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INTERNATIONAL ECONOMIC COMPARISONS

The poor performance of industrial economies so far this year has raised doubts about the predictions of a rebound in the second half and for strong growth through 1987 and 1988. Growth projections are being scaled back and pessimistic views have gained ground. The official U.S. growth forecast for 1986 has been cut from 4.0 percent to 3.2 percent. The Administration maintains that the fundamentals for a speedier growth have not diminished and will be reflected in next year's growth performance. Leaving out inventory accumulation and the trade deficit from the calculations, the U.S. real GNP grew well in excess of 4.0 percent during the second quarter, rather than by the officially announced 1.1 percent. Consumer expenditures grew by a healthy 5.9-percent annual rate, but industrial output—still suffering from heavy import competition—declined by 2.9 percent, and capital investment in real terms edged down from its first quarter level. The Federal deficit is expected to reach a new record of $230.2 billion during the current fiscal year, and the 1986 trade deficit may easily exceed last year's record of $148.5 billion.

The U.S. trade deficit is now commonly perceived as a critical factor in suppressing economic growth in the United States. The following circumstances contribute to its persistance: (1) The Federal deficit has not been brought down. Until the deficit is reduced, U.S. demand for foreign loans is likely to continue to be strong. As long as the United States is a net borrower in international markets, it will register a corresponding deficit in the trade balance, regardless of actions to restrict imports. (2) Economic growth in the rest of the industrial world has been weaker than U.S. growth so far this year. A switch in relative growth performance is needed to assure the expansion of U.S. exports. (3) Trade patterns have caused sectoral developments that are hard to reverse. During the 1980's, while the U.S. service industry has prospered, agriculture and manufacturing have gone into stagnation, and consumption has grown faster than production. Consumers have developed brand loyalty to foreign products, and foreign producers have become dependent on U.S. markets. (4) Foreign suppliers show a great determination to hang on to their U.S. market share through such measures as cutting costs at home and absorbing losses. (5) The dollar-exchange rates of the currencies of several major U.S. trading partners have either depreciated or have not changed since yearend 1985 (see External Balances).

A minority of analysts say that the recovery has run out of steam and the U.S. economy is within a hairbreadth of a new recession. Soft commodity prices, strong stock markets, high real interest rates, the persistent international debt, ballooning personal debts, forceful protectionist undercurrents, and short circuits in international monetary cooperation have led a number of commentators to draw parallels with the economic situation of the late 1920's. Of course, there are safety nets now that did not exist 60 years ago and the world community is probably wiser. At the same time, analysts caution, increased national and international economic interdependence has made the world more vulnerable to economic dislocations.

Industrial Production

Following a 0.4-percent decline in May, U.S. industrial production fell by another 0.5 percent in June. The annual rates of industrial growth in the other 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, 5.2 percent; France, -1.5 percent; Italy, 7.7 percent; Japan, -1.8 percent; the United Kingdom, -0.5 percent; the United States, -0.2 percent; and West Germany, 2.3 percent.

Investment

U.S. nonresidential business investment declined by 0.1 percent in real terms from January–March to April–June 1986. It will fall by 4.5 percent from 1985 to 1986, according to the investment firm of Morgan Stanley. The most important factor hampering a brisker pace of capital formation is the slide of corporate profits. For the sixth consecutive quarter, corporate profits fell by 5 percent during the second quarter of 1986. According to some private economists, the prospective elimination of the investment tax credit under the pending tax reform is already slowing investment. The continued reduction of the savings rate (from 5.1 percent in May to 4.5 percent in June) and signs of strengthening cohesion among oil producers are also negatively affecting investment prospects. According to the Conference Board, the stronger overall U.S. economic growth forecast for the second half of 1986 will not materialize without a pickup in investment.

Employment

The rate of unemployment in the United States (on a total labor-force basis, including military personnel) declined from 7.0 percent in May to 6.8 percent in June. The decline was the composite result of continued growth in new jobs and a minor loss in the size of the work force. Most analysts see the jobless rate climbing back again in the coming months. Chase Econometrics says, however, that the monthly average unemployment rate will stay at its May level for the rest of 1986. The national statistical offices of other countries reported the following unemployment rates for the month of June: 9.5 percent in Canada, 11.7 percent in the United Kingdom, and 9.0 percent in West Germany. The May rate was 10.0 percent in France, 13.9 percent in Italy, and 2.7 percent in Japan. (For foreign unemployment rates adjusted to U.S. statistical concepts, see the tables at the back of this issue.)

External Balances

The deficit in U.S. merchandise trade remained at $14.2 billion during June, the same as during May. The trade deficit with Japan declined from $5.0 billion in May to $3.7 billion in June. Imports from Japan increased from $6.7 billion in May to $7.6 billion in June. A rough calculation (taking the change in currency rates and U.S. and Japanese price indices into account) indicates that the volume of U.S. imports from Japan also increased during this period. Japanese industries that have grown dependent on selling their wares in the United States try very hard to hang onto their U.S. market share. Newspaper reports tell about Japanese willingness to absorb profit losses and efforts to cut domestic costs of production. Larger economies of scale facilitated by increased worldwide demand for some Japanese products are helping these efforts.

More than one-half of the U.S. deficit in June was incurred in trade with seven countries (Canada, Mexico, Taiwan, Korea, Hong Kong, Venezuela, and Saudi Arabia), the currencies of which have either remained the same or depreciated against the dollar since the end of 1985.

Prices

The U.S. Consumer Price Index rose by a sharp 0.5 percent in June, following a more moderate increase of 0.2 percent in May and a 0.3 percent decline in April. This acceleration over the 3-month period reminded economists of stagflation, where the rate of inflation exceeds a niggling real growth of the economy.

The inflation rate during the 1-year period ending in June was 3.7 percent in Canada, 2.3 percent in France, 6.3 percent in Italy, 2.5 percent in the United Kingdom, and 1.7 percent in the United States. The West German price level declined by 0.2 percent during the period. The inflation rate in Japan during the 1-year period ending in May was 0.5 percent.

Forecasts

Economic growth

Economists expect the U.S. real GNP to grow at an annual rate of 4.0 percent during the last half of 1986, according to a recent survey by the *Journal of Commerce*. The surveyed economists predict an imminent halt to the decline in U.S. industrial production and project a 5 percent growth in output during the next 12 months. Despite the lackluster economic performance during the first half of 1986, only about one-third of the surveyed economists expect a recession before 1988, and more than one-half of these believe the slump is going to be minor.

The Organization for Economic Cooperation and Development (OECD) projects a bright picture for the West German economy. Despite the contraction during the first quarter of 1986, the OECD predicts that the growth of West German real GNP will accelerate from 2.4 percent during 1985 to 3.4 percent during 1986 and 3.1 percent during 1987. Investment in machinery and equipment appears to be the strongest component of the West German economy. This sector is projected to grow by 10.1 percent during 1985 and by 10.9 percent during 1987.

Private economists in France put the annual rate of real growth of the French economy at an average of 2.7 percent during the 5 years between 1986 and 1990. This is less than the 3.0 percent growth rate recorded during 1973–78 but considerably more than the low 1.2 percent rate during 1979–85.

Employment

The International Labor Organization (ILO) says that 1.9 billion new jobs need to be created between now and the year 2025 in order to solve the global employment problem. This includes jobs for the 90 million currently unemployed, the 300 million underemployed, and for the 1.5 billion new entries in the labor market between now and then. Thus the world community faces the challenge of creating 47 million new jobs per year during the next 40 years. ■

INTERNATIONAL TRADE DEVELOPMENTS

United States Reaches Textile Accords With Hong Kong, Taiwan, and the Republic of Korea

On June 30, United States Trade Representative Yeutter announced that Hong Kong, the largest exporter of textiles and apparel to the United States by value and the fourth largest by volume, signed a pact with the United States agreeing to limit its textile exports. Two weeks later, Ambassador Charles Carlisle, Chief Textile Negotiator in the Office of the United States Trade Representative, announced a similiar accord with Taiwan that sharply restricts the growth of that country's textile shipments during the next 2 years. Taiwan is the largest supplier of textiles and clothing in terms of volume to the United States. An accord was reached with the Republic of Korea (Korea) in early August. These agreements are the result of U.S. efforts to get its top three textile suppliers—Taiwan, Hong Kong, and Korea—to agree to limit the the growth of their shipments to the United States and thereby fend off heavy congressional pressure for even sharper cutbacks.

In addition to ceilings on total textile shipments to the United States (in both Multifiber Arrangement (MFA) and non-MFA categories), the Hong Kong agreement also adds silk blends and vegetable-fiber products (ramie, linen, and jute) to the restricted categories. Prior to the new accord, textile exports in some categories were tightly controlled but flexibility was permitted in other groups. That fact enabled Hong Kong to increase textile and apparel exports of all fibers by 63 percent between 1980 and 1985, or an average of 12 percent per annum. However, the new accord sharply curtails access to the U.S. market by placing a ceiling on Hong Kong apparel and textile products. Reportedly, the growth rates for exports are very low during the first 3 years—0.5 percent in 1986, 0.75 percent in 1987, and 1.0 percent in 1988. After 1991, when the agreement ends, the growth rate will increase to 2.5 percent.

With the exception of restraints on silk and vegetable-fiber products, which became effective on August 1, Hong Kong's agreement takes effect retroactively from January 1, 1986. It establishes three main categories of goods—cotton, wool, and manmade fibers—subdivided into garment and nongarment items. Silk and ramie products will be subject to quota restrictions for the first time.

The Taiwan accord, which also takes effect retroactively from January 1, is similiar in scope to the Hong Kong agreement. It also expands coverage from cotton, wool, and manmade fibers to include nearly all fabrics, including silk blends, linen, and ramie. According to U.S. officials, the pact will reduce Taiwan's 1986 textile and apparel shipments to the United States by about 7 percent compared with the level reached during the 12-month period ending in May. Under the agreement, the amount of Taiwan's exports will grow only minimally, about 0.5 percent a year from 1985 through 1988. Taiwan, like Hong Kong, had been able to increase its textile shipments to the United States by expanding into unrestricted categories and by enlarging production of other categories that had not used up their quotas. This ability enabled Taiwan to increase the value of its shipments to the United States an average of 15 percent annually between 1981 and 1985.

Unlike the Hong Kong agreement, Taiwan's agreement will end on December 31, 1988, and does not allow for a second 3-year period of slightly higher growth rates. According to Ambassador Carlisle, the more favorable conditions for Hong Kong reflect the fact that it is a free port. If Taiwan reduces its prohibitively high tariffs on U.S. textile and apparel products and reduces other barriers to textile imports, Ambassador Carlisle said the United States would be prepared to negotiate an extension and possibly higher growth rates in the future.

Korea's 4-year textile agreement was announced on August 4. The accord limits import growth to 0.8 percent a year, compared with an average annual growth of 8.6 percent from 1981 to 1984. As with the Hong Kong and Taiwan agreements, it also extends coverage to include silk blends, ramie, and linen.

The accords have failed to placate the U.S. textile industry, which is lobbying for sharper restrictions on textile imports from the four biggest suppliers to the United States—Taiwan, China, Korea, and Hong Kong. (China, the second largest supplier of textiles to the United States will not be covered by a new agreement. It signed an accord with the United States in 1982 and the new MFA will provide curbs on future growth.)

Hong Kong, Taiwan and Korea were hoping the agreements would reduce some of the pressure in Congress to override President Reagan's veto of the Jenkins Bill. That legislation would slash textiles imports from the major textile exporters by up to 30 percent. On August 6, the

House of Representatives failed to override the President's veto of the Jenkins Bill by eight votes. ■

Korea Concedes on Three Longstanding Trade Disputes With the United States

On July 21, after months of negotiations, United States Trade Representative Yeutter and the Korean Ambassador to the United States signed an accord containing agreements that settle three longstanding bilateral trade disputes. Under the terms of the agreements, the Republic of Korea will relax its ban on the sale of foreign cigarettes, allow U.S. companies access to its tightly restricted fire and life insurance markets, and enact legislation within a year to protect foreign books, records, technology, and other products from piracy.

Although intellectual property protection and access to the insurance market have been subjects of numerous U.S.-Korean consultations over the past few years, the newly concluded accord was the result of a more agressive trade policy mandated by the President last fall. Under that mandate, in September 1985, the United States Trade Representative (USTR), initiated a section 301 case against Korean trade practices affecting the insurance sector. In October 1985, the USTR initiated a case against inadequate protection of U.S. intellectual property in Korea. Without a resolution to the cases, the United States could have imposed retaliatory restrictions against Korean exports.

Under the intellectual property rights agreement, Korea will submit legislation on copyright protection to its National Assembly in September to take effect next July. Copyrights will be protected for a term of life plus 50 years for individual authors and for a period of 50 years for works authored by corporations. Retroactive protection will be applied to foreign products published since 1977. Korea will also accede to the Universal Copyright Convention. Under a separate law, effective July 1, 1987, software technology will be protected for a period of up to 50 years. Retroactive protection will be granted to software products developed since July 1980.

Product patents will be protected in Korea beginning July 1, 1987. A bill to amend the patent law to include coverage for chemicals, pharmaceuticals, and their production processes will be submitted to the National Assembly by the end of September 1986. The protection period for patents will be 15 years.

The objective of the section 301 case against Korean insurance practices was to gain access for U.S. firms to Korea's $5 billion insurance market. Prior to the agreement, compulsory fire insurance in Korea was reserved for a "fire pool" of 11 Korean underwriters. Life insurance was sold solely by six Korean companies. Under the accord, Korea agreed to license two U.S. nonlife firms currently operating in Korea (American Home Assurance Co. and Cigna Insurance Co.) to take part in the "pool" system and to begin underwriting compulsory fire insurance as of July 31, 1986. One U.S. company, not yet determined, will be licensed to sell life insurance in Korea by yearend. Gradually, Korea will open its market to more companies.

The United States had been trying for years to gain access to the Korean cigarette market. Under the accord, U.S. and other foreign cigarettes will be allowed to enter Korea's market in September of this year. Korea's $1.8 billion-a-year cigarette market is protected by a highly effective nontariff barrier—it is illegal for Koreans to possess foreign cigarettes. Korean nationals may smoke cigarettes offered to them by foreigners, but possession in almost any other context could result in arrest and fines. Korea will repeal this restriction. Under the agreement, Korea will increase its imports of cigarettes (some foreign brands are imported for sale exclusively to foreigners and are sold only in duty-free shops and foreign commissaries, accounting for 0.04 percent of total domestic consumption) by 40 million packs annually, or 1 percent of the Korean market, worth about $15 million annually. With a 100-percent import tax, foreign brands will sell for approximately $1.60 a pack, compared with $O.60 for domestic brands. Korea will also introduce legislation to dismantle its Office of Monopoly, which controls the manufacture, distribution, and importation of tobacco.

Korea's merchandise trade surplus with the United States in the first half of 1986 was a record $3.26 billion, up 75.9 percent from the same period last year. The agreements, coming during a period when protectionist sentiment is running high in Congress and bilateral trade tensions are exacerbated by Korea's huge trade surplus with the United States, should help ease the trade frictions. ■

The United States and Japan Conclude Semiconductor Negotiations

U.S. negotiators emerged from their talks with the Japanese on semiconductors with an agreement in hand. The agreement, announced by the President on July 31, seems to contain most

of the provisions that U.S. negotiators had set as goals earlier in the month when partial settlements concerning the suspension of two antidumping cases were initialed by officials of both Governments. Officials of the U.S. Government and industry hope to gain up to $2 billion in increased sales of semiconductors in the Japanese market as a result of the agreement.

Contained in the 5-year agreement are provisions promising a steady increase in the U.S. share of the Japanese market. Although not officially stated, most expect the increased share to amount to about 20 percent, up from the 8.5 percent market share the United States currently holds. The Japanese have also agreed to monitor costs and export prices of Japanese semiconductor firms in order to prevent pricing at less than fair value. The antidumping cases on erasable read only memory (EPROM) and 256K random access memory (RAM) components have been suspended and the U.S. industry is withdrawing its unfair trade complaint, contingent on continued satisfactory compliance with the agreement's provisions.

A provision concerning the monitoring of third-country pricing has also been included, to the satisfaction of U.S. officials. European officials, worried that the exclusion of such a provision would lead to dumping in their markets, lobbied the U.S. Government to include this provision. U.S. industry officials were worried that the failure of the agreement to include such a provision would force U.S. producers of semiconductor-utilizing products offshore with their circuit board assembly operations, hurting the U.S. job market.

A spokesman for the Semiconductor Industry Association called the agreement "strong and workable," but also stated that the success of the agreement depends greatly on the amount of dedication devoted to it by all involved. The Japanese pledged to back up their part of the deal by creating new Government units for monitoring semiconductor costs and prices and by creating an association dedicated to helping foreign firms increase sales in Japan. In addition, the Japanese Government agreed to allow all Japanese-based foreign manufacturers to share in benefits offered to domestic firms in Japan. This includes Government sponsored research and tax breaks.

The U.S. Government retains the right to reinstate the antidumping cases and the unfair trade complaint at any time if it feels that the agreement is being violated. The two Governments will meet periodically to evaluate the progress of the agreement. In case of a dispute, emergency consultations may be called by either Government. Only time will tell if this long-contested issue has come to a conclusion. ■

A Loan Accord Between the IMF and Mexico Breaks New Ground

On July 22, Mexico and the International Monetary Fund (IMF) signed a landmark accord. Recognizing that Mexico is unable to absorb the losses caused by plummeting petroleum prices (*IER*, October 1985 and May 1986), the IMF committed new credits to Mexico's rescue and, at the same time, announced its support for Mexico's growth-oriented policy. The new IMF financing amounts to $1.6 billion through the end of 1987. In return, Mexico promised economic policy reforms that would amount to reducing the role of the Government, which owns or controls about three-fourths of the economy. Although Mexico's new commitments include major budget cutting, they are seen as compatible with a 3.5-percent growth rate in 1987.

Mexico is already burdened by foreign debt amounting to nearly $98 billion and debt-servicing commitments it is unable to meet. The new pact, although by itself not seen as a solution for the country's grave economic problems, is expected to provide Mexico with access to new financing from other sources such as the World Bank, commercial banks, and foreign governments. The IMF assistance, combined with the funds hoped for from these additional sources, could add up to significant relief.

Until recently, Mexico has been regarded as the Latin American country most willing to accept austerity as the price to be paid for its huge accumulated debt (see *IER*, December 1985). In June, however, the Mexican Government announced that debt repayment schedules would have to be reconciled with its commitment to economic growth.

The IMF's endorsement of Mexico's growth-oriented policies is seen as a departure from its position in the past. Prior to the July accord, the IMF invariably required austerity measures from beneficiary countries in return for support, and made no provisions against the recessionary consequences. In contrast, the July agreement provides for supplementary investment funds in the event Mexican economic growth falls below the targeted 3.5 percent. In another unprecedented feature, the new accord allows additional "compensatory" financing for Mexico if the price of crude oil dips to a level between $5 and $9 a barrel and stays there for 90 days or more. (This provision is reportedly causing some concern that linking assistance to specific commodity prices

might set a precedent for similar demands from other debtor countries.)

The July accord broke a 5-month deadlock in negotiations. The principal sticking point was how much Mexico must slash its Federal budget. The IMF reportedly demanded that the budget deficit be reduced to 5 percent of the Gross Domestic Product (GDP), to which Mexico countered with 12 to 13 percent. The parties eventually agreed that, by the end of 1987, Mexico will reduce its deficit to 10 percent of GDP. This year's deficit is projected to be 13 to 18 percent.

In its efforts to cut down on spending and increase the efficiency of the public sector, the Mexican Government has already begun closing down unprofitable state-owned companies or selling them to the private sector. Twenty-three state enterprises were sold or closed between February 1985 and June 1986. The most notable of these was the shutdown in May of Fundidora Monterrey, which is Latin America's oldest steel mill.

Further Mexican commitments include a reform of the Government's pricing policies, improvement in the tax system and tax collection, liberalization of trade, and promotion of foreign direct investment. Its imminent accession to the General Agreement on Tariffs and Trade (GATT), slated for August 24, also forces Mexico to carry out some of the same measures. Trade liberalization has been in progress in Mexico for some time, but it still has a long way to go (*IER*, July 1985).

The July agreement comes within the framework of Treasury Secretary Baker's plan to help indebted Third World nations grow and pay back their creditors. Secretary Baker, Federal Reserve Board Chairman Volcker, and other officials of the U.S. Government participated actively in forging Mexico's pact with the IMF.

In the months prior to the agreement, Mexico's economic and political stability—major U.S. foreign policy objectives—appeared to be threatened. Renewed capital flight and the peso's rapid depreciation were obvious economic distress signals. There were also signs of political unrest in response to the economic hardship suffered by a broad segment of the population, and there were rumors that the Government was under pressure to suspend interest payments to foreign banks. The Government was eventually forced to replace the Minister of Finance, who was known for his advocacy of continued austerity, and to shift from an austerity program to a growth-oriented policy.

The accord with the IMF resolved Mexico's immediate cash-flow problem, but prospects for improvement will largely depend on the willingness of commercial bankers to grant fresh loans. Immediately following the accord with the IMF, Mexico requested commercial banks (which already hold 80 percent of the country's $97.6 billion foreign debt) to supply $6 billion in new loans through the end of 1987. ■

China Devalues in Response to Mounting Deficit

On July 5, China devalued its currency, the renminbi (RMB), by 15.8 percent against the U.S. dollar. The Chinese unit was also cut sharply against the Japanese yen and the Hong Kong dollar, the currencies of its first- and second-ranking trading partners, and against the Swiss franc, the currency China uses to settle imbalances in its trade accounts with the Soviet Union and other Soviet bloc countries. The RMB is a nonconvertible currency, whose rates are set by China's State Administration of Foreign Exchange Control and are reportedly based on an unspecified basket of international currencies.

The devaluation—from 3.19 RMB to 3.69 RMB per U.S. dollar—was the largest single currency adjustment made by China since it resumed posting U.S. dollar rates (after a 20-year suspension) in 1972. It followed a series of gradual adjustments against the dollar in 1985, resulting in a cumulative devaluation last year of approximately 14.3 percent. These earlier moves have failed to check the rise in China's trade deficit, however, and analysts are doubtful that the recent devaluation can do much to reduce it over the short run.

After 3 years of foreign-trade surpluses (1981–83), China began to import heavily during the last half of 1984. This buying surge was spurred not only by planned purchases of capital equipment to modernize the Chinese economy, but by the widespread introduction of reforms in both the foreign-trade and the urban, industrial sectors. Under the reform program, China's leaders began to allow independent export and import agents to operate in addition to the Government foreign trade corporations, to extend more decisionmaking authority in foreign trade to provincial and city governments, and to decentralize the operation of business enterprises, allowing them to retain for their own use part of their foreign-exchange earnings. The result was an unprecedented increase in China's imports that the Government, despite the imposition of a series of import restrictions, was unable to bring under control until late 1985. Meanwhile, the

growth of China's exports slowed significantly, and its foreign-exchange reserves plummeted (*IER*, November 1985).

China's merchandise trade deficit totaled $7.61 billion in 1985, up from $1.1 billion in 1984, according to its Ministry of Foreign Economic Relations and Trade. These data show that imports grew by 31.8 percent, and exports increased by only 5.7 percent. However, figures released by Chinese Customs, which are probably more reliable since they include trade transactions by organizations not directly controlled by the central Government, show a $14.9 billion deficit in 1985, with imports climbing 54.2 percent and exports increasing by 4.7 percent. On top of this record deficit (on the basis of either set of figures), imports for the first 5 months of 1986, as reported by Customs, exceeded exports by $5.35 billion. China's foreign-exchange reserves, after peaking at $18.9 billion in July 1984, declined to $11.91 billion at yearend 1985, and continued to slide to $10.34 billion at the end of March 1986.

The July 5 devaluation was a response to the continuing foreign-exchange crisis. Although Government controls aimed primarily at severely restricting purchases of consumer goods have reduced the overall rate of import growth, imports of steel, other construction materials, and machinery and equipment have remained high. These are products, however, that China wants to continue importing to meet development needs. Yet the present level of imports can be sustained only if exports rise enough to reduce the merchandise trade deficit to a level where it can be covered by nontrade earnings and a reasonable amount of foreign borrowing. China's leaders have recently indicated a willingness to borrow more, but they have repeatedly stated that annual debt repayments must be kept to within 15 to 20 percent of total foreign-exchange earnings from exports. Boosting exports is, therefore, the main objective of the devaluation.

A number of factors suggest, however, that the devaluation may not help much. One reason is that most Chinese export contracts are denominated in dollars or other foreign currencies. Another is that China has been relying heavily on higher oil exports to increase its foreign-exchange earnings. Crude oil accounted for 28 percent of the value of China's exports last year, but even as the price of oil continued to slide, the volume of China's oil shipments dropped to 7 million tons during the first quarter of 1986, 40 percent less than the quantity it exported during the last 3 months of 1985. Moreover, increased earnings from clothing and other textile products, which normally account for at least another quarter of China's export revenues, are likely to be limited by the quantitative import restrictions of China's major textile markets, the United States and the European Community. The expansion of export earnings from textiles—as well as from many other low-valued Chinese products—will depend mainly on improvement in product quality, rather than on still lower export prices. On the other hand, the devaluation should help China to achieve greater diversification in its export products. Under the new RMB-dollar rate, the prices of many exportable Chinese manufactures and specialty agricultural products will no longer be higher than prevailing world prices. ■

GATT Preparatory Committee Fails to Draft Declaration

The GATT committee charged with preparatory work on the proposed new trade round failed to agree on a draft declaration to forward to the September meeting of trade ministers in Punta del Este. In order to launch a new round, the ministers must now sort out the details of three proposed documents and arrive at a common agenda. One of the drafts was tabled by Brazil and contains wording unacceptable to the United States and other developed countries. Another draft, the one most nearly achieving consensus, was drafted by a group of small developed countries. Argentina also submitted its own version of a draft declaration at the last minute.

The preparatory committee met in formal and informal sessions for 6 months and covered a list of more than 30 potential negotiating topics. At the July deadline for preparing a draft ministerial text, less than a handful of issues stalemated the GATT members. The EC, France in particular, refused compromise wording on agricultural issues. At the same time, Brazil stood firmly against folding "new areas" such as services and investment into the trade talks. Both issues are important aspects of the U.S. agenda for negotiations.

According to statements made by United States Trade Representative Clayton Yeutter, the U.S. Government agenda includes plans to promote greater world market access through reductions in foreign tariff and nontariff barriers. Further, Yeutter has called for improving the rules on agriculture, subsidies, and safeguards so that governmental actions in these areas do not permanently impede trade. The U.S. negotiators also hope to fold new rules into the system to cover important U.S. trading interests in services, intellectual property rights, and investment. Further, Yeutter views improving the

dispute settlement process as indispensable to buttressing the integrity of the rules.

One of the concerns of trade policymakers in the 1980's has been that trade liberalization and GATT rules do not benefit all sectors equally. Sectoral priorities differ from country to country, however. Such sectors as agriculture, tropical products, natural resources, and textiles have been named in this regard. The United States and Australia support bringing agriculture more fully under GATT principles. Developing countries have shown particular interest in applying GATT rules more strongly to trade in tropical products. Some countries, most notably Canada, have complained of the GATT's inattention to problems of trade in natural resources. In addition, developing countries consider textiles and clothing to be removed from direct GATT coverage by the Multifiber Arrangement. These countries argue that the sector should be brought back under normal GATT rules. ■

Multifiber Arrangement Extended Amid Calls For Tighter Textile Import Quotas

Representatives from more than 50 countries agreed in Geneva last month to extend the Multifiber Arrangement (MFA), which expired on July 31, for another 5 years. The new agreement contains several key demands made by the United States. After 10 months of negotiations that pitted it against the less developed countries (LDC's) that are major textile suppliers, the United States obtained the inclusion of new fibers, to provide for MFA coverage of nearly all textile fibers; a provision to increase control over import surges; and a provision that permits the imposition of import quotas as an antifraud measure.

In negotiations on the new MFA, the United States insisted on expanding product coverage to fibers such as silk, linen, and ramie. The old MFA had applied only to cotton, wool, and manmade fibers. The United States sought expanded fiber coverage out of concern that increased trade in non-MFA fibers in recent years allowed producer countries to circumvent the agreement's quota limitations.

The provision for responding to unexpected import surges extends quotas to counteract such surges from 1 year to 2 years. To combat fraud, such as false declarations on quantity and the type and origin of products, the new agreement allows importing countries to enact quotas against offending countries and requires cooperation by exporting countries in investigating such fraud. In addition, however, the new accord contains special provisions for small supplier countries, new entrants into the market, and the least developed countries. Such suppliers are not normally subject to MFA restrictions, but if exports from these countries are restricted under the new agreement, they are to be treated more favorably than exports from major supplier countries.

The U.S. negotiating position was buttressed by the threat of a possible congressional override of President Reagan's veto of a more restrictive textile quota bill sponsored by Representative Jenkins (D-Ga.). The override vote failed to garner the necessary two-thirds majority, so the veto was sustained. U.S. textile industry and congressional leaders lobbied hard for the override, however, arguing that the new MFA contains too many loopholes, falls short of the protection they feel is needed for the U.S. industry, and does not effectively guard against import surges. The Jenkins bill, if enacted, would have cut U.S. textile imports from the major supplier countries—Hong Kong, Taiwan, and the Republic of Korea—by a maximum of 30 percent and would have frozen the imports of nine other supplier countries at 1984 levels. It would also have provided import relief for footwear and copper. Before the vote, the Reagan administration warned that a veto override would prompt retaliation by U.S. trading partners and endanger the new GATT round of trade negotiations scheduled to get underway in September.

In the face of rising imports from low-cost producers, the MFA was established in 1974, and was extended in 1978 and 1982. Operating under the aegis of the GATT, it functions to regulate trade in textiles by providing a framework for the negotiation of bilateral agreements between the major textile importing countries and LDC suppliers. ■

STATISTICAL TABLES

Industrial production

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

Country	1983	1984	1985	1985 I	1985 II	1985 III	1985 IV	1986 I	1986 Jan.	Feb.	Mar.	Apr.	May	June
United States	5.9	11.6	2.3	2.1	1.3	2.1	1.9	0.5	2.9	-9.1	-10.9	8.0	-4.7	-5.6
Canada	5.3	8.8	4.4	0.7	4.5	9.4	6.1	-0.9	-0.8	8.2	-31.9	4.6	-21.9	
Japan	3.5	11.1	4.7	-2.6	11.2	-0.4	-2.9	0.7	-6.7	1.0	-2.9	0.0	4.0	6.1
West Germany	0.3	2.4	5.0	-2.4	12.2	0.1	0.8	-0.6	23.4	-3.4	-23.7	72.6		
United Kingdom	3.9	1.3	4.6	11.5	7.6	0.4	0.7	3.4	8.1	15.4	-1.1	6.8	-15.2	
France	1.1	2.5	0.5	-3.0	4.1	7.3	0.0	-5.8	0.0	9.5	0.0	55.7	-46.5	
Italy	-3.2	3.3	1.2	7.4	1.1	-2.5	-1.8	11.7	20.7	39.3	44.9	16.4	-55.3	

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, August 1, 1986.

Consumer prices

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

Country	1983	1984	1985	1985 II	1985 III	1985 IV	1986 I	1986 II	1986 Jan.	Feb.	Mar.	Apr.	May	June
United States	3.2	4.3	3.5	4.2	2.6	4.3	1.4	-1.7	4.1	-4.6	-5.0	-3.3	2.2	5.7
Canada	5.8	4.3	4.0	3.8	3.4	4.4	4.8	2.9	5.4	2.6	2.9	2.7	5.0	0.1
Japan	1.8	2.3	2.0	1.3	2.1	2.1	0.0	-0.8	0.2	0	-6.3	0.3	1.5	0.6
West Germany	3.3	2.4	2.2	2.5	0.2	1.0	-0.9	-1.1	-1.1	-3.2	-2.1	-1.2	0.2	0.4
United Kingdom	4.6	5.0	6.1	9.1	3.0	3.2	4.5	0.3	5.9	3.4	0.7	-1.3	1.0	1.1
France	9.5	7.7	5.8	6.0	4.3	3.2	0.8	1.6	-0.6	-3.1	0.7	1.6	2.6	5.0
Italy	14.9	10.6	8.6	10.2	7.2	6.9	6.2	5.0	3.6	5.3	5.3	3.5	5.8	6.4

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, August 1, 1986.

Unemployment rates

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

Country	1983	1984	1985	1985 II	1985 III	1985 IV	1986 I	1986 II	1986 Feb.	Mar.	Apr.	May	June	July
United States	9.6	7.5	7.2	7.3	7.2	7.0	7.1	7.2	7.3	7.2	7.1	7.3	7.1	6.9
Canada	11.9	11.3	10.5	10.6	10.2	10.1	9.7	9.6	9.8	9.6	9.6	9.6	9.5	
Japan	2.7	2.8	2.6	2.6	2.7	2.9	2.7		2.6	2.8	2.9	2.7		
West Germany	7.5	7.8	7.9	8.0	7.9	7.8	7.8	7.6	7.8	7.8	7.7	7.6	7.6	
United Kingdom	12.8	12.9	13.2	13.2	13.4	13.0	13.1	13.2	13.1	13.3				
France	8.6	9.9	10.3	10.4	10.4	10.1	10.2	10.5	10.2	10.3	10.5	10.6	10.5	
Italy	5.3	5.9	6.0	5.8	6.0	6.3	6.3	6.5			6.5			

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 1986.

Trade balances

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

Country	1983	1984	1985	1985				1986	1986					
				I	II	III	IV	I	Jan.	Feb.	Mar.	Apr.	May	June
United States[1]	-57.5	-108.1	-132.0	-114.8	-135.2	-128.0	-147.2	-157.2	-180.0	-134.4	-157.2	-129.6	-153.6	-152.4
Canada	14.4	15.9	12.3	16.0	12.8	8.8	11.6	6.8	8.4	1.2	12.0	9.6	7.2	
Japan	31.5	44.0	55.9	46.4	52.4	57.2	67.6	71.6	70.8	66.0	76.8	84.0	102.0	
West Germany	16.6	18.8	25.3	18.4	25.6	27.6	29.6	40.4	43.2	39.6	38.4	55.2	38.4	
United Kingdom	-1.6	-5.3	-2.5	-5.6	-1.2	-2.4	-1.2	-8.0	2.4	-6.0	-21.6	-4.8	-12.0	-10.8
France	-5.9	-2.8	-2.6	-4.4	-1.6	-3.2	-1.6	0.4	6.0	0	-4.8	-8.4	-3.6	-2.4
Italy	-7.9	-10.9	-11.9	-15.2	-14.8	-4.4	-14.4	-12.4	-19.2	-8.4	-9.6	0.0	2.4	3.6

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

Note.—The U.S. Department of Commerce reports monthly exports and imports without seasonal adjustment beginning with January 1986. U.S. data for prior periods have been accordingly changed. This does not affect the comparability of U.S. and foreign trade balances on an annual basis.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, August 1, 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	1985			1986		1985	1986				
				II	III	IV	I	II	Jan.	Feb.	Mar.	Apr.	May	June
Commodity categories:														
Agriculture	20.0	18.4	9.6	2.1	1.7	2.5	1.7	0.2	0.5	0.7	0.5	0.3	-0.2	0.1
Petroleum and selected products, unadj	-49.1	-52.5	-45.9	-12.8	-11.0	-12.6	-10.6	-6.7	-4.6	-3.2	-2.8	-1.6	-2.3	-2.8
Manufactured goods	-31.3	-78.9	-102.0	-24.2	-24.9	-29.7	-31.1	-32.0	-11.1	-9.1	-10.9	-9.6	-10.7	-11.7
Selected countries:														
Western Europe	1.2	-14.1	-23.3	-6.0	-5.7	-7.1	-6.6	-8.1	-2.7	-1.6	-2.3	-2.4	-2.3	-3.4
Canada	-12.1	-20.1	-21.7	-5.3	-4.7	-6.8	-5.9	-5.8	-1.7	-1.9	-2.3	-1.8	-2.1	-1.9
Japan	-19.6	-33.8	-46.5	-11.8	-12.0	-12.5	-14.3	-12.5	-5.1	-4.0	-5.2	-4.4	-4.7	-3.4
OPEC, unadj	-8.2	-12.3	-10.2	-2.8	-2.4	-3.7	-3.5	-1.5	-1.8	-1.0	-0.7	-0.1	-0.6	-0.8
Unit Value (per barrel) of U.S. imports of petroleum and selected products, unadj	$28.60	$28.11	$26.59	$27.09	$25.98	$26.35	$22.70	$13.40	$26.02	$23.70	$18.39	$13.94	$13.29	$12.97

Note.—The U.S. Department of Commerce reports monthly exports and imports without seasonal adjustment beginning with January 1986. U.S. data for prior periods have been accordingly changed. This does not affect the comparability of U.S. and foreign trade balances on an annual basis.

Source: *Summary of U.S. Export and Import Merchandise Trade*, U.S. Dept. of Commerce, June 1986.

Money-market interest rates

(Percent, annual rate)

Country	1983	1984	1985	1985 II	1985 III	1985 IV	1986 I	1986 II	1986 Feb.	Mar.	Apr.	May	June	July
United States	9.2	10.7	8.3	8.6	7.9	7.8	7.6	6.5	7.7	7.2	6.0	6.7	6.7	6.4
Canada	9.5	11.3	9.7	9.9	9.1	9.0	11.1	8.9	11.8	10.9	9.6	8.6	8.7	
Japan	6.8	6.7	6.5	6.3	6.3	7.0	6.0	4.7	6.0	5.5	4.9	4.6	4.5	
West Germany	5.7	6.0	5.5	6.0	4.9	4.8	4.5	4.6	4.5	4.5	4.5	4.6	4.6	
United Kingdom	10.1	9.9	12.1	12.6	11.5	11.6	11.9	10.1	12.6	11.7	10.4	10.2	9.7	
France	12.4	11.7	10.0	10.5	9.7	9.1	8.7	7.4	8.8	8.3	7.7	7.2	7.2	
Italy	18.2	15.9	15.0	15.4	14.4	14.3	15.5	12.9	15.9	16.1	13.6	13.4	11.8	

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

Source: Statistics provided by Federal Reserve Board.

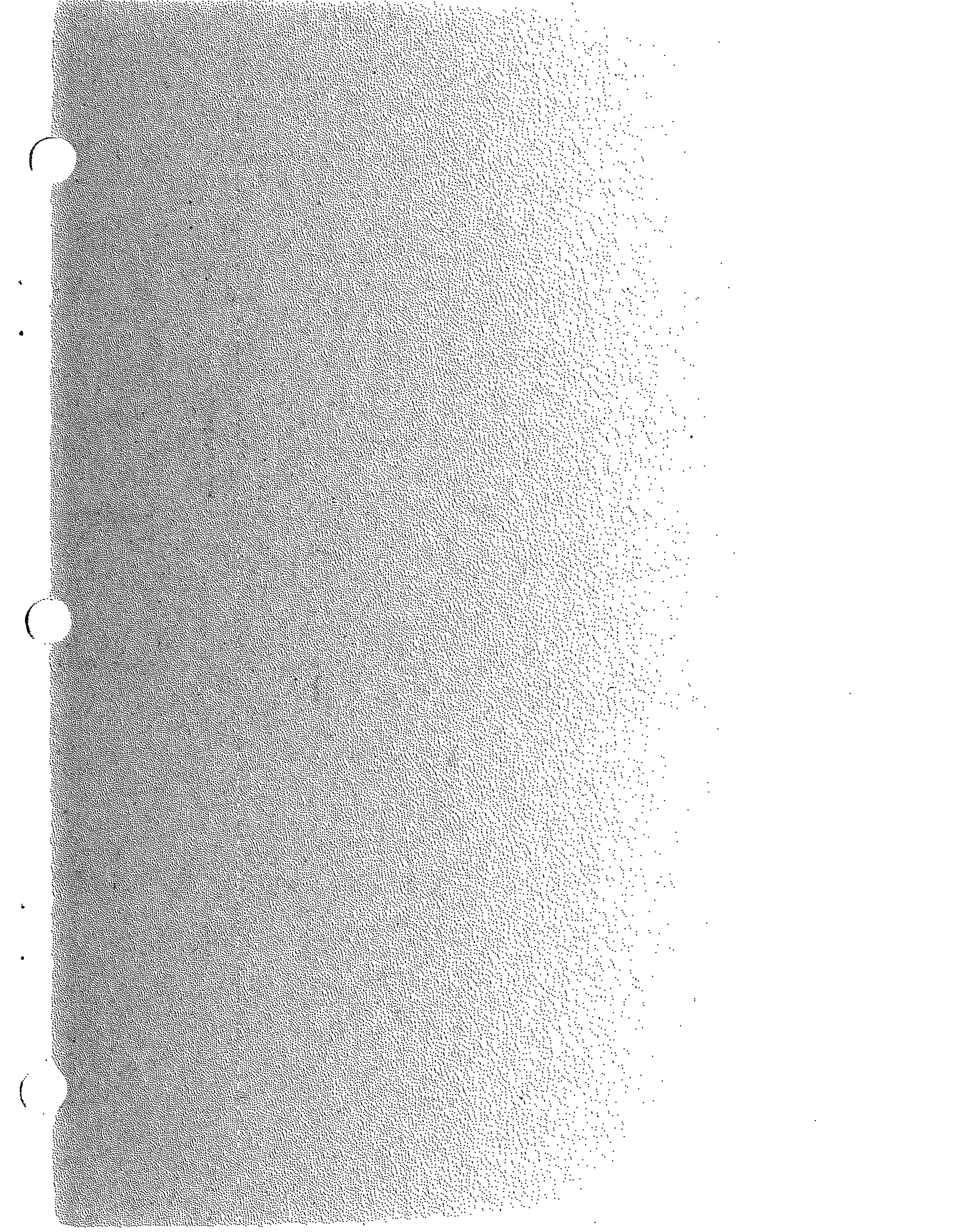
Effective exchange rates of the U.S. dollar, unadjusted and adjusted for inflation differential

(Index numbers, 1980-82 average=100; and percentage change from previous period)

Item	1983	1984	1985	1985 II	1985 III	1985 IV	1986 I	1986 II	1986 Feb.	Mar.	Apr.	May	June	July
Unadjusted:														
Index number	114.2	122.4	127.1	131.3	125.0	117.3	117.8	106.7	111.2	109.0	108.0	105.8	106.5	103.9
Percentage change	4.0	7.2	3.8	-2.8	-4.8	-6.2	0.4	-4.6	-3.3	-2.0	-0.8	-2.1	0.8	-2.4
Adjusted:														
Index number	112.7	118.2	121.3	124.3	119.4	112.0	106.3	99.1	105.2	101.9	101.0	100.0	101.0	98.3
Percentage change	2.5	4.9	2.6	-3.5	-3.9	-6.2	-5.1	-6.8	-4.3	-2.9	-0.9	-1.0	1.0	-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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