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INTERNATIONAL TRADE DEVELOPMENTS

NAFTA Panel Report On Agricultural Dispute Released

A longstanding dispute between the United States and Canada over agriculture officially came to an end with the release of the panel report. The problem is the result of differing interpretations of rights and obligations under both the North American Free-Trade Agreement and the WTO Uruguay Round Agreement. A unanimous decision by the panel upheld the Canadian position.
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INTERNATIONAL ECONOMIC COMPARISONS

U.S. Economic Conditions

Real gross domestic product increased at a seasonally adjusted annual rate of 2.0 percent in the third quarter of 1996, according to preliminary estimates of the U.S. Department of Commerce. This increase followed a much larger increase in the second quarter of 4.7 percent.

Slower GDP growth in the third quarter was caused by declines in major GDP components: personal consumption expenditure, government spending, residential investment and exports. The acceleration in other GDP components: nonresidential fixed investment particularly in producers' durable equipment and inventory investments, moderated the third quarter's GDP downward slide.

Personal Consumption expenditure

Real personal consumption expenditures, GDP largest component, rose in the third quarter, by 0.6 percent compared with an increase of 3.4 percent in the second quarter. Consumer spending on durable goods declined by 2.0 percent in the third quarter, having increased by 11.4 percent in the second. Nondurable goods spending increased by 0.3 percent in the third quarter compared to an increase of 1.3 percent in the second quarter, and spending on services increased by 1.3 percent in the third quarter compared to an increase of 2.7 percent in the second quarter.

Factors that normally account for the decline in consumer spending, include rising unemployment and interest rates; declining disposable personal incomes; high consumer levels of debt and declining indexes of consumer confidence. The slow growth of disposable personal income most likely has lead to the decline in consumer spending. Most recent data show real disposable personal income has declined by 0.1 percent in July, increased by 0.5 percent in August and deccreaed by 0.1 percent in September following larger increases in the second quarter.

Federal Government consumption and gross investment

Real Federal Government consumption expenditures and gross investment decreased by 3.4 percent in the third quarter after increasing by 9.4 percent in the second quarter. National defense spending decreased by 5.2 percent in contrast to an increase of 10.0 percent in the second quarter.

Exports, imports, and trade balance

Exports declined by $1.8 billion to $816.1 billion in the third quarter from the second; imports increased by $22.2 billion to $954.8 billion and the trade deficit grew to $138.7 billion from $114.7 billion in the second quarter.

Nonresidential fixed investment

Partially compensating for the decline in consumer spending were the increases in nonresidential fixed investment and in business inventory investment. Nonresidential fixed investment increased by 16.9 percent in the third quarter compared with an increase of 3.8 percent in the second quarter. Producers' durable equipment investment demonstrated the largest increase, rising by 20.3 percent compared with an increase of 6.7 percent in the second quarter.

Business inventory investment

Business inventory investment increased, raising real GDP in the third quarter by $25.7 billion after adding $10.1 billion to second quarter GDP change. Businesses increased their inventories by $32.8 billion following an increase of $7.1 billion in the second quarter.

Forecasts for 1997

In 1997, the U.S. economy is expected to grow at a similar rate of the past year. A consensus of forecasters expects growth to average 2.4 percent. Unemployment is expected to hover around 5.4 percent. Inflation is projected to remain at 2.5 to 2.7 percent. And, unless an unexpected development disrupts this trend, this projected economic growth rate could be maintained. Consequently, the Federal Reserve Board is expected to keep key interest rates within relatively small margins of change.

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

Economic growth

As mentioned earlier, U.S. real GDP—the output of goods and services produced in the United States measured in 1992 prices—grew at a revised annual rate of 2.0 percent in the third quarter of 1996, following an increase of 4.7 percent in the second quarter.

The annualized rates of real GDP growth in the third quarter of 1996 were 3.3 percent in Canada, 3.7 percent in France, 3.3 percent in Germany, 2.0 percent in Italy, 0.4 percent in Japan and 2.6 percent in the United Kingdom.

Industrial production

The Federal Reserve Board reported that U.S. industrial production (IP) increased by 0.8 percent in December 1996, following similar gain in November 1996. The output of non-energy consumer goods, business equipment, and non energy materials advanced sharply. The output of utilities declined due to the unseasonably mild weather in December. Manufacturing output increased by 1.1 percent in December and was 5.6 percent higher than it was in December 1995. Total industrial production in December 1996 was 5.1 percent higher than it was in December 1995. In the fourth quarter, industrial production grew by a 4.1-percent annual rate down from a 4.5-percent increase in the third quarter. Total industrial capacity utilization edged up by 0.4 percentage points, to 83.3 percent and was 4.0 percent higher than in December 1995.

Other Group of Seven (G-7) member countries reported the following growth rates of industrial production. For the year ending November 1996, Japan reported a 4.0-percent increase, Germany reported a 1.3 percent increase, the United Kingdom reported a 1.3 percent increase and Italy reported a 5.9 percent decrease. For the year ending October 1996, Canada reported a 2.8 percent increase and France reported a 1.4 percent increase.

Prices

Seasonally adjusted U.S. Consumer Price Index (CPI) rose 0.3 percent in November 1996 following the same increase in October. For the 12-month period ended in November 1996, the CPI increased by 3.3 percent, up from 3.2 percent in the previous 12 months.

During the 1-year period ending November 1996, prices increased by 2.0 percent in Canada, by 1.6 percent in France, by 1.4 percent in Germany, by 2.6 percent in Italy, by 0.5 percent in Japan, and by 2.7 percent in the United Kingdom.

Employment

The Bureau of Labor Statistics reported that nonfarm payroll employment increased by 262,000 in December, and the unemployment rate was unchanged at 5.3 percent.

December jobless rates for the major worker groups—adult men (4.4 percent), adult women (4.9 percent), teenagers (16.5 percent), whites (4.6 percent), blacks (10.5 percent), and Hispanics (7.7 percent)—showed little or no change over the month.

Employment in the services industry increased by 112,000 in December, the largest gain since May. Increases occurred in nearly all components of the industry. Business services added 45,000 jobs, following a small loss in November. Computer services employment continued its rapid rise. Help supply added 12,000 jobs in December, following a net decline over the prior 3 months. Also job gains continued in health services, engineering and management services, and amusement and recreation

Retail trade employment rose by 48,000 in December. Much of the gain was in eating and drinking places. In December, employment continued to rise in furniture and home furnishings stores and building supplies retailers, each of which added workers at a brisk pace in 1996. Following strong seasonal hiring in October, employment in general merchandise stores declined in November and December, after seasonal adjustment. Wholesale trade showed sluggish job growth for the second straight month.

Employment in transportation and public utilities edged up by 5,000 in December, as strength in air transportation more than offset declines in trucking,

communications, and public utilities. Finance, insurance, and real estate employment rose by 17,000 in December, continuing its relatively strong growth trend. Gains were concentrated in finance, particularly in nondepository institutions, security brokerages, and other investment offices.

Manufacturing added 19,000 jobs in December. Over-the-month job growth was widespread, with notable increases occurring in aircraft and in food and kindred products. From September through December, factory employment increased by 32,000. Despite this gain, 94,000 factory jobs were lost in 1996, as steep declines in nondurable goods industries were only partially offset by gains in durables.

Aided by unusually mild weather across most of the country, employment in the construction industry rose by 23,000 in December. Over the year, construction employment increased by 287,000, more than two and one-half times the rise in the prior year.

In other G-7 countries, their latest employment rates in 1996 were as follows: 10.0 percent in Canada, 12.7 percent in France, 10.7 percent in Germany, 12.2 percent in Italy, 3.2 percent in Japan, and 6.9 percent in the United Kingdom.

Forecasts

Six major forecasters expect real growth in the United States to average around 2.3 percent (annual rate) in the fourth quarter of 1996, table 1. In the first half of 1997, growth is expected to average around 2.4 percent annual rate. Factors that are most likely restrain growth in the fourth quarter of 1996 and in the first half of 1997 could include slowing consumer spending, and the contractionary impact of the decline in government spending and investment if unaccompanied by monetary policy easing. Table 1 shows macroeconomic projections 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 1997. Inflation (as measured by the GDP deflator) is expected to remain subdued at an average rate of about 2.5 to 2.7 percent.

U.S. International Transactions U.S. Current account

The U.S. current-account deficit increased to $48.0 billion in the third quarter, from $40.2 billion in the second quarter, according to estimates of the Commerce Department. The increase was accounted for by increases in the deficit on goods and services and the deficit on investment income.

The deficit on goods and services

The deficit on goods and services increased to $33.8 billion in the third quarter from $28.6 billion in the second. The deficit on goods increased to $51.6 billion in the third quarter from $47.0 billion in the second. Goods exports decreased to $149.9 billion from $153.1 billion. Nonagricultural exports accounted for virtually all of the decrease. Goods imports increased to $201.5 billion from $200.1 billion. Both petroleum and nonpetroleum imports increased.

The surplus on services decreased to $17.8 billion in the third quarter from $18.4 billion in the second. Service receipts decreased to $55.6 billion from $55.9 billion. Decreases in travel and in passenger fares more than offset an increase in "other" private services.

Service payments increased to $37.8 billion from $37.5 billion. Increases in royalties and license fees (which included payments for broadcast rights to the Summer Olympics) and in "other" private services more than offset decreases in travel and in passenger fares.

The deficit on investment income

The deficit on investment income increased to $4.7 billion in the third quarter from $2.3 billion in the second. Income receipts on U.S. assets abroad edged up to $48.3 billion from $48.0 billion. The increase was almost entirely accounted for by a rise in "other" private receipts.

Income payments on foreign assets in the United States increased to $53.0 billion from $50.3 billion. U.S. Government payments rose strongly, reflecting substantial foreign acquisitions of U.S. Treasury securities in recent quarters. Direct investment payments also rose strongly.

Table 1
Projected changes of selected U.S. economic indicators, by quarters, July 96–June 97
(Percent)

Period	Conference Board	E.I. Dupont	UCLA Business Forecasting Project	Merrill Lynch Capital Markets	Data Resources Inc. (D.R.I.)	Wharton WEFA Group	Mean of 6 forecasts
			GDP current dollars				
1996:							
July-Sept	3.8	3.8	3.8	3.6	3.8	3.8	3.7
Oct.-Dec	7.2	4.5	5.0	3.2	3.8	4.3	4.6
1997:							
Jan.-Mar	6.8	4.9	5.8	4.0	4.9	4.4	5.1
Apr.-June	7.2	4.5	5.0	3.9	4.4	4.3	4.9
			GDP constant (chained 1992) dollars				
1996:							
July-Sept	2.0	2.0	2.2	2.0	2.6	2.0	2.1
Oct.-Dec	3.9	1.9	2.2	1.6	2.2	1.9	2.3
1997							
Jan.-Mar	3.3	2.3	2.5	1.8	2.4	1.9	2.4
Apr.-June	3.6	2.3	2.2	1.8	2.5	1.8	2.4
			GDP deflator index				
1996:							
July-Sept	1.8	1.6	1.6	1.6	0.9	1.8	1.6
Oct.-Dec	3.2	2.6	2.7	1.6	1.6	2.3	2.3
1997:							
Jan.-Mar	3.4	2.6	3.2	2.2	2.5	2.5	2.7
Apr.-June	3.6	2.2	2.7	2.1	1.9	2.4	2.5
			Unemployment, average rate				
1996:							
July-Sept	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Oct.-Dec	5.3	5.3	5.2	5.3	5.2	5.3	5.3
1997:							
Jan.-Mar	5.1	5.4	6.2	5.3	5.3	5.4	5.3
Apr.-June	4.9	5.4	6.2	5.3	5.4	5.5	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: November 1996.

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

Capital account

Net recorded capital inflows were $69.3 billion in the third quarter, compared with $49.8 billion in the second. Acquisitions of U.S. assets by foreign residents accelerated more than acquisitions of foreign assets by U.S. residents.

U.S. assets abroad

U.S. assets abroad increased $54.7 billion in the third quarter, compared with an increase of $50.7 billion in the second.

U.S. claims on foreigners reported by U.S. banks increased $32.5 billion in the third quarter, following virtually no change in the second. The increase was attributable both to a surge in banks' domestic customers' claims and an increase in banks' own claims.

Net U.S. purchases of foreign securities were $21.3 billion in the third quarter, up from $20.2 billion in the second. The increase was more than accounted for by a large step up in net U.S. purchases of foreign bonds. Net U.S. purchases of foreign stocks decreased sharply.

Net capital outflows for U.S. direct investment abroad were $8.4 billion in the third quarter, down sharply from $26.2 billion in the second. The decrease was more than accounted for by a large shift to net intercompany debt inflows. Reinvested earnings

decreased by a small amount, and net equity capital outflows picked up.

Foreign assets in the United States

Foreign assets in the United States increased $124.0 billion in the third quarter, compared with an increase of $100.5 billion in the second.

U.S. liabilities to foreigners reported by U.S. banks, excluding U.S. Treasury securities, increased $0.3 billion in the third quarter, following an increase of $1.9 billion in the second, indicating little U.S. demand for funds from overseas .

Net foreign purchases of U.S. Treasury securities were a record $42.0 billion in the third quarter, up from $31.2 billion in the second, partly reflecting a shift in investor preferences from stocks to bonds.

Net foreign purchases of U.S. securities other than U.S. Treasury securities were $33.0 billion in the third quarter, up from $29.1 billion in the second. A strong increase in net foreign purchases of U.S. corporate and other bonds more than offset a sharp decrease in net foreign purchases of U.S. stocks.

Net capital inflows for foreign direct investment in the United States were $25.1 billion in the third quarter, up from $17.4 billion in the second. The increase was mostly accounted for by a rise in net equity capital inflows. In addition, both net intercompany debt inflows and reinvested earnings also increased.

Foreign official assets in the United States increased $23.6 billion in the third quarter, following an increase of $13.6 billion in the second. The step-up resulted from increased accumulation of dollar assets by developing countries. Table 2 shows a summary of U.S. current account.

Table 2
Summary of U.S. current account, 1995-1996-IIQ-IIIQ
(Billion dollars)

Item	1995	1995 IIQ	1996 IIQ	1996 IIIQ
Balance on goods	-173.4	-42.5	-47.0	-51.6
Balance on services	68.4	18.2	18.4	17.8
Balance on goods & services	-105.1	-24.3	-28.6	-33.8
Balance on investment income	-8.0	-4.4	-2.3	-4.7
Balance on goods, services &	-113.1	-28.7	-30.8	-38.5
Unilateral transfers	-35.1	-9.0	-9.4	-9.4
Balance on current account	-148.1	-37.7	-40.2	-48.0
U.S. assets abroad, net (increase, capital outflow (-))	-307.9	-108.3	-50.7	-54.7
Foreign assets in the United States, net (increase/ capital inflow (+))	424.5	118.8	100.6	124.0
Net capital inflows	116.6	10.5	49.9	69.3

Source: U.S. Department of Commerce.

U.S. TRADE DEVELOPMENTS

The U.S. Department of Commerce reported that seasonally adjusted exports of goods and services of $71.7 billion and imports of $79.7 billion in October 1996 resulted in a goods and services trade deficit of $8.0 billion, $3.4 billion less than the $11.4 billion deficit in September. The October 1996 deficit was approximately $1.1 billion more than the deficit registered in October 1995 ($6.9 billion) and virtually equal to the average monthly deficit registered during the previous 12 months (approximately $8.0 billion).

The October 1996 trade deficit on goods was $14.1 billion, approximately $3.4 billion lower than the September deficit ($17.5 billion). The October 1996 services surplus was $6.1 billion, $16 million higher than the September services surplus ($6.1 billion).

In the January-October period, total U.S. exports of goods and services increased by $41.2 billion over the corresponding period of previous year, to a record of $691.6 billion. Total imports increased by roughly $43.1 billion to $786.1 billion.

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 3. Nominal export changes and trade balances for specific major commodity sectors are shown in table 4. U.S. exports and imports of goods with major trading partners on a monthly and year-to-date basis are shown in table 5, and U.S. trade in services by major category is shown in table 6.

Table 3
U.S. trade in goods and services, seasonally adjusted, Sept.-Oct. 1996
(Billion dollars)

Item	Exports Oct. 96	Exports Sept. 96	Imports Oct. 96	Imports Sept. 96	Trade balance Oct. 96	Trade balance Sept. 96
Trade in goods (BOP basis)						
Current dollars—						
Including oil	52.9	50.3	67.0	67.8	-14.1	-17.5
Excluding oil	52.9	50.8	60.3	61.2	-7.4	-10.4
Trade in services						
Current dollars	18.8	18.5	12.7	12.4	6.1	6.1
Trade in goods and services						
Current dollars	71.7	68.8	79.7	80.3	-8.0	-11.4
Trade in goods (Census basis)						
1992 dollars	57.2	54.6	68.5	69.5	-11.3	-14.9
Advanced-technology products (not seasonally adjusted)	13.9	12.3	11.6	11.3	2.3	1.0

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)*, Dec. 19, 1996.

Table 4
Nominal U.S. exports and trade balances, of agriculture and specified manufacturing sectors, Jan. 1995-Oct. 1996

Sector	Exports Oct. 1996	Exports Jan.-Oct. 1996	Change Oct. 1996 over Sept. 1996	Change Jan.-Oct. 1996 over Jan.-Oct. 1995	Share of total, Jan.-Oct. 1996	Trade balances, Jan.-Oct. 1996
	Billion dollars		*Percent*			*Billion dollars*
ADP equipment and office machinery	3.4	32.6	6.2	12.0	6.3	-22.0
Airplanes	2.0	14.9	66.7	30.7	2.9	11.7
Airplane parts	1.0	9.7	11.1	14.1	1.9	6.9
Electrical machinery	5.0	47.0	8.7	7.1	9.1	-16.4
General industrial machinery	2.4	22.1	14.3	9.4	4.3	0.8
Iron & steel mill products	.4	4.0	0	-9.1	0.8	-7.0
Inorganic chemicals	.4	3.9	0	5.4	0.8	-0.2
Organic chemicals	1.3	12.4	8.3	-8.1	2.4	0
Power-generating machinery	2.1	18.3	10.5	1.1	3.5	-0.5
Scientific instruments	1.8	17.0	12.5	11.1	3.3	6.8
Specialized industrial machinery	2.2	21.3	10.0	10.9	4.1	5.9
TVs, VCRs, etc	1.9	16.2	11.8	3.8	3.1	-11.9
Textile yarns, fabrics and articles	.7	6.5	0	8.3	1.3	-2.0
Vehicle parts	4.6	41.0	7.0	1.5	7.9	-44.7
Manufactured exports not included above	14.0	133.9	8.5	7.6	25.9	-75.3
Total manufactures	43.2	400,8	10.5	7:2	77.6	-147.9
Agriculture	5.1	48.4	18.6	9.0	9.4	21.3
Other exports not included above	7.8	67.3	8.3	3.5	13.0	-14.1
Total exports of goods	56.1	516.5	10.9	6.9	100.0	-140.7

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)*, Dec. 19, 1996.

Table 5
U.S. exports and imports of goods with major trading partners, Jan. 1995-October 1996
(Billion dollars)

Country/area	Exports Oct. 96	Exports Jan.-Oct. 96	Exports Jan.-Oct. 95	Imports Oct. 96	Imports Jan.-Oct. 96	Imports Jan.-Oct. 95
North America	17.8	157.9	144.9	20.4	190.8	172.0
Canada	12.0	111.4	106.4	13.5	130.3	120.8
Mexico	5.8	46.5	38.5	6.9	60.6	51.2
Western Europe	12.6	117.6	110.8	14.4	130.0	120.5
European Union (EU-15)	11.4	105.7	101.4	13.1	117.8	109.3
Germany	2.0	19.4	18.3	3.4	32.0	30.2
European Free-Trade Association (EFTA)[1]	0.9	8.9	6.5	1.1	10.1	9.2
Former Soviet Union/Eastern Europe	0.6	5.9	4.5	0.7	5.5	6.0
Former Soviet Union	0.5	4.2	3.0	0.5	3.7	4.2
Russia	0.2	2.8	2.3	0.4	2.8	3.5
Pacific Rim Countries	16.1	155.3	148.8	28.0	241.6	242.1
Australia	1.0	10.0	9.0	0.3	3.0	2.8
China	0.9	9.1	9.5	5.8	43.0	38.5
Japan	5.8	56.8	53.0	10.8	95.9	104.6
NICs[2]	6.4	62.3	61.4	7.5	69.1	67.8
South/Central America	4.8	43.0	41.3	4.4	40.3	35.1
Argentina	0.4	3.7	3.4	0.2	1.9	1.5
Brazil	1.2	10.3	9.4	0.7	7.3	7.3
OPEC	2.0	18.3	16.2	4.0	34.0	29.3
Total	56.1	516.5	483.2	73.6	657.2	620.2

[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)*, Dec. 19, 1996.

Table 6
Nominal U.S. exports and trade balances of services, by sectors, Jan. 1995-Aug. 1996, seasonally adjusted

	Exports Jan.-Oct. 96	Exports Jan.-Oct. 95	Change Jan.-Oct. 96 over Jan.-Oct. 95	Trade balances Jan.-Oct. 96	Trade balances Jan.-Oct. 95
	— Billion	dollars —	Percent	— Billion	dollars —
Travel	53.4	50.5	5.7	13.1	12.3
Passenger fares	16.2	15.3	5.9	4.4	3.4
Other transportation	24.0	23.2	3.4	0	-1.3
Royalties and license fees	23.9	22.3	7.2	17.8	17.1
Other private services[1]	56.0	51.2	9.4	24.9	23.1
Transfers under U.S. military sales contracts	11.3	11.2	0.9	2.2	2.9
U.S. Govt. miscellaneous services	0.7	0.6	16.7	-1.5	-1.7
Total	185.5	174.3	6.4	60.8	55.8

[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)*, Dec. 19, 1996.

INTERNATIONAL TRADE DEVELOPMENTS

NAFTA Report on Agricultural Dispute Released

The final decision by a North American Free-Trade Agreement (NAFTA) dispute settlement panel on the tariffication of certain agricultural products was formally released in November, thus bringing to a close a period of uncertainty in U.S.-Canada bilateral trade relations. The case was significant in that it had possible implications for further decisions in NAFTA and the Free-Trade Agreement of the Americas (FTAA). Although the decision of the panel was unofficially leaked last June, it did not become official until the formal publication of the report by the NAFTA Secretariat.

In the spring of 1994, shortly after NAFTA entered into force, differences in understanding quickly developed between elements of the trilateral NAFTA and the then-recently negotiated multilateral agreement on agriculture [see *IER*, April 1994.] The difference of opinion centered on the goal of zero tariffs enshrined in the NAFTA and the conversion of nontariff barriers to tariffs as part of the Uruguay Round (UR) agreements. Canada asserted that UR tariffication held precedence over NAFTA free trade. The United States disagreed.

UR Provisions on Agriculture—The Uruguay Round Agreement on Agriculture included commitments in the areas of domestice support; export subsidies and market access on agricultural products. The market access portion of the agriculture package provided for the conversion of certain nontariff barriers (e.g. quotas, variable levies, restrictive licenses, etc.) into tariffs, a process known as "tariffication." Finally, members committed to accomplish a 36-percent overall reduction in ordinary rates of duty, including the rates established by the tariffication procedure. The reductions are specified in the market-access schedules of concessions concerning agriculture. The practical effect of these measures was that countries that imposed certain nontariff barriers had to convert such measures into their tariff equivalents and then reduce them in six equal installments, beginning in 1995.

The UR commitments meant that the U.S. section 22 measures, designed to support programs that stabilize U.S. domestic agricultural prices by placing quotas on imported goods, also had to be replaced by tariffs and then reduced. Similarly, Canada and other countries with official supply management systems for agricultural products had to replace such systems with tariffs and then reduce them in accordance with the schedule contained in the UR agreements. It is argued that such systems interfere with the transparency of a market price system. Canadian peanuts, sugar, cotton products and dairy products were directly impacted.

In January 1994, Canada announced the new tariff rates for certain agricultural products that would go into effect on July 1, 1995, as a result of tariffication. Even after the 6-year reduction, such Canadian duties were slated to be prohibitive, equalling 299 percent for imported butter, 241 percent for eggs, 245 percent for cheese, and 155 percent for turkey.

CFTA/NAFTA—The U.S. reaction to the 1994 Canadian announcement was to point out that according to the terms of the U.S.-Canada Free-Trade Agreement (CFTA), and the NAFTA, all duties between the two countries were to be eliminated by 1998. Canada maintained that the WTO/UR agreement took precedence over both the CFTA and the NAFTA.

The question of the precedence of one accord over another is perhaps not new to international legal practitioners. However, the resolution of such matters is typically spelled out in the rules for dispute settlement that are part of each individual international agreement.

The NAFTA text recognizes the possibility of overlap between agreements. Article 103 states that "In the event of any inconsistency between this Agreement and such other agreements, this Agreement shall prevail to the extent of the inconsistency, except as otherwise provided in this Agreement." Chapter 7 of the NAFTA, which treats agricultural measures, recognizes that "domestic support reduction commitments may result from agricultural multilateral negotiations under the GATT" (Article 704). Although the article acknowledges that a signatory may change its domestic support measures at its discretion, it makes no specific mention of the tariffication that may

accompany domestic support reduction commitments in the UR.

Because the differences in interpretation of the NAFTA duty elimination requirements and the UR tariffication procedures were not resolved in bilateral consultations in July 1995, the issue was referred by the United States to the dispute settlement proceedings under the NAFTA.

The United States, as the party invoking the dispute settlement process, argued that the tariffs resulting from Canada's adherence to the WTO tariffication commitment violated the previous NAFTA (CFTA) commitment to eliminate duties between the free-trade partners. The U.S. also held that the tariffs resulting from the tariffication process were higher than those agreed to under the NAFTA, and thus the Canadian action constituted a violation of NAFTA article 302's prohibition on increasing duties.

Canada, on the other hand, maintained that it was required to establish these new tariffs as a result of the WTO Agreement on Agriculture. In effect, Canada's implicit position was that the WTO/UR commitments took precedence over those of the NAFTA. Canada further argued that its obligation to tariffy nontariff barriers was consistent with its commitments under the NAFTA.

The panel upheld the U.S. contention that the imposition of Canadian tariffs on the goods in question "on its face violates the straightforward prohibition contained in the words of NAFTA Article 302" (paragraph 127 of the panel report.) Since the U.S. had established a *prima facie* case, the panel had to determine whether Canada had shown either that its actions were consistent with article 302, or that they were allowed under an exception to the article. After a significant examination of specific articles and the effect of their incorporating by reference both the CFTA and GATT/WTO rights and obligations, the panel decided that article 710 of the CFTA brings into the NAFTA by reference the replacement regime for nontariff barriers that was ultimately established by the WTO Agreement on Agriculture. As a result, the Canadian duty increases were found to be "otherwise provided for in the agreement" and therefore consistent with NAFTA article 302. In short, Canada acted in conformance with both its NAFTA obligations and its WTO commitments.

U.S. reaction to the panel decision was predictably negative. Acting United States Trade Representative Barshefsky and USDA Secretary Glickman expressed "deep disappointment" at the decision. They maintained that a more open trade regime would benefit both U.S. producers and Canadian consumers. The practical effect of the NAFTA panel decision will be to preclude U.S. sales of dairy and poultry products in Canada, since the high tariffs that were imposed as a result of the tariffication effort have been upheld. As a result of the supply management system in Canada, Canadian consumers pay some of the world's highest prices for milk, butter, and other products covered by the decision.

Mexico Still To Face A Large Foreign Debt and Costly Debt Servicing

Foreign debt has been a perennial problem in Mexico, virtually since the country's independence from Spain in 1821. The 1982 announcement of the Government of Mexico that it was unable to continue servicing foreign debt, then approaching $100 billion, started a chain reaction that became known as the Latin American debt crisis, and eventually led to free-market reforms throughout Latin America.

In December 1994, Mexico suffered a crisis of a different nature. This so called "peso crisis" resulted in an initial loss of one-half the peso's value, because the peso could no longer be sustained at its artificially high exchange rate to the U.S. dollar. This crisis followed political disturbances and growing macroeconomic imbalances in Mexico that, combined with external factors such as high interest rates in the United States, triggered a massive outflow of capital from the country. Sudden withdrawal of these funds was made possible by Mexico's excessive dependence on foreign portfolio investment in 1991-94—a period encompassing the heady years preceding the North American Free-Trade Agreement (NAFTA,) and the first year of this accord implementation (see *IER*, March and May 1995). Portfolio investment, unlike direct investment, can be withdrawn with ease.

The debt crisis and peso crisis were both similar in that they were preceded by an overvalued peso, balance-of-payment deficits, capital outflows, and major devaluations. A critical difference was, however, that Mexico at the time of the peso crisis was a very different country from the Mexico of the debt crisis. Between the 1982 and 1994 crises, the Mexican economy underwent a total systemic transformation under the presidencies of Miguel de la Madrid (1982-88) and Carlos Salinas de Gortari (1988-94). One of the world's most closed and protected economies at the time of the debt crisis, Mexico became a model of free-market reform for developing countries. Mexico privatized its large state-owned sector, opened its doors to foreign products and capital, and joined global trade organizations as well as regional economic groupings—most important, NAFTA.

Mexico also took steps to reduce its debt burden. Although between 1982 and 1989 continued capital flight and a heavy debt service burden added to Mexico's already substantial external financial obligations, several renegotiation exercises markedly improved debt service terms. In addition, Mexico's outstanding foreign debt, which, according to some calculations, peaked in relative terms at 70 to 80 percent of the Gross Domestic Product (GDP) in 1983 and 1986-88, dropped in the early nineties to below 40 percent of GDP. As a result, and also in recognition of the sweeping economic liberalization measures taking place in Mexico, the country's foreign debt ceased to be a major concern.

However, the problem did not go away, and debt jitters resurfaced after the peso crash. In 1995, the international community, led by the United States, put together a financial stabilization package to assist Mexico with its solvency problems and with calming financial markets (see *IER*, March 1995). At the same time, this emergency loan package itself added to the public component of Mexico's foreign debt. Total foreign debt (both public and private) surged from $136.5 billion in 1994 to a recently estimated $173 billion. With the increase in the stock of external debt came larger repayment obligations. According to *El Financiero,* over $27 billion will have been paid on foreign debt in 1996 (amounting to some 10 percent of GDP)—over $13 billion in principal, and $14 billion in interest.

Despite the serious hardships the peso crisis brought Mexicans, the Government of Mexico has met Mexico's financial obligations in a timely manner. However, many analysts are concerned that the real cost of Mexico's rising debt levels will be lower growth in the future. They warn that even the combination of increased exports and oil revenues, and the proceeds from the privatization of state-owned assets, will be insufficient to shoulder these payments and still leave internal resources for domestic purposes. There is concern that the huge repayment burden will hold Mexico's economic and social development hostage to foreign creditors for many years to come.

To ease the foreign debt problem, the Government of Mexico refinanced the public portion of external debt, and significantly altered its composition. Mexico's foreign debt strategy of improving repayment terms and stretching out repayment schedules included the prepayment of U.S. government loans. To begin with, Mexico drew only $13.5 billion of the $20 billion made available for its use by the United States in February 1995, and repaid, ahead of schedule, nearly three quarters of that amount. The most recent prepayment, in August 1996, amounted to $7 billion, which left a balance of only $3.5 billion outstanding. Retiring the U.S. loan ahead of schedule allowed Mexico to regain full access to that portion of its revenues from petroleum exports that had been used as loan guarantee.

The Government of Mexico accomplished the reduction of the U.S. loan principally by acquiring new credit from a consortium of major international banks, swapping part of the "Brady bonds" (debt backed by U.S. Treasury bonds) for new, 30-year, dollar-denominated bonds with no collateral, and selling these to private investors. As a result, the terms of Mexico's external credit mix improved, easing short term pressures. According to Mexico's Secretary of Finance, current debt policy is geared not only to receiving credit at better terms, but also to facilitating Mexico's return to international money markets.

Indeed, this policy, coupled with an economic recovery in 1996, succeeded in attracting private foreign capital to Mexico once again. (That a recovery is taking place in Mexico is attested by an estimated 3.7 percent growth of GDP in 1996, compared with a decline of 6.9 percent during the 1995 recession.) However, in October, massive withdrawals of funds from Mexico, a speculative dollar-buying frenzy, and a renewed drop in the peso exchange value began to take place. After holding steady throughout the year in nominal terms (and appreciating markedly in real, inflation-adjusted terms) the peso dipped to more than 8 to the dollar on October 30—its lowest exchange value since the December 1994 crisis. It is believed that Mexico's retreat early October from its commitment to fully privatize state-owned, secondary petrochemical plants may have played a role in these developments.

WORKING PAPERS

The following is a list of Office of Economics working papers. Copies of unpublished papers which are currently available can be obtained from the Office of Economics. Please request working papers by reference code, title, and author. Submit all requests to the Office of Economics, U.S. International Trade Commission, 500 E Street, S.W., Washington, DC 20436, USA, or by fax at (202) 205-2340. (* indicates non-staff member of the USITC.)

Reference Code	Title	Author Status
1996		
96-11-B	Consequences of the Commodity Composition of Trade in Latin America	Michael J. Ferrantin and *Sheila Amin Gutierrez de Piñeres
96-11-A	The Effect of Global Trade Liberalizaton on Toxic Emissions in Industry	Michael J. Ferrantino Linda A. Linkins
96-09-B	Computable General Equilibrium Models: Introduction in a Historical Perspective	Peter Pogany
96-09-A	Multicountry Results from a Single-Country Model: The Case of U.S.-Chilean Trade Liberalizeration	Michael P. Gallaway and Linda A. Linkins
96-06-A	Free Trade with Chile May Increase U.S. Investment Opportunities in Latin America (Background Information for CGE Policy Simulations)	Nancy Benjamin and Peter Pogany
96-05-A	The Almost Ideal Demand System and Applications in General Equilibrium Calculations	Peter Pogany
96-04-A	Japanese Corporate Activities in Asia: Implications for U.S.-Japan Relations	Diane Manifold
96-01-A	Dynamic Investment Responses to Real Exchange Rate Changes	Nancy Benjamin
1995		
95-12-A	Export Diversification and Structural Change Change: Some Comparisons for Latin America	*Sheila Amin Gutierrez de Piñeres and Michael J. Ferrantino

Reference Code	Title	Author Status
95-07-A	Transition to A Market Economy in the Countries of the Central European Free Trade Agreement (Visegrad Group)	Peter Pogany
95-06-D	After NAFTA: Western Hemisphere Trade Liberalization and Alternative Paths To Integration	Sandra A. Rivera
95-06-C	International Trade, Labor Standards & Labor Markets Conditions: An Evaluation of the Linkages	Mita Aggarwal
95-04-A	International Trade, Environmental Quality and Public Policy	Michael J. Ferrantino
95-03-A	Export Diversification and Structural Dynamics in the Growth Process: The Case of Chile	*Sheila Amin Gutierrez-de Piñeres and Michael J. Ferrantino
1994		
94-12-C	Regional Trade Arrangements and Global Welfare	Nancy Benjamin
94-12-B	The General Equilibrium Implications of Fixed Export Costs on Market Structure and Global Welfare	Michael P. Gallaway
94-11-B	Economic Analysis for Trade and Environment - An Introduction	Michael J. Ferrantino
94-11-A	A Brief Description of International Institutional Linkages in Trade and Environment	Michael J. Ferrantino
94-10-B	Explaining Japanese Acquisitions in the United States: The Role of Exchange Rates	Bruce Blonigen
94-10-A	The Cash Recovery Method and Pharmaceutical Profitability	Christopher T. Taylor
94-08-A	Towards a Theory of the Biodiversity Treaty	Michael J. Ferrantino
94-07-A	Economic and Cultural Distance in International Trade: An Empirical Puzzle	*Dale Boisso and Michael Ferrantino
94-06-A	Estimating Tariff Equivalents of Nontariff Barriers	Linda A. Linkins and Hugh M. Arce

STATISTICAL TABLES

Indexes of industrial production, by selected countries and by specified periods, Jan. 1993-October 1996

(Total industrial production, 1991=100)

				1995	1996									
Country	1993	1994	1995	IV	I	II	III	Apr.	May	June	July	Aug.	Sept.	Oct.
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	126.6
Japan	92.0	93.1	96.0	98.0	96.9	96.0	(2)	97.0	93.2	97.8	103.2	(2)	(2)	(2)
Canada[3]	101.4	105.5	107.6	108.2	105.0	108.7	(2)	106.8	108.5	110.9	105.4	(2)	(2)	(2)
Germany	92.8	93.9	95.9	99.4	94.0	95.0	(2)	94.7	93.5	96.7	97.3	87.8	(2)	(2)
United Kingdom	98.4	103.3	105.9	110.4	111.8	104.5	(2)	104.0	107.2	101.5	88.5	(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)	(2)
Italy	95.7	102.2	107.8	113.0	110.1	111.6	(2)	108.4	110.5	115.3	109.4	(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, October 1996, *Federal Reserve Statistical Release*, November 15, 1996.

Consumer prices, by selected countries and by specified periods, Jan. 1993-September 1996

(Percentage change from same period of previous year)

				1995	1996											
Country	1993	1994	1995	IV	I	II	III	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.
United States	3.0	2.6	2.8	2.7	2.7	2.9	2.9	2.7	2.7	2.8	2.9	2.9	2.8	3.0	2.9	3.0
Japan	1.3	0.7	-0.1	-0.5	-0.2	0.4	0.2	-0.4	-0.2	0.1	0.4	0.3	0.0	0.4	0.2	0.0
Canada	1.8	0.2	1.7	2.1	1.4	1.4	1.5	1.6	1.3	1.4	1.4	1.5	1.4	1.2	1.4	1.5
Germany	4.2	3.0	1.7	1.5	1.4	1.3	1.4	1.4	1.4	1.4	1.3	1.5	1.2	1.3	1.4	1.4
United Kingdom	1.6	2.5	3.4	3.2	2.8	2.4	2.2	2.9	2.7	2.7	2.4	2.2	2.1	2.2	2.1	2.1
France	2.0	1.7	1.7	1.9	2.1	2.4	(1)	2.0	2.0	2.3	2.4	2.4	2.3	2.3	1.6	(1)
Italy	4.4	1.0	5.2	5.6	5.0	4.5	3.4	5.4	5.0	4.5	4.5	4.3	3.9	3.6	3.3	3.4

1 Not available.

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

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

			1995	1996												
Country	1993	1994	1995	IV	I	II	III	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.
United States	6.8	6.1	5.6	5.5	5.6	5.4	5.2	5.8	5.5	5.6	5.4	5.6	5.3	5.4	5.1	5.2
Japan	2.5	2.9	3.2	3.4	3.3	3.5	3.4	3.4	3.3	3.1	3.5	3.6	3.6	3.4	3.4	3.3
Canada	11.2	10.4	9.5	9.4	9.5	9.6	9.7	9.6	9.6	9.3	9.4	9.4	10.0	9.8	9.4	9.9
Germany	5.8	6.5	6.5	6.7	7.0	7.1	7.2	7.0	7.0	7.1	(2)	7.1	7.1	7.1	7.2	7.3
United Kingdom	10.4	9.6	8.8	8.6	8.4	8.4	8.2	8.5	8.5	8.3	8.3	8.3	8.6	8.1	8.1	8.0
France	11.3	12.3	12.3	12.3	11.9	12.1	(2)	12.5	12.6	12.6	(2)	12.1	12.2	12.2	12.3	(2)
Italy	10.3	11.4	12.0	12.0	12.0	12.5	11.9	12.0	(3)	(3)	(3)	(3)	(3)	11.9	(3)	(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, November 1996.

h. -y-market interest rates,[1] by selected countries and by specified p , Jan. 1993-November 1996

(Percentage, annual rates)

Country	1993	1994	1995	1995 IV	1996 I	II	III	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.
United States	3.2	4.6	5.8	5.6	5.2	5.3	5.5	5.2	5.3	5.3	5.4	5.5	5.5	5.5	5.4	5.3
Japan	2.9	2.2	1.2	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.6	0.6	0.5	(2)	(2)
Canada	5.1	5.5	7.1	6.1	5.3	4.9	4.3	5.2	5.0	4.8	4.8	4.7	4.3	4.1	(2)	(2)
Germany	7.1	5.2	4.4	3.9	3.3	3.2	3.2	3.2	3.2	3.1	3.2	3.2	3.2	3.0	(2)	(2)
United Kingdom	5.8	5.4	6.6	6.5	6.2	5.9	5.7	6.0	5.9	6.0	5.8	5.6	5.7	5.7	(2)	(2)
France	8.3	5.7	6.4	5.9	4.3	3.8	3.7	4.1	3.8	3.7	3.8	3.7	3.8	3.6	(2)	(2)
Italy	10.0	8.4	10.4	10.6	9.9	9.0	8.6	9.8	9.6	8.8	8.7	8.7	8.7	8.4	(2)	(2)

[1] 90-day certificate of deposit.
[2] Not available.

Source: *Federal Reserve Statistical Release*, December 2, 1996; *Federal Reserve Bulletin*, November 1996.

Effective exchange rate of the U.S. dollar, by specified periods, Jan. 1993-November 1996

(Percentage change from previous period)

Item	1993	1994	1995	1995 IV	1996 I	II	III	May	June	July	Aug.	Sept.	Oct.	Nov.
Unadjusted:														
Index[1]	100.1	98.5	92.9	94.3	96.4	97.6	97.4	97.6	98.0	97.5	96.9	97.8	98.2	97.3
Percentage change	3.1	-1.6	-5.6	.9	1.6	1.2	-.2	.4	.4	-.5	-.6	.9	.4	-.9
Adjusted:														
Index[1]	104.2	101.5	93.9	95.2	97.9	100.3	100.7	100.2	100.8	100.5	100.1	101.3	101.5	100.6
Percentage change	3.3	-2.7	-7.4	2.9	2.7	2.4	.4	.7	.6	-.3	-.4	1.1	.2	-.8

[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, December 1996.

Merchandise trade balances, by selected countries and by specified periods, Jan. 1993-September 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 IV	1996 I	1996 II	Mar.	Apr.	May	June	July	Aug.	Sept.
United States[1]	-115.7	-150.6	-159.6	-138.9	-153.8	-161.1	-147.9	-157.1	-172.9	-154.3	-187.4	-171.5	-192.6
Japan	120.3	121.2	106.0	90.3	67.4	54.4	82.4	30.1	57.7	75.6	(2)	(2)	(2)
Canada[3]	13.4	17.0	27.8	34.2	28.0	33.8	29.6	30.2	38.6	32.7	(2)	(2)	(2)
Germany	35.8	45.6	63.6	66.3	63.7	(2)	60.9	68.5	66.4	(2)	(2)	(2)	(2)
United Kingdom	-25.5	-22.5	-22.4	-24.8	-26.6	-28.5	-21.4	-30.1	-27.7	-27.7	(2)	(2)	(2)
France[3]	15.6	14.7	20.0	21.7	23.1	18.7	27.1	7.4	26.0	22.5	(2)	(2)	(2)
Italy	20.6	22.0	27.6	21.0	37.5	(2)	42.1	43.0	(2)	(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, November 20, 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-September 1996

(In billions of dollars)

Country	1993	1994	1995	1995 IV	1996 I	1996 II	1996 III	Apr.	May	June	July	Aug.	Sept.
Commodity categories:													
Agriculture	17.8	19.0	25.6	8.0	7.9	5.6	5.1	2.0	1.9	1.7	1.6	1.8	1.7
Petroleum and selected product—(unadjusted)	-45.7	-47.5	-48.8	-11.3	-12.4	-15.6	-16.1	-5.2	-5.4	-5.0	-5.5	-5.1	-5.5
Manufactured goods	-115.3	-155.7	-173.5	-44.9	-30.5	-36.9	-52.5	-11.7	-12.7	-12.5	-18.5	-16.7	-17.3
Selected countries:													
Western Europe	-1.4	-12.5	-10.6	-2.8	-1.6	-1.9	-6.7	-.4	-.8	-.7	-4.2	-1.5	-1.0
Canada	-18.6	-25.1	-31.6	-5.6	-4.4	-6.5	-6.1	-1.6	-2.5	-2.4	-1.8	-2.5	-2.0
Japan	-60.1	-66.4	-61.4	-12.2	-11.7	-10.3	-11.7	-4.0	-3.1	-3.2	-4.3	-3.7	-3.7
OPEC (unadjusted)	-11.6	-13.8	-15.7	-3.7	-3.8	-4.9	-5.6	-1.6	-1.9	-1.4	-1.7	-1.7	-2.2
Unit value of U.S.imports of petroleum and selected products (unadjusted)	$15.13	$14.22	$15.83	$15.41	$16.65	$18.76	$18.97	$19.33	$18.95	$18.02	$18.24	$18.65	$20.02

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

Source: *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, November 20, 1996.