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INTERNATIONAL ECONOMIC COMPARISONS

Trade and fiscal imbalances, jittery financial markets, and an aging economic expansion occupy the economic front. The current U.S. economic expansion will enter its 74th month in January 1989. According to the National Bureau of Economic Research (NBER), the upswing has already lasted 39 months longer than the average for the previous 30 business-cycle upswings. Nevertheless, major economic forecasters predict that the U.S. economy will continue its expansion through the fourth quarter of 1988 and beyond. (See economic forecast section.)

The turbulence in international financial markets caused by trade and fiscal imbalances has failed to slow the forces of real economic growth. Demand and production are increasing in the United States, Western Europe, and Japan. In Japan, the current account surplus has narrowed slightly whether measured in U.S. dollars or as a share of Japan's Gross National Product (GNP). Moreover, according to the International Monetary Fund (IMF), the world economy looks stronger than previously expected. The economies of both industrial and developing countries are growing more rapidly on average than in 1987. The IMF looks for world economic growth of about 3.1 percent in 1989, compared with 3.8 percent in 1988. World trade is expected to grow by a robust 7.5 percent in 1988 and maintain momentum through 1989. A projected rise in the export earnings of the developing countries may keep their debt situation from deteriorating.

Economic Growth

The annualized rate of real economic growth was 2.2 percent in the United States during the third quarter of 1988. The latest data available indicate that the rate of real economic growth (annualized) during the second quarter of 1988 was 3.9 percent in Canada, 2.4 percent in France, 3.6 percent in Italy, and 1.8 percent in the United Kingdom. Real income declined at an annual rate of 3.9 percent in Japan during the second quarter, but was still 5.6 percent higher than during the corresponding quarter of 1987. West Germany's real income slipped 0.7 percent during the second quarter of 1988, but was 3.4 percent higher than during the corresponding period of 1987.

Industrial Production

U.S.industrial production rose at a seasonally adjusted rate of 0.4 percent in October after rising 0.2 percent in September and 0.3 percent in August. The October gain reflected further increases in the output of business equipment and automotive products and an increase in the production of construction supplies. The total index for October was 5.1 percent higher than a year earlier. The most recent available data on the seasonally adjusted annual growth rates of industrial production in the major industrialized countries are: the United States, 5.5 percent; Canada, 5.1 percent; France, 5.4 percent; Italy, 6.9 percent; Japan, 9.1 percent; the United Kingdom, 3.7 percent; and West Germany, 3.6 percent.

Prices

The seasonally adjusted U.S. Consumer Price Index recorded no increase in October compared with that in September. The average rate of inflation during the 1-year period ending in October was 4.6 percent in Italy and 1.3 percent in West Germany. The average rate of inflation during the 1-year period ending in September 1988 was 4.1 percent in Canada, 0.6 percent in Japan, 5.9 percent in the United Kingdom, 3.0 percent in France, and 4.2 percent in the United States.

Employment

The seasonally adjusted rate of unemployment in the United States (on a total labor force basis, including military personnel) decreased from 5.3 percent in September to 5.2 percent in October. The West German Government reported that the country's rate of unemployment was 8.6 percent in October, and Canada reported a rate in October of 7.9 percent. The national statistical offices of other countries reported the following unemployment rates in September: 16.5 percent in Italy, 2.5 percent in Japan, and 8.0 percent in the United Kingdom. (For foreign unemployment rates adjusted to U.S. statistical concepts, see the tables at the end of this issue.)

Investment

Gross fixed investment during 1980–87 averaged 18.1 percent of GNP in the United States, compared with 29.0 percent in Japan, 21.0 percent in Canada, 20.5 percent in West Germany, 20.5 percent in France, 21.7 percent in Italy, and 16.7 percent in the United Kingdom. The Morgan Guaranty Trust Co. of New York estimates that U.S. net fixed investment (investment net of depreciation) should be at 8.0 percent of GNP to achieve continued growth in standards of living. In 1987, U.S. net investment was only 5.3 percent of GNP, and net national saving (private domestic saving minus the Government deficit) sank below 2.0 percent of GNP, having fallen from 5.5 percent of GNP at the beginning of the 1980's. The gap between net saving

(2.0 percent) and net investment (5.3 percent) was filled by an inflow of foreign capital.

Growth of National Debt

U.S. Federal debt increased more during the past 15 years than during the entire preceding two centuries of the Nation's history. Yet, according to data published by the Federal Reserve Bank of St. Louis, the growth rate of the U.S. Government's debt was actually smaller during 1973–80 than that of the debt of any other G–7 country, and it was only slightly higher than the simple average for the other countries during 1980–87, as shown below (in percent):

Country	*1973-87*	*1987*	*1980-87*
United States	13.4	11.7	15.0
Canada	16.3	15.9	16.8
France	21.8	26.6	17.3
Germany	15.1	20.9	9.6
Italy	24.3	25.6	23.0
Japan	22.4	34.6	11.4
United Kingdom	12.4	14.3	10.6
Average[1]	18.7	23.0	14.8

[1] Excluding the United States.

Forecasts

Table 1 shows the macroeconomic projections of three major forecasters.

Projections for nominal GNP growth range from 5.6 to 7.3 percent during the fourth quarter of this year, followed by 6.7- to 8.5-percent growth during the first quarter of 1989. Nominal growth rates during the second quarter of 1989 are projected to range from 5.6 to 6.1 percent. Since monetary authorities are expected to respond to inflationary pressures by raising interest rates, real growth is widely projected to decelerate. Forecasters call for real GNP growth of 2.1 to 3.7 percent during the first quarter of 1989 and for real growth ranging from 1.4 to 1.7 percent during the second quarter.

The GNP deflator (considered the broadest measure of inflation in the economy) is projected to be higher during the first two quarters of 1989 than during the fourth quarter of 1988. The unemployment rate is expected to range between 5.1 and 5.7 percent during these three quarters.

U.S. TRADE DEVELOPMENTS

U.S. exports have gained a price advantage due to the fall of the dollar on foreign-exchange markets since the first quarter of 1985. However, the decline in the U.S. trade deficit has been less than might be expected because of the J-curve effect, the most commonly cited explanation for the delayed impact of exchange-rate changes on a trade balance (*IER*, November 1988). It is also possible that the periodic strengthening of the dollar and the anticipation of further declines in its value have lengthened the process of eliminating the deficit. Many foreign importers of U.S. goods have expected the dollar to continue to fall and temporarily held back their orders, thereby moderating the growth in U.S. exports.

Table 1.
Projections of the GNP and other U.S. economic indicators, by 3 major forecasters, 1988-89

(In Percent)

Indicator and year	*Data Resources Inc.*	*Merill Lynch Economics Inc.*	*Wharton F.A. Inc.*
GNP in current dollars:			
October-December 1988	5.6	7.3	6.0
1989:			
January-March	8.5	6.7	7.2
April-June	6.0	6.1	5.6
GNP in constant (1982) dollars:			
October-December 1988	2.2	2.8	2.3
1989:			
January-March	3.7	2.1	2.2
April-June	1.7	1.4	1.4
GNP deflator index[1]			
October-December 1988	3.4	4.4	3.6
1989:			
January-March	4.7	4.5	4.9
April-June	4.2	4.7	4.2
Unemployment rate:			
October-December 1988	5.3	5.1	5.3
1989:			
January-March	5.2	5.1	5.5
April-June	5.2	5.2	5.7

[1] 1982=100.

Source: The Conference Board, *Statistical Bulletin*, vol. 21, No. 9, September 1988.

Nevertheless, the September trade figures were promising. The seasonally adjusted U.S. merchandise trade deficit decreased by 14.6 percent, from $12.3 billion in August to $10.5 billion in September. The September deficit was 16.0 percent below the $12.5 billion average monthly deficit registered during the previous 12-month period, and it was 24.5 percent below the $13.9 billion deficit of September 1987. During the period from October 1987 to September 1988, the deficit was at its highest level in October 1987 ($15.6 billion) and at its lowest level ($9.5 billion) in July 1988. The cumulative January–September deficit declined from $127.3 billion in 1987 to $102.9 billion in 1988. The following tabulation shows the percentage changes in the January–September year-to-date figures for U.S. exports, imports, and the U.S. deficit:

Item	*Jan.-Sept. 1986 to Jan.-Sept. 1987*	*Jan.-Sept.1987 to Jan.-Sept. 1988*
Exports	9.5	28.6
Imports	9.9	9.3
Deficit	10.7	-19.2

Exports set a new monthly record in September, increasing to $28.2 billion from $27.5 billion in August. Imports decreased by 2.8 percent, from $39.8 billion in August to $38.7 billion in September. Table 2 shows the percentage change in exports and imports from August to September (not seasonally adjusted) for principal commodity groupings.

The increase in exports and the decline in imports of agricultural commodities resulted in a positive trade balance in this sector of $1.4 billion in September compared with $813.5 million in August. In manufactured goods, exports increased and imports declined slightly, resulting in a decline in the trade deficit in this sector from $12.6 billion in August to $11.4 billion in September. The biggest percent gains in exports of manufactures were registered in iron and steel products, chemicals, and automatic data processing equipment and office machinery. The oil import bill fell from $3.4 billion in August to $3.0 billion in September as both import volume and prices declined.

On a regional basis, the United States experienced declines in its trade deficits with Western Europe, Japan, the newly industrialized countries (NIC's), and OPEC from August to September. The deficit with Canada grew, and the small deficit with the rest of the world became a small surplus. The U.S. deficit with Japan declined by 15.6 percent, from $4.5 billion in August to $3.8 billion in September. The U.S. deficit with Western Europe declined by 47 percent, from $1.0 billion in August to $533.4 million in September. The deficit with the NIC's declined from $3.0 billion to $2.8 billion (6.7 percent), and the deficit with OPEC declined from $974 million to $518.4 million (47 percent). The U.S. trade balance with the rest of the world went from a deficit of $407.8 million to a surplus of $295.2 million. However, the U.S. deficit with Canada deepened from $396 million to $1.1 billion. The Commerce Department estimates that the overall U.S. deficit will be only $137.2 billion in 1988, down from $170.3 billion in 1987.

The United States derives price advantage from the depreciation of the dollar vis-a-vis another country's currency only if U.S. unit labor costs increase less than unit labor costs in the other country. Considering the movements of the dollar against the currencies of 16 other industrialized countries and correcting these with the appropriate changes in unit labor costs, a general increase in U.S. price competitiveness may be demonstrated. The real, effective exchange-rate index of the dollar based on relative unit labor costs fell from its peak of 138.3 percent in 1985 to 85.5 percent in the second quarter of 1988, representing a decline of 52.8 percent (table 3). As the table shows, the U.S. gain in relative price competitiveness was the largest against the Japanese yen and was smaller against the Canadian dollar and the West German mark.

Table 2

Percentage change in exports and imports of selected commodity groupings, August 1988 to September 1988

Commodity grouping	*Exports*	*Imports*
Agricultural commodities	10.5	-12.7
Manufactured goods	3.5	- 2.0
ADP equipment & office machinery	7.5	0
Chemicals, organic/non-organic	22.1	-16.6
Electrical machinery	-1.2	0
General industrial machinery	0	-6.7
Iron & steel mill products	40.3	-10.9
Power generating machinery	3.9	2.8
Specialized industrial machinery	-0.7	-7.6
New cars to Canada	70.6	36.9
New cars to Japan	327.3	-19.2
Petroleum & petroleum products	-14.4	-10.7
Crude material excl. agricultural	1.5	-4.9

Source: Bureau of the Census, *Commerce News*, Nov. 16, 1988.

Table 3

Real, effective exchange-rate indexes[1] of specified currencies based on relative unit labor costs[2]

Currency	1985	1986	1987	April-June 1988
U.S. dollar	138.3	107.9	92.6	85.5
Canadian dollar	105.7	99.8	104.1	110.3
Japanese yen	106.8	134.6	139.8	151.5
Deutsche mark	92.6	101.2	109.4	110.2

[1] 1980=100.0.

[2] The real, effective exchange-rate index based on relative unit labor costs is a nominal trade-weighted exchange-rate index deflated by the relative unit labor costs of the 17 industrial countries included in the index. The unit labor cost is defined as compensation of employees per unit of real output or value added in the manufacturing sector.

Source: International Monetary Fund, *International Financial Statistics*, November 1988.

INTERNATIONAL TRADE DEVELOPMENTS

A New Setback in U.S.-Brazil Economic Relations

Although the Government of Brazil claims to be in favor of liberalizing its protectionist trade policy (*IER*, October 1988), it continues to maintain severe restrictions and disincentives against foreign trade and investment in selected areas. For more than 4 years, efforts to establish a Brazilian computer industry under a protectionist umbrella has been a source of conflict between Brazil and the United States. Barriers against computer imports and foreign investment in Brazil's computer industry, as well as lack of copyright protection for computer software in Brazil, have brought U.S. authorities several times to the brink of retaliatory trade action. However, action was delayed each time in response to last-minute concessions made by Brazilian authorities—most recently in February of this year (*IER*, March 1988). The issue remains a source of bilateral friction.

Recently, pharmaceuticals have eclipsed computers as the principal area of contention between the two countries. On October 20, President Reagan ordered 100-percent *ad valorem* tariffs on U.S. imports of various Brazilian products in retaliation for Brazil's refusal to provide patent protection for U.S. pharmaceuticals and fine chemicals. These sanctions were triggered by a petition from the U.S. Pharmaceutical Manufacturers Association (PMA), filed in July 1987 under section 301 of the U.S. Trade Act of 1974. PMA has protested for years against patent infringement in Brazil.

In August of this year, in the course of investigating the complaint, the United States Trade Representative (USTR) published a list of Brazilian products targeted for sanctions. In September, the USTR held hearings where U.S. producer and consumer groups testified for or against including certain items on the U.S. retaliation list. Three categories of Brazilian products were ultimately chosen for penalty duties: paper, certain nonbenzenoid drugs, and consumer electronics.

During 1985–87, total U.S. imports from Brazil in the three categories have averaged $39 million per year. (Total U.S. imports from Brazil in 1987 amounted to $7.6 billion.) The sanctions on electronics do not significantly affect currently traded items; they are directed mostly at products that have just recently received Government approval for export, including video cassette recorders and microwave ovens. Brazil reportedly planned a major push into the U.S. consumer electronics market, but will now be hindered in this effort by prohibitive tariffs.

The President's retaliatory measures were preceded by more than 2 years of unsuccessful bilateral consultations between U.S. and Brazilian officials. Brazil has stuck adamantly to its plans to develop its own pharmaceutical industry behind protective barriers. Some 85 percent of this industry is currently controlled by foreign manufacturers.

In making the announcement on retaliatory measures, United States Trade Representative Clayton Yeutter pointed out that "pharmaceutical and chemical companies have little motivation to invest in the research and development of products important to mankind unless they are assured that the right to market those products will be safeguarded by patent protection. Patent piracy simply cannot go unchallenged."

Reportedly, Brazilians received the specifics of the U.S. announcement with a sigh of relief. They had feared that sanctions might be imposed on other originally targeted products—such as footwear, jewelry, and air conditioners. According to some views, Brazil doesn't regard the new measure as painful enough to force a change in its patent protection policy.

Officially, Brazil takes the position that the U.S. sanctions are, in the words of Flecha de Lima, Brazil's senior trade negotiator, "illegal, truculent, unjustified, and without support in international law." On November 8, Rubens Ricupero, the Brazilian delegate to the General Agreement on Tariffs and Trade (GATT), declared at its annual meeting that punitive U.S. tariffs on Brazilian imports violated the accord's existing rules and disciplines. Brazil, along with India, has opposed in the GATT U.S. efforts to establish an international agreement on patents and other intellectual property.

Japan's Distribution System Comes Under Scrutiny

The United States has long complained that Japan's complex distribution system makes it difficult for foreign suppliers to enter the Japanese market. Now, Japanese opinion leaders appear to be moving towards a consensus that something must be done to make the process of getting goods from producers to consumers more efficient and less discriminatory. Several studies on the distribution system have recently been undertaken by the Japanese Government and private sector, with the Prime Minister's Administrative Reform Council due to make public its preliminary recommendations in December. At the same time, the United States has begun to seek ways to address problems the current system poses for U.S. suppliers. A bilateral dialogue on the matter is likely to be set up in the early months of the Bush administration.

High prices in Japan and low levels of imports have long been attributed partly to barriers inherent in Japan's distribution system. The fact that Japanese consumers have benefited little from the yen's substantial appreciation since 1985 has led to a more critical examination of the country's distribution system in recent months. Japan's Economic Planning Agency (EPA) recently concluded that just 38 percent of the 29 trillion yen import savings from October 1985 to December 1987 were passed on to Japanese consumers in the form of lower prices; manufacturers and distributors retained more than 60 percent of the profits from the yen's gains.

Structural features, some protected by law, have limited price competition. Consumer goods like food products are often highly expensive as a result of practices such as trade barriers, exclusive import rights, an archaic and cumbersome web of wholesalers, and a limited number of retail outlets. Some manufactured goods move through longstanding networks of related suppliers, middlemen, and dealers, making it difficult for "outsiders" to crack established markets. Even if they can gain entry, U.S. suppliers complain that high markups by import agents and retailers erode their initial landed price advantage.

The distribution system in Japan contains many more layers than the one in the United States. According to official Japanese Government statistics, wholesalers with fewer than 10 workers accounted for 80 percent of the total number of wholesalers in 1985. Retailers with fewer than 10 workers accounted for 95 percent of Japan's 1.6 million retail establishments. Japan's EPA estimates that the ratio of wholesale transactions to retail transactions in Japan is 4.2, more than double the rates prevailing in other advanced countries like the United Kingdom, France, the United States, and West Germany.

Traditional ways of doing business have also frustrated the efforts of newcomers. EPA estimates that as much as 88.7 percent of Japanese retailers' supplies arrive through domestic wholesale routes; direct procurement from domestic and foreign suppliers accounts for an estimated 9.2 and 0.3 percent, respectively. Mutual relationships, often involving cross-ownership among banks, manufacturers, wholesalers, and retailers, are also common in Japan's distribution system. U.S. businesses have complained that these relationships impede their exports of products such as electric appliances and pharmaceuticals.

Legal barriers have also played a role. The United States has complained about three in particular: government restrictions on the expansion of large retailers, such as supermarkets and department stores; tightly controlled licensing of liquor sales; and limitations on the offering of sales premiums. These restrictions limit consumer choice and dampen retail competition, the United States believes.

Large retailers, with their extensive shopping areas and sophisticated purchasing departments, have been major vendors of imported consumer products in Japan. Smaller stores tend to rely upon domestic producers and traditional wholesale routes for their stock. It is common for Japan's trading companies, the most frequently used middlemen, to accept returns of unsold merchandise. Larger stores are more likely to place orders in quantities that are commercially viable for foreign firms and to assume risks for unsold goods.

The so-called Large-Scale Retail Store Law has been blamed for slowing down the expansion of chain stores and restricting the kinds of business they can engage in. The law discriminates between outlets by size, requiring a prospective store operator to submit a report to the Government on the proposed site, size, and operating hours of any new retail store when plans call for the store to have sales space of more than 500 square meters. In practice, the Government requires retailers to obtain approval from local confederations of retailers before it will accept a company's application, giving smaller retailers a substantial say in the prospective store's plans. In many cases, the original construction plan is delayed for years and the store size reduced in an effort to preserve harmony with local small- and medium-sized retail store owners. Applications can take up to 10 years to process.

Other aspects of retailing are also tightly controlled. A Government-issued license is required for selling liquor, tobacco, rice, real estate, and pharmaceuticals. Official permission is needed for selling certain foods at a retail store to ensure compliance with the Food Sanitation Law. Even the sales of salt, antiques, thermometers, and pets are regulated by legal codes.

Restrictions on sales promotions have also made it difficult for new entrants to introduce their products to Japanese consumers and to reward distributors for promoting their wares. Originally intended to protect consumers from fraudulent claims, these restrictions are enforced by Japan's Fair Trade Commission (JFTC) in consultation with industry associations in Japan. Although the JFTC recently issued new guidelines that liberalize such controls, industry-specific fair competition codes remain a barrier to U.S. sales efforts.

Many of the Japanese Government's legal requirements are rooted in a desire to achieve domestic policy objectives. Small "mom and pop" shops have played a role in stabilizing Japan's unemployment rate and their owners are now important backers of the ruling Liberal Democratic Party. Strict regulations on liquor retailing were enacted one-half century ago to enhance tax collections. But with liquor taxes being the third largest source of central government tax revenue, the Government itself has reportedly put the brakes on the expansion of cut-rate liquor stores.

Frustration with such regulations in Japan's business community has recently come to the fore. On March 17, Keidanren (a federation of Japan's largest businesses) submitted a 107-page proposal to the Prime Minister's advisory panel, blaming government controls over distribution, transportation, and 12 other industrial fields for impeding competition. The Japan Chain Stores Association on June 23 called upon the Government to revise the Retail Store Law and to ease rules controlling sales of liquor, rice, and other commodities.

Faced with mounting criticism from both foreigners and businesses in Japan, the Japanese Government is beginning to consider some degree of deregulation. Prime Minister Takeshita pledged at the Toronto Economic Summit to streamline Japan's distribution system. At least five Government organs are currently investigating the matter: the Administrative Reform Council's Committee on Public Deregulation, an advisory council to the Prime Minister; the Management and Coordination Agency; the Japan Fair Trade Commission, and the EPA. The Ministry of International Trade and Industry (MITI) recently created a high-level post to develop plans for distribution reform. A distribution "vision" is reportedly slated for completion by MITI next spring.

Takeshita's advisory council is due to provide draft recommendations in November, with Prime Ministerial approval of the preliminary report expected in December. According to the *Japan Economic Journal,* the panel is likely to recommend relaxing Government controls over sales of liquor, pharmaceuticals, and trucking tariffs; more rapid settlement of disputes over opening of large retail stores; and lowering restrictions on premium campaigns for sales promotion. Administrative discretion by Government officials is expected to be curtailed in an effort to speed approvals and improve transparency. However, the panel is unlikely to make much progress in addressing less formal barriers associated with traditional supplier relationships and ways of doing business.

There is some evidence that Japan's distribution system has begun to respond to changes in economic circumstances and consumer tastes. With the yen appreciating during the past 3 years, Japanese consumers have become more willing to try new products and change traditional shopping habits. New distribution channels have also been created. Convenience stores have been springing up and expanding sales rapidly, as have mail-order distributors. Outlets for the sale of inexpensive consumer goods and volume discounters for household products have been established. Major retailers are responding to the intensified competition by designing their own products and importing them directly for sale under the store's brand names. Trading companies are increasingly being circumvented as demand for smaller lots of diversified fashions grows. U.S. firms have developed independent sales networks for products such as chocolate confectionery and wood products. Still, setting up completely new distribution outlets can be expensive and U.S. suppliers who must work through the existing distribution network often find it resistant to penetration.

Some analysts expect adoption of a consumption tax next year to encourage further streamlining, since taxes will be collected at each stage of the distribution chain. However, the Japanese Government may well allow associations of retailers to collude in determining how such a tax will be passed on to consumers by exempting such associations from Japan's antimonopoly law.

U.S. officials have expressed concern that such an exemption could work against the goal of distribution reform.

The U.S. Government formally raised its concerns about Japan's distribution system at the U.S.-Japan Trade Committee meeting in early September and the bilateral economic subcabinet meeting held in mid-October. Detailed consultations on Japan's restrictions on sales premiums and discriminatory aspects of industry fair competition codes were held at a September meeting of the two countries' antitrust authorities. The subject was also raised during Secretary of Commerce Verity's "Market Japan" mission in mid-September.

A bilateral "dialogue" on distribution issues has been proposed as a possible option for dealing with U.S. concerns about Japan's distribution system. However, some U.S. officials feel it could be a waste of time to spend months jointly identifying problems encountered by U.S. firms and discussing whether they are "anticompetitive," "unfair," or "illegal." They also believe that meaningful progress on distribution will be achieved only if bilateral negotiations go further than strictly governmental barriers, such as the Retail Store Law, to aspects of industrial structure, financial relationships, competition policy, and ways of doing business. The Japanese Government, on the verge of passing tax reform legislation over the objection of small retailers, is wary of proposing sweeping change. Nevertheless, it appears to be aware of the need to streamline Japan's distribution system and to be willing to begin a constructive dialogue with the United States to address specific concerns.

China Reins in a Troubled Economy

With prices officially reported to be increasing at an annualized rate of 20 percent in recent months, and estimated by foreign observers to be rising much more rapidly in major urban areas, the Chinese Government has imposed a series of stringent measures aimed at bringing the overheated economy under control. This process has brought to a halt, and to some extent reversed, China's shift to a more decentralized, market-oriented economy.

The first move made to curb inflation was the announcement in August that no more price reforms would be implemented during the remainder of the year. Since November 1987, when the selection of new leaders at the 13th Communist Party Congress marked a victory for China's strongest advocates of economic reform, the Government had been moving ahead more quickly to dismantle controls and allow commodity prices to rise to levels determined by supply and demand. In May, the prices of four major food items—sugar, pork, vegetables, and eggs—were decontrolled in cities throughout the country. By mid-August, however, bank runs and panic buying in response to these and other planned price increases had resulted in runaway inflation, forcing policymakers to temporarily abandon price reforms.

In October, after the action taken in August failed to stop the runs on banks and panic buying, the State Council announced that it would reimpose price ceilings on basic foods, strictly manage the prices of other products essential to the people's daily life, and institute enforcement procedures to stop any unauthorized increases in the prices of key agricultural and industrial inputs. Recent announcements indicate that the prices of some consumer goods will be decontrolled in 1989 but that the pace of price reform will be slow.

In a further effort to reduce inflation and stabilize the economy, Government leaders also announced plans to restore many of the direct administrative controls they had relinquished during the past few years as economic decisionmaking was decentralized. Although excessive investment continued to fuel the inflation, China's central bank was unable to restrain the lending policies of provincial and regional banks as the economy overheated. Both local governments and enterprises continued to borrow heavily to fund capital construction and other investment projects. Moreover, much of the local investment was in plants geared to growing consumer demand, and, with energy and raw materials in short supply, these plants were using resources needed for developing the economic infrastructure and other priority projects. Competition for scarce inputs was also adding to the inflationary pressure as the total industrial output increased by 17.5 percent during the first 9 months of the year, far above the targeted growth rate of 7 to 8 percent. As a result of these developments, a number of new central controls were imposed in an effort to clamp down on the capital spending of provincial and local officials and limit their decisionmaking powers.

The new investment measures, which were issued in October to be put in effect December 1, call for eliminating projects for the production of more than 100 different commodities. These include investments in plants and equipment for the production of goods made from raw materials that are chronically in short supply, such as cotton textiles, leather and rubber goods, tractors, and television sets; investments for the production of goods that consume too much energy, such as vacuum cleaners and irons; and nonproductive construction projects such as city halls, theaters, guest houses, and sports stadiums. Almost the only investment projects exempt from the measures are those in five priority areas: energy, transportation, telecommunications, some raw materials, and agricultural products. Enterprises with foreign investment will also be spared; however, other new regulations issued by the State Council are aimed at tightening restrictions on the types of foreign investment in China that provincial and local authorities can approve.

Foreign trade was another area targeted for more central government intervention, only months after plans were announced for the decentralization of this sector (*IER*, May 1988). All unauthorized trading companies have been ordered to close down, and the Ministry of Foreign Economic Relations and Trade will increase its regulatory power through the use of controls such as quotas and import and export licenses.

STATISTICAL TABLES

Industrial production, by selected countries and by specified periods, January 1985-September 1988

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

Country	1985	1986	1987	1987 II	1987 III	1987 IV	1988 I	1988 II	1988 Apr.	May	June	July	Aug.	Sept.
United States	1.9	1.1	3.8	4.3	8.7	7.1	4.0	4.5	7.4	6.4	3.6	15.0	1.8	0
Canada	2.8	.8	2.7	5.3	5.8	4.4	4.2	3.4	5.9	4.8	1.9	2.9	0.9	(1)
Japan	3.7	-.3	3.4	-.8	15.2	15.7	13.5	-1.0	-10.2	-24.7	47.8	-10.2	29.2	12.2
West Germany ...	3.8	2.2	.2	-1.3	2.2	2.9	6.2	-2.0	-18.5	-3.4	18.7	-7.7	(1)	(1)
United Kingdom ..	4.7	1.4	4.8	3.5	6.3	3.8	-1.5	6.8	19.3	4.5	6.8	0	16.3	(1)
France	.6	.9	2.1	6.7	2.6	3.9	2.6	1.3	-10.8	12.0	25.1	11.7	0	(1)
Italy	1.2	2.7	4.0	8.1	-10.8	14.0	11.1	-2.6	34.2	-27.0	19.8	13.1	30.2	(1)

[1] Not available.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Nov. 4, 1988.

Consumer prices, by selected countries and by specified periods, January 1985-September 1988

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

Country	1985	1986	1987	1987 III	1987 IV	1988 I	1988 II	1988 III	1988 Apr.	May	June	July	Aug.	Sept.
United States	3.5	1.9	3.7	3.9	3.6	3.4	4.8	4.7	5.3	4.2	4.2	5.2	5.2	4.1
Canada	4.0	4.2	4.4	4.4	3.5	3.4	4.8	4.2	4.9	6.1	3.0	4.0	5.0	4.4
Japan	2.0	.6	.1	-.8	1.1	-2.1	2.8	(1)	6.1	1.2	-2.3	-2.3	3.6	(1)
West Germany ...	2.2	-.2	.3	1.5	0	.7	1.8	2.0	2.1	1.8	.9	2.1	3.2	1.6
United Kingdom ..	6.1	3.4	4.1	3.9	4.9	2.6	6.0	8.8	7.2	5.9	8.3	8.0	13.4	7.1
France	5.8	2.5	3.3	2.7	2.4	2.3	2.8	3.8	2.7	2.7	3.3	4.4	4.3	2.9
Italy	8.6	6.1	4.6	6.5	5.7	3.3	4.6	6.0	5.1	4.1	5.0	6.6	7.6	5.1

(1) Not available.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Nov. 4, 1988.

Unemployment rates,[1] by selected countries and by specified periods, January 1985-October 1988

(In percent)

Country	1985	1986	1987	1987 III	1987 IV	1988 I	1988 II	1988 III	1988 May	June	July	Aug.	Sept.	Oct.
United States	7.2	7.0	6.2	6.0	5.9	5.7	5.5	5.5	5.6	5.3	5.4	5.6	5.4	5.3
Canada	10.5	9.6	8.9	8.8	8.2	7.9	7.7	7.9	7.8	7.6	7.9	8.0	7.8	(2)
Japan	2.6	2.8	2.9	2.8	2.7	2.7	2.5	(2)	2.6	2.4	2.5	2.6	(2)	(2)
West Germany ...	7.5	7.0	6.9	7.0	7.0	6.9	7.0	6.9	7.0	7.0	7.0	6.9	6.9	(2)
United Kingdom ..	11.2	11.2	10.3	10.0	9.5	9.0	8.6	(2)	8.6	8.4	8.2	8.0	(2)	(2)
France	10.4	10.6	10.8	10.8	10.6	10.6	10.6	(2)	10.6	10.7	10.8	10.8	(2)	(2)
Italy	6.0	7.5	7.9	8.1	8.0	8.0	8.0	(2)	(2)	(2)	(2)	(2)	(2)	(2)

[1] Seasonally adjusted; rates of foreign countries adjusted to be comparable with U.S. rate.
[2] Not available.

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, November 1988.

Trade balances, by selected countries and by specified periods, January 1985–September 1988

(In billions of U.S. dollars, f.o.b. basis, at an annual rate)

Country	1985	1986	1987	1987 III	1987 IV	1988 I	1988 II	1988 III	1988 Apr.	May	June	July	Aug.	Sept.
United States[1]	-132.8	-155.1	-170.3	-171.6	-171.9	-149.6	-133.1	-128.8	-123.7	-117.1	-158.6	-113.7	-147.2	-125.5
Canada	12.0	7.1	8.3	8.4	4.4	7.2	8.8	(2)	6.0	6.0	14.4	18.0	8.4	(2)
Japan	55.9	92.5	96.2	89.2	91.6	99.6	86.0	(2)	93.6	78.0	86.4	93.6	87.6	(2)
West Germany	25.3	52.6	65.7	62.8	74.0	65.2	76.8	(2)	72.0	60.0	97.2	69.6	81.6	(2)
United Kingdom	-2.6	-12.6	-16.9	-20.0	-21.2	-28.4	-32.4	-37.6	-27.6	-37.2	-32.4	-54.0	-37.2	-21.6
France	-2.6	.1	-5.2	-4.4	-4.4	-2.8	-4.0	-7.6	-4.8	-3.6	-2.4	-7.2	-16.8	1.2
Italy	-12.1	-2.1	-8.7	-6.4	-10.8	-12.0	-4.0	(2)	-6.0	0	-6.0	-9.6	(2)	(2)

[1] Exports, f.a.s. value, adjusted; imports, c.i.f., adjusted. Beginning with 1986, figures include previously undocumented exports to Canada. Data for individual quarters do not reflect similar adjustments.
[2] Not available.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Nov. 4, 1988, and *Advance Report on U. S. Merchandise Trade*, U.S. Department of Commerce, Nov. 16, 1988.

U.S. trade balance,[1] by major commodity categories, by selected countries, and by specified periods, January 1985–September 1988

(In billions of U.S. dollars, c.i.f. value basis for imports)

Item	1985	1986	1987	1987 III	1987 IV	1988 I	1988 II	1988 III	1988 Apr.	May	June	July	Aug.	Sept.
Commodity categories:														
Agriculture	9.6	4.5	7.0	2.1	3.2	3.0	3.3	3.1	1.2	1.2	0.9	0.9	0.8	1.4
Petroleum and selected products, unadj	-45.9	-31.8	-39.5	-11.7	-10.1	-9.7	-9.9	-9.5	-3.1	-3.6	-3.2	-3.1	-3.4	-3.0
Manufactured goods	-102.0	-134.3	-146.1	-36.3	-36.2	-35.0	-35.5	-36.8	-10.9	-11.0	-13.6	-12.8	-12.6	-11.4
Selected countries:														
Western Europe	-23.3	-28.2	-27.9	-7.0	-6.9	-4.0	-3.9	-4.6	-.8	-1.2	-1.9	-2.3	-1.4	-.9
Canada[2]	-21.7	-23.0	-11.5	-2.8	-3.1	-3.8	-4.1	-2.6	-1.9	-1.1	-1.1	-1.1	-.4	-1.1
Japan	-46.5	-55.3	-58.0	-13.8	-14.5	-13.1	-12.9	-13.3	-4.1	-4.4	-4.4	-4.4	-4.8	-4.1
OPEC, unadj	-10.2	-8.9	-13.7	-4.6	-3.3	-2.6	-3.1	-2.8	-.9	-1.1	-1.1	-.9	-1.2	-.7
Unit value (per barrel) of U.S. imports of petroleum and selected products, unadj	$26.59	$15.02	$18.12	$19.01	$18.40	$16.35	$16.11	$15.16	$15.69	$16.40	$16.19	$15.77	$15.15	$14.60

[1] Exports, f.a.s. value unadjusted; imports c.i.f. value unadjusted.
[2] Beginning with February 1987, figures include previously undocumented exports to Canada.

Source: *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, Nov. 16, 1988.

Money-market interest rates,[1] by selected countries and by specified periods, January 1985–October 1988

(Percentage, annual rate)

Country	1985	1986	1987	1987 II	1987 III	1987 IV	1988 I	1988 II	1988 May	1988 June	1988 July	1988 Aug.	1988 Sept.	1988 Oct.
United States	8.3	6.5	6.8	6.8	6.8	7.6	6.7	7.6	7.8	7.9	7.3	8.7	8.2	8.4
Canada	9.7	8.6	8.4	8.0	9.2	9.0	8.7	9.2	9.3	9.3	9.6	10.2	([2])	([2])
Japan	6.5	4.9	3.9	3.7	3.7	3.9	3.8	3.8	3.8	3.8	4.0	4.2	([2])	([2])
West Germany	5.5	4.6	4.0	3.7	4.2	4.1	3.3	3.9	3.6	4.4	5.2	5.4	([2])	([2])
United Kingdom	12.1	10.8	9.8	9.3	10.0	9.2	8.9	8.7	7.8	9.9	10.9	12.2	([2])	([2])
France	10.0	7.7	8.2	8.1	7.9	8.5	7.9	7.5	7.3	7.3	7.4	8.1	([2])	([2])
Italy	15.0	12.8	11.3	10.7	11.9	11.6	11.0	10.8	11.0	10.9	11.3	10.9	([2])	([2])

[1] 90-day certificate of deposit.
[2] Not available.
Note.—The figure for a quarter is the average rate for the last week of the quarter.

Source: *World Financial Markets*, Morgan Guaranty Trust Co. of New York, Sept. 9, 1988, and *Federal Reserve statistical release*, Selected Interest Rates, Board of Governors of the Federal Reserve System, Nov. 14, 1988.

Effective exchange rates of the U.S. dollar, unadjusted and adjusted for inflation differential, by specified periods, January 1985–October 1988

(Percentage change from previous period)

Item	1985	1986	1987	1987 III	1987 IV	1988 I	1988 II	1988 III	1988 Apr.	1988 May	1988 June	1988 July	1988 Aug.	1988 Sept.
Unadjusted														
Index number	127.0	106.0	94.1	95.2	90.3	87.5	86.5	91.0	86.1	87.6	90.1	91.7	91.3	88.8
Percentage change	3.8	-16.5	-11.2	1.2	-5.1	-3.1	-1.1	5.2	.3	1.7	2.9	1.8	-.4	-2.7
Adjusted:														
Index number	121.7	100.9	90.2	87.0	87.4	84.9	84.1	89.2	83.7	85.3	88.1	89.8	89.6	87.2
Percentage change	1.8	-17.1	-10.6	-3.9	.5	-2.9	-.9	6.1	.5	1.9	3.3	1.9	-.2	-2.7

[1] 1980-82 average=100.
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: Morgan Guaranty Trust Co. of New York, November 1988.

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