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International Economic Indicators

Economic indicators point to sustained, moderate growth in the United States and in most other industrial nations. Prospects for cheaper oil and the orderly descent of both the U.S. Federal deficit and the dollar increased analysts' faith in the longevity of the current expansion and raised their expectations about short-term U.S. growth. Before the announcement of the pickup in employment and production at yearend, private forecasters projected a 2.8-percent growth for the U.S. economy in the first half of 1986, and a stronger 3.5-percent growth in the second. A recent reading of indicators sparked upward revisions for the first half, in some instances by an entire percentage point, moving private projections closer to the administration's forecast of 4.0-percent growth for the entire year of 1986.

Not all analysts find the current good news conclusive. Many believe that record imbalances in trade and in personal and public finances have made the U.S. economic situation precarious and difficult to manage. There is particular concern about the consequences of planned Federal budget cutting, since that will both stimulate and contract total spending. To maintain growth, combined increases in private consumption, investment, and exports will have to take place in time and in an amount that exceeds Government spending reductions. Some analysts are doubtful that the heavily leveraged personal consumption component of U.S. demand (representing about two-thirds of the nation's total output of goods and services) will react as expected to the stimulus of lower interest rates that reduced deficits should deliver. The use of credit in consumer purchases is now at an historic high: installment debt payments represent 18.8 percent of disposable income.

Industrial production

U.S. industrial production grew 0.3 percent in January 1986 following a 0.7 percent rise in December 1985.

The annual rates of industrial growth in the major industrialized countries, calculated by comparing the latest available monthly output with the output in the corresponding month of the previous year, were as follows: Canada, 5.3 percent; France, 3.8 percent; Italy, -1.5 percent; Japan, 0.5 percent; the United Kingdom, 7.2 percent; the United States, 2.2 percent, and West Germany, 4.6 percent.

Investment

U.S. gross private domestic investment registered a small 0.3-percent increase from $659.9 billion during the fourth quarter of 1984 to $662.2 billion during the fourth quarter of 1985. Non-residential fixed investment increased by 6.0 percent, from $457.8 billion to $485.4 billion over the period.

The volume of private and public, medium- and long-term funds raised on world capital markets increased by 32 percent from 1984 to an alltime high of $261 billion in 1985, according to the Organization for Economic Cooperation and Development (OECD). Rising by 50 percent, the $167 billion borrowing on international bond markets was also at a record level in 1985.

France's Socialist Government has begun to restore some degree of independence to firms nationalized 3 years ago. State-owned companies are now allowed to sell shares in subsidiaries. Some of these shares could end up in U.S. portfolios as French brokers look to enter the U.S. equity markets for the first time since World War II. The absence of French shares from U.S. markets is an anomaly. Along with Canadian, British, Dutch, Scandinavian and Japanese firms, French firms rank among the top in making direct investments in the United States.

Employment

The rate of unemployment in the United States (on a total labor force basis including military personnel) was 6.6 percent in January, a promising decline from December's 6.9 percent. The national statistical offices of other countries reported the following unemployment rates for December: Canada, 10.0 percent; France, 10.5 percent; Italy, 13.5 percent; the United Kingdom, 13.2 percent; and West Germany, 9.2 percent. The November rate was 2.9 percent for Japan. (For foreign unemployment rates adjusted to U.S. statistical concepts, see tables at the back of this issue.)

Joblessness worsened in all the industrialized nations of Europe during the 1980's, according to the European Commission. Unemployment increased from 6.4 percent in 1980 to 10.7 percent in 1985 in France; from 7.1 percent to 12.6 percent in Italy; from 6.0 percent to 12.0 percent in the United Kingdom; and from 3.3 percent to 8.4 percent in West Germany.

External balances

The U.S. merchandise trade deficit hit a record $148.5 billion in 1985. The December deficit of $17.4 billion was a new monthly record. The administration and many private analysts believe that the U.S. trade deficit will begin to diminish in the next couple of months. This prediction is based on the observation that currency depreciation, like that experienced by the dollar since last March, corrects trade deficits only after a certain lag. Depreciation initially worsens the deficit since existing import commitments may have to be settled with cheaper dollars. It is only after a time lag that higher import prices translate into smaller import volumes. The expansion of exports stimulated by the cheaper dollar also requires some time. This phenomenon of initial worsening of a trade deficit following depreciation giving way to improvement afterwards is often illustrated by a J-shaped curve.

Japan chalked up a record annual merchandise trade surplus of $46.1 billion for the year of 1985. The previous annual record of $33.6 billion was registered in 1984. Japan's surplus in trade with the United States increased from $33.1 billion in 1984 to $39.6 billion in 1985, according to Japanese statistics. In trade with the European Community, Japan's surplus increased from $10.1 billion in 1984 to $11.1 billion in 1985.

The U.S. current account deficit increased from $102 billion in 1984 to $128 billion in 1985, according to preliminary estimates. Japan's current account surplus increased from $35 billion in 1984 to $48 billion in 1985, and Western Europe's grew from $10 billion to $17 billion.

Prices

In December, the U.S. consumer price index rose 0.2 percent following a 0.3-percent increase in each of the preceding 2 months. The rate over the 1-year period ending in January was 1.4 percent in West Germany. The rate over the 1-year period ending in December was 4.4 percent in Canada; 4.7 percent in France; 8.6 percent in Italy; 5.7 percent in the United Kingdom; and 3.8 percent in the United States. The rate for the 1-year period ending in November was 1.9 percent in Japan.

There are no clear indications where prices will go from here. On the wholesale level prices increased by 2.1 percent during the fourth quarter as the dollar fell. But December's increase was 0.4 percent, half of what it had been during the previous 2 months. The administration and most private economists expect inflation to increase this year as a result of strong growth in the money supply and expected declines in the dollar. Recent drops in the price of oil, however, are expected to partially offset these factors.

Inflation in the 21 industrial nations (as classified by the International Monetary Fund), abated from 7.5 percent in 1982 to 3.8 percent in 1985. But inflation on a worldwide basis intensified from 12.3 percent to 15.3 percent over the same period. In the less developed countries (LDC's) as a whole, inflation accelerated from 28.4 percent in 1982 to 56.5 percent during the first 7 months of 1985, the latest period for which data is available. There is large variation in price performance within the LDC group. Asian LDC's followed the pattern of industrialized nations and reduced their inflation from 5.7 percent in 1982 to 4.6 percent in 1985. Latin American inflation, on the other hand, jumped from 73.3 percent in 1982 to 185.3 percent, with a considerable list of triple-digit performers in 1985. Bolivia's rate soared from 124.0 percent to 872.0 percent over the period. (This experience is still dwarfed by the classical examples of galloping inflation. During the great Hungarian inflation of 1945-46, for example, the rate averaged 20,000 percent per month for 1 year.)

Forecasts

In its latest assessment of the world economy, the OECD said that economic stability in the coming years can be assured only if differentials among the growth rates of industrialized countries are kept to a minimum and exchange rates conducive to balanced trade relations develop. According to the OECD, the U.S. current account deficit will reach $146 billion in 1986. Japan's current account surplus is expected to widen to $57 billion and that of OECD

Europe to $35 billion. If U.S. growth continues to exceed the average growth of the rest of the world and the dollar remains comparatively strong, the U.S. current account deficit could soar to $500 billion by the end of the decade, according to the OECD, provoking strong protectionism in this country. However, if adjustment to reach equilibrium were too quick, inflation could be rekindled and that would necessitate repressive monetary measures leading to a new recession.

Many energy analysts have reached the conclusion that the Organization of Petroleum Producing and Exporting Countries (OPEC) has lost control over the market and that the best they can hope to achieve through concerted production restraints in 1986 is to slow the descent of oil prices. Economists generally contend that cheaper oil will boost production in the industrial countries and will push inflation rates down further. According to a cautiously formulated projection of <u>The Economist</u>, a drop of $10 a barrel in the price of oil could boost GDP growth by 0.5 to 1.0 percent per year in the industrialized countries.

The average forecast of 50 economists surveyed by the <u>Blue Chip Economic Indicators</u> shows the following annualized increases in the U.S. consumer price index: 3.6 percent during the first quarter of 1986, 3.7 percent in the second, 3.9 percent in the third, and 4.2 percent in the fourth. Despite this acceleration, the surveyed economists believe that inflation will remain below 5.0 percent in 1987. The mean of 25 forecasts on inflation published by the <u>Wall Street Journal</u> is 4.5 percent for the second half of 1986.

Average rates of return on dollar-denominated assets currently exceed average rates on foreign assets denominated in the currencies of other major industrial countries by about 3 to 4 percent, according to economists at the K. Aufhauser & Company. This may be considered the market's expectation of the dollar's annual depreciation since the market is supposed to equalize total returns to investment across countries. If this expectation proves accurate, it will take 6-1/2 years for the dollar to depreciate the additional 25 percent prescribed by many analysts as necessary to achieve a decisive cut in the U.S. trade deficit. Thus the market is forecasting a lengthy process of adjustment.

International Trade Developments

Advanced GSP beneficiaries continue to get most of the program's benefits

Preliminary tabulation of data on U.S. imports in 1985 under the Generalized System of Preferences (GSP) shows that seven relatively advanced developing countries continue to get most of the benefits of the duty-free program (table 1). Seven so-called newly industrialized countries (NIC's)--Taiwan, Korea, Brazil, Mexico, Hong Kong, Israel, and Singapore--accounted for just over three-quarters of the total value of otherwise dutiable U.S. imports that entered duty free under the GSP program last year. Taiwan alone accounted for 24.2 percent of all U.S. imports under the GSP in 1985.

The share of the top seven beneficiaries was up slightly from 1984, even though over half of the exports of GSP-eligible products from these countries were not given duty-free treatment because of the "competitive need" provisions of the program. These provisions were intended to help spread the benefits of the program to less advanced countries by cutting off GSP treatment when the amount or share of imports of any one product from a single country exceeds specified limits.

GSP trade was also relatively more important in the total exports of the leading beneficiary countries to the United States last year: 14.9 percent of all imports from these seven countries benefitted from GSP treatment, while only 8.2 percent of the U.S. imports from middle-income LDC's and 7.4 percent of those from the poorest countries came in under the GSP.

Total GSP imports last year were $13.3 billion, up just slightly from $13.0 billion in 1984. The share of GSP imports in total U.S. imports actually declined to 3.9 percent last year from 4.1 percent in 1984.

Oil's slide complicates Gorbachev's economic plans

The recent fall in oil prices to below $20 a barrel will reduce Soviet hard-currency income directly and indirectly. Oil, the Soviet Union's leading export, generates around 60 percent of Soviet hard-currency export earnings. According to some rough estimates, the Soviet Union stands to lose $500 million to $700 million for each $1 decline in the price of oil. Since the price of its second largest hard-currency earner, natural gas, is linked to that of oil, the Soviet Union also stands to lose hard currency on sales of natural gas to Western Europe, which has accounted for another 20 percent of Soviet hard-currency exports in recent years. Some West European natural gas customers have already been able to use the weakness of oil prices in 1984 to extract price concessions from the Soviet Union. Falling oil prices also jeopardize Soviet sales of arms to Middle Eastern oil producers, another major source of hard-currency income. Some analysts estimate that Soviet arms sales have already started to fall off.

The decline in oil prices comes at a bad time for the Soviet Union, which is launching a new 5-year plan to modernize its economy. Both the plan and Gorbachev were virtually silent on the role imports from the West were to play in the economy over the next 5 years, but most analysts expected the Soviet

Table 1.-U.S. imports for consumption 1/ from GSP beneficiary countries by development status 2/, 1985

Item	Advanced GSP beneficiaries	Middle income GSP beneficiaries	Low income GSP beneficiaries	Total, all beneficiary countries	Total, all countries
Total imports-------thousand dollars--	$67,424,463	$39,140,580	$983,933	$107,548,975	$341,843,890
GSP-eligible products---------do---	27,548,052	4,880,759	235,653	32,664,464	113,056,465
Duty-free under GSP---------do---	10,023,332	3,226,284	73,249	13,322,865	13,322,865
Competitive-need exclusions---do--	14,463,440	789,232	17,723	15,270,395	15,270,395
Other---------------------do----	3,061,281	865,243	144,680	4,071,204	84,463,205
Noneligible product imports---do----	39,876,411	34,259,820	748,280	74,884,511	228,787,425
Ratio of:					
GSP-eligible imports to total imports---------------percent----	40.9	12.5	24.0	30.4	33.1
GSP duty-free imports to GSP eligible imports----------do-----	36.4	66.1	31.1	40.8	11.8
Competitive-need exclusions to GSP-eligible imports-------do-----	52.5	16.2	7.5	46.7	13.5
Other imports to GSP-eligible imports------------------do-----	11.1	17.7	61.4	12.5	74.7
GSP duty-free to total imports------------------do-----	14.9	8.2	7.4	12.4	3.9
Country group share of total GSP duty-free imports---------do-----	75.2	24.2	0.5	100.0	100.0
Country group share of total competitive-need exclusions---do--	94.7	5.2	0.1	100.0	100.0

1/ Customs value basis. Imports into the U.S. Virgin Islands are excluded, which is consistent with the concept of U.S. imports used in the GSP program for competitive-need determinations.

2/ For the purposes of this table, advanced GSP beneficiaries include Taiwan, Korea, Hong Kong, Mexico, Brazil, Singapore, and Israel. The low-income GSP beneficiary category includes 26 countries designated least-developed developing countries in headnote 3(d) of the Tariff Schedules of the United States. The middle-income category includes the other 108 countries or territories currently eligible for GSP treatment.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Union to step up purchases of machinery and equipment from Western companies. Throughout much of 1985, Soviet orders for Western machinery and equipment were significantly above the low levels of the previous 2 years, but some observers think they may have begun to fall off during the last 3 months of 1985.

Problems in the oil sector may jeopardize a second element of Gorbachev's economic strategy. He initially seemed to favor a shift in investment priorities from the energy sector to machine tools, electronics, robotics, and other industries whose development is essential to Soviet economic modernization. However, the budget approved in November 1985 calls for a 31-percent increase in capital investment in the oil industry during 1986.

Further complicating the Soviet hard-currency outlook is the decline in oil production, which was 3 percent lower in 1985 than in 1984. Oil shipments to Western Europe fell sharply from an estimated 1.6 million barrels a day (mbd) in 1984 to 0.9 mbd in the first quarter of 1985. Delivery problems, which were partially due to the harsh winter, were apparently largely resolved later in the year and shipments returned to near-normal levels. Most Western analysts believe that the severe delivery shortfalls of early 1985 are unlikely to be repeated in 1986. In their view, Soviet oil production has peaked but its decline will be gradual, and the Soviet Union will do whatever is necessary to maximize production and maintain oil deliveries to Western Europe as close to normal levels as possible. As evidence, they cite the Soviet Union's lack of other major export possibilities, the plans to step up oil prospecting announced in 1985, and the increase in investment in the oil industry. Judging from the Soviet decision to reduce oil deliveries to Eastern Europe by only about 7 percent during the difficult first months of 1985, many analysts have concluded that the Soviets do not view reductions in supplies to Eastern Europe as a viable option for the future.

The seemingly bleak outlook for Soviet hard-currency earnings in 1986 is brightened somewhat by the increase in grain production and the downward trend in world grain prices. Some analysts predict that this year the Soviet Union will spend about $3 billion less on food imports than in 1985. The extent to which nonfood imports will be cut in 1986 depends on where oil prices stabilize and how the Soviet leadership chooses to react.

The Soviet Union has a number of options to avoid having to slash nonfood imports from the West in 1986. First, it has large reserves of gold and hard currency on deposit in Western banks to draw upon. In fact, during the first half of 1985, the Soviet Union drew down its assets in Western banks and sold more gold than during all of 1983. However, since the market for gold is soft and South Africa is also likely to be selling, some analysts wonder how much more gold the Soviets can sell in the near term without depressing the price of that commodity, too.

Since their net debt to Western governments and private banks is relatively small--estimated at $10.9 billion at the end of 1984--and their credit rating is good, the Soviets could probably increase borrowing from the West. Borrowing from the West is likely to be limited by the Soviet Union's traditional caution in financial matters, but there are already signs of stepped-up Soviet borrowing. The terms the Soviets obtained for large syndicated loans in mid-1985--reportedly one-quarter percent over LIBOR for the first 4 years and three-eights of a percent for the last 4 years--indicate that Western bankers view the Soviet Union as a good credit risk relative to other borrowers. However, this could change if the price of oil remains depressed for long.

Few Western projections are available of Soviet trade if oil prices remain below $20 a barrel. According to one made by Wharton Econometric Forecasting Associates last October, the direct and indirect losses to the Soviet Union would amount to $6 billion if the price of oil averages $19 a barrel in 1986. However, the Soviets might be able to offset about two-thirds of this loss through various adjustments: larger gold sales, increased borrowing from the West, and reduced lending to Third World countries to support arms sales. Thus, they might have to cut imports by less than 5 percent from the level estimated by Wharton in its baseline projection, which assumes only a slight decline in oil prices in 1986.

New trade round sparks interest in accession to the GATT

In upcoming meetings of the GATT Council, the member countries (contracting parties) will review the applications of Costa Rica and Morocco for accession to the world's only multilateral trade agreement. With the launching of a new round of multilateral trade negotiations before the end of this year almost assured, a renewed interest in membership is surfacing. Costa Rica and Morocco initiated formal steps toward accession in 1985 and will negotiate terms of accession during 1986. China and Mexico have marked their rekindled interest with public pronouncements but have not yet formally deposited applications. Countries that become GATT members will be able to participate fully in the swapping of concessions and remaking of trade rules that the new round will bring.

The process of accession can be complicated and time consuming. Application sets off a series of negotiations in which the applicant offers trade concessions to existing contracting parties as an "entry price" for joining the ranks of GATT members. Normally, a working party is established to study information on the country's application, its trade patterns, and the tariff and nontariff aspects of its trade regime. Although unilateral tariff reductions are the most traditional form of entry concession, countries joining the GATT in recent years have frequently been asked to make nontariff concessions such as paring down their export subsidies or refraining from dumping practices. Once they are accepted, however, new members would be on equal footing with other members in negotiating new agreements and mutual tariff reductions in a new trade round.

Morocco's application for GATT accession was first presented to the Council in mid-1985. Moroccan officials reasoned that membership in the GATT would offer more reliable and predictable market access for their exports and that, in the long run, further trade liberalization would expand trade opportunities for Morocco and other developing countries. Unlike that of Morocco, Costa Rica's application requests provisional, rather than full, accession. Costa Rican officials have described the move as a step toward definitive accession, but, for now, it is joining Tunisia, which has been a provisional member of the GATT without completing the full accession process for more than 10 years.

China, having shown tentative interest in accession for some time, made its intentions clear in 1984 in the course of its request for observer status in GATT meetings. China has now informed GATT Director General Arthur Dunkel that it will formally apply for accession in the near future. China has stated that joining new round negotiations is one of its key motives for applying at this time. Nevertheless, its move has stirred controversy in GATT circles and the entry negotiations are likely to be lengthy. First, the terms of accession for a nonmarket economy are more complicated than those for their market-oriented counterparts. Since China is a nonmarket economy, there is a general concern among existing GATT members that the benefits of standard tariff concessions could easily be thwarted. Compromise solutions sought in entry negotiations with other nonmarket economy members have sometimes included a commitment to accept progressively increasing levels of imports from GATT members as a whole. Second, some contracting parties expressed concern that China would want to reclaim a previous "China seat" and thus enter GATT offering only a minimum of new trade concessions to current members. China is apparently aware of this concern.

Mexico's current initiative toward GATT accession follows earlier moves in this direction since the 1970's. After lengthy negotiations with the United States and other countries, Mexico decided in the end not to join, expressing concern that adhering to GATT rules might limit internal economic policy choices. During 1985, Mexican officials revived the idea of joining GATT, with the apparent conviction that the domestic political climate was more favorable. In spite of the sharp declines in the price of oil and the consequent ill effects on Mexico's economy, President de la Madrid recently reaffirmed his position, telling a group of U.S. and Mexican bankers that he hoped GATT entry negotiations would by wrapped up by this fall.

Investment in the Philippines

Foreign investors in the Philippines, having generally held steady throughout the past few years of economic sluggishness, are now considering their options in light of the uncertainties the country is likely to face now that the Presidential election is over. For decades, debate in the country has focused on the impact of foreign investments on the economy.

Critics have claimed that foreign investments dominate the economy, often to the detriment of local industry. Foreign firms operating in the Philippines have been accused of using a disproportionate amount of scarce domestic credit and of introducing technology that is either outdated or inappropriate for local conditions. However, even as the debate continues, substantial amounts of foreign investment are required to meet development needs. Foreign investment is also expected to play a major role in the economy's recovery.

The Philippines is trying to recover from more than 2 years of a debilitating austerity program. Conditions worsened when creditors began cutting ties, and in October 1983 the Philippines declared a debt moratorium on foreign credit repayments. Economic problems were further exacerbated by political instability following the murder of opposition leader Benigno Aquino and reports of Marcos' failing health. The ensuing foreign-exchange shortage forced a severe cutback in most economic activity. During the subsequent period of austerity measures, numerous domestic industries failed, but foreign investment remained relatively stable. Although some foreign-invested enterprises did shut down, notably the auto assembler Ford Philippines, Inc., the majority of investors held on. In 1985, unemployment increased to 15 percent and weak domestic demand cut the utilization of manufacturing capacity to between 45 and 60 percent.

Currently, the Government offers a number of incentives to promote investment in those areas of highest priority. Generally, foreign investment is limited to 40 percent equity, but there are exceptions permitting up to 100 percent foreign ownership in priority areas. Foreign ownership is prohibited in retail trade, mass media, and rural banking. Between October 1983 and October 1984, dividends and other remittances were blocked due to foreign exchange restrictions. These restrictions were lifted at the end of 1985.

A concern among the foreign business community is that a stable and predictable Government policy on investment does not exist. Past shifts in policy have posed numerous problems for some investors. For example, a shift in Government priorities away from import-substitution industries toward export-oriented ventures has hurt certain capital-intensive manufacturing companies that had established operations mainly to supply the domestic market. On the other hand, the Government has delayed the final stage of a tariff-lowering program that would have increased imports, particularly of luxury goods. The aim of the tariff-reduction program is to force local industries to become more efficient by facing increased competition. It will ultimately lower tariff rates from an average of about 50 percent ad valorem to about 25 percent ad valorem. Affected industries, concerned about a deluge of imports are pressing the Government to continue delaying the measure to help them adjust to the current economic situation.

President Marcos is known for policies that encourage the entry of more foreign capital. Foreign investment flows gained momentum shortly after he declared martial law in September 1972, eased all restrictions on foreign investment, and gave guarantees on repatriating capital. During the recent election campaign, Marcos pledged to continue actively promoting foreign investments through various incentives. Opposition candidate Corazon Aquino took the position that while foreign investment is welcome, it should be used as a supplement where domestic capital is inadequate. She pledged that control of utilities and strategic enterprises would be reserved for nationals.

Regardless of political affiliation, there is agreement about the importance of attracting foreign capital, particularly in new industries. One proposal that has gained considerable support is to break from the traditional pattern of industrialization and move into the rural sector. Government support would then go not just toward growing crops for domestic consumption and export, but also toward processing the products and thereby increasing the value added. This strategy, which could help move the country toward industrialization, has been in the proposal stage for some years.

The United States is the Philippines' largest trading partner; it provides over 25 percent of total imports and takes over 35 percent of the country's exports. U.S. investment is well established in the Philippines, conservatively estimated at over $1.5 billion.

China's 1986 plans give top import priority to many U.S. products

Repeating their practice of "readjusting" the economy after a year of fast-paced change, China's leaders will attempt in 1986 to consolidate the gains and correct the excesses that resulted from economic decontrol and decentralization in 1985. During the first 9 months of 1985, industrial output grew by 21 percent over the same period of 1984. This runaway expansion, much of which consisted of consumer goods production by local enterprises outside the direct control of central Government authorities, put severe pressure on scarce inputs, especially energy resources and transport facilities. The introduction of policies to tighten credit and restore central Government control over the approval of some projects apparently succeeded in reducing industrial growth during the last few months of the year, but China's State Statistical Bureau has estimated that industrial output for 1985 will still show an increase of 17 percent over that reported for 1984.

Perhaps even more disturbing to China's leaders was the unanticipated surge in imports which, with exports stagnating, resulted in a steep decline in foreign exchange reserves (IER, November 1985). The imposition of higher tariffs and other controls aimed primarily at restricting access to foreign exchange may have helped to curb import growth during the second half of the year. Nevertheless, China registered an alltime record merchandise trade deficit in 1985, although statistics on the exact magnitude of that deficit are conflicting. Preliminary data released by Chinese Customs show a trade deficit of $13.8 billion, while the statistics published by China's Ministry of Foreign Economic Relations and Trade (MOFERT) indicate the deficit was $7.6 billion. Most analysts consider the Customs figure the more reliable one because MOFERT reports only business done by the Government Foreign Trade Corporations. With the decentralization of the foreign trade sector during 1985, independent organizations are also now conducting both import and export trade.

Since China cannot sustain either the rate of industrial growth or the level of imports registered in 1985, its plans for 1986 call for pausing temporarily and reasserting control over both domestic spending and imports. Yet despite the series of restrictive measures that China's leaders have already put into effect and additional controls that are now being considered, most U.S. companies doing business with China should not be affected adversely by, and may even benefit from, the adjustments that are underway. Imports will be kept as low as possible, but Chinese authorities have also made it clear that foreign exchange will continue to be made available for items that are considered necessary for modernization: transport equipment, machinery to develop energy resources and to upgrade existing industrial plants, computers and other office equipment, and scientific instruments. The China market for some other products in which the United States is a leading competitor--notably, logs for railway and other construction projects and certain chemicals--should also remain strong.

U.S. exports to China of capital goods and other advanced equipment and technology amounted to $2.2 billion in 1985, more than double their value in 1984. In addition to the high priority that China is continuing to place on these items, U.S. companies should benefit in 1986 from the elimination of COCOM clearance for certain types of high-technology exports destined for China (IER, December 1985) and may also benefit from the decline in the dollar. However, as part of its effort to check the rise in imports and increase export sales, China has allowed the renminbi to depreciate. Between the end of 1984 and mid-December 1985, its depreciation against the dollar was 19.7 percent.

The outlook for U.S. exports to China will partly depend upon the degree to which China's Government authorities succeed in regaining control after moving ahead so quickly with the decentralization of the foreign trade sector and with the delegation of decisionmaking to local enterprises during 1985. Their task will be more difficult if there continues to be widespread evasion of the central Government's administrative regulations, as there was in 1985, and the use of foreign exchange for imports now restricted or barred (automobiles, televisions, and other consumer goods) cannot be effectively controlled. The success of U.S. companies in selling goods to China will also partly depend on China's success in maintaining or increasing its exports to the United States. Although China has traditionally sought bilateral balance with each of its trading partners, the precipitous decline in its foreign exchange reserves in 1985 has led to a renewed emphasis on importing more from a country only after raising exports to that country.

Controversial U.S.-Brazil maritime agreement is extended

Last December, the United States and Brazil reached an agreement to extend their 15-year-old maritime accord for 1 more year. The original pact was entered into in 1970 and was renewed in 1983 for 2 years, until the end of 1985. Prior to again extending the pact, U.S. exporters--principally those companies selling chemicals, paper, and automotive products to Brazil--argued vigorously for allowing the controversial agreement to lapse. The Brazilian Government favored the extension, however, and was supported by U.S. maritime interests.

The original agreement grew out of a Brazilian measure of 1969 (Decree No. 666) that all "government cargo" must be reserved for Brazilian-flag vessels. However, the measure allowed Brazil's share in Government cargo to drop to 50 percent provided a cargo-sharing agreement with a trading partner had been concluded. Brazil defines Government cargo broadly to cover any exports and imports by its public entities or any cargo that benefits from Government assistance. Because of this broad definition of what constitutes Government cargo and the strong role of the Government in Brazil's production, the measure allocated an overwhelming share of U.S.-Brazil ocean traffic to Brazilian-flag vessels.

In southbound traffic, Brazil classifies an estimated 80 to 90 percent of shipments as "government cargo." On these grounds, U.S. carriers would have been virtually barred from hauling their own exports to Brazil had a maritime accord not been reached. Instead, the pact allows U.S. carriers equal access to U.S. exports considered Government cargo under Brazil's definition, giving both the United States and Brazil one-half of this traffic. However, since third-country carriers are implicitly excluded from this trade, the maritime accord came under attack by U.S. exporters, many of whom favored the price competition that third-country service would have provided. Exporters claimed that the arrangement drove up their freight rates, making U.S. exports generally more expensive.

Exporters were especially angry that Brazil waived the controversial "government cargo" measure for the purposes of northbound traffic, agreeing to a 20-percent participation of third countries. As a result, the U.S.-Brazilian maritime pact calls for 80 percent of northbound traffic to be shared on an equal basis, giving each partner 40 percent. This allows Brazil's own exports to the United States to benefit from the lower shipping rates of third-country lines--an advantage that U.S. exporters are deprived of. Claiming that the accord has increasingly contributed to a major imbalance in bilateral trade in recent years, exporters strongly urged the U.S. Government to allow the pact to expire.

To gain the support of U.S. maritime interests, Brazil agreed to permit the use of additional U.S. flag carriers under the terms of the new extension and to make still other concessions. On their part, U.S. maritime interests were fearful that the absence of an accord in force could virtually shut them out of United States-Brazil traffic in favor of third-country lines. They were therefore satisfied with the extension, especially since it contained modifications in their favor.

Disappointed U.S. exporters say that by agreeing to the extension, the United States undermined its own commitment to resist the increase of cargo reservation in global maritime service. Maritime officials of the United States admit that the accord with Brazil has been a departure from U.S. maritime policy that generally favors competition. However, these officials do not see the exporters' case lost for good, claiming that the 1-year extension is no more than a necessary compromise to gain time.

U.S. negotiators warned Brazil that without a satisfactory resolution of outstanding issues the pact would definitely lapse on December 31, 1986. The two countries are expected to meet frequently this year to forge an accord that will be more acceptable to the United States. Discussions are likely to focus on Brazil's willingness to roll back their cargo preference laws, thus opening up more bilateral maritime traffic to third-country competition.

Trade representatives move closer to coordinated MTN positions

On January 17-18, trade ministers from the four major free-world economies--the United States, Canada, Japan, and the European Community--met in San Diego to attend the eleventh Quadrilateral Trade Ministers' Conference. The purpose of the meeting was to define the priorities and strategies of industrial countries in the new round preparatory discussions now underway in the GATT. Five specific trade issues were discussed at the Quad meeting: the GATT dispute settlement process, a safeguards code, trade-related investment issues, natural resource pricing, and intellectual property rights. In addition, the ministers discussed ways to gain the support of the developing nations for a new round of talks. Although they do not consider the new round to be in jeopardy, they expect the choice of topics for the agenda and the scope of each topic to be the source of hot disputes.

U.S.-EC disagreements over the GATT dispute settlement process largely result from EC support of the principal of consensus as opposed to a more expeditious and binding system favored by the United States. Nevertheless, both agreed that the process needs to be streamlined so that the settlement of disputes is more timely. EC Commissioner Willy de Clercq supported the U.S. suggestion of giving the GATT Secretariat a bigger role in the process. Also, de Clercq suggested that setting stricter time limits and using independent panelists to review trade cases (rather than panelists who are officials of member countries) would streamline the process.

The Quad participants agreed that approval of a safeguards code, which would regulate the use of emergency restrictive trade measures, should be given high priority during the new round. Although the issue that blocked agreement during the last trade round remains unresolved (whether safeguard measures could be selectively applied or should always be applied on an MFN basis), the ministers agreed that proposed emergency restrictions must meet strict criteria before they are used and should not inhibit the normal process of structural adjustment.

The trade representatives also agreed that GATT should cover trade-related investment issues but that the topic needs to be narrowed before the talks begin. Clayton Yeutter, the U.S. Trade Representative, said that natural resource pricing is also a topic that should be discussed during the next round of negotiations since this area is largely exempt from current GATT authority. Although agriculture was not officially on the agenda of the Quadrilateral conference, the trade ministers were more optimistic than previously that this sensitive issue could be adequately addressed in the new round.

Ways to prevent piracy of copyrights and patents were the last item on the official agenda of the Quadrilateral meeting. The ministers agreed that intellectual property rights need protection and that an anticounterfeiting code, which was proposed during the last round, should be approved as early as possible during the new negotiations. De Clercq opposed, however, the U.S. suggestion to install an immediate code on counterfeiting to be followed by another code addressing more complicated issues such as patent and copyright violations across national borders. De Clercq maintained that the developing countries are opposed to a general code addressing patents and copyrights and that the issue should therefore be approached more cautiously.

Gaining the support of developing countries for the new round is one of the top priorities of the preparatory discussions now being held in the GATT. De Clercq stressed that the trade round agenda needs to include areas where the developing countries stand to gain, such as market access for tropical food products. De Clercq also expressed concern over the U.S. negotiating strategy on the renewal of the Multifiber Arrangement that expires this July. Although the United States has not officially announced its position, a tough protectionist stance could hurt third-world support for the new trade round. To encourage the support of the developing countries, Quad participants discussed the possibility of instituting a standstill, or freeze, on trade barriers among developed countries, but the issue was postponed until the next Quadrilateral conference, scheduled for September in Portugal. At that time, just prior to the official beginning of the new round of trade negotiations, the trade ministers may make a strong call for a worldwide standstill on trade barriers.

In addition to Clayton Yeutter and Willy de Clercq, the conference was attended by James Kelleher, the Canadian Minister of International Trade, and Michio Watanabe, the new Japanese Minister of International Trade and Industry. This session was one of a series of meetings, usually held two to three times a year, that began in January 1982 to provide a forum for discussing major trade issues on an informal basis. Ambassador Yeutter pronounced this Quad especially worthwhile as it "dealt with more concrete substantive issues than we have confronted previously."

GATT Preparatory Committee meets to set new round agenda

Officials of GATT member countries have held the first of a series of meetings to set an agenda for a new round of trade talks. The January 27-29 meeting marked the first formal session of the new round Preparatory Committee formed last fall by the specially convened Senior Officials Group. The Preparatory Committee will meet regularly until July of this year, the deadline for presenting a draft agenda for discussion in the GATT Council. More meetings are scheduled in February and March to initially review the more than 30 negotiating topics proposed by delegates in earlier meetings of the Senior Officials Group. Next September, a Ministerial-level conference will host final negotiations on the agenda.

Issues floated in the January meeting included proposals for standstill and rollback of protectionist measures (which refer respectively to freezing or reducing the current level of protectionism), safeguards (emergency action against injurious imports sanctioned by GATT article XIX), and ways GATT can address the needs of developing countries. The concept of a standstill was received favorably as a move to inspire confidence in the multilateral trading system. Debate on rollback focused on specifics of how such a concept would be implemented. Delegates generally agreed that the GATT safeguards clause should be renegotiated. The agenda on developing countries included the longstanding issue of trade in tropical products and debate about whether developing country trade concessions would become the quid pro quo for increased aid. The agenda for the February meetings include discussion of agricultural trade, dispute settlement, nontariff measures, and the Tokyo Round codes (covering such practices as subsidies, dumping, import licensing, etc.).

Optimism about the Committee's work does not prevail because GATT members are still far from agreement on some key issues. The question of whether trade in services should be included in the new round remains the most controversial issue, and it was deliberately reserved for later committee meetings to buy time for further behind-the-scenes negotiations. Although major trading partners came to terms on several new round issues at the recent quadrilateral meetings in San Diego (see the companion article on the quadrilateral conference), common ground with developing countries has yet to be found. The United States on the one hand and Brazil and India on the other remain divided on the U.S. proposal that services negotiations form part of the new round.

Citing the growing protectionism in many major world economies, GATT members are now basically unanimous in calling for a new round to break this trend. Moreover, the multifaceted work program that evolved out of the 1982 Ministerial meeting is now recognized as having provided the groundwork for new round discussions. The remaining task is for the Preparatory Committee and the subsequent Ministerial meeting to chart the issues and terms for negotiation. In order to facilitate consensus among the competing interests of committee members, GATT Director General Arthur Dunkel has offered to take responsibility for preparing an issues paper for the their approval. The paper would reflect Preparatory Committee deliberations and serve as a working paper for the September Ministerial. If deliberations go as planned, a new round is likely to be officially launched at the September Ministerial meeting, slightly behind the originally slated U.S. target of early 1986.

STATISTICAL TABLES

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

Country	1983	1984	1985	1984 IV	1985 I	1985 II	1985 III	1985 IV	1985 Aug.	1985 Sept.	1985 Oct.	1985 Nov.	1985 Dec.	1985 Jan.
United States	5.9	11.6	2.3	-2.3	2.1	1.3	2.1	3.8	9.1	-1.9	-7.4	7.4	8.7	3.7
Canada	5.3	8.8		0.7	0.7	4.5	11.4		-0.8	-2.4	8.4			
Japan	3.5	11.1	2.8	11.6	-2.6	11.2	-0.4	2.8	-14.4	-12.9	12.5	-11.1	7.1	
West Germany	0.3	2.4		5.5	-2.5	12.5	0.7		-25.4	12.6	11.0			
United Kingdom	3.9	1.2		3.4	11.1	7.5	0.6		3.4	22.1	0	15.2		
France	1.1	2.3		-9.5	-3.0	4.1	7.3		0	-16.4	9.4	30.4		
Italy	-3.2	3.1		-6.9	7.4	1.1	-2.6		11.9	29.8	-32.9	31.8		

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, January 31, 1986.

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

Country	1983	1984	1985	1984 IV	1985 I	1985 II	1985 III	1985 IV	1985 July	1985 Aug.	1985 Sept.	1985 Oct.	1985 Nov.	1985 Dec.
United States	3.2	4.3	3.5	3.5	3.3	4.2	2.4	4.1	2.4	2.4	2.3	3.8	6.9	5.3
Canada	5.8	4.3	4.3	3.3	5.4	3.8	3.4	4.4	3.1	4.1	4.0	2.4	3.9	9.6
Japan	1.8	2.3	2.1	3.3	2.4	1.3	2.1	2.5	4.2	-2.0	-3.7	9.1	-0.7	7.6
West Germany	3.3	2.4	1.8	2.8	3.5	2.5	0.1	1.0	-1.1	-0.3	2.1	-0.2	2.2	1.4
United Kingdom	4.6	5.0	5.6	6.0	7.1	9.1	3.0	3.0	0.6	2.7	1.9	1.5	4.5	5.9
France	9.5	7.7	4.8	6.5	5.7	6.0	4.4	3.1	3.4	3.0	2.3	2.4	4.2	4.5
Italy	14.9	10.6	8.6	6.0	10.1	10.2	7.3	6.7	6.5	7.1	2.5	7.2	6.6	13.7

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, January 31, 1986

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

Country	1983	1984	1985	1984 IV	1985 I	1985 II	1985 III	1985 IV	1985 Aug.	1985 Sept	1985 Oct.	1985 Nov.	1985 Dec.	1986 Jan.
United States	9.6	7.5	7.2	7.2	7.3	7.3	7.2	7.0	7.0	7.1	7.1	7.0	6.9	6.7
Canada	11.9	11.3	10.6	11.2	11.1	10.6	10.3	10.2	10.3	10.1	10.3	10.2	10.0	
Japan	2.7	2.8		2.7	2.6	2.6	2.7		2.4	2.8	2.8	2.9		
West Germany	7.5	7.8	7.9	7.8	7.9	8.0	7.9	7.9	7.9	7.9	7.9	7.9	7.9	
United Kingdom	12.8	13.0	13.3	13.0	13.1	13.3	13.5	13.1	13.7	13.4	13.2	13.1	13.2	
France	8.6	10.1	10.3	10.4	10.4	10.3	10.5	10.1	10.5	10.4	10.2	10.1	10.0	
Italy	5.3	5.9	6.1	5.8	5.9	5.9	6.2	6.3			6.3			

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, February 1986.

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

Country	1983	1984	1985	1984 IV	1985 I	1985 II	1985 III	1985 IV	1985 July	Aug.	Sept.	Oct.	Nov.	Dec.
United States-1/	-57.5	-107.9	-132.8	-96.4	-114.8	-135.2	-127.6	-153.6	-110.4	-104.4	-168.0	-122.4	-147.6	-190.8
Canada	14.4	15.9		17.6	16.4	12.8	8.8		2.4	9.6	15.6	19.2	4.8	
Japan	31.5	44.1		53.6	46.4	52.4	56.8		56.4	60.0	55.2	61.2	73.2	
West Germany	16.6	18.8		23.6	18.4	26.0	28.0		32.4	20.4	27.6	27.6	27.6	
United Kingdom	-1.6	-5.3	-2.4	-6.4	-5.6	-1.2	-2.8	0	-1.2	-3.6	-3.6	0	-2.4	2.4
France	-5.9	-2.8	-2.8	-1.6	-4.4	-1.6	-2.8	-2.4	-4.8	0	-3.6	1.2	1.2	-4.8
Italy	-7.9	-10.9		-14.8	-15.6	-14.4	-4.0		-7.2	-2.4	0	-7.2	-19.2	

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

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, January 31, 1986.

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	1983	1984	1985	1984 IV	1985 I	1985 II	1985 III	1985 IV	1985 July	Aug.	Sept.	Oct.	Nov.	Dec.
Commodity categories:														
Agriculture	20.0	18.4	9.6	4.6	3.3	2.1	1.7	2.5	0.5	0.7	0.5	0.9	0.9	0.7
Petroleum and selected products, unadj	-49.1	-52.5	-45.9	-12.8	-9.5	-12.8	-11.0	-12.6	-3.7	-3.3	-4.0	-4.0	-4.1	-4.5
Manufactured goods	-31.3	-78.9	-102.0	-17.5	-23.2	-24.2	-24.9	-29.7	-6.9	-6.9	-11.1	-7.6	-9.7	-12.4
Selected countries:														
Western Europe	1.2	-14.1	-23.3	-2.6	-4.5	-6.0	-5.7	-7.1	-1.6	-1.1	-3.0	-1.5	-2.4	-3.2
Canada	-12.1	-20.1	-21.7	-5.7	-4.9	-5.3	-4.7	-6.8	-1.2	-1.4	-2.1	-2.0	-1.9	-2.9
Japan	-19.6	-33.8	-46.5	-7.9	-10.2	-11.8	-12.0	-12.5	-3.7	-3.5	-4.8	-3.0	-4.3	-5.2
OPEC, unadj	-8.2	-12.3	-10.2	-2.5	-1.3	-2.8	-2.4	-3.7	-.6	-.5	-1.3	-1.1	-1.2	-1.4
Unit Value (per barrel) of U.S. imports of petroleum and selected products, unadj	$28.60	$28.11	$26.59	$27.69	$26.96	$27.09	$25.98	$26.35	$26.19	$26.05	$25.72	$25.97	$26.25	$26.53

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

Money-market interest rates
(Percent, annual rate)

Country	1983	1984	1985	1984 IV	1985 I	1985 II	1985 III	1985 IV	1985 Aug.	1985 Sept.	1985 Oct.	1985 Nov.	1985 Dec.	1986 Jan.
United States	9.2	10.7	8.3	9.4	8.8	8.6	7.9	7.8	7.8	7.8	7.9	7.8	7.9	7.8
Canada	9.5	11.3	9.7	11.2	10.6	9.9	9.1	9.0	9.2	8.9	8.7	8.9	9.4	10.5
Japan	6.8	6.7	6.5	6.3	6.5	6.3	6.3	7.0	6.5	6.3	6.5	7.3	7.1	6.5
West Germany	5.7	6.0	5.5	5.9	6.1	6.0	4.9	4.8	4.8	4.7	4.8	4.8	4.8	4.6
United Kingdom	10.1	9.9	12.1	10.1	12.8	12.6	11.5	11.6	11.2	11.4	11.5	11.5	11.7	11.6
France	12.4	11.7	10.0	10.7	10.6	10.5	9.7	9.1	9.8	9.4	9.3	9.0	9.0	8.9
Italy	18.2	15.9	15.0	17.0	15.8	15.4	14.4	14.3	14.4	14.4	14.2	14.3	14.3	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	1983	1984	1985	1984 IV	1985 I	1985 II	1985 III	1985 IV	1985 Aug.	1985 Sept.	1985 Oct.	1985 Nov.	1985 Dec.	1986 Jan.
Unadjusted:														
Index number	114.2	122.3	127.2	128.2	135.1	131.3	125.0	117.3	124.0	125.3	118.9	116.9	116.1	115.0
Percentage change	4.0	7.1	4.0	2.5	5.4	-2.8	-4.8	-6.2	-1.4	1.0	-5.1	-1.7	-0.7	-0.9
Adjusted:														
Index number	112.4	118.3	121.1	123.0	128.8	124.3	119.4	112.0	118.5	119.5	112.0	112.1	111.9	111.3
Percentage change	2.4	5.2	2.4	1.8	4.7	-3.5	-3.9	-6.2	-1.4	0.8	-6.3	0.1	-0.2	-0.5

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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