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International Economic Indicators

U.S. economic growth averaged a meager 1.0 percent in the first half of 1985. Although administration economists do not see any particular reason why growth should not pick up to 3.4-4.0 percent in the second half of 1985, alternations between good and bad news about the economy leaves the near-term outlook for U.S. economic growth uncertain. Even if growth rebounds to 4.0 percent in the second half, the 2.5-percent average for the full year would fall significantly below the 4.0-percent average projected earlier. Lower than anticipated growth will hamper efforts to pare the Federal budget deficit appreciably, posing a threat to U.S. and world economic recovery.

A recent GATT report noted that North American imports accounted for almost two-thirds of the increase in the value of world trade in 1984 and were the driving force behind last year's upsurge in international trade. U.S. imports from the industrialized countries grew by more than 30 percent in 1984 and by more than 60 percent since 1980. Thus, the current growth in world trade is very closely tied to the U.S. economic recovery.

There is a renewed concern over world debt. The export drive of debtor nations to acquire the hard currency necessary to pay their debts has contributed to a buildup of protectionist pressures in the Western creditor nations. Protectionism, in turn, threatens the ability of debtor nations to continue servicing their debts. The menace of a partial moratorium on payments has resurfaced as developing nations toughen their demands for international monetary reforms. New measures suggested by developing nations would ease the pressure that debt payments exert on their economies.

Industrial production

U.S. industrial production grew by only 0.1 percent in June after a similar growth in May. The annual rates of industrial growth in the major industrialized countries, calculated by dividing the latest available monthly output by the output in the corresponding month of the previous year, were as follows: Canada, 4.5 percent; France, 0.0 percent; Italy, 2.8 percent; Japan, 5.5 percent; the United Kingdom, 6.0 percent; the United States, 1.9 percent; and West Germany, 3.0 percent.

Investment

U.S. net domestic investment increased sharply from $49.8 billion in 1983 to $106.7 billion in 1984. The pace has reportedly slackened so far this year. Even with last year's surge in purchases of new machines and equipment, the United States reinvests a smaller share of its output than the share reinvested by its competitors. Japan's share of net investment in total output is twice as high as the U.S. share. Even the United Kingdom spends 20 percent more than the United States on new capital. With 27.9 percent of Japan's cumulative direct foreign investment, the United States leads the world in attracting direct investment from Japan. As of the end of March 1985, these investments amounted to $19.9 billion.

Employment

The rate of unemployment in the United States (on a total labor force basis including military personnel) remained 7.2 percent in July, the same as during the previous 5 months. Unemployment rates in June as reported by national statistical offices were as follows: Canada, 10.5 percent; France, 9.6 percent; Italy, 12.6 percent; Japan, 2.6 percent; the United Kingdom, 13.1 percent; and West Germany, 9.4 percent. (For foreign unemployment rates adjusted to U.S. statistical concepts, see tables at the back of this issue.)

External balances

The monthly deficit in U.S. merchandise trade rose from $12.7 billion in May to $13.4 billion in June, the second-largest monthly deficit in U.S. history. Exports showed a near stagnation in June. This is particularly disturbing since, given the large imbalance between exports and imports, exports would have to be increasing at a significantly faster rate than imports merely to check the U.S. trade deficit from further widening.

Japan's trade surplus, which was less than $20 billion in 1982, is expected to exceed $45 billion in 1985. Pressure from the United States, the European Community and Japan's main Asian trading partners (Hong Kong, Korea, Singapore and Taiwan) to reduce this surplus resulted in an "action program" by the Japanese Government. (See articles on Japan in this issue.) New estimates show that the U.S. trade deficit with Japan may increase from $37 billion in 1984 to $50 billion in 1985.

Italy's merchandise trade deficit reached a record $7.7 billion in January-May 1985 causing a sharp depreciation of the lira against other major currencies. Italy's price inflation, which is considerably higher than that of other key EC nations, is blamed for this development.

Prices

The U.S. consumer price index rose 0.3 percent in June after the 0.2-percent increase in May. Inflation continues to be under control in the United States, partly owing to the restraining effects of import competition on U.S. industries. At present, many analysts are more worried about the possibility of a new recession than about inflation.

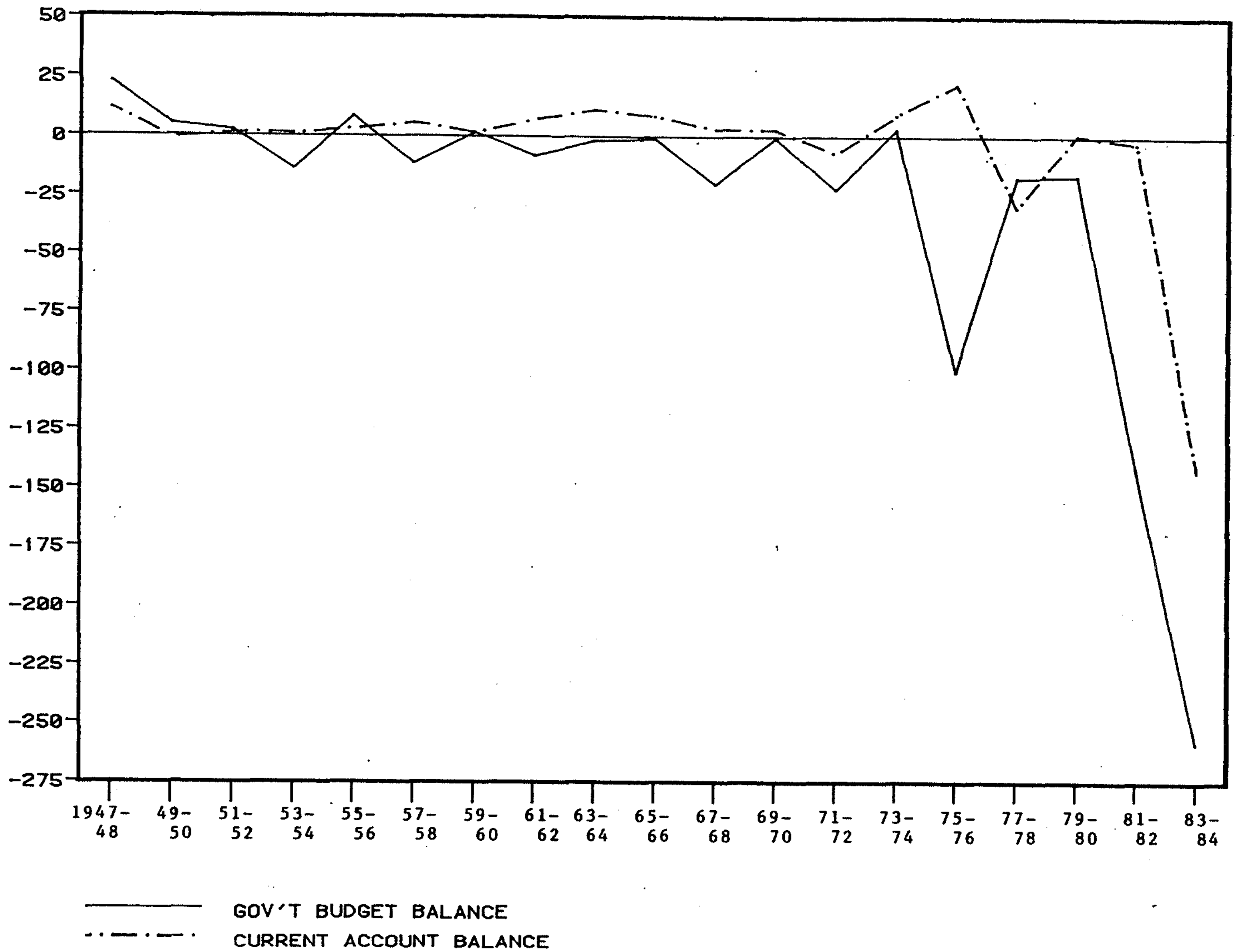
In July 1985, the annualized rate of consumer price inflation was 2.3 percent in West Germany. The June rate was 4.1 percent in Canada, 6.4 percent in France, 8.7 percent in Italy, 2.2 percent in Japan and 7.0 percent in the United Kingdom.

Forecasts

Errors in forecasting national economic developments and drastic turnabouts of expert opinion on economic outlook in the past few months have prompted caustic comments about the dependability of economic projections. A recent study by some OECD economists on the accuracy of forecasts of the GNP growth in individual countries has found that only about half of these forecasts have been within 1 percentage point of the actual result during the past two decades. The study suggests that by paying more attention to the influence of OECD-wide economic developments on the national economies, national economic forecasts could be improved.

The attached graph illustrates the historic relationship between public (Federal, State and local government) borrowing in the United States and the U.S. current account balance. Until the 1975-76 period, there were relatively minor fluctuations in both balances, but they appear to have been correlated. Since the dollar was allowed to float in 1973, changes in the current account balance have lagged changes in the budget balance but it can be seen that there was a close relationship. Because the budget balance continued to move further into deficit in 1983-84, the current account deficit can be expected to increase again in 1985-86. Corroborating this, the latest U.S. Government forecast is that the U.S. current account deficit will rise from $102 billion in 1984 to $135-$140 billion in 1985.

Current Account Balances and Government Budget Balances
(1947-1984)



Note: The government budget balance is the sum of all Federal, State and local government balances as reported in the U.S. national income and product accounts. The current account balance is the balance on U.S. international transactions in goods and services. Two-year totals are presented for both the government budget balances and the current account balances.

Source: Tables B-74 and B-98, Economic Report of the President, 1985, and U.S. Department of Commerce, "Current International Trade Position of the United States," May 1985.

International Trade Developments

Brazil's new Government faces foreign trade issues

Brazil's foreign trade policy is currently being reviewed by the country's new Government, which came into office in March. The fundamental objective of this policy will undoubtedly remain the same as that of the previous administration: attainment of a large surplus to provide for payments on the country's huge international debt. (Brazil's current debt amounts to some $103 billion.) The new Government is thus bound to continue its predecessor's mercantilist trade policies--vigorous promotion of exports coupled with a strong import substitution drive. Analysts stress that, even with a sizable trade surplus, servicing its foreign debt will leave Brazil with very limited resources to finance a recovery from its 4-year old recession.

The new Government was quick to remind Brazil's trading partners of its predicament. During his first months in office, Foreign Minister Olavo Setubal repeatedly emphasized that a large trade surplus is the key to Brazil's ability to pay its debts. Like its predecessor, the new administration seeks broad access to the export markets of advanced industrial countries and a lenient attitude from these countries towards its own protectionism.

Last year, Brazil boasted a record trade surplus of $13 billion, but has had poorer results thus far this year. The causes include shrinking opportunities to export to the United States and elsewhere, pressures to increase imports from their 1984 austerity level, and uncertainties caused by the illness and death of Tancredo Neves, the President elect. Analysts currently predict that Brazil's 1985 surplus will be smaller than last year's, but still in the range of $9 billion to $11.5 billion. Trying to maximize the surplus in the face of adversities, the new Government is presently grappling with strategies to combat foreign barriers to its exports on the one hand and to deal with charges against its own restrictive import measures on the other. The new administration also supports countertrade, and has established a special office to encourage countertrade by private companies.

<u>Charging "U.S. protectionism</u>."--In 1984, the United States continued to be Brazil's largest customer, accounting for 28 percent of the country's overall exports and almost 40 percent of its trade surplus. The major U.S. role in Brazil's trade explains why the new Government has adopted the theme of "U.S. protectionism" as a major concern of its export drive. The charge is due in large measure to the proliferation in recent years of formal U.S. protests against the surge of Brazil's exports to the United States.

Most complaints from business concerning Brazilian competition were handled under the unfair trade provisions of the United States. Antidumping and especially countervailing duty proceedings against Brazilian goods have increased dramatically since 1981, some resulting in the imposition of special duties or sparking the negotiation of restraint agreements. Proceedings under certain provisions other than those covering unfair trade have also been directed against imports from Brazil.

Two recent and notable examples of U.S. action against imports from Brazil involved steel and footwear. A bilateral agreement limiting Brazil's steel exports to the United States, especially shipments of the more expensive finished steel products, was concluded in September 1984 and was signed this February. This was followed in June by a determination of the U.S. International Trade Commission (ITC) that nonrubber footwear imports were seriously injuring the domestic footwear industry. The recommendation of the majority of ITC Commissioners was to apply global quantitative restrictions against U.S. footwear imports for 5 years. This recommendation for relief is presently under consideration by the President. Since the United States accounted for 89 percent (by value) of Brazil's leather footwear exports in 1984, any form of trade relief President Reagan might order would cut into Brazil's export earnings. The social impact of a possible adverse decision in this case is also a major concern of Brazil's new Government. Unlike Brazil's steel industry, which is largely Government-owned and not overly labor-intensive, Brazil's footwear industry is mostly in private hands and has a large work force.

Complying with Brazil's commitments.--While protesting against "protectionism" in the United States, the new Brazilian Government must also deal with charges against its own trade restrictions. For example, the previous Government was committed to the International Monetary Fund (IMF) to gradually convert its quantitative import restrictions to tariffs. The new administration is presently developing a list of products from which longstanding import barriers can be removed.

Brazil also promised both the IMF and the United States to phase out its expensive export subsidies program. In particular, Brazil agreed in 1979 to eliminate two large subsidy programs in return for injury protection in U.S. proceedings against its exports. Under the new Government, Brazil's compliance with this agreement became subject to scrutiny by a special team of the Office of United States Trade Representative. This team concluded in June that, albeit with considerable delay, Brazil has actually eliminated the two programs in question.

Canada to lift shoe restraints?

In early July the Canadian Import Tribunal recommended that import quotas on most types of footwear be eliminated by the end of the year. The recommendation, which covered all categories of shoes except ladies' and girls' footwear, was contained in a report commissioned earlier this year by the Canadian Government. The report examined the state of health of the Canadian footwear industry and concluded that sufficient recovery had been made for the 5-year old restrictions to be lifted.

Import quotas on nonrubber footwear were originally imposed by Canada in December 1977. Although intended to be temporary, they have been continuously renewed. The current 12 month extension is scheduled to expire November 30, 1985.

The Tribunal's report recommended that quotas on all categories of shoes, except ladies' and girls', be terminated—and that the restrictions on ladies' and girls' shoes be phased out over a 3-year period. This sector is of particular interest to the EC since it accounts for over 60 percent of EC exports to Canada. The EC would prefer that restrictions on ladies' and girls' footwear be aimed at the nonleather segment of the market, a move that would impact heavily on developing country suppliers of footwear.

The timing of the Canadian Government's consideration is somewhat ironic in that it coincides with U.S. deliberations on the imposition of import restraints on footwear into the United States. The International Trade Commission recommended relief for the domestic industry in June, and the President has until September 1 to decide what type of action, if any, will be taken. It has been reported that the U.S. outcome will be an important factor in the Canadian Government's decision whether or not to accept the Import Tribunal's recommendation.

<u>Another transatlantic steel dispute is averted by an agreement restricting certain European Community steel exports to the United States</u>

On August 5, 1985, the United States and the European Community (EC) reached an agreement restricting EC exports of certain steel products to the United States during the last 5 months of 1985. The agreement was reached within the context of the 1982 U.S.-EC Arrangement Concerning Trade in Certain Steel Products (the Arrangement). The Arrangement places limits on U.S. imports of EC carbon steel products and subjects other steel products to consultations should imports from the EC rise. Had agreement not been reached, the United States was expected to take unilateral action under the terms of the Arrangement, and the EC would probably have retaliated.

In a package deal reached in June 1985 (see <u>IER</u>, July 1985), the United States allowed the EC to ship 100,000 tons of steel pipe to the U.S. market (in addition to an import quota already in effect) in exchange for an EC commitment to negotiate the extension of the Arrangement to quotas for other steel products. U.S. imports of EC steel pipes and tubes are not covered formally in the body of the Arrangement, but are subject to an exchange of letters holding the EC to 5.9 percent of the U.S. pipe and tube market. According to the exchange of letters, consultations are to be held should EC shipments exceed this level. When negotiations in late 1984 failed to result in EC export restraint, the United States took unilateral action. The U.S. embargo of imports of EC steel pipes and tubes during the last month of 1984 was lifted only after the EC agreed in January 1985 to restrain exports for 2 years.

Seventeen steel products are subject to consultation procedures, rather than quotas, under the terms of the Arrangement. If EC steel exports to the United States are diverted from products subject to quotas to products subject to consultation, the United States may then ask the EC to enter into consultations about the diversion.

According to many U.S. steel producers, the consultation provision of the Arrangement has created an opportunity for certain EC producers to switch production for export from steel subject to quotas to steel subject to consultation. U.S. imports of the consultation products have increased substantially since 1982. Pressure from the U.S. Government to obtain EC export restraints on the consultation products apparently resulted in the August agreement.

The agreement restricts EC shipments to the United States of 16 steel products grouped into 11 categories to no more than 197,917 net tons for the 5-month period from August 1 to December 31, 1985, or to 475,000 tons for the entire year. The EC had pushed for a 540,000 ton annual limit. The 11 categories (and their export ceilings) are: round and flat wire (73,090 short tons), cold-finished and other bar (32,275), black plate (23,856), tin-free steel (17,498), cold-rolled strip (13,393), electrical sheet and strip (10,870), alloy wire rod (9,241), bar shapes under 3 inches (9,212), wire products (5,164), rail products (2,538), and concrete reinforcing bars (780).

While the August agreement diffuses a potentially disruptive trade problem, many other U.S.-EC bilateral steel questions remain. Relations between the two sides are already strained over negotiations for renewal of the 1982 Arrangement, which expires at yearend. In addition, the U.S. steel industry will respond negatively to the EC's expected extension of the December 31, 1985, deadline for ending all member governments' subsidies to their steel industries. Under a temporary emergency plan, the EC Commission permits certain subsidies to the members' steel industries if they are linked to restructuring. Under normal circumstances, such subsidies would be illegal under EC competition laws. The U.S. industry has complained that these subsidies give EC steel producers an unfair advantage in world steel trade.

Prospects for U.S.-Chinese nuclear cooperation

On July 23, President Reagan and President Li of China signed a bilateral agreement on peaceful nuclear cooperation. This pact is the same one that was initialed by President Reagan in Beijing on April 30, 1984, but further action was delayed at that time because of U.S. concern about China's stand on the transfer of nuclear technology and materials to other countries. This concern stemmed mainly from reports of possible Chinese nuclear assistance to Pakistan in the past. The agreement was signed and transmitted to the Congress only after a series of bilateral consultations and other actions and statements by China during the past year further demonstrated its willingness to adhere to the principles and practices of nonproliferation. The next step, a 30-day period of continuous session during which Congress consults with the administration, is now underway but was interrupted by the August recess. The consultation period will be followed by a 60-day continuous session during which Congress can approve or disapprove the pact. Thus, barring congressional rejection, the agreement is expected to go into effect in December or in early 1986.

Even with permission to sell nuclear power equipment and technology to China, U.S. companies will still face a number of problems in entering this market. China's leaders have repeatedly expressed interest in obtaining U.S. nuclear technology, but U.S. firms acknowledge that their competitors have a considerable lead. Arrangements to build a 1,800-megawatt nuclear power plant at Daya Bay in Guangdong Province are close to completion. Although the contracts have not yet been awarded for this $3.51-billion project, Framatome of France is in the final stages of its negotiations to sell China the two nuclear reactors, and the General Electric Co. of Great Britain is currently the only contender to supply the power generating turbines. In addition, Kraftwerk Union, a West German firm, is reported to have made considerable progress in negotiating contracts to construct two 1,000-megawatt nuclear power plants in China, for which Brazil would also supply some components. Negotiations are reportedly also underway between China and the Soviet Union. China is said to have proposed importing two nuclear power plants from the U.S.S.R. under a 5-year Sino-Soviet trade agreement that was signed in July.

Opportunities for U.S. sales could depend to a considerable extent on how many plants China's leaders decide are needed before they are able to undertake construction without foreign assistance. The Chinese already have the technical expertise to build small nuclear power stations, and construction on the first such plant--a 300-megawatt station near Shanghai--was begun in January 1985. Their plans call for also taking over the construction of large-scale plants after an unspecified number have been imported. Moreover, recent statements made by China's nuclear officials indicate an increasing emphasis on importing foreign technology for the purpose of developing domestic production capacity.

Although China's leaders remain committed to the development of nuclear power, opposition to the size of the projected program and, to some extent, even to the program itself is growing within the Government. The safety issue has been raised, and some officials have reportedly questioned the economic viability of nuclear power. These officials have pointed out that the cost of nuclear energy is rising in almost every country, whereas the costs of energy from coal, oil, and gas--which China has in abundance--are increasing more slowly or dropping. Proponents of the program may be able to defuse the economic issue only if China can strictly limit its imports of nuclear technology and equipment by rapidly becoming self-sufficient in the production of large reactors.

<u>Much ado about . . . Japan's latest market opening moves</u>?

Billed in April as a long-term program to completely reorient Japan's trade regime, the latest of Japan's seven post-Tokyo round market access packages, released on July 30, is considerably less far-reaching than optimists had hoped. Furthermore, some segments of the program that could be of greatest benefit to U.S. suppliers have yet to be spelled out in detail. Significant strides in the area of regulatory procedures were made, though, and Prime Minister Nakasone continues to demonstrate a strong commitment to the goal of allowing imports to enter Japan freely, as a general rule, by 1988. Meanwhile, recent statements by high-level Japanese trade officials suggesting that the trade problem is really based on lack of effort, poor product quality, and mismarketing by foreigners sent a disturbing signal to a U.S. Congress grappling with the domestic effects of a trade deficit expected to reach nearly $150 billion by yearend.

The package.--The recent market opening measures fall into three general categories: improving customs procedures; minimizing the "red tape" faced by foreign suppliers of goods subject to technical standards in Japan; and promoting Japanese purchases of foreign goods. The plan is to take effect over the course of the next 3 years.

Japanese officials indicated that the announced changes in import procedures will cut by 60 percent the number of import documents needed to bring goods into Japan and substantially reduce the time required for imports to clear Japanese customs. However, the officials noted, the program is intended to be a long-term effort to make the Japanese market more accessible to foreigners; immediate increases in imports are not anticipated or claimed.

The single most significant measure will change the procedures for certifying that foreign products conform with Japanese industrial (JIS) and agricultural (JAS) standards. By April 1986, the Ministry of International Trade and Industry (MITI) will allow U.S. testing bodies to inspect U.S. factories as official agents of the Japanese Government. This should remove a major obstacle for American producers seeking to obtain the JIS mark of approval--a widely accepted sign of quality in Japan--for their industrial exports to Japan. By April 1988, the Government will also reduce the number of JIS industrial standards by 10 percent. U.S. makers of health care products, electrical appliances, processed foods, fertilizers and chemicals, and telecommunications equipment stand to benefit when the promised steps are implemented.

Other changes in the standards area are likely to benefit U.S. suppliers. As of April 1988, MITI will no longer require Government inspection of some 200 electrical appliances, and U.S. suppliers of products still subject to inspection will be able to use American testing laboratories to generate conformity data. In the area of forest products, the Ministry of Agriculture, Forestry and Fisheries will take foreign views into account when it develops new standards for pine, plywood, and panel products. A new "priority handling" system for imported cars will also be introduced by the end of 1985; in the meantime, the Government agreed to simplify documentation and testing of lots up to 1,000 units. The Government reaffirmed regulatory improvements ironed out in earlier talks on pharmaceuticals, medical equipment, electronics, and telecommunications (IER, April and June 1985), and it announced that some of these improvements would be applied to new areas.

Purchases of foreign goods will be promoted via tariff cuts, low-interest loans, and an officially sponsored "buy foreign" campaign announced in July. Largely in response to pressures from its Asian trading partners, Japan will lower tariffs by 20 percent on more than 1,800 products, including duties on eight agricultural goods that are also of interest to the United States. Tariffs on 32 industrial products will be eliminated. However, tariffs on forest products, an item of interest to the United States, were unchanged by the plan.

Although several broad improvements in Government procurement procedures were indicated, few specifics were provided, and no mention was made of reversing Nippon Telegraph and Telephone's low and falling purchases of foreign telecommunications gear. Meanwhile, 60 major private concerns have been summoned to Tokyo to set import targets, and an unofficial goal of increasing imports from the United States by $5 billion by yearend has been set.

The prospects.--In April, Prime Minister Nakasone said that he would oversee the creation of a 3-year action program designed to fundamentally shift Japan's trade orientation (IER, May 1985). By mid-1988, imports would be free as a matter of policy, Nakasone said, with restrictions only imposed on a temporary and exceptional basis. The statement was greeted with cautious optimism by many foreign analysts, since it seemed to signal a shift to a more comprehensive, long-term effort by Japan to deal with trade frictions.

However, in the months that followed the April announcement, Japanese officials seemed intent on downplaying the potential effects of the July steps. Part of the reason for this public "backpedalling" may have been based on the belief that whatever steps Japan took, imports would increase only modestly and at a halting pace. These officials noted that the Japanese economy is growing at a modest clip, while the economies of some other countries, such as the United States, are advancing rapidly. Japan's expansion has relied heavily on investment in plant and equipment where foreign firms have made only modest inroads (see the following article) and less on rises in consumer spending. The yen, which has strengthened relative to several European currencies, still remains weak relative to the dollar, making Japanese products extremely price competitive in the United States and U.S. goods relatively expensive in Japan. Also, Japanese firms are becoming more competitive in industries where the United States has previously dominated--notably in the production of high-technology products like computers, office equipment, and telecommunications gear. These sectors are the same sectors in which U.S. demand has increased most rapidly in the current recovery.

The July package does offer potential benefits to U.S. firms. The Government's commitment to make the product approval process in Japan simpler and less cumbersome, to remove unnecessary technical regulations, to allow foreign suppliers to have their views taken into account in decisions affecting them, and to speed up customs clearance could substantially benefit U.S. suppliers. U.S. trade officials will seek clarification of these positive elements in the weeks ahead, while urging further movement in the areas of Government procurement, competitive policy, and high technology. Though U.S. trade officials believe that some of the plan's provisions will ultimately benefit American suppliers of key products, they acknowledge that the steps outlined will have little immediate impact on Japan's huge and growing surplus in merchandise trade with the United States.

Nevertheless, U.S. officials and private interests have long argued that fundamental aspects of Japan's economic structure have had the unintended effect of dampening foreign sales to Japanese consumers. The extensive linkages of Japanese companies--whether through long-term supplier relationships, financial or trading company ties, or intra-industry cooperative groups--often have worked to the disadvantage of new entrants, particularly foreign ones. Government product approval and other paperwork requirements have also been significant barriers to foreign firms. The announced changes in Government procedures were thus a welcome step in the process of making the Japanese market more accessible to foreign firms. But the July package did little to allay fears by foreign policymakers that more fundamental forces are preventing their firms from getting a bigger piece of Japan's $650-billion market for manufactured goods.

Imports of manufactures still play a minor role in Japan

A recent Commission staff analysis suggests that since the conclusion of the Tokyo round of multilateral trade negotiations in 1979, Japan's trade pattern has been characterized by growing trade surpluses, an increasing dependence on the United States as an export market, and a growing contribution of exports to GDP growth. Import penetration levels in Japanese manufacturing industries have been low and relatively stable throughout the period. In five of the nine Japanese industries surveyed, foreign suppliers accounted for less than $6 out of every $100 spent in 1984.

From 1979-84, manufactured goods accounted for more than 90 percent of Japan's exports and about 19 percent of its imports. In 1984, one category of manufactures--machinery and transportation equipment--comprised nearly two-thirds of total Japanese exports; mineral fuels accounted for nearly half of the value of Japan's imports.

Japan's imports grew by an average 10.7 percent per year from 1979-84, and U.S. imports climbed by at an annual rate of 11.3 percent. However, Japan's low level of manufactured imports contributed to lower import penetration ratios in most manufacturing industries than those registered in the United States. In the nine Japanese industries studied, the shares of apparent consumption accounted for by imports ranged from 2.3 percent to 17.6 percent in 1984: the weighted average import penetration was 5.3 percent in 1979 and rose to 5.5 percent in 1984. In the United States, import penetration ranged from 4.1 to 19.8 percent in 1984. In the nine U.S. industries studied, the weighted average import penetration was 9.0 percent in 1979 and rose to 12.4 percent in 1984. The import penetration ratios in the selected U.S. and Japanese industries in 1979 through 1984 are shown on the following page.

July meetings fail to clear the way for a new round of multilateral trade negotiations

Trade representatives from the United States, Canada, Japan, and the European Community formed a united front on key issues in a new trade round at the tenth Quadrilateral Trade Ministers' Conference. Their hopes were soon dashed, however, when the GATT Council failed to set a date for a preparatory meeting.

Talk of a new round has only inched toward its goal over the past 2 years. For some time, the developing countries and some European countries (notably France at the Bonn Summit) held to the argument that conditions were not ripe for starting a new round. The EC countries argued that work on a program set up by the 1982 GATT Ministerial should be completed first. Developing countries argued that industrialized countries must first show good faith by honoring previous commitments to refrain from and roll back protectionist measures.

In addition, trade in services has been the focus of particularly bitter debate. Few countries are as enthusiastic as the United States about bringing services trade under GATT discipline. Developing countries fear foreign domination of their markets. But services constitute a growing sector of the

Overall import penetration ratios in selected industries, 1979-84: the United States and Japan. 1/
(in percent)

A. The United States

	1979	1980	1981	1982	1983	1984
Overall import penetration in manufacturing 2/	9.0	9.7	10.1	10.6	12.0	12.4
Food & beverages	5.2	5.1	5.2	4.8	4.9	4.9
Chemicals	6.8	7.1	6.8	7.9	8.9	11.3
Pulp, paper & prods.	4.3	4.3	4.1	3.7	3.6	4.1
Textiles	9.9	10.3	11.2	12.3	12.6	16.3
Machinery	7.7	8.8	9.2	10.4	11.8	13.7
Electrical machinery	13.1	13.8	15.1	16.1	16.8	19.3
Transport equipment	15.2	17.9	18.2	19.3	18.9	19.8
Precision instruments	13.4	13.3	14.1	14.0	15.3	17.2
Metal products	8.7	10.0	10.4	11.6	10.1	11.3

B. Japan

	1979	1980	1981	1982	1983	1984
Overall import penetration in manufacturing 2/	5.3	5.6	5.1	5.5	5.5	5.2
Food & beverages	3.1	3.6	2.8	2.7	2.5	2.6
Chemicals	7.0	7.2	7.2	8.3	8.1	8.5
Pulp, paper & prods.	5.0	6.0	4.9	5.5	5.4	5.6
Textiles	16.1	15.9	15.7	16.7	14.7	17.6
Machinery	5.2	6.2	5.1	5.8	5.4	5.8
Electrical machinery	2.5	2.5	2.3	2.4	2.2	2.5
Transport equipment	2.5	3.1	3.1	1.9	3.0	2.3
Precision instruments	12.8	13.3	11.8	14.5	14.4	17.6
Metal products	5.6	6.0	5.9	6.9	7.4	8.0

1/ Import penetration is here defined as the ratio of imports to apparent consumption. Apparent consumption is considered to be output, minus exports, plus imports. Production data for 1984 was estimated.

2/ Weighted average of the 9 sectors studied. The formula used in this calculation is: Import penetration in industry 1 * [Apparent Consumption in Industry 1/Total Apparent Consumption in the 9 industries studied] + Import Penetration in industry 2 * [Apparent Consumption in Tndustry 2/Total Apparent Consumption in the 9 industries studied]. . .+ Import Penetration in industry 2 * [Apparent Consumption in Industry 9/Total Apparent Consumption in the 9 industries studied].

U.S. economy and are gaining importance in U.S. trade. At a meeting of the GATT Consultative Group of 18 held on July 8-9, the United States presented a position paper outlining its desire to establish rules and procedures within the framework of the GATT to govern international trade in services, but a bloc of developing countries led by India, Brazil, and Egypt voiced their opposition. The Indian spokeman said his country would not be able to participate in any talks that would commit it to negotiate services within the GATT framework. With this opposition in mind, trade ministers from the United States, Canada, Japan, and the European Community decided their next move at a Quadrilateral meeting held in Sault Ste. Marie, Ontario.

Quadrilateral Trade Ministers' Conference

The tenth Quadrilateral Trade Ministers' Conference ended July 14 with a consensus among participants on a variety of contentious issues proposed for the new round of multilateral trade negotiations. Present were Canada's International Trade Minister, James Kelleher; the United States Trade Representative, Clayton Yeutter; the EC's Commissioner for External Relations, Willy de Clercq; and Japan's Minister for International Trade and Industry, Keijiro Murata. After the meeting, Ambassador Yeutter reported "a remarkable unanimity on the part of this group on a whole host of issues." Minister Kelleher, who hosted the informal conference, noted "a recognition among us of the dangers we all face in the world trading system. . . . We consider that early movement towards new negotiations is a critical aspect of our efforts to control [protectionist] pressures."

The trade ministers identified eight subjects for inclusion in a new round of trade talks. Each country was responsible for conducting discussions on two of the topics: the EC, on services and tariffs; the United States, on subsidies and trade-related investment measures; Japan, on intellectual property and trade in high-technology products; and Canada, on dispute settlement and safeguards. (Safeguards are emergency restrictive trade measures that may be taken when rising imports that are not necessarily unfairly traded through subsidies or dumping injure or threaten serious injury to a domestic industry.)

One of the most notable outcomes of the meeting was an agreement among the participants on the need to include trade in services in any new round of talks within the GATT. Responding to the opposition of some developing countries to the inclusion of services in the new negotiations, Yeutter said trade in services "is not an issue that can be ignored or put aside." Developing countries should not expect major concessions on trade in goods, he noted, if they are unwilling to make concessions on services in return. Yeutter added that the United States could not take part in multilateral trade talks that did not include services.

The Quadrilateral participants agreed to try to schedule a preparatory meeting of senior GATT officials in September to lay the groundwork for a new trade round to begin in 1986. They also agreed to appeal to the developing countries to participate in the talks, despite their impatience with certain "intransigent" developing nations whose opposition to the inclusion of services continues to delay the process. According to reports on the meeting, the ministers hope to win support in the GATT this fall for the establishment of a formal committee to work on detailed preparations for the new round.

GATT Council Meeting

A GATT Council meeting held July 17 through 19 was critical to the strategy of marking September for preparatory talks to set the groundwork for a new round of trade negotiations. Despite the now widespread consensus on holding trade talks, the time for the new round and the status of talks on trade in services remained in question. Brazil and India led a small group of developing countries sticking fast to the position that some of their prime concerns must be on the agenda of trade talks. These same countries continue to insist that negotiations on services be treated separately, but a number of other developing countries are shelving their opposition to covering services in the new round.

While the United States remains committed to negotiations on services, finding a trade-off will be the next challenge. Some of the priority concerns of developing countries, such as trade in textiles and manufactures, touch on politically sensitive sectors of the U.S. economy. The divergent priorities have an element in common, however. Each group wants access to the other's markets--the United States for its services and the developing countries for their manufactured products. For its part, the United States contends that the developing countries have extensive barriers to trade. These barriers, predominantly nontariff barriers such as licensing requirements and exchange controls, have an impact that is hard to measure, making them more difficult to negotiate than the tariffs traditionally covered by the GATT framework.

In spite of the lack of consensus at the July Council meeting, U.S. negotiators remain confident that the differences can be ironed out as discussion gets underway. In a basically parliamentary maneuver, the United States now hopes to succeed in calling a special session of the GATT Contracting Parties in the early fall. This meeting would take the place of a meeting of senior policy makers proposed earlier by the United States, but would require only a plurality vote to be called rather than complete consensus.

Trade and economic growth: World Bank urges industrialized countries to resist protectionism

The annual World Development Report released last month by the World Bank and a recent report by the GATT Secretariat caution industrial nations against imposing a variety of nontariff barriers to solve their trade imbalances. Both reports agree that restrictive trade measures fail to solve the domestic difficulties of the industrialized nations.

According to the World Bank's report, sustained economic growth in the period 1985-1990 "will require continued policy reforms in developing countries, sustained growth in industrial countries, and a rollback of protectionism so that developing countries can access industrial countries' markets." The report warned, however, that increasing protectionist pressures in the industrial countries pose a substantial threat to world economic growth and to a satisfactory solution of the debt problems in many developing countries.

The Bank's report attributes the revival of protectionist sentiment in developed countries to the economic instability of the 1970's. It credits aggregate supply shocks, rising unemployment, and increasing capital obsolescence with creating a need for economic revitalization among industrialized countries at a time when inflation was high and growth was low. These economic difficulties were incorrectly blamed on the rising volume of imports. Thus, in an effort to ease economic instability and promote domestic growth, the industrial nations began imposing import restrictions.

The Bank report notes that many of the protectionist remedies imposed by developed nations to solve their economic problems have consisted of nontariff barriers (NTB's) against the products of developing nations. Targets of such nontariff restrictions include agricultural products, steel, and footwear--all significant exports of many developing nations. In 1983, the report noted, NTB's affected 29 percent of developing countries' agricultural exports and 18 percent of their manufactured exports to industrialized countries.

The recent GATT Secretariat paper offers further evidence of the growing trend toward protectionism. According to this report, the use of restrictive trade measures continued to increase during the period October 1984-March 1985, in spite of a world economic recovery that accelerated in 1984. The report also observes that pressure for protectionist measures to relieve the increasing trade deficit is mounting in the United States, and that high unemployment in the face of economic growth has contributed to continued protectionist pressures in Western Europe. Voluntary export restraints appear to be the most popular form of NTB, particularly in the steel sector. The GATT paper also notes more restrictive use of the Multifiber Arrangement and an increase in the use of countertrade worldwide.

The World Development Report points out some of the possible consequences of the trend toward greater use of NTB's. It warns that "further proliferation of such barriers could well revive . . . the export pessimism that prevailed in many developing countries in the 1930s and 1940s." Moreover, the report emphasizes that the increasing use of NTB's by industrial nations is self-defeating: It will not help to improve their trade balances. Instead, protectionism will deny the developing nations the market access they need to earn the money necessary to buy industrial nations' goods. Thus, "protection accorded to import-competing industries is protection taken away from export industries."

Increased financial links between industrial and developing nations, the Bank noted, have opened an important channel through which macroeconomic developments in industrial nations can be transmitted to developing nations. Consequently, if protectionism was eliminated and government budgets were balanced, both developing and industrial nations would enjoy increased economic growth in the period of 1985-1990. The report concludes that under such optimal conditions, developing countries' annual growth could average 5.5 percent, and industrial nations could experience 3.5-percent growth annually.

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

Country	1982	1983	1984	1984 I	1984 II	1984 III	1984 IV	1985 I	1985 Jan.	1985 Feb.	1985 Mar.	1985 Apr.	1985 May	1985 June
United States	-7.2	5.9	11.6	11.4	8.6	6.4	-2.3	2.1	2.2	2.2	2.9	2.9	1.0	1.9
Canada	-10.0	5.7	8.7	2.4	3.3	13.1	0.7	-1.1	-8.7	-4.9	-2.5	10.5		
Japan	0.4	3.5	11.1	13.5	11.6	6.1	11.6	-2.6	3.0	-1.0	-15.7	39.0	25.1	-8.4
West Germany	-3.2	0.3	2.4	2.5	-10.9	16.5	5.5	-4.6	-1.2	-1.2	15.6	18.2	-15.4	
United Kingdom	2.1	3.9	1.2	-2.4	-7.9	0.4	3.4	5.9	5.9	4.7	28.5	3.4	13.1	
France	-1.5	1.1	2.6	7.4	-4.0	9.5	-9.5	-3.0	-24.6	74.8	19.8	-23.8	19.9	
Italy	-3.1	-3.2	3.1	4.5	2.1	7.7	-6.9	7.4	-37.9	174.3	3.7	-41.1	7.8	

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, August 2, 1985.

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

Country	1982	1983	1984	1984 I	1984 II	1984 III	1984 IV	1985 I	1985 Jan.	1985 Feb.	1985 Mar.	1985 Apr.	1985 May	1985 June
United States	6.2	3.2	4.3	5.0	3.7	3.7	3.5	3.3	2.3	4.2	5.8	4.6	2.7	2.6
Canada	10.8	5.8	4.3	5.7	2.7	3.3	3.3	5.4	6.0	5.2	2.0	6.3	2.0	3.0
Japan	2.6	1.8	2.3	3.6	1.0	1.3	3.3	2.3	4.9	-4.3	0.2	3.0	-1.0	8.7
West Germany	5.3	3.3	2.4	2.8	2.0	0.6	2.8	3.7	4.3	5.2	5.6	1.9	1.4	-0.8
United Kingdom	8.6	4.6	5.0	4.4	3.0	5.5	6.0	7.0	7.4	9.9	12.5	12.1	6.0	5.5
France	12.0	9.5	7.7	7.3	6.2	7.3	6.5	5.7	5.3	5.9	6.7	5.9	6.7	6.4
Italy	16.4	14.9	10.6	11.1	10.4	8.0	6.0	10.2	10.0	10.6	10.9	11.8	9.1	9.1

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, August 2, 1985

Unemployment rates
(Percent; seasonally adjusted; rates of foreign countries adjusted to be roughly comparable to U.S. rate)

Country	1982	1983	1984	1984 I	1984 II	1984 III	1984 IV	1985 I	1985 Feb.	1985 Mar.	1985 Apr.	1985 May	1985 June	1985 July
United States	9.7	9.6	7.5	7.9	7.5	7.4	7.2	7.3	7.3	7.3	7.3	7.3	7.3	7.3
Canada	11.0	11.9	11.3	11.4	11.4	11.2	11.1	11.1	11.0	11.2	10.9	10.5	10.5	
Japan	2.4	2.7	2.8	2.8	2.7	2.8	2.7	2.6	2.6	2.6	2.5	2.6		
West Germany	5.9	7.3	7.4	7.2	7.4	7.5	7.3	7.9	8.0	8.0	8.0	8.1	7.9	
United Kingdom	12.2	13.1	13.4	13.2	13.3	13.6	13.5	13.2	13.2	13.2	13.4	13.3	13.4	
France	8.7	8.8	10.0	9.5	10.0	10.2	10.3	10.5	10.6	10.5	10.5	10.5	10.4	
Italy	4.8	5.3	5.6	5.5	5.6	5.5	5.6				5.6			

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

Source: Statistics provided by Bureau of Labor Statistics, U.S. Department of Labor, August 1985.

Trade balances
(Billions of U.S. dollars, f.o.b. basis, seasonally adjusted at annual rate)

Country	1982	1983	1984	1984 I	1984 II	1984 III	1984 IV	1985 I	1985 Jan.	1985 Feb.	1985 Mar.	1985 Apr.	1985 May	1985 June
United States-1/	-31.6	-57.5	-107.9	-104.8	-104.8	-124.4	-96.4	-114.8	-106.8	-121.2	-116.4	-126.0	-135.6	-142.8
Canada----------	14.4	14.4	16.1	14.4	16.4	16.4	17.6	15.6	12.0	15.6	19.2	19.2	15.6	
Japan-----------	18.6	31.5	44.1	40.0	40.0	40.0	53.6	46.0	55.2	42.0	38.4	46.8	54.0	
West Germany----	21.1	16.6	18.8	18.8	12.8	20.0	23.6	18.0	16.8	19.2	16.8	25.2	25.2	21.6
United Kingdom--	4.1	-1.8	-5.5	-0.4	-6.8	-8.4	-6.4	-6.0	-1.2	-3.6	-13.2	-3.6	3.6	-3.6
France----------	-14.0	-5.9	-2.8	-6.0	-4.8	1.6	-1.6	-4.4	-4.8	-7.2	-1.2	-4.8	-1.2	
Italy-----------	-12.8	-7.8	-10.7	-9.6	-12.8	-6.4	-14.8	-15.2	-14.4	-14.4	-15.6	-19.2		2.4

1/ Exports, f.a.s. value; imports, customs value.

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, August 2, 1985.

U.S. trade balance, by major commodity categories and by selected countries
(Billions of U.S. dollars, customs value basis for imports, seasonally adjusted unless otherwise indicated)

Item	1982	1983	1984	1984 I	1984 II	1984 III	1984 IV	1985 I	1985 Jan.	1985 Feb.	1985 Mar.	1985 Apr.	1985 May	1985 June
Commodity categories:														
Agriculture-------------	21.6	20.0	18.4	5.2	4.4	4.0	4.6	3.3	1.4	1.2	.7	1.1	.5	.5
Petroleum and selected products, unadj---------	-54.6	-49.1	-52.5	-13.1	-13.4	-13.2	-12.8	-9.5	-3.7	-3.2	-2.6	-4.2	-4.1	-4.5
Manufactured goods------	-4.9	-31.3	-78.9	-19.0	-18.1	-25.1	-17.5	-23.2	-6.6	-8.4	-8.2	-7.7	-8.0	-8.5
Selected countries:														
Western Europe----------	7.6	1.2	-14.1	-3.6	-2.9	-4.5	-2.6	-4.5	-1.6	-1.6	-1.3	-1.3	-2.4	-2.3
Canada------------------	-12.6	-12.1	-20.1	-4.3	-5.1	-5.3	-5.7	-4.9	-1.1	-1.8	-2.0	-2.0	-1.6	-1.7
Japan-------------------	-17.0	-19.6	-33.8	-7.0	-7.8	-11.0	-7.9	-10.2	-3.4	-3.9	-2.9	-3.7	-3.9	-4.2
OPEC, unadj-------------	-8.3	-8.2	-12.3	-2.6	-3.7	-3.7	-2.5	-1.3	-.6	-.5	-.2	-.8	-1.1	-.9
Unit Value (per barrel) of U.S. imports of petroleum and selected products, unadj---------	$31.48	$28.60	$28.11	$28.31	$28.45	$27.98	$27.69	$26.96	$27.19	$26.98	$26.71	$26.91	$27.34	$27.02

Source: Summary of U.S. Export and Import Merchandise Trade, U.S. Dept. of Commerce, June 1985.

Money-market interest rates
(Percent, annual rate)

Country	1982	1983	1984	1984			1985		1985					
				II	III	IV	I	II	Feb.	Mar.	Apr.	May	June	July
United States	12.4	9.1	10.4	10.9	11.5	9.4	8.6	7.9	8.7	9.0	8.5	7.9	7.4	7.6
Canada	14.4	9.5	11.3	11.4	12.5	11.2	10.6	9.9	10.6	11.4	10.2	9.8	9.6	9.3
Japan	6.8	6.8	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3
West Germany	8.8	5.7	6.0	6.0	6.0	5.9	6.1	5.8	6.1	6.4	6.0	5.8	5.7	5.3
United Kingdom	12.2	10.1	9.9	9.2	11.1	10.1	12.9	12.6	13.7	13.5	12.7	12.6	12.4	12.0
France	14.6	12.4	11.7	12.3	11.4	10.7	10.6	10.5	10.6	10.7	10.5	10.2	10.8	10.0
Italy	20.0	18.0	17.1	17.0	16.8	17.0	15.8	15.0	15.8	15.8	15.2	14.9	15.0	14.4

Note.--The figure for a quarter is the average rate for the last week of the quarter.

Source: Statistics provided by Federal Reserve Board.

Effective exchange rates of the U.S. dollar, unadjusted and adjusted for inflation differential
(Index numbers, 1980-82 average=100; and percentage change from previous period)

Item	1982	1983	1984	1984			1985		1985					
				II	III	IV	I	II	Feb.	Mar.	Apr.	May	June	July
Unadjusted:														
Index number	109.8	114.2	122.3	118.8	125.1	128.2	135.1	131.3	136.4	136.8	131.7	131.9	130.4	125.8
Percentage change	10.4	4.0	2.5	1.4	5.3	2.5	5.4	-2.8	3.3	0.3	-3.7	0.2	-1.1	-3.5
Adjusted:														
Index number	109.8	112.4	118.3	114.9	120.8	123.0	128.8	124.3	130.0	130.2	124.8	124.6	123.5	120.2
Percentage change	9.0	2.4	1.9	0.5	5.1	1.8	4.7	-3.5	3.0	-0.5	-4.1	-0.2	-0.9	-2.7

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 U.S. and in these other nations; thus a decline in this measure suggests an increase in U.S. price competitiveness.

Source: World Financial Markets, Morgan Guaranty Trust Company of New York.

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