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INTERNATIONAL ECONOMIC COMPARISONS

Many forecasters are predicting that economic expansion in the industrialized countries will continue at a moderate pace in 1988. (See the section on Economic Growth under Forecasts below.) However, economists disagree on the manner in which an economic downturn can be avoided. According to one school of thought, expounded by British economist Stephen Marris, the business upswing in the industrialized countries will continue only if the United States steps up its efforts to cut the Federal budget deficit, and Japan and West Germany stimulate their domestic demand. Professor Marris argues that European countries should engage in forceful fiscal and monetary policies to eliminate chronic unemployment and spur consumption. He also says that some Asian countries (including Korea and Taiwan) should take active steps to reduce their trade surpluses. According to this view, further declines in the value of the dollar in foreign-exchange markets are useless and dangerous. They are useless because U.S. exports are already at full capacity. They are dangerous because lower levels of the dollar would create inflationary pressures leading to global recession.

According to another viewpoint represented by Professor Martin Feldstein, only further considerable declines in the dollar can prevent another global recession. The lower dollar will increase U.S. exports and will finally force cuts in the budget deficit. Foreigners will become increasingly reluctant to purchase U.S. Treasury bonds because of fears of inflation. Squeezed by the drastic increase in U.S. exports, the Europeans and Japanese will be forced to stimulate their economies and substitute domestic sales for lost exports. This view assumes that there will be a rise in the current level of inflation, and a full preservation, if not an increase, in national economic sovereignty.

During the closing quarter of 1987, the annualized rate of the U.S. gross national product (GNP) in 1982 constant dollars was 4.4 percent above the 1986 GNP. The increase was 1.0 percent from the third quarter of 1987 to the last quarter. The unusual surge in inventories (see Investment below) supports the view that the economy is slowing in the wake of weakened consumer spending. Personal consumption expenditures in constant dollars at annual rates dipped by 1.0 percent from the third quarter to the fourth. This was the first fourth-quarter decline in consumer outlays measured in constant dollars since 1981. If accumulation of nonfarm business inventories during the fourth quarter of 1987 had remained at the same level as during the third quarter, the GNP would not have expanded over the period. However, most U.S. economists do not expect a recession in 1988 and, as corporate surveys suggest, the nation's business community remains optimistic.

Industrial Production

U.S. industrial production rose by 0.2 percent in January 1988, following an increase of 0.4 percent in December 1987. Orders to U.S. factories surged by 2.5 percent in December, largely as a result of huge orders to U.S. aircraft manufacturers. In 1987, factory orders were 7.3 percent above their 1986 level. This was the largest jump in factory orders since 1984.

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, 8.1 percent; France, 4.0 percent; Italy, 3.6 percent; Japan, 11.0 percent; the United Kingdom, 3.7 percent; the United States, 5.1 percent; and West Germany, 1.0 percent.

Investment

U.S. nonresidential investment in 1982 constant dollars declined by 1 percent from an annualized rate of $463.7 billion during the third quarter of 1987 to $459.5 billion during the fourth quarter. Producers' durable equipment declined by nearly 2 percent from $336.5 billion to $330.3 billion over the same period. Both nonresidential investment and investment in producers' durable equipment increased from the first quarter through the third quarter of 1987. At $58.2 billion, the increase in the annual rate of inventories during the fourth quarter of 1987 was the largest quarterly increase in 3 years. The accumulation occurred mostly among wholesalers and retailers, not in factories. Wholesalers and retailers tend to react to inventory buildup by cutting prices and manufacturers have to respond immediately with cutbacks in output and employment.

Japanese interest in the U.S. financial market remains relatively weak, as recent U.S. Treasury auctions have demonstrated. U.S. Treasury papers and U.S. corporate bonds offer solid gains in dollar terms. However, Japanese investors worry that the dollar may further decline against the yen, wiping out their gains in terms of their domestic currency. According to recent press reports, in 1987, the appreciation of the yen

against the dollar resulted in a portfolio loss of $13 billion for Japan's seven largest life insurance companies.

Science and Technology

The National Science Foundation reports that the proportion of scientists and engineers to the labor force remained virtually unchanged in the United States between 1965 and 1984 but grew in other major industrialized nations. In 1965, Japan, France, the United Kingdom, and West Germany, all had about one-third as many scientists and engineers in proportion to the labor force as the United States. By 1984, Japan had almost caught up, and the other three countries had approximately two-thirds of the U.S. level.

Employment

The rate of unemployment in the United States (on a total labor force basis, including military personnel) remained 5.8 percent in January 1988—the same as in December 1987.

The national statistical offices of other countries reported the following unemployment rates for December 1987: 8.1 percent in Canada, 10.4 percent in France, 14.8 percent in Italy, 9.4 percent in the United Kingdom, and 9.0 percent in West Germany. The November rate was 2.7 percent in Japan. (For foreign unemployment rates adjusted to U.S. statistical methods, see the tables at the end of this issue.)

External Balances

Japan's total current account surplus increased from $85.85 billion in 1986 to a record $86.69 billion in 1987. (Current account includes trade in goods and services and transfer payments.) According to 1987 monthly data, Japan's current account surplus appeared to be subsiding until December when a surge of exports pushed the monthly surplus to $9.44 billion. This was the highest monthly figure during 1987 and exceeded the $9.20 billion level of December 1986. Analysts who believe that Japan's surplus position is on its way down attribute the export surge to increased Japanese direct investment abroad and to the "J curve effect." (The latter means that the appreciation of the yen made Japanese exports more expensive, causing the country's surplus to widen before it narrows.)

Prices

The U.S. Consumer Price Index rose at a seasonally adjusted rate of 0.1 percent in December 1987. The Journal of Commerce's Industrial Price Index—measuring changes for a wide array of industrial input prices—showed a declining trend from July 1987 to date. Although higher than during the first months in 1987, the index remained below its 1980 base so far this year. In contrast, the annual average of the Consumer Price Index grew by 37.9 percent from 1980 to 1987.

The average rate of inflation during the 1-year period ending in December 1987 was 4.2 percent in Canada, 3.1 percent in France, 5.1 percent in Italy, 3.7 percent in the United Kingdom, 4.4 percent in the United States, and 1.0 percent in West Germany. The average rate of inflation during the 1-year period ending in November 1987 was 0.7 percent in Japan.

Forecasts

Economic growth

The U.S. Administration forecasts 2.4-percent growth in the Nation's real GNP in 1988. Forecasts by private analysts place U.S. real economic growth in the range of 2.0 to 2.5 percent. The Wharton Econometric Forecasting Associates projects a 2.5-percent growth in the real gross domestic product (GDP) of the United States, Japan, and the United Kingdom in 1988; 1.5 percent in France; and 1.9 percent in West Germany.

According to the Inter-American Development Bank, real economic growth in the Latin American countries as a group decelerated from 41 percent in the 1970's to near zero thus far in the 1980's. Most analysts agree that Latin American economic prosperity remains hostage to the way the region's governments handle their cumulative debt of $390 billion. Some analysts believe that the countries of the region could start paying off their debt and resume economic growth only if they effectively cut their domestic fiscal deficits, reduce state ownership in industry, and open their doors to foreign competition.

Third World debt

The World Bank forecasts an increase in the nominal value of developing country debt, from $1.190 trillion at the end of 1987 to $1.245 trillion at the end of 1988. At the end of 1987, the debt was 2.5 percent higher than at the end of 1986 and 15 percent higher than at the end of 1985. The World Bank's most recent report on the debt situation was unusually downbeat. It re-

ferred to a "growing frustration and fatigue at the lack of progress from debtors and creditors alike." This pessimism reflects the fact that the debts of most developing nations are growing faster than their national economies and their stocks of productive capital.

Some analysts see positive developments ahead in alleviating the Third World debt problem. A major European bank forecasts an increase in the secondary market of developing country debt paper, from $15 billion in 1987 to $25 billion in 1988. As prices for developing country debt papers decline, the debtor countries are expected to buy back at least some of their own debt. The increasingly active cooperation between developing country governments and Western commercial banks and a projected increase in U.S. Government-initiated debt-equity conversions are also seen as favorable indications for the future.

U.S. TRADE DEVELOPMENTS

At $12.2 billion, the seasonally unadjusted deficit in U.S. merchandise trade was 15.3 percent lower than the $14.4 billion average deficit for the previous 12-month period and 4.2 percent lower than the $12.7 billion deficit registered for December 1986. U.S. exports increased by 4.2 percent from November to December 1987, and imports remained virtually unchanged. The merchandise trade deficit for the full year of 1987 amounted to $171.2 billion, or 9.6 percent higher than the 1986 deficit of $156.2 billion.

At $12.7 billion, the deficit in the trade of manufactured goods was $475.6 million higher in December than in November 1987. The comparable deficit was only $9.8 billion in December 1986. In a year-on-year comparison, the deficit in manufactured goods trade increased from $145.1 billion in 1986 to $153.7 billion in 1987.

Exports of manufactured goods decreased by $71.2 million and imports increased by $404.6 million from November to December 1987. Declines occurred in the shipments of new passenger cars, electrical machinery, motor vehicle parts, office machinery and automated data processing (ADP) equipment, and general industrial machinery. Some encouraging increases were registered in the exports of aircraft and parts, power generating machinery, specialized industrial machinery, and telecommunications equipment.

The rise in total exports from November to December 1987 is largely attributable to increased foreign demand for homogenous U.S. products, such as agricultural goods, coal, chemicals, wood and paper products, and metals. The increased competitiveness of U.S. exporters as a result of the cheaper dollar is more evident in these goods than in highly differentiated manufactured products. The cheaper dollar helps U.S. exporters of sophisticated capital goods, but the reestablishment of U.S. market shares will require more time.

The oil import bill decreased from $4.0 billion in November to $3.6 billion in December. The volume of oil imports dropped from 215.1 million barrels to 199.2 million barrels, and the average price of imported oil declined from $18.55 per barrel to $17.97 per barrel. The U.S. surplus in agricultural trade increased from $1.0 billion to $1.2 billion over the period. U.S. shipments of wheat, corn, cotton, animal feeds, and raw tobacco increased in December over those in November. Thus, the smaller oil import bill and higher agricultural trade surplus together account for $600 million, or 60 percent, out of the total $1 billion improvement of the trade balance from November to December.

Geographically, the $618.1 million decline in the deficit with Canada was the most significant development from November to December. The U.S. trade deficit with Japan, Taiwan, the Organization of Petroleum Exporting Countries (OPEC), the non-OPEC developing countries, and the nonmarket economy (socialist) countries declined over the period. However, the deficit increased in trade with the 12-nation European Community (EC), Mexico, and Brazil. The deficit in trade declined with the East Asian Newly Industrialized Countries from November to December.

A study by the U.S. International Trade Commission indicated that approximately 5.6 percent of the nation's exports in 1984 may have involved countertrade obligations. Since then, there have been no official U.S. Government estimates of countertrade. According to some private assessments, countertrade arrangements will continue to squeeze out currency-based trade as a result of international payments difficulties, foreign industrial targeting, and protectionism. Some analysts also predict that countertrade will gain even more prominence in the 1990's when the U.S. trade account will show surpluses.

Aerospace firms that depend heavily on foreign trade are particularly susceptible to countertrade demands. For example, McDonnell Douglas' outstanding export obligations involving

countertrade alone amounted to $8 billion at yearend 1987.

INTERNATIONAL TRADE DEVELOPMENTS

Hong Kong, South Korea, Singapore, and Taiwan are Graduated from the U.S. GSP Program

In a move not wholly unexpected, the White House announced on January 29 that four advanced NIC's—Hong Kong, South Korea, Singapore, and Taiwan—will be removed from the GSP program effective January 2, 1989. (*IER*, January 1988). This action was taken after a review of a broad range of economic and competitiveness indicators, including per capita GNP, economic growth rates, and the countries' ability to export manufactured items into the United States. Although these NIC's have been conspicuous in achieving exceptionally rapid growth despite few natural resources, the Administration emphasized that the graduation should not be viewed as a penalizing gesture but instead reflects the economic successes these countries have achieved. (The U.S. trade deficit with the four countries reached $37 billion in 1987, or 22 percent of the total U.S. trade deficit—up from a deficit of $6.1 billion in 1981.) Last year a disproportionate amount of GNP benefits—nearly 60 percent of total benefits—went to these four countries leaving only 40 percent in benefits for the remaining 136 GSP-eligible countries. The Administration says graduation of the NIC's will open up additional opportunities for the remaining beneficiaries.

Reaction to the NIC's graduation in the U.S. business community has generally been negative. Many U.S. companies contributed to the NIC's phenomenal growth by investing in them and purchasing from Asian manufacturers to cut production costs. In Singapore, a large bite of the graduation measure will be felt by the U.S.-owned factories that account for 52 percent of the country's exports to the United States. U.S. multinationals in Hong Kong account for 13 percent of that country's exports to the United States. In addition, a group known as the GSP Coalition of U.S. Businesses estimates that the graduation will have a significant negative effect on many U.S. manufacturers that import components from the affected countries. The average duty that the United States would impose could be about 5 to 6 percent. To some extent, importers will pass that cost on to their customers, although some may absorb the cost to retain their market share. Some importers may also attempt to source from other countries, but for importers of electronic components, that may not be easy.

The removal of GSP privileges will affect less than one-fifth of the total imports from the four countries, adding about $500 million annually to the price of those goods in the United States. Each of the affected countries was aware that graduation was likely, and their reactions have been mixed. Some members of Singapore's parliament angrily urged their Government to reexamine its decision to strengthen copyright protection, an action that was taken as a result of pressure from the United States. In South Korea, where graduation was anticipated, the Government initially took a hardline stance claiming it would subsidize or otherwise aid affected industries. The Government has since moderated its position, saying such assistance is unlikely, and that it intends to monitor the situation. Officials in Taiwan and Hong Kong say that the loss of GSP will have an impact on exports, particularly for small- and medium-sized firms, but it will not damage these industries irreparably.

Tension Mounts in the United States-Brazil Computer Dispute

Over the past few years, Brazil's efforts to establish a domestic computer industry under a protectionist umbrella has generated heated trade disputes between Brazil and the United States (*IER*, January and August 1987). The conflict over Brazil's policy of a protected computer market, restrictions on foreign investment, and lack of protection for computer software in Brazil first reached critical proportions in September 1985. At that time, the United States opened an investigation of these issues under section 301 of the Trade Act of 1984 (*IER*, November 1985).

The United States set June 30, 1987, as the third deadline for Brazil to take corrective action in this longstanding dispute. However, just a few days before the U.S. deadline, the Brazilian Chamber of Deputies passed a bill extending copyright protection for computer software that appeared to be somewhat acceptable to U.S. officials and industry representatives. Sensing that trade sanctions might not be needed after all, President Reagan allowed the June deadline to pass and even suspended the software- protection portion of the ongoing section 301 investigation. (The President had already suspended one other part of the case relating to Brazil's market reserve policy when he postponed retaliatory action

in December 1986. He also deferred reprisals in the previous case.).

Following the President's action in the summer of 1987, only one part of the computer investigation—the one relating to Brazil's investment policies—remained under active consideration. The reason for not suspending the entire case was that certain provisions of the new software bill continued to be unacceptable to the United States. The proposed legislation sustained the Brazilian Government's right to deny licensing of foreign software, provided an "equivalent" product of domestic origin is available. This condition is based on Brazil's so-called Law of Similars which prohibits imports of products similar to those already made in Brazil.

The Law of Similars has proven to be a major import barrier because of the arbitrary protectionist interpretation of "similarity" by Brazilian authorities. Last July, Brazilian officials ruled that a local product (SISNE) is similar enough to the popular MS-DOS #3.2 personal computer operating program of Microsoft, a U.S. company, to deny a license to the U.S. product. Microsoft challenged the ruling of alleged similarity, claiming that its own system is superior. In November 1987, President Reagan announced his intention to apply reprisals. The United States Trade Representative (USTR) subsequently released a list of imports from Brazil that were targeted for punitive action. The USTR indicated that the products to be selected from this list would have a total value of $105 million.

Meanwhile, there was some softening on the Brazilian side. In late November, Brazil's Senate approved a modified version of the software copyright protection bill that the House passed in June. The Senate clarified the House bill by providing definitions of what constitutes similarity between domestic and foreign software products. These definitions served to diminish the arbitrary application of the Law of Similars. In December, the Senate bill was enacted as Brazil's copyright protection law. According to U.S. software producers, however, the new law still contains language that could be used to impede their access to the Brazilian market.

Meanwhile, Brazilian exporters of items targeted for punitive U.S. action pressured the Brazilian Government to make a conciliatory gesture to the United States. In apparent recognition of the threat to these exporters' interests, on January 20, the Government made a concession. The government announced that, although they sustained the ban on Microsoft's disputed product (MS-DOS #3.2), they will allow licensing of Microsoft's newer, more sophisticated systems software (MS-DOS #3.3).

The prolonged uncertainty following the November announcement of impending sanctions cast a shadow over all U.S.-Brazilian trade. U.S. importers who expected to be affected, including footwear and civilian aircraft importers, began to cancel or postpone orders from Brazil for fear that they might face surcharges on imports up to 100 percent. These actions by U.S. importers resulted in a decline in Brazilian production of such products. In addition, there was some speculation that U.S. exporters could also be affected, if Brazil responded to U.S. sanctions with reprisals of its own.

GATT Accessions Rise As Uruguay Round Gets Underway

A string of new applicants to the GATT are anticipating the opportunity to participate in the Uruguay Round of Multilateral Trade Negotiations, formally launched in the fall of 1986. During the last major negotiations (the Tokyo Round), a number of countries that were not contracting parties were allowed to participate fully in negotiations. For this round, however, the rules on participation were tightened, in part to encourage more countries to become active in the GATT and adhere to its rules.

The strategy appears to be working. Lesotho is the most recent new member and the first to join the GATT in 1988. Its accession came into effect formally on January 8. Lesotho's accession brings the number of GATT members (known as Contracting Parties) to 96, an increase of almost 15 percent since 1978. Meanwhile, nine applications (six for full and three for provisional accession) are under consideration.

As a country counted among former colonies that apply GATT rules on a defacto basis, Lesotho simply filed a declaration of membership under GATT article XXVI to become a full Contracting Party. Botswana (1987), and Antigua and Barbuda (1987), and Hong Kong (1986), joined the GATT using the simple article XXVI declaration. Other countries must submit to a comprehensive review of their trade regime and undertake complex entry negotiations to become full members. Morocco joined in 1987 and Mexico in 1986, both undergoing the full entry negotiations.

Several countries are under consideration this year for new membership. These countries include China, Costa Rica, Tunisia, Algeria, Bulgaria, and Bolivia. Three countries—Honduras, El Salvador, and Guatemala—have applied for

provisional membership. Other countries have also made inquiries about membership, but have not formally applied.

If all current applicants succeed in their membership bids by the end of 1988, the GATT will have achieved a 25-percent increase in membership during the last 10 years. Moreover, more countries may be on board in time to take part in the final stages of hard bargaining on rules and trade concessions of the Uruguay Round.

FTA and North American Automotive Trade

The U.S.-Canada Free Trade Agreement (FTA), signed by the leaders of both countries on January 2, 1988, contains a chapter on automotive trade. Presently, this sector is the most significant portion of North American commerce, accounting for over $50 billion of cross-border exchange between the United States and Canada. The high level of trade flows in this area is due in large part to the 1965 Automotive Products Trade Agreement (APTA) that established a certain degree of free trade between the two countries in the area of new automobiles and original equipment parts.

If free trade already existed in the single most important sector of U.S.-Canadian trade, then why is automotive trade included in the recently announced bilateral FTA? The primary reason is that a number of important segments of automotive trade remain encumbered even under APTA, and the negotiations presented an opportunity to address some of these problem areas. The FTA provided a basis for further agreement and liberalization by openly acknowledging the importance of automotive trade to the economies of both countries and the need to ensure that the sector continues to prosper.

The FTA specifically provides for the elimination of all remaining tariffs in the automotive sector over 5 to 10 years; the elimination of the Canadian prohibition on the importation of used cars under APTA; the elimination of Canada's export-based duty remission program; and the establishment of a higher North American content requirement. The latter will stimulate production of U.S. and Canadian automotive parts and materials. The FTA also allows current APTA participants (the "Big Three" plus a number of truck makers and body suppliers) to retain their APTA benefits. In effect, this locks in existing APTA privileges and freezes out new companies from receiving duty-free access to vehicles or parts from third countries.

The Canadian duty-remission program allowed for tariff concessions to be linked to export performance and/or local production. The program was used by foreign automobile manufacturers. The agreement eliminates duty-remission schemes insofar as they are based on exports to the United States on January 1, 1989. Programs that are based on exports to third countries must be eliminated by January 1, 1998. Other duty-remission programs, based on commitments with respect to Canadian production, are allowed to remain in operation until their expiration, but not later than January 1, 1996. Such programs are in now effect with Honda, Toyota, Hyundai, and a joint venture between General Motors and Suzuki.

The question of whether or not the automotive sector was to be included in the negotiations leading up to the FTA was a highly charged one, particularly in Canada, where there were fears that any negotiation covering autos would seriously alter the terms of APTA. However, the ongoing existence of APTA could be problematic. A source of uncertainty is the select panel created by the FTA "to assess the state of the North American industry and to propose public policy measures and private initiatives to improve its competitiveness in domestic and foreign markets." Although the FTA explicitly commits both parties to the continuous administration of APTA, observers have wondered what the panel of "informed persons" might have to say about the agreement's future.

Industry reaction to the treatment of automotive trade in the FTA has been mixed. U.S. auto manufacturers welcome the elimination of the duty-remission program and the limitation of APTA benefits. The auto unions and the U.S. auto parts industry are dissatisfied, claiming that a higher rule of origin is necessary in order to ensure continued American sourcing of auto parts.

APTA has benefited the North American automotive industry quite well during the 23 years it has been operating. To the extent that the FTA secures and enshrines those benefits, it, too, should serve to encourage the growth of the industry in North America. The question remains, however, as to how that integrated industry will meet the increased competitive pressures of third country manufacturers in the years ahead.

OECD Raises Mixed Credit Interest Rates

On January 15, the Organization for Economic Cooperation and Development (OECD) raised the minimum interest rates that member coun-

the minimum interest rates that member countries may charge on mixed credits. So-called mixed credits reduce the effective interest rate on loans to developing countries by mixing development aid with commercial export financing.

The OECD-authorized minimum interest rates are reviewed each January and July and are subject to automatic revision according to a market-based formula. A movement of one-half of 1 percent in the weighted-average bond rates denominated in U.S. dollars, West German marks, British pounds sterling, French francs, and Japanese yen induces automatic adjustment in the OECD minimum rates.

Minimum interest rates allowed for mixed credit export financing offers differ depending on three categories of developing countries (relatively rich, intermediate, and relatively poor) for two time periods of financing (2 to 5 years and over 5 years). The interest rates across nearly all of the various country groupings and time periods rose in January. The short-term interest rates rose by six-tenths of 1 percent for all three country groups to 10.15 percent for relatively rich, 8.85 percent for intermediate, and 8.00 percent for relatively poor. Long-term interest rates for relatively rich and relatively poor countries also rose by the same percentage, to 10.40 percent and 8.00 percent, respectively. Long-term interest rates for intermediate countries were unchanged at 9.35 percent.

In 1987, after several years of urging by the United States, the OECD strengthened the rules governing mixed credits, making their use more expensive for lending countries. The revised rules increase the humanitarian grant element of the mixed credit offer from 25 to 35 percent over 2 years for developing countries (to 50 percent for the least developed countries), revamped the method for calculating the grant element, and reduced or eliminated subsidies on export credits to relatively rich countries (*IER*, April 1987). The changes reduce an advantage enjoyed by countries with relatively low interest rates. Previously, a 10 percent rate was used to determine the subsidy element. The revised rules use a formula that more closely reflects actual costs in the lending country.

The controversy surrounding the use of mixed credit offers by OECD countries to win export deals for their manufacturers has not, however, faded with the rule change. The rule changes were intended to limit the growing practice of developed countries competing against each other for export contracts to developing countries through excessively generous offers of aid and financing packages. In January, the Export-Import Bank (Eximbank) of the United States, which puts together U.S. mixed credit offers, was reportedly preparing two mixed credit offers to counteract subsidized offers by one or two other countries. Japan, France, West Germany, and some other EC members are reportedly among the countries most frequently using mixed credit offers to win export contracts. Congress has allocated a $110 million fund for the Eximbank to use when competing for export contracts against other prospective supplier countries that are subsidizing their financing offers if the bank can certify such offers do not impair regular Eximbank lending.

Use of mixed credit offers may diminish later this year, once the next phase of the revised OECD rules takes effect, making the credits more expensive for lenders. Under last year's agreement, the humanitarian grant element required by OECD rules will rise to 35 percent of the mixed credit offer in July. The increase in the grant element is intended to raise the cost of mixed credit offers, thereby discouraging their use as a tool for winning export contracts.

China Reports Turnaround in Foreign Trade

Preliminary foreign-trade figures reported by China's General Administration of Customs in mid-January showed a 29.0-percent increase in total exports (f.o.b.) during 1987, to an all-time high of $39.9 billion. However, imports (c.i.f.) increased by only 2.2 percent to $43.9 billion, reducing the deficit to $4.0 billion from $14.8 billion in 1985 and $12.0 billion in 1986. Although China does not report trade data on a balance of payments basis (exports and imports f.o.b.), estimates made on this basis indicate that its merchandise trade yielded a balance or small surplus in 1987. This performance represents an impressive achievement since a balance in the trade account of China's international balance of payments in 1984 was followed by deficits of $12.1 billion in 1985 and $8.7 billion in 1986.

China's trade-balance problems began following the widespread introduction of reforms in the urban industrial economy and the foreign trade sector during the last half of 1984. As part of this comprehensive reform program, the Chinese leadership began to extend more decisionmaking authority in foreign trade to provincial and local governments and to allow business enterprises to retain part of the foreign exchange they generated for their own use. With numerous entities operating as virtually autonomous units, the result was an unprecedented surge in imports of both industrial and consumer goods. The situation was further exacerbated when the price of oil,

one of the country's major sources of export earnings, declined in 1985 and 1986. China was forced to cover the large merchandise-trade deficits by drawing down its foreign-exchange reserves (from a high of $16.7 billion in September 1984 to $10.5 billion by yearend 1986) and by significantly increasing its foreign borrowings (from an estimated $14 billion in 1984 to in the range of $25 billion to $27 billion at the end of 1986).

Efforts to curtail imports were initiated in early 1985. The Chinese Government began by severely restricting imports of consumer goods. As State controls over foreign-exchange expenditures were tightened in the last half of 1985 and again in 1986, however, the list of restricted items was extended to cover a wide variety of agricultural and industrial inputs, including machinery and other high-technology equipment needed for modernizing the economy.

In 1987, after experiencing only limited success in reducing its deficit by cutting back on imports, China launched a major drive to boost export sales. This program consisted mainly of an increase in the Government's export incentives, such as tax rebates for so-called export enterprises, bonuses based on the actual value of the goods an enterprise exported, and payments for losses the enterprise incurred in fulfilling export quotas assigned by the State. The result of these measures was a significant rise in China's exports of manufactured commodities during 1987, especially clothing and other textile products such as fabrics, yarns, and household goods. Exports of manufactures as diverse as machine tools, electrical equipment, and toys also increased substantially.

Having achieved a balance in its trade account, China is expected to show a surplus in the current account (merchandise trade plus services and unilateral transfers) of its balance of payments in 1987. The country's foreign-exchange reserves have also grown, reportedly reaching just under $15 billion by September 1987. With this additional cushion of reserves, it is likely that the Chinese Government will begin to relax its import controls.

U.S. exporters are in an especially good position to take advantage of any increase in China's demand for imports during 1988. Since mid-1986, when the renminbi, China's unit of currency, was officially devalued by approximately 15 percent against the U.S. dollar and other major trading currencies, the Chinese authorities have allowed the renminbi to depreciate further by unofficially pegging it to the falling U.S. dollar. Thus, as a general rule, U.S. exports to China have become less expensive than those of other major suppliers to the China market such as Japan and West Germany.

STATISTICAL TABLES

Industrial production

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

Country	1984	1985	1986	1986		1987			1987					1988
				III	IV	I	II	III	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
United States	11.2	1.9	1.1	1.9	3.3	3.1	4.3	8.7	3.7	-2.9	13.3	4.9	4.9	2.4
Canada	8.8	2.8	.8			1.8	5.3	5.6				4.9	-1.0	
Japan	11.1	4.6	-.4	-2.1	-2.4	5.6	-.8	15.4	-7.3	44.5	15.9	0	17.7	
West Germany ...	3.3	3.9	2.3	-4.5	-.1	-2.3	-1.2	1.3		-9.8	-5.6	33.2		
United Kingdom ..	1.3	4.7	1.5	5.6	.5	1.3	2.9	9.6	9.9	-11.8	11.0	-4.1		
France	1.7	.6	.8	5.4	-5.1	-1.3	9.5	2.6	12.2	-10.8	0			
Italy	3.4	1.2	2.7	-12.8	7.3	11.5	7.4	-7.4	-19.2	9.9	33.7	-10.9		

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Jan. 29, 1988.

Consumer prices

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

Country	1984	1985	1986	1986		1987			1987					
				III	IV	I	II	III	July	Aug.	Sept.	Oct.	Nov.	Dec.
United States	4.3	3.6	1.9	2.6	2.7	5.3	4.9	3.9	2.9	5.8	2.4	4.6	3.5	1.2
Canada	4.3	4.0	4.2	4.7	4.9	3.6	5.4	4.6	5.9	.9	0	4.4	5.3	
Japan	2.3	2.0	.6	-2.0	-.1	-2.2	5.0	-0.8	-5.8	1.2	15.3	0	-2.3	
West Germany ...	2.4	2.2	-.2	-.5	-1.5	1.0	1.4	1.7	3.6	-1.0	-2.9	2.0	0	
United Kingdom ..	5.0	6.1	3.4	2.4	6.5	5.6	2.2	3.7	4.6	3.6	3.6	6.0	6.0	
France	7.7	5.8	2.5	2.6	3.2	5.2	2.3	2.6	2.8	2.9	1.4	2.9	1.4	
Italy	10.6	8.6	6.1	5.0	3.2	4.1	4.5	6.7	7.1	3.3	9.0	11.3	3.2	

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Jan. 29, 1988.

Unemployment rates

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

Country	1984	1985	1986	1986	1987				1987					1988
				IV	I	II	III	IV	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
United States	7.5	7.2	7.0	6.9	6.6	6.3	6.0	5.9	6.0	5.9	6.0	5.9	5.8	5.8
Canada	11.3	10.5	9.6	9.4	9.6	9.1	8.8	8.2	8.8	8.6	8.4	8.2	8.1	
Japan	2.8	2.6	2.8	2.9	3.0	3.1	2.8		2.8	2.8	2.8	2.7		
West Germany ...	7.4	7.5	7.2	7.0	7.1	7.2	7.2	7.3	7.3	7.3	7.2	7.2	7.3	
United Kingdom ..	11.7	11.3	11.1	10.9	10.7	10.3	9.8	9.2	9.8	9.5	9.4	9.1	9.0	
France	9.9	10.4	10.7	10.8	11.2	11.2	11.1	10.8	11.2	11.0	10.9	10.8	10.8	
Italy	5.9	6.0	6.3	6.6	6.7	6.7	6.8							

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 1988.

Trade balances

(Billions of U.S. dollars, f.o.b. basis)

Country	1984	1985	1986	1986 III	1986 IV	1987 I	1987 II	1987 III	1987 July	Aug.	Sept.	Oct.	Nov.	Dec.
United States[1]	-107.3	-133.6	-149.6	-155.6	-166.8	-144.4	-149.2	-159.6	-164.4	-169.2	-151.2	-192.0	-134.4	-127.2
Canada	16.0	12.4	7.5	6.4	8.0	9.2	10.0	8.4	4.8			9.6	6.0	
Japan	43.9	55.8	92.5	104.8	104.0	110.8	94.0	88.8	92.4			93.6	86.4	
West Germany	18.8	25.4	52.6	60.4	57.2	64.4	62.0	63.2	62.4			121.2	75.6	
United Kingdom	-5.7	-2.6	-12.4	-17.2	-14.8	-6.8	-15.6	-19.6	-18.0			-9.6	-25.2	
France	-2.8	-2.6	.1	-8.8	1.6	-4.0	-8.8	-4.4	-6.0			-57.6	-1.2	
Italy	-11.0	-12.1	-2.1	1.6	-.8	-6.8	-12.0	-5.6	-14.4			-7.2	-2.4	

[1] Exports, f.a.s. value, unadjusted; imports, customs value, unadjusted. Beginning with 1986, figures include previously undocumented exports to Canada. Data for individual quarters do not reflect similar adjustments.

Note.—Beginning with January 1986, the U.S. Department of Commerce stopped reporting export and import data on a seasonally adjusted basis. U.S. data for prior periods have been changed accordingly. 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, Jan. 29, 1988.

U.S. trade balance, by major commodity categories and by selected countries

(Billions of U.S. dollars, customs value basis for imports)

Item	1984	1985	1986	1986 III	1986 IV	1987 I	1987 II	1987 III	1987 July	Aug.	Sept.	Oct.	Nov.	Dec.
Commodity categories:														
Agriculture	18.4	9.6	4.5	5	2.3	1.4	1.3	2.1	.7	.6	.8	.8	1.1	1.3
Petroleum and selected products, unadj	-52.5	-45.9	-31.8	-7.2	-6.8	-7.6	-9.0	-11.7	-4.1	-4.2	-3.4	-3.8	-3.4	-2.9
Manufactured goods	-78.9	-102.0	-134.3	-36.1	-34.7	-32.7	-34.9	-36.3	-13.3	-12.2	-10.8	-14.4	-11.1	-11.6
Selected countries:														
Western Europe	-14.1	-23.3	-28.2	-7.3	-6.3	-5.2	-6.6	-7.0	-3.5	-2.1	-1.4	-2.6	-2.0	-2.3
Canada[1]	-20.1	-21.7	-23.0	-5.9	-5.4	-3.2	-2.3	-2.8	-.6	-.9	-1.3	-1.3	-1.2	-.6
Japan	-33.8	-46.5	-55.3	-13.5	-15.0	-13.6	-14.5	-13.8	-4.8	-4.6	-4.4	-5.5	-4.5	-4.5
OPEC, unadj	-12.3	-10.2	-8.9	-2.1	-1.8	-2.4	-2.8	-4.6	-1.6	-1.6	-1.4	-1.5	-1.0	-.8
Unit value (per barrel) of U.S. imports of petroleum and selected products, unadj	$28.11	$26.59	$15.02	$11.41	$12.60	$15.55	$17.23	$17.99	$18.15	$18.33	$17.49	$17.51	$17.54	$16.78

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

Note.—Beginning with January 1986, the U.S. Department of Commerce stopped reporting export and import data on a seasonally adjusted basis. U.S. data for prior periods have been changed accordingly. 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. Department of Commerce, December 1987.

Money-market interest rates (90-day certificate of deposit)

(Percentage, annual rates)

Country	1984	1985	1986	1986 III	1986 IV	1987 I	1987 II	1987 III	1987 Aug.	1987 Sept.	1987 Oct.	1987 Nov.	1987 Dec.	1988 Jan.
United States	10.7	8.3	6.5	6.0	5.8	6.1	6.8	6.8	6.6	7.3	8.0	7.2	7.7	6.9
Canada	11.3	9.7	8.6	6.1	8.4	7.4	8.0	9.2	9.2	9.2	9.3			
Japan	6.7	6.5	4.9	4.7	4.4	4.1	3.7	3.7		3.7	3.8			
West Germany	6.0	5.5	4.6	4.5	4.7	3.9	3.7	4.2	4.0	4.6				
United Kingdom	9.9	12.1	10.8	9.9	11.3	10.5	9.3	10.0	10.3	10.2				
France	11.7	10.0	7.7	7.2	7.6	8.2	8.1	7.9	7.9	7.9				
Italy	15.9	15.0	12.8	11.4	11.2	10.9	10.7	11.9	12.3	12.4				

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

Source: Statistics provided by Federal Reserve Board.

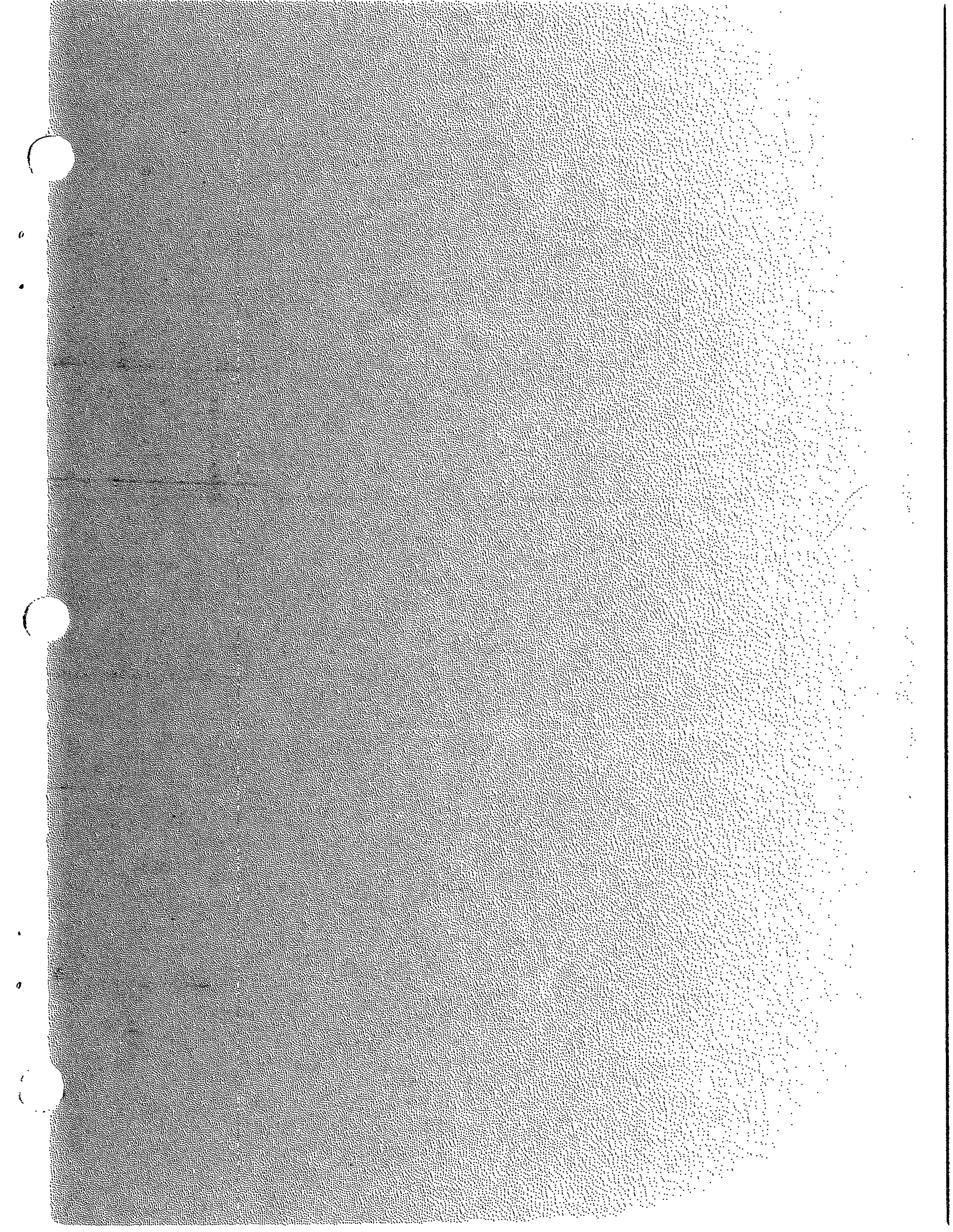
Effective exchange rates of the U.S. dollar, unadjusted and adjusted for inflation differential

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

Item	1984	1985	1986	1986 IV	1987 I	1987 II	1987 III	1987 IV	1987 Aug.	1987 Sept.	1987 Oct.	1987 Nov.	1987 Dec.	1988 Jan.
Unadjusted:														
Index number	122.4	127.1	106.0	102.7	97.1	94.1	95.2	90.3	95.7	93.9	93.5	90.0	87.4	87.4
Percentage change	7.2	3.8	-16.6	-.1	-5.5	-3.1	1.2	-5.1	-.3	-1.9	-.4	-3.7	-2.9	0
Adjusted:														
Index number	119.6	122.5	101.5	98.3	93.4	90.5	91.6	87.4	92.2	90.0	90.5	87.3	84.5	84.9
Percentage change	6.1	2.4	-17.1	1.4	-5.0	-2.9	1.2	-4.6	-.3	-2.4	.5	-3.5	-3.2	.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 United States and in other nations; thus, a decline in this measure suggests an increase in U.S. price competitiveness.

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



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