eventually lead to their application for OECD membership. In particular, the Ministers said the Centre for Co-operation with European Economies in Transition (CCEET), set up under the auspices of the OECD, can play a role in forming a comprehensive and coherent assistance program for the Governments of central and Eastern Europe. They also emphasized the special services and assistance available from the OECD under the Centre's "Partners in Transition" (PIT) programme. Memoranda of understanding to establish PIT programs for the Czech and Slovak Federal Republic, Hungary, and Poland were signed June 4, 1991, during the OECD Ministerial conference.

The Partners in Transition program is specifically designed for countries that show a strong commitment to a rapid transition to pluralist democracy and a market economy. In general, this program will help a country prepare to meet the conditions for OECD membership through participation in the work of the OECD committees, where review of the partner country's economy can help counsel national authorities on how their reforms and other policy measures could affect different aspects of macroeconomic, sectoral, and structural performance. The PIT programs will also provide various forms of technical assistance to these countries, in addition to activities already underway through the CCEET. The particular content of each program, however, will be defined jointly between the Centre and the partner countries' authorities in response to specific needs in each country. An annual review of activities will be carried out by a special liaison committee for each country composed of representatives from OECD member countries, the partner country, the Centre, and the OECD Secretariat.

Export credits

Regarding export credits, the Ministers sought to agree that they would try to avoid tied-aid credits to central and Eastern Europe, excluding outright grants, food aid, and humanitarian aid. This represents one of two proposals concerning tied-aid cred-

its, neither of which was fully resolved at the Ministerial conference. The EC Commission said at the meeting that it wished to reserve its position on a U.S. proposal to ban or otherwise restrict tied-aid credits to central and eastern Europe. The U.S. proposal aims to prevent tied-aid loans from distorting trade to the region and thus proving harmful in the long run to these countries' economies.

On the broader subject of export credit subsidies, the Ministers asked at the 1990 OECD ministerial meeting for an agreement to reduce trade distortions stemming from tied-aid credits and officially supported commercial credits. They asked that a report on this subject be submitted to them in 1991 following negotiations on improved disciplines and transparency in the OECD Arrangement on Guidelines for Officially Supported Export Credits (known also as the OECD Export Credit Arrangement). While the Ministers had hoped to finalize the agreement at this year's conference, last-minute disagreements among the EC member states prevented a final report by June 1991, although Ministers voiced the hope that an agreement will be forthcoming by the end of 1991.

SPECIAL FOCUS

Rules of Origin in a North American Free-Trade Agreement (NAFTA)

One of the major issues in negotiating a free-trade agreement (FTA) with Mexico—or a North-American accord (NAFTA) also including Canada—is how to prevent third countries from taking undue advantage of the concessions the North-American partners will grant one another. Some say that an FTA or NAFTA will induce third countries—primarily Japan, South Korea, Taiwan, and Hong Kong—to channel production intended for the U.S. market through Mexico, and thereby circumvent tariff and nontariff trade barriers applicable to them.

The fear is that third countries may target the United States through the back door by exporting to Mexico and then, after some minor transformation—such as repackaging, assembly, dilution—reexport it to the U.S. market as a Mexican product. In addition, even though appropriate "rules of origin" could be put in place to prevent this strategy, some worry that third countries could still inundate the U.S. market with products from facilities built in Mexico for this purpose. A report issued in May by the Economic Strategy Institute of Washington, DC warns that " an agreement must . . . discourage the development of Mexico as first and foremost an export platform into the United States for third-country producers."[1]

Rules of origin — As described by the United States International Trade Commission, "Rules of origin are those laws, regulations, and administrative practices that are applied to ascribe a country of origin to products in international trade."[2] These rules are used to determine which goods imported by one FTA party from another, or by a grantor of unilateral trade preferences from the beneficiary country (such as under the Generalized System of Preferences) are eligible to benefit from the trade concessions accorded under a specific agreement or program, particularly when the inputs are not wholly produced in the pertinent country. Product eligibility varies from program to program, but is generally based on proof that the materials imported from a third country underwent "substantial transformation" in the preferential area, sometimes evidenced by a change in their tariff classification. In addition, a specified minimum "value-added" requirement of the beneficiary countries may also be imposed.

For example, the rules of origin of the United States-Canada Free-Trade Agreement (CFTA) are founded on the principle that third-country inputs must be transformed in specific ways, in some cases adding the condition of a 50-percent Canadian or United States combined value-added.[3] The Caribbean Basin Economic Recovery Act (CBERA) provides for rules of origin that are also based on "substantial transformation" (although they are determined by a different method than under the CFTA,) and include a value-added criterion. CBERA rules generally require no less than 35-percent value-added by Caribbean beneficiaries of which 15 percent may come from U.S. materials.[4] The United States-Israel Free-Trade Area (IFTA) has rules of origin similar to those established under CBERA.[5]

However, there are indications that for the purposes of an FTA with Mexico or a NAFTA, more extensive transformation of imported components and a larger North American contentis being contemplated. In its May 1 response to a letter to the President by Senator Bentsen and Representative Rostenkowski concerning negotiations with Mexico, the administration signaled its intention of seeking strong rules of origin in order to "to ensure that the benefits of NAFTA do not flow to mere passthrough operations exporting third-country products to the United States with only minimal assembly in Mexico." The administration promised that—

- Rules of origin will impose clear, tough, and predictable standards to the benefit of North American products.
- We will seek to strengthen the required North American content for assembled automotive products.
- We will consult closely with the private sector and Congress in designing these rules.[6]

Current suggestions on the level of North American content generally range from 50 to 75 percent. For example, Peter Morici of the University of Maine suggests 50 percent.[7] In his article *Our Back Door Will Need Double Locks,* Representative Esteban E. Torres, member of the House Banking, Finance and Urban Affairs Committee, suggests that "60 to 65 percent of a product, in either labor, parts or raw materials, come from countries party to this agreement."[8] The above-mentioned Economic Strategy Institute report recommends that "In order to qualify for liberalized trade treatment in a North American Free-Trade Area, goods made in Mexico should have to undergo double transformation (meaning two tariff classification changes) and contain at least 75 percent North American manufacturing content."

While most U.S. analysts appear to be advocating "high-content" rules of origin, some caution that an

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[1] Robert Cohen and Alan Tonelson, *Doing it Right: A Winning Strategy for U.S.-Mexico Trade,* Report of the Economic Strategy Institute, Washington, DC, May 1991, p. 5.

[2] *The Impact of Rules of Origin on U.S. Imports and Exports,* Report to the President on Investigation No. 332-192 Under Section 332 of the Tariff Act of 1930, USITC Publication 1695, April 1985.

[3] For more detail see *Assessment of Rules of Origin under the Caribbean Basin Economic Recovery Act,* USITC Publication 2381, May 1991, p. 12.

[4] Special rules for counting Puerto Rican content were recently added.

[5] *Assessment of Rules. . .,* ibid. p. 11.

6 *Administration Response to the Bentsen/Rostenkowski Letter on Mexico,* May 1, 1991, Executive Summary, p. 2.

[7] Peter Morici, "Trade Talks with Mexico: A Time for Realism," April 1991, p. 27.

8 Rep. Esteban E. Torres "Our Back Door Will Need Double Locks," *Los Angeles Times,* June 7, 1991.

overly cumbersome process of demonstrating origin could negate the expected benefits of North American integration. The General Accounting Office is currently investigating whether this is the case with the CFTA. Alternatively, stringent rules of origin could lead third-country exporters to the United States to "shop around" to qualify for reduced duties under some preferential U.S. programs (for example GSP) instead of trying to channel exports through Mexico. This would deprive Mexico from the benefits of foreign investment, without keeping the products in question off the U.S. market.

What position Mexico will adopt on the issue of "low-content"-rules *versus* "high-content"-rules of origin is not yet known. However, it is apparent that with a lower threshold requirement, Mexico could attract more foreign ventures because, in the words of Representative Torres, "with low-content rules of origin, a Japanese automobile assembled in Mexico could enter the United States duty-free, even though the bulk of its parts originated in Asia."[9]

It is widely recognized that Mexico sees the FTA's main allure to be its potential for attracting additional investment. Indeed, studies on the effects of an FTA on the Mexican economy predict significantly greater gains if the pact can be counted on to trigger major additional capital flows to Mexico. On these grounds, Mexico will probably object to the stringent origin rules the United States might propose.

Third-country investment in Mexico — Some express concern that discouraging third countries from targeting North American markets through Mexico might require more than rules of origin, however stringent. For example, Peter Morici argues that "rules of origin have no effect on purchases of capital equipment." He says that "With regard to components, FTA rules (presumably meaning free-trade agreements in general) are not that strict." He also notes that even with strict rules of origin, U.S. tariffs are generally low and will not constitute a major barrier to exports from Mexico.[10]

Some analysts seem to envisage third countries wanting to target North American markets from Mexico, even in the event that rules of origin would restrict these countries from passing their essentially domestically produced exports through the Mexican "backdoor." Reassured by a more stable investment environment in a NAFTA-affiliated Mexico, they would be attracted to combine their own technology, capital equipment, management resources and skills with cheap Mexican labor, and with the benefits of proximity to the U.S. market, even without the benefit of saving duties on home-produced inputs.

Furthermore, in industries where United States or Canadian nontariff trade restrictions are in effect, such as apparel, third-country investors in Mexico might also benefit from the phasing out of these barriers in a NAFTA. If so, new direct investments by third-countries drawn to Mexico exclusively with NAFTA markets in mind could develop into enough of a problem for the affected North American industries and labor to be considered a possible negotiating issue.

It would be ironic if it came to that, since the United States has traditionally held that foreign investment should have free access to Mexico, regardless of source. By contrast, until a few years ago, Mexico's isolationist policy had stipulated rigid controls of foreign ventures. However, in a sharp break with past policies, Mexico has come around to woo foreign investment into most sectors of its economy, although restrictions still exist in others.

Meanwhile, Japanese interest in the Mexican maquiladora industry—evidenced by the presence among them of Sony, Matsushita, Sanyo and Hitachi—began to raise concerns in the United States that these operations are aimed at circumventing U.S. trade restrictions or disguising the true levels of Japanese exports to the U.S. market. As of mid-1989, 58 of the 1,699 maquiladoras operating in Mexico were Japanese-owned, many of them incorporated as subsidiaries of Japanese operations in the United States. Japanese maquiladoras produce a wide range of products including televisions, cameras, electronics products, and household appliances.[11]

Between 1980 and 1990, Japan reportedly doubled its foreign direct investment in Mexico from $818 million to $1.7 billion.[12] The rate of increase slowed considerably in 1989 and 1990, reflecting Japanese concerns about the uncertainties of the Mexican investment climate.[13] Mexican officials are hoping that the promise of secure access to the U.S. market, along with the codifying effect of a NAFTA on Mexico's economic and investment reforms, will be sufficient to overcome a measure of diffidence demonstrated by Japanese and other foreign investors to date.

Indeed, according to some analysts, the prospect of a NAFTA reignited Japanese interest in Mexico. In his article "Japan in Mexico: Taking the Long View," Derek Ramsamooj, an international relations analyst, points out that "Japan is seizing the opportunity to export plants and equipment to Mexico, thereby stimulating a dependency relationship in terms of finance, maintenance, management and the distribution of output."[14]

Other East Asian countries are also very interested in Mexico. South Korean exports to the United States last year fell by some 6.3 percent. Koreans seem especially eager to increase their investments in Mexico. "Korea has no choice but to go to Mexico," said Minha Hwang, a trade analyst at Korea

[9] Ibid.
[10] Morici, ibid.

[11] See Diane Manifold, "Japanese Foreign Investments", in *International Economic Review,* June 1991, p. 19.
[12] Torres, ibid.
[13] Presentation of Takashi Eguchi, chief representative, Japan Center for International Finance, at a conference on January 11, 1991, in San Diego, CA on "Trade and Investment Prospects in Mexico."
[14] Derek Ramsamooj "Japan in Mexico: Taking the Long View," *Business Mexico,* May 1991, p.18.

Trade Promotion Corp., a Government-funded company promoting South Korean trade worldwide.[15]

Mexico, for its part, is now seeking to attract foreign investment from all over the world, not only from the North American countries. In Guadalajara, at a May 8 meeting of the Pacific Basin Economic Council (to which Mexico was recently admitted,) President Salinas de Gortari stated that "Mexico could serve as a bridge for Asian investment to the North American market" and expressed great interest in such investment, especially in high-value-added, high-technology industries.

Neither does it seem likely that Mexico would wish to exclude third-country investors targeting North American markets, even if by using their own equipment and materials these offer comparatively little backward linkage to the Mexican economy. In the words of Peter Morici, "Although it may serve Mexican interests to look more favorably on foreign investment projects that source parts and maximize employment in Mexico, it does not serve Mexican interests to insist that parts that cannot be sourced in Mexico be sourced in the United States, as opposed to Japan, Europe or elsewhere."[16]

In the United States, nascent concerns about third-country investors in Mexico stand now to be rekindled by the prospect of an FTA or NAFTA. Japanese and other East Asian countries are widely expected to begin positioning themselves inside the FTA/NAFTA area, worried about losing market share to preferential partners, or wishing to increase market share through enhanced competitiveness. (The other option of East Asian countries in these times of emerging regional economic formations—to form their own East Asian trade bloc, as recently proposed by Malaysia—also appears to be under active consideration, largely as a result of Japan's increased interest in broadening its sphere of influence.[17]) For example, Monica Durand, U.S. operations manager for PRISSA, the economic development arm of the State of Sonora, Mexico (based in Tucson, AZ and Sonora, Mexico) is quoted as saying: "The Asians are attracted to Mexico because they recognize that it is much more cost-effective to serve U.S. markets from there. . . . They (the Asians) are also preparing strategically to position themselves to take advantage of opportunities anticipated under the FTA."[18]

Some analysts have offered solutions in case export-oriented third-country investment in Mexico could become a problem for the United States or Canada in the context of an FTA or NAFTA.[19] Suggestions that Mexico consider granting preferential terms for direct investments by NAFTA partners, as opposed to investment from third countries, have been mentioned. For example, Laura d'Andrea Tyson of UCLA says that "A free-trade agreement could include, for example...more rapid elimination (in Mexico) of investment restrictions for U.S. firms than from other foreign investors.[20]

Also the Economic Strategy Institute report discusses what it considers a threat to the northern partners of third-country investment in Mexico. The authors offer suggestions for preventive measures, recommending among others that "over the short-term, third-country producers in Mexico should be required to export to third countries a certain portion of their Mexican production—say 30 percent. These rules would be phased out over a 10-year period."[21]

These and other suggestions have led some to warn that any attempt to apply differential rules on investment or determination of origin to third-country investors would bring cries of protest from affected countries, and undermine previous U.S. commitments to the GATT and OECD principles of "national treatment" for investment.[22]

The United States has traditionally endorsed the notion of harmonized rules of origin, that is, a standardization in the rules across country lines. Negotiators in the Uruguay Round (UR) are seeking to move toward harmonizing nonpreferential rules of origin—the rules that are used for determinations involving most–favored–nation status. A 3–year study of this harmonization, to follow a GATT UR agreement on rules of origin, will focus initially on origin changes that arise from changes in tariff classification due to "substantial transformation" or value–added during the production process. Any new GATT discipline could require legal and administrative changes to the way the United States implements its nonpreferential rules of origin. Thus far, there has been no agreement to pursue harmonization of preferential rules of origin.

Some question whether it is in the interest of the United States to dampen foreign investors' enthusiasm for Mexican facilities. An analysis prepared by Peat Marwick predicts that U.S. gains under an FTA with Mexico in terms of real incomes, wages, and trade with the world would double if additional

[15] Yuchol Nam, "Trade Pact May Bring Asians to Mexico," *Investors Daily*, Apr. 26, 1991.
[16] Morici, ibid., p. 27.
[17] See Manifold, ibid., p. 21.
[18] *Management Review*, June 1991.
[19] The scope of the problem would depend on many variables which are now open to argument. Such a variable is whether we are talking about transfer of facilities to Mexico that are already sources of U.S. imports, *versus* new third-country investment in Mexico.

[19]—*Continued*
For example, some claim that if an investment in Mexico represents a transfer of an existing production process from, say, Korea to Mexico with the result of shifting ongoing U.S. imports from Korea to Mexico, the United States might benefit from such a change. The reason is that whereas U.S. imports from Mexico are likely to result in Mexican purchases from the United States, reciprocity in trade from Korea is less likely.
[20] Laura D'Andrea Tyson, "Reality a snag in trade talks," *Cleveland Plain Dealer*, June 21, 1991, p.19.
[21] Cohen and Tonelson, ibid., p. 9.
[22] The national treatment concept is typically defined in the U.S. bilateral treaties of Friendship, Commerce and Navigations (FCN) and *The 1976 OECD Declaration on International Investment* as: "treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situations, to nationals, companies (or) products." (U.S. Dept. of the Treasury, *National Treatment Study*, 1990, p. 30.

capital were permitted to flow into Mexico freely, regardless of its source.[23] Mexico's gains would be even higher. According to Peat Marwick, in a scenario where an FTA is accompanied by unrestricted foreign capital influx to Mexico, the U.S. trade balance with Mexico would deteriorate by an estimated 20.79 percent, due to an increase in U.S. imports from Mexico by an estimated 6.05 percent. However, this deterioration would be more than offset by an overall improvement of the U.S. trade balance with the rest of the world, and result in a 0.07-percent improvement in the overall U.S. balance.[24]

Conclusion.—It appears that in order to develop a position on the probable effect of third-country investment in Mexico on the United States (or Canada) in a NAFTA, the United States (and Canada) would need to clarify a few concepts in the near future. Principal pertinent questions include the following: Is it possible that new third-country investment in Mexico geared principally to supply North American markets will develop into a problem for the United States (or Canada) in the NAFTA context? If so, would appropriate rules of origin satisfactorily address any threat of penetration in all its possible forms, and how stringent should these rules be? Furthermore, if rules of origin would not fully resolve the problem, should additional ways be considered to discourage third countries from using Mexico as an export platform to NAFTA markets? Should this kind of thinking be restricted to those industries where a NAFTA will phase out high U.S. tariffs and existing nontrade barriers—such as apparel—with the effect of making Mexico an especially attractive base for third-country exporters to the U.S. market?

Translated into the urgent task of formulating U.S. negotiating positions, should there be anything other than rules of origin on the table to prevent "back-door penetration?" Would, for example, limiting the portion of overall sales to North American markets from the new third-country facilities in Mexico be viable? Or is it advisable to propose that Mexico grant preferential terms for new direct investments of NAFTA partners *versus* those of third countries? And last but not least, would these and possibly other similar negotiating points be compatible with the traditional U.S. position of supporting unrestricted transborder capital flows, or with GATT and OECD rules on foreign investment?

[23] KPMG Peat Marwick, *The Effects of a Free Trade Agreement Between the US and Mexico*, February 1991

[24] Ibid., p.13.

STATISTICAL TABLES

Industrial production, by selected countries and by specified periods, January 1988–April 1991

(Percentage change from previous period, seasonally adjusted at annual rate)

				1990					1991				
Country	*1988*	*1989*	*1990*	*II*	*III*	*IV*	*Nov.*	*Dec.*	*I*	*Jan.*	*Feb.*	*Mar.*	*Apr.*
United States	5.4	2.6	1.0	4.3	4.0	–7.2	–17.1	–11.5	–9.6	–6.5	–9.7	–7.7	1.1
Japan	9.5	6.2	4.6	7.7	9.8	7.1	–8.9	–8.1	–0.8	17.1	–6.3	–14.1	(1)
Canada	4.4	2.3	0.3	0.7	0.5	4.7	2.2	0	–0.4	1.1	–4.2	–4.3	(1)
Germany	3.2	5.2	5.9	0.8	8.5	6.7	–2.9	2.0	(1)	(1)	–10.3	(1)	(1)
United Kingdom	3.7	0.3	–0.8	7.3	–12.4	–6.1	–16.4	–7.6	–0.4	–7.7	21.2	2.3	(1)
France	4.1	3.6	1.0	6.1	6.0	–10.4	–21.8	–17.8	0.1	2.8	–6.2	–27.8	(1)
Italy	6.9	3.9	–0.7	1.0	–1.2	–8.1	–12.5	–1.0	3.9	6.7	–13.4	2.1	(1)

[1] Not available.

Note.—Data presented for Germany includes information only for what was once West Germany. When data for the combined Germanys are available, they will be used.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, May 31, 1991.

Consumer prices, by selected countries and by specified periods, January 1988–April 1991

(Percentage change from previous period, seasonally adjusted at annual rate)

				1990						1991			
Country	*1988*	*1989*	*1990*	*II*	*III*	*IV*	*Oct.*	*Nov.*	*Dec.*	*Jan.*	*Feb.*	*Mar.*	*Apr.*
United States	4.1	4.8	5.4	3.9	6.9	7.0	7.5	3.7	3.6	5.5	2.7	–0.9	2.7
Japan	0.7	2.3	3.1	2.3	3.2	6.2	12.9	5.7	1.1	12.5	–2.7	2.2	–3.5
Canada	4.0	5.0	4.8	2.8	4.1	6.9	10.3	8.3	2.1	33.2	–2.7	5.1	2.5
Germany	1.3	2.8	2.7	1.8	3.6	4.3	8.4	–2.3	1.4	2.1	1.6	1.5	2.5
United Kingdom	4.9	7.8	9.5	15.5	9.8	6.3	7.8	–2.2	5.0	4.5	4.4	5.3	2.4
France	2.7	3.5	3.4	2.7	4.2	4.5	6.0	–0.5	1.7	4.7	2.2	1.1	0.3
Italy	5.0	6.6	6.1	5.4	7.2	6.9	6.5	6.8	6.1	6.8	8.8	4.5	5.7

[1] Not available.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, May 31, 1991

Note.—Data presented for Germany includes information only for what was once West Germany. When data for the combined Germanys are available, they will be used.

Unemployment rates, (total labor force basis)[1] by selected countries and by specified periods, January 1988–April 1991

(Percent)

				1990					1991				
Country	*1988*	*1989*	*1990*	*II*	*III*	*IV*	*Nov.*	*Dec.*	*I*	*Jan.*	*Feb.*	*Mar.*	*Apr.*
United States	5.4	5.2	5.4	5.2	5.5	5.8	5.8	6.0	6.4	6.1	6.4	6.8	6.5
Japan	2.5	2.3	2.1	2.1	2.1	2.1	2.1	2.0	2.1	2.0	2.0	2.1	(4)
Canada	7.7	7.5	8.1	7.4	8.1	9.1	9.0	9.3	10.1	9.6	10.2	10.4	10.2
Germany	6.2	5.6	5.2	5.3	5.2	4.8	4.7	4.7	4.5	4.5	4.5	4.4	4.4
United Kingdom	8.2	6.4	6.4	6.1	6.2	6.7	6.7	7.0	8.1	7.7	8.1	8.5	8.9
France	10.1	9.9	9.2	9.1	9.2	9.2	9.4	9.3	9.2	9.2	9.2	9.3	9.4
Italy[2]	7.8	7.7	6.9	6.7	6.7	6.8	(3)	(3)	7.1	(3)	(3)	(3)	(3)

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

[2] Many Italians reported as unemployed did not actively seek work in the past 30 days, and they have been excluded for comparability with U.S. concepts. Inclusion of such persons would increase the unemployment rate to 11–12 percent in 1986–1990.

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

[4] Not available.

Source: *Unemployment Rates in Nine Countries*, U.S. Deapartment of Labor, June 1991.

Money–market interest rates,[1] by selected countries and by specified periods, January 1988–May 1991

(Percentage, annual rates)

Country	1988	1989	1990	1990						1991					
				II	III	IV	Oct.	Nov.	Dec.	I	Jan.	Feb..	Mar.	Apr.	May
United States	7.8	9.3	8.3	8.4	8.2	8.1	8.1	8.0	7.8	6.8	7.2	6.5	6.5	6.1	5.9
Japan	4.4	5.3	6.9	6.7	6.9	7.5	([2])	7.5	7.7	7.7	([2])	7.7	([2])	([2])	([2])
Canada	9.6	12.2	13.0	13.7	13.1	12.3	12.5	12.4	11.9	10.5	11.1	10.4	9.9	9.6	([2])
Germany	4.3	7.0	8.5	8.3	8.4	8.9	8.6	8.9	9.2	9.1	9.3	9.0	9.1	9.1	([2])
United Kingdom	8.9	13.3	14.8	15.1	14.9	13.8	13.9	13.6	13.8	13.1	13.9	13.1	12.4	11.8	([2])
France	7.9	9.2	10.3	9.9	10.2	10.1	10.0	10.1	10.2	9.7	10.3	9.6	9.4	9.2	([2])
Italy	11.0	12.7	12.7	12.7	11.8	13.0	11.7	13.1	14.0	14.0	11.1	12.3	12.4	11.9	([2])

[1] 90–day certificate of deposit.

[2] Not available.

Note.—Data presented for Germany includes information only for what was once West Germany. When data for the combined Germanys are available, they will be used.

Source: *Federal Reserve Statistical Release, April 22, 1991 Economic and Energy Indicators*, Central Intelligence Agency, May 31, 1991.

Effective exchange rates of the U.S. dollar, unadjusted for inflation differential, by specified periods, January 1988–May 1991

(Percentage change from previous period)

Item	1988	1989	1990	1990				1991					
				IV.	Oct.	Nov..	Dec.	I	Jan.	Feb.	Mar.	Apr.	May
Unadjusted:													
Index[1]	88.0	91.3	86.5	81.7	81.8	81.1	82.2	82.8	82.2	81.1	87.4	86.8	87.3
Percentage change	–6.5	6.4	–5.3	–4.2	–2.8	–.8	1.3	1.3	0	–1.3	7.2	–.7	.6
Adjusted:													
Index[1]	87.4	91.8	88.1	84.1	83.9	83.4	84.7	85.2	84.9	84.0	85.1	89.1	89.3
Percentage change	–4.8	6.8	–4.0	–3.1	–2.0	–.5	1.5	1.3	.2	–1.1	1.3	4.5	.2

[1] 1980–82 average=100.

Note.—The foreign–currency value of the U.S. dollar is a trade–weighted average in terms of the currencies of 15 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, June 1991.

Trade balances, by selected countries and by specified periods, January 1988–April 1991

(In billions of U.S. dollars, f.o.b. basis, at an annual rate)

Country	1988	1989	1990	1990 II	III	IV	Nov.	Dec.	1991 I	Jan.	Feb.	Mar.	Apr.
United States[1]	–118.5	–109.1	–100.5	–90.8	–104.4	–104.4	–114.4	–75.9	–68.4	–88.5	–66.0	–48.8	–57.3
Japan	94.9	77.4	63.2	57.6	65.2	66.0	66.0	68.4	86.8	82.8	80.4	97.2	([3])
Canada	8.2	5.9	9.3	10.4	11.2	9.6	12.0	10.8	7.2	2.4	7.2	12.0	([3])
Germany[2]	72.9	72.0	60.4	67.2	50.0	32.8	13.2	26.4	11.6	–3.6	25.2	12.0	([3])
United Kingdom	–37.5	–39.3	–32.0	–35.6	–28.0	–23.2	–24.0	–19.2	–22.4	–30.0	–16.8	–20.4	([3])
France	–5.5	–7.0	–9.4	–7.6	–15.6	–13.6	–1.2	–21.6	–13.2	–13.2	–8.4	–10.8	([3])
Italy	–11.1	–13.0	–11.8	–8.0	–12.0	–17.2	–33.6	4.8	–3.6	–21.6	–4.8	14.4	([3])

[1] 1986, exports, f.a.s. value, adjusted; imports, c.i.f. value, adjusted. Beginning with 1987, figures were 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] Imports, c.i.f value, adjusted.

[3] Not available.

Note.—Data presented for Germany includes information only for what was once West Germany. When data for the combined Germanys are available, they will be used.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, May 31 1991 and *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, June 19, 1991.

U.S. trade balance[1], by major commodity categories,and by specified periods, January 1988–April 1991

(In billions of dollars)

Country	1988	1989	1990	1990 II	III	IV	Oct.	Nov.	Dec.	1991 I	Jan.	Feb.	Mar.	Apr.
Commodity categories:														
Agriculture	13.9	17.9	16.3	4.1	3.3	4.2	1.2	1.6	1.4	4.4	1.2	1.6	1.6	1.0
Petroleum and selected product—(unadjusted)	–38.1	–44.7	–54.6	–10.8	–13.5	–16.2	–6.4	–5.4	–4.3	–10.4	–4.5	–2.8	–3.1	–3.3
Manufactured goods	–146.1	–103.2	–90.1	–19.5	–27.0	–24.3	–10.4	–8.6	–5.3	–14.7	–5.8	–5.7	–3.2	–3.6
Selected countries:														
Western Europe	–12.5	–1.3	4.0	2.9	–.8	.6	–.6	–.4	1.6	5.7	1.1	1.4	3.2	2.1
Canada[2]	–9.7	–9.6	–7.5	–1.3	–2.7	–2.8	–1.3	–.6	–.9	–1.4	–.4	–.5	–.5	–.2
Japan	–51.7	–49.0	–41.0	–9.9	–9.9	–11.7	–4.5	–3.8	–3.4	–10.3	–3.5	–3.2	–3.6	–3.3
OPEC (unadjusted)	–8.9	–17.3	–24.3	–4.3	–6.6	–7.1	–2.7	–2.5	–1.9	–4.3	–2.0	–1.3	–1.0	–1.0
Unit value of U.S.imports of petroleum and selected products (unadjusted)[3]	$18.12	$16.80	$20.34	$15.59	$19.45	$28.20	$30.09	$29.56	$25.70	$19.57	$22.98	$18.58	$17.15	$16.40

[1] Exports, f.a.s. value, unadjusted.1986–88 imports, c.i.f. value, unadjusted; 1989 imports, customs value, unadjusted.

[2] Beginning with February 1987, figures include previously undocumented exports to Canada.

[3] Beginning with 1988, figures were adjusted to reflect change in U.S.Department of Commerce reporting of imports at customs value, seasonally unadjusted, rather than c.i.f. value.

Source: Advance Report on U.S. Merchandise Trade, U.S. Department of Commerce, June 19, 1991.

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