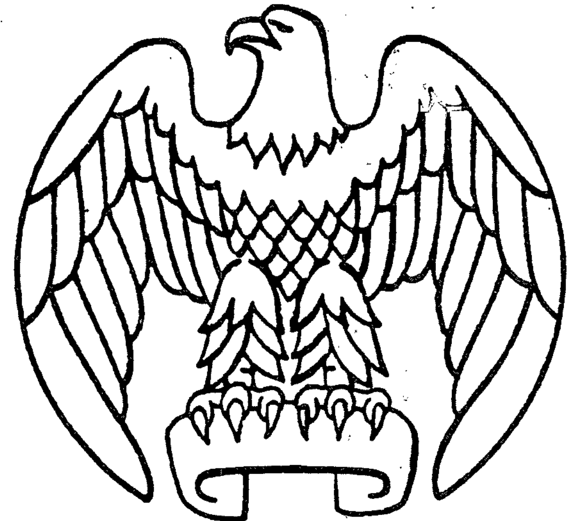
INTERNATIONAL ECONOMIC REVIEW



FEBRUARY 1985

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OFFICE OF ECONOMICS

U.S. INTERNATIONAL TRADE COMMISSION

WASHINGTON, D.C. 20436

OFFICE OF ECONOMICS
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International Economic Indicators

The combined economies of the OECD countries grew 4.75 percent in 1984--the largest annual gain since 1976. The growth in the U.S. real GNP, the most rapid since 1951, was 6.8 percent in 1984. This reasserts hope for the widely predicted continuation of Western economic expansion at least until mid-1986. The fourth quarter's 3.9 percent annual rate of real growth in the United States supported the administration's forecast for a 4.0 percent expansion in 1985. This growth level underlies the administration's plan to reduce the Federal budget deficit this year.

U.S. foreign trade, however, shows a much less rosy picture. The U.S. merchandise trade balance registered an all-time high deficit of $123.3 billion in 1984. Some leading authorities on foreign trade predict a further increase in the deficit this year and believe that current U.S. trade policies lack breadth and coherence to deal with the domestic welfare implications of U.S. trade problems. "Entering the third year of a recovery, U.S. trade is in a growing disarray," observed Chairwoman Paula Stern of the U.S. International Trade Commission in her recent speech to the International Forum of the World Affairs Council. The ITC saw nearly 200 hundred unfair trading cases in 1984. "[T]he Commission on a day-to-day basis," said Chairwoman Stern in her speech, "has become a veritable 'MASH' unit for industrial casualties."

The inflow of foreign capital has been a major source of financing private U.S. investment during the current recovery in the face of unprecedented demands placed by the Federal government on credit markets. At the same time, though, it has contributed to the high price of the dollar on international money markets, which has caused complaints from both U.S. industries and foreign governments. The recent meeting of the finance ministers and central bank presidents of the five leading industrial democracies was reportedly dominated by concerns of U.S. allies over the dollar's still unabated strength.

Industrial production

U.S. industrial production in December 1984 increased by a strong 0.6 percent. Despite this, production in the fourth quarter of 1984 remained at roughly the same level as in the third quarter. Annual average industrial output in 1984 was a robust 11 percent higher than in 1983.

The annual rates of industrial growth in the key industrial countries, calculated by taking the latest available monthly output data over the output level in the corresponding month 1 year before, were as follows: Canada, 3.9 percent; Italy, -0.3 percent; Japan, 10.8 percent; the United Kingdom, -0.3 percent; and West Germany, 3.8 percent. Despite the November-to-November decline in Italian industrial production, the country's industrial output in the first 11 months of 1984 was 3.5 percent higher than in January-November 1983. The November decline in British industrial production is largely explained by the coal strike. After a substantial recovery since mid-1984, French industrial production leveled off at the end of the year. Slower growth of foreign demand has been cited as the primary cause of France's slackened industrial expansion.

Employment

The rate of unemployment in the United States was 7.3 percent in January (on a total labor force basis including military personnel). December's rate was 7.1 percent. The seasonally adjusted unemployment rates in December as reported by national statistical organizations were as follows: Canada, 10.8 percent; Italy, 13.5 percent; the United Kingdom, 12.9 percent; and West Germany, 9.0 percent. Japan's rate of unemployment was 2.8 percent in November. (For foreign unemployment rates adjusted to U.S. statistical concepts, see tables at the back of this issue.)

According to the U.K. Government, high British unemployment is a temporary consequence of a needed shift in the country's economic structure. The OECD reportedly dissents from this view by considering British unemployment a tenacious, long-run problem. It urges the British Government to create more jobs.

External balances

The monthly deficit in U.S. merchandise trade declined to a seasonally adjusted $8.2 billion in December from $9.9 billion in November. Much of the blame for the continued high U.S. deficit falls on the superstrong dollar that stimulates imports and discourages exports. Sen. Richard G. Lugar (R-Ind.), chairman of the Senate Foreign Relations Committee, said that the strong dollar reduces the ability of U.S. domestic industries to compete on world markets by 40 percent.

Japan's merchandise trade surplus increased from $20.5 billion in 1983 to $33.7 billion in 1984 and it is expected to top $40 billion this year. Japan posted a $33.1 billion surplus in trade with the United States, and a $10.1 billion surplus with the EC for 1984. The West German trade surplus amounted to an estimated $19 billion in 1984. The Federal Republic's exports increased by 10.0 percent in real terms from 1983 to 1984. The share of exports in overall West German production is 30 percent. (The ratio of U.S. exports to total GNP is 10.1 percent.)

Prices

The U.S. consumer price index rose by 0.2 percent in December 1984, the same as in November. For the year 1984, the consumer price index advanced 4.0 percent.

In December 1984, the annualized rate of consumer-price inflation was 3.8 percent in Canada; 4.6 percent in the United Kingdom, and 2.2 percent in West Germany. France's consumer prices rose 0.3 percent in December, the best result in 12 years. France's 1984 rate of inflation was 6.7 percent, exceeding the Government's target of 5.0 percent. French President François Mitterrand said recently that the impact of the U.S. dollar on the French domestic price level is particularly strong, since 40 percent of the country's imports are dollar denominated.

Consumer prices in OECD countries rose at an annualized rate of 5.1 percent in November 1984. Although the decline in inflation rates has been general in the OECD area, inter-country differences remain significant. The 12-month rate in November was 4.0 percent or less in eight OECD countries; it was between 4.1 percent and 9.9 percent in eleven, but it remained in the double digits in five (Greece, Iceland, Portugal, Spain and Turkey.)

Forecasts

The latest OECD growth projections show a weakening in the overall growth of Western economies from 1985 to the first half of 1986. OECD forecasts of seasonally adjusted real GNP growth rates are as follows: United States, 3.0 percent both in 1985 and in the first half of 1986; Japan, 5.0 percent in 1985 and 4.5 percent in the first half of 1986; West Germany, 2.75 percent both in 1985 and in the first half of 1986; OECD Europe, 2.5 percent in 1985 and 2.25 percent in the first half of 1986; and total OECD, 3.0 percent in 1985 and 2.75 percent in the first half of 1986.

The European Commission has revised upwards its forecast for the 10-nation Community's 1985 GDP growth from 2.3 percent to 2.5 percent. As in 1984, GDP is expected to advance in all EC countries in 1985. The anticipated 1985 growth rates range from 3.0 percent for the United Kingdom and 2.9 percent for Denmark to 1.7 percent for France and 1.0 percent for Belgium. The outlook on the labor front, however, remains unsatisfactory. The average rate of unemployment in the Community rose from 10.6 percent in 1983 to 10.9-11.0 percent in 1984, and it is expected to climb further to 11.5 percent this year.

Mr. Jacques Delors, the new president of the EC Commission, designated 1992 as the year when all barriers to trade and to the free movement of individuals should be removed within the Community.

Forecasts of Japan's economic growth for 1985 are in the 4.0-5.0 percent range. These forecasts are being held despite the anticipated slowdown in U.S. and European expansion which is expected to weaken Japan's export-driven economy. The real growth of the Japanese economy in 1984 is estimated at 5.3 percent, an acceleration from the 3.0 percent recorded for 1983. The West German Government predicts a 5.1 percent real GNP growth for 1985. A prestigious West German economic research institute (D.I.W.), however, believes that the Federal Republic's economy will grow only by 2.0 percent in 1985. The West German economy grew by 2.6 percent in 1984.

According to GATT, world trade is unlikely to increase faster in 1985 than in 1984, when its volume expanded by 5-6 percent. (The volume of world trade increased by 2.0 percent in 1983 after declining by a similar amount in 1982.)

International Trade Developments

Restraints on Japanese auto exports have cost U.S. consumers $15.7 billion, Commission estimates

Japan's voluntary export restraints (VER) on U.S.-bound car shipments cost American consumers an estimated $15.7 billion during the first 4 years they were in effect, according to a preliminary report released by the International Trade Commission February 9. Despite these costs, auto industry employment was only 44,000 higher in 1984 than it would have been in the absence of the VER. Meanwhile, the average hourly wage of American auto workers increased by nearly 50 percent since 1981, rising to $15.33 (excluding benefits) during the first six months of 1984. That wage was about two-thirds higher than the average for all manufacturing workers in 1984.

Japanese car companies would have garnered a 28 percent share of the U.S. market for autos in 1984 without the VER, the Commission estimated. This is nearly 10 percentage points more than the 18.4-percent Japanese share actually recorded by Japanese makers in the year. American consumers would have purchased about 1 million more Japanese cars in 1984 had they been available, the Commission estimated. This excess demand translated into significantly higher prices for both Japanese and domestic cars, with VER-induced shortages pushing up prices of Japanese cars by an average of $1,300 per car, or 17 percent, in 1984 alone.

The cost of the VER to consumers approximately doubled each year from 1981 to 1984, as improving U.S. economic conditions fueled demand for automobiles, both imported and domestic. Because they account for the largest share of U.S. sales, most of this cost was the result of higher prices for domestic cars: only $3.3 billion was attributed by the Commission to higher-than-market prices for Japanese autos since 1981. Nevertheless, prices of Japanese cars rose substantially: prices for small cars rose by more than one-fifth and prices for large cars rose by more than one-third. U.S. car prices also rose, although small car prices increased by less than the overall consumer price index (7.2 percent from April 1981 to January 1985, compared to a 17 percent rise in the overall CPI during the same period). Prices for large domestic autos rose substantially more.

Sales by U.S. automakers were about 8 percent higher during the restraint period than they would have been otherwise, the Commission estimated. This means that U.S. makers sold 618,000 more cars in 1984 than they would have in the absence of Japanese restraints. Profits by U.S. makers also rose to record levels: the industry's combined profits of $10 billion in 1984 were nearly double the record $6.3 billion in profits chalked up by the top four American makers during the previous year. The industry spent about $9.2 billion for equipment, facilities, and research in 1983. Nevertheless, total spending by the industry on new equipment and research and development peaked in 1981, the first year of the auto restraints.

Partly as a result of such expenditures, the industry made substantial progress in improving its competitiveness during the 4 years of restricted imports, the Commission reported. Break-even operating levels fell by 33 percent at GM, 41 percent at Ford, and 52 percent at Chrysler. Capacity utilization also increased, from a low of 68 percent in 1981 to almost 87 percent in 1984. Older, inefficient plants were shut down, while other plants were renovated and retooled. Despite wage increases, the industry was able to lower its total labor bill by cutting jobs and improving productivity. Even with these changes, however, Japanese firms were estimated to enjoy a $1,000 to $1,500 per car cost advantage in 1984. This edge results from lower wages, higher productivity, and the current strength of the dollar relative to the yen.

The ITC report, Publication No. 1648, can be obtained by calling 523-0036.

Administration hasn't asked for continued voluntary restraints on Japanese autos

The Reagan Administration apparently has not decided to seek a fifth year of voluntary restraints on Japan's U.S.-bound auto shipments. The restraints are set to expire on March 31 unless renewed by Japan. However, at a January 31 meeting a Cabinet group recommended that the United States use its leverage while the renewal decision is still pending to pressure Japan to open its market to more American manufactured goods. U.S. trade officials indicated that they will vigorously press for more open access to Japan's markets for telecommunications equipment and services, electronics, pharmaceuticals, medical equipment and forest products. U.S. Trade Representative Bill Brock will head a high level delegation to Tokyo in mid-February to urge Japan to open its market further to imported goods and direct investment.

The decision to focus negotiations on selected sectors came in early December, as preparations for the Reagan-Nakasone meeting on January 2 were underway. At that time, the Cabinet rejected proposals by the Department of Commerce and the U.S. Trade Representative (USTR) that the United States ask Japan to agree to fixed timetables for increasing its imports of manufactured goods. A 10-15 percent import surcharge on Japanese goods was also rejected as inconsistent with U.S. international obligations. Instead, the Cabinet group agreed to focus U.S.-Japan trade negotiations in 1985 on gaining access to sectors of Japan's economy viewed as presenting significant export potential for American firms. After some debate, the telecommunications, electronics, forest products, medical equipment, and pharmaceuticals sectors were selected. At their January 2 meeting, President Reagan and Prime Minister Nakasone agreed on this approach, and charged their foreign ministries with coordinating the negotiating effort. The State Department is spearheading U.S. preparations, with the Department of Commerce and the Office of the USTR focusing on telecommunications and electronics and the Department of Agriculture on forest products. At the time of this writing, the Treasury Department is attempting to take the lead in negotiations on pharmaceuticals and medical equipment, issues currently in the domain of the Commerce Department and USTR.

America's shift in strategy toward Japan is the result of growing frustration with slow progress on bilateral issues, particularly in light of the burgeoning U.S. trade deficit with Japan. A year of tense and often unproductive trade talks resulted in only one major market-opening measure:

the yen-dollar accord signed in early May. The U.S. negotiators spent much of 1984 demanding Japanese import liberalization, while Japanese officials, particularly those in MITI, threatened to put up new barriers to American high technology products. After agreeing to shelve the beef and citrus issue until 1987, the two sides spent much of the year stalemated over proposed Japanese restrictions on foreign sales of satellites, and on aspects of proposed laws that would substantially change the terms of competition in Japan's market for computer software, integrated circuits, and telecommunications equipment and services. Furthermore, Japan was slow to make good on its promise to give foreigners easier access to its standards certification process. Although a good deal of political capital was expended on high technology and financial-market issues in 1984, old standbys also played a major role in last year's trade scenario: U.S. restrictions on autos, textiles, steel, and electronics affected a substantial proportion of bilateral trade. Indeed, Japanese suppliers were affected by a record number of U.S. antidumping, countervailing duty, patent infringement, and escape clause actions. Japanese high-technology electronics firms in particular complained about disingenuous use of U.S. trade laws to limit their U.S.-bound shipments.

Even though the Administration has decided not to take the lead in asking for a continued cap on Japan's car shipments, many on Capitol Hill and within the U.S. industry believe restraints are vital to the continued health of America's auto industry. Several members of Congress are attempting to garner support for an extension of the VER or other restrictions on car imports. They point out that the U.S. bilateral trade deficit in Japan widened by nearly 50 percent in 1984 and claim that the restrictions will offset the fact that the United States has made little progress in securing increased sales of American-made goods to Japan. It is clear that whatever the outcome of the VER debate, bilateral trade talks in 1985 will be laden with long simmering frustrations and continued Administration concern about the steady deterioration of the U.S. current account since 1980.

Soviet oil production shows first year-to-year decline since World War II

In 1984, Soviet oil production registered its first year-to-year decline since World War II. According to official Soviet statistics, the oil industry produced 613 million metric tons (MMT) of oil and gas condensates (roughly equivalent to 12.2 million barrels a day). This equaled 1982 output and represented a decline of 3 MMT from 1983 production.

Presumably reflecting leadership concerns about the oil industry, the Soviet press featured numerous articles criticizing the oil industry during the year. Criticism focused on operations in the Tyumen region of Siberia. Increasing Tyumen's production is essential to offset declining production in older fields in other parts of the country, but the region has apparently failed to meet its plan for the third consecutive year.

According to the articles, production conditions in Tyumen are dismal. Oil field workers are paid four or five times the average Soviet wage, but labor turnover is high because of the intense cold and poor living conditions. Only one-third of the "permanent" workers remain on the job after 3 years and, as a result, the work force is inexperienced. More than 2,000 rigs in Western Siberia (which includes Tyumen) are idle, in part due to a shortage of skilled workers to repair them. Delays by the Ministry of Power and Electrification and the Ministry of Industrial Construction in building power plants and a transmission grid caused power outages, which reportedly led to the loss of 1 MMT of oil in 1984. Construction of canals to bring in water for the injection method of oil recovery is also lagging as are roads and railroads needed to exploit deposits in remote areas. Insufficient attention is being paid to putting new deposits into production and repairing existing wells. Some drilling brigades are still being paid by the number of meters drilled, which gives them an incentive to start drilling a new well instead of continuing work when drilling becomes difficult. In an unusual criticism, oil industry officials were accused of reducing the production target instead of working to solve Tyumen's problems.

The Western press reported that the Soviet Union was not fulfilling monthly contracts for sales to many West European customers in December 1984 and January 1985. Western analysts were perplexed since Soviet exports of crude oil and products had increased from 1.6 million barrels a day (mbd) in 1983 to 1.8 mbd during the third quarter of 1984. Soviet sources reportedly explained that production was not satisfying increasing domestic demand. Although the monthly production statistics issued by the USSR indicated that output was running below 1983 levels during most of the year, many Western experts were skeptical of the Soviet explanation since the shortfall was relatively small. Many concluded that the Soviet Union was deliberately holding oil off the market in an attempt to support the contract price of $28 per barrel. This explanation suggests that the Soviets will be able to increase oil deliveries to Western Europe in the coming months.

Other observers concluded that the Soviet explanation could have some validity, citing increased demand for oil products during the winter and the rise in Soviet industrial production. In this case, the production shortfall would have contributed to the drop in deliveries by further reducing the amount of oil available for export. Even if this explanation is valid, demand could slacken and production recover, leaving more oil available for export to Western Europe in the near term.

Since production leveled off in the late 1970's, last year's decline in output may mean that production has peaked. However, given the importance of oil exports to the Soviet hard currency balance, Western analysts expect that the Soviets will strive to maintain oil deliveries to the West at or near 1983 levels and do whatever is necessary to remain an oil exporter for many years to come. The Soviet Union has a number of options for maintaining oil exports. They include stepped-up development of other energy sources (nuclear, gas, and coal) to replace oil in domestic uses; intensified oil conservation measures; and reduced deliveries of oil to Eastern Europe (perhaps substituting increased deliveries of natural gas to avoid politically unacceptable decreases in East European economic performance). The Soviets appear to be pursuing all of these options simultaneously, despite the difficulties and costs involved.

U.S.-Chinese grain agreement expires

The 4-year U.S.-Chinese grain agreement, under which China was committed to import 6 to 8 million metric tons of wheat and corn annually, expired on December 31, 1984, and will not be renewed. U.S. grain exports to China had exceeded the minimum terms of the agreement in its first 2 years, with shipments amounting to 7.9 million metric tons in 1981 and 8.4 million metric tons in 1982. In 1983, however, China's imports of U.S. grain declined sharply, reaching only 3.8 million metric tons of wheat and corn combined, almost 2.2 million metric tons short of its minimum commitment. Although China technically avoided reneging on the agreement in 1983 by indicating it would make up the shortfall and buy an additional 6 million metric tons of grain in 1984, its imports of U.S. grain, consisting entirely of wheat, were only 4.1 million metric tons by yearend.

The reasons for China's failure to meet this pledge in 1984 or to seek a new agreement are different now than they were in 1983. In that year, China stopped buying U.S. wheat for 7 months in retaliation against the unilateral quotas that the United States applied to Chinese textile and apparel imports. In 1984, despite another dispute between the two countries over further U.S. action to regulate trade in textile products (IER, October 1984), it was not the textiles issue but the immense success of China's agricultural reforms that was mainly responsible for the decline in its demand for grain imports.

Since the Chinese Government revised its agricultural policies in 1978, relating farm income to productivity and giving individual rural families an increasingly greater role in managing the land they contracted from the state, the output of this sector--crops, livestock, forest products, and aquatic products--has grown rapidly. Despite a reduction in the amount of land devoted to grain, China's traditional crop, grain output increased from 304.7 million tons in 1978 to 387.2 million tons in 1983, according to official Chinese statistics. Moreover, preliminary data indicate that the grain harvest in 1984 may have exceeded 400 million tons. These gains appear to have resulted directly from productivity-related increases in the procurement prices that the Government pays the peasants for grain, from the increased use of fertilizers, and from the more widespread introduction of tractors in grain cultivation. Generally favorable weather conditions in China in recent years may have also contributed to the higher output. By yearend 1984, Government leaders were declaring that China had solved its long-standing grain shortage.

In 1984, China's total grain imports, consisting primarily of wheat, were 9.7 million metric tons, according to preliminary data compiled by the U.S. Department of Agriculture. This quantity is substantially less than the 13.1 million metric tons that it imported in 1983. China also failed to renew its bilateral grain agreements with Argentina and Australia, both of which expired in 1984. It is likewise not expected to renew its one remaining long-term grain agreement with Canada, which will expire in July 1985. In addition, partly owing to a shortage of adequate storage facilities and to internal transportation problems, China is estimated to have exported about 1.5 million metric tons of corn and corn sorghum in 1984. In view of these developments, prospects for a revival in U.S. grain exports to China are not good.

Despite its overall self-sufficiency in grain, China is expected to continue buying U.S. wheat. As in the past, imported wheat will be required for consumption in urban centers that are not readily accessible to the grain-producing areas. To meet this need, China has ordered wheat from the United States (357,000 metric tons as of January 31), Argentina, and the European Community in recent weeks.

New Interest is shown in Latin American regional trade cooperation

Many Latin American countries (including Central American and Caribbean ones), are once again reaffirming their commitment to what is loosely termed regional economic integration. Regional and subregional integration of markets (involving preferential tariff and nontariff barriers in trading with each other or joint customs tariffs in trading with the outside world), and trade balancing arrangements with neighbors, are seen as important steps in this direction. This view is expressed in a recently released report of the Inter-American Development Bank (IDB), entitled "Economic and Social Progress in Latin America." A Part I of this report is devoted entirely to the subject of economic integration.

Latin American countries have experimented with various types of economic integration in the past two decades. The first major effort was the establishment in 1960 of the Latin American Free Trade Association (LAFTA). This was followed by the formation of the Central American Common Market (CACM) in 1962, and the Caribbean Free Trade Association (CARIFTA) in 1965. Some Latin American countries that remained outside LAFTA formed the more ambitious Andean Group (ANCOM) in 1969. In addition to integrating markets, members of the Andean Group aimed at coordinating certain aspects of their social and economic policies, including industrial, trade and investment policies. The Caribbean Community and Common Market (CARICOM) replaced CARIFTA in 1973.

These economic integration efforts met with limited success at best. To facilitate progress, LAFTA members founded in 1980 the Latin American Integration Association (LAIA), a loose regional arrangement, which was less ambitious than LAFTA or ANCOM. Unlike the multilateral approach taken by its predecessors, LAIA is primarily a system of bilateral negotiations of preferential trade agreements between members. According to the LAIA concept, bilaterally negotiated concessions can be extended to other members, and the process would ultimately lead to increased intra-regional trade.

Since 1982, the most serious debt and economic crisis facing Latin America over the last 50 years (IER, March 1984, p. 10) forced its nations to focus on national interest at the expense of the cooperation effort. They erected numerous nontariff barriers to trade not only with third countries but also with each other, which contributed to a decline of intra-regional trade in the 1980's.

Even while the integration effort lost ground, Latin American and Caribbean countries continued to believe that efforts to foster integration should be stepped up. With burdensome debt-service payments limiting their hard-currency imports, and resistance from advanced industrial economies to their export promotion efforts, these countries are now increasingly interested in turning to one another for supplies and markets.

New interest in regional economic solidarity is attested to by numerous pronouncements of Latin American and Caribbean leaders. Most notably, the Latin American Conference held early 1984 in Quito, Ecuador, produced a consensus to "adopt common positions" in areas such as international economic relations with third countries, development financing and, especially, foreign debt (IER, March 1984, p. 11). This conference also identified promotion of intra-regional trade as a major goal.

The IDB report stresses that regional and subregional integration of markets is a most urgent step towards higher forms of economic integration. Certain short-term measures must be taken to this end, such as removal of nontariff barriers to trade with one another, putting preferential tariff systems in place, and negotiating "offsetting trade flows" to balance trade with each other.

While Latin American rhetoric on regional cooperation can be heard more and more frequently, real efforts to integrate particular regional markets have also been reported. LATINEQUIP is a notable example. LATINEQUIP, a company jointly established by Argentinian, Brazilian and Mexican public sector banks, is scheduled to start operations in March 1985. Its purpose is reportedly to boost regional trade in capital goods and technical services. To date, Latin American trade of goods and services has been transacted mostly with advanced industrial countries, especially the United States. LATINEQIP reportedly expects to double intra-Latin trade within three years. The company also plans to foster Latin American exports of capital goods and services to third countries. The U.S. market is regarded as a high priority target.

Another example is OLADE, the Latin American energy organization, which plans to establish an integrated Latin American energy and technology market. Its 24 members have already started a regional energy data bank, cataloguing available natural resources, technologies, capital goods, and services. OLANDE will also study ways for members to reduce the role of the dollar as a reference currency in their trade. Exchange techniques would include major reliance on barter--such as trading oil or electrical energy for equipment or engineering services.

North Korea and South Korea are talking trade

On November 15, 1984, North and South Korea met for the first time since the outbreak of the Korean war in 1950 to discuss economic cooperation. Both countries are strongly motivated to see the talks succeed: in addition to benefiting directly from improved ties, cooperation could also mean benefiting from trade and economic expanded contact with the other's allies. Although some analysts do not expect the talks to yield immediate results, the fact that they were scheduled at all is viewed as evidence that both sides are determined to preserve the relatively cordial atmosphere that developed in 1984.

After years of economic isolation, North Korea needs technology and foreign investment to exploit its natural resources. Faced with the need to modernize its production facilities, Pyongyang is eager for joint investment projects with Japan and other advanced western nations. Moreover, since defaulting on foreign loans three years ago, North Korea is struggling to make payments on an outstanding $2-4 billion foreign debt. Banks from non-communist countries are unwilling to extend credit--even for trade financing--thus forcing North Korea to pay for all imported materials and equipment in cash and deplete its meager foreign exchange resources. The North's biggest obstacle to achieving either increased foreign investment or access to world capital markets is its ongoing political conflict with South Korea.

At the economic talks, North Korea placed top priority on developing joint ventures with South Korea in mining and fisheries, as well as buying steel, tungsten, naptha, and textiles. Pyongyang also hopes to win Seoul's approval of its recently announced plan for attracting foreign investment from the United States, Japan, and Europe.

Seoul showed little interest at the November talks in joint ventures but did propose to sell its steel, aluminium, copper products and a variety of consumer products to the North in exchange for coal, iron ore, lead, zinc, and some farm products. South Korea currently imports large quantities of coal and natural resources from Africa, Australia, Canada, and the United States. Access to the vast reserves in North Korea could mean substantial savings in shipping time and costs.

Seoul, concerned by what it views as growing protectionism in its major trading partners, also views formal trade relations with the communist north as a means to gain direct access to markets in China. In the past, strong opposition from Pyongyang has forced trade between South Korea and China to be channelled through third parties such as Japan and Hong Kong. Reportedly, China has encouraged Pyongyang to seek cooperation with Seoul as it has opened its own borders to foreign investment and initiated economic reforms. For its part, China has provided incentives to South Korea to cooperate with the North through trade contacts and indications that it will participate in the 1988 Olympic games in Seoul.

Seoul's participation in the talks is also motivated by a desire to improve relations with North Korea's major communist allies in anticipation of the upcoming Olympics. South Korea has placed the success of the Olympic games at the top of its foreign policy objectives, and wishes to attract as many countries as possible which are friendly to Pyongyang, particularly China and Soviet bloc nations.

A second round of economic talks were scheduled for December 1984. However, these were postponed by North Korea in the aftermath of the late-November Panmunjom shooting incident. (A Soviet citizen crossed the demarcation line, initiating gunfire between the two sides). Rescheduled for 17 January 1985, the talks were later postponed by North Korea. Pyongyang's stated reason for the second postponement is objection to South Korean-U.S. military exercises scheduled for February. The military exercises, called Team Spirit, have been held annually since 1976. Both sides have indicated that the talks will continue, but a new date has not been set.

Commission study on targeting in the NICs released

According to a recently released Commission study, Brazil, Korea, Mexico, and Taiwan have all actively used government policy instruments to shape the structure of their economies and to promote development of particular industries. However, they have had mixed success in implementing such programs. The study, the Commission's third on foreign targeting practices, surveys the industrial policies of five major U.S. trading partners. Four of the countries studied--Brazil, Korea, Mexico, and Taiwan--are considered newly industrializing countries or NICs.

The NICs surveyed each grew at a rapid and steady pace, but those in Asia grew at a faster clip than their Latin American counterparts. Mexico's GNP growth from 1960-80 averaged 7 percent in real terms, while Brazil's growth was around 6 percent annually. In comparison, Taiwan and Korea grew at double digit rates for much of the period, each averaging about 11 percent growth in GNP from 1960-80. Chronic inflation and debt problems have plagued Brazil and Mexico, but Korea (which now has a substantial foreign debt) and Taiwan have not had similar difficulties.

Not surprisingly, every NIC surveyed targeted basic industries for development. Cement, machinery, oil refining, petrochemicals, steel, and shipbuilding were among the industries given government support through the 1970's. More recently, high value-added industries--such as autos, aircraft, computers, electronics, and telecommunications--have been the focus of such efforts. Though the textiles industry has been an important foreign exchange earner for the NICs surveyed, each has tried to shift resources from it into more sophisticated industries.

Mexico and Brazil relied heavily on import-substitution policies to promote the growth of their manufacturing sectors, shielding them from foreign competition and providing substantial financial and tax incentives. Foreign direct investment and technology transfer did play an important role in the development of their manufacturing sectors, however, sometimes coming in lieu of direct shipments of foreign-made equipment. Both countries also used government influence in the economy to promote social goals--for example, encouraging domestic employment or ownership of key industries. These aims often conflicted with stated industrial goals, resulting in misallocation of resources and underinvestment in the very industries the Government was attempting to promote.

Brazil and Mexico turned to the world market at a later stage than did their Asian counterparts, and then relied more heavily on direct and indirect subsidies to promote foreign sales. Taiwan and Korea, on the other hand, shifted to export-led expansion in the early 1960's, and have been quite successful in world markets for textiles, apparel, footwear, steel, and electronics.

Despite the similarity of their development paths, the ITC study showed that Taiwan and Korea have differed markedly in their production strengths. Although both countries have targeted basic industries for development, Korea has generally been more successful in capital-intensive, large scale production. Its electronics, machinery, chemical, and apparel industries, meanwhile, are less developed than Taiwan's. Taiwan's strength is evident in small scale production and in manufacture of sophisticated goods, such as chemicals, machine tools, electronics, and high-quality textiles, footwear, and apparel.

All of the NICs surveyed are now attempting to remove price rigidities and lessen government influence in their economies. Since 1982, Taiwan and Korea have been liberalizing their import polices and lowering the subsidies implicit in Government-provided development loans. Brazil and Mexico are also attempting to dismantle domestic price controls and subsidies. They still employ fairly restrictive import policies, however, and continue to regulate foreign investment in key manufacturing industries.

U.S. imports of manufactures from the NICs surveyed rose substantially from 1960-84--in some cases, at exponential rates. Taiwan and Korea again led the group, but Brazil, and to a lesser extent Mexico, have become important sources for industrial products in the U.S. market. Until recently, textiles, apparel, and footwear were the leading U.S. imports from these countries, but shipments of steel, machine tools, and pharmaceuticals have gained prominence in recent years. The NIC's have been less successful in the U.S. computer market: the combined shipments of the four countries came to less than 6 percent of total U.S. imports of computers in 1979.

Although import restrictions were extensively used by each of the NICs studied, the United States was able, until 1980, to maintain a surplus in manufactures trade with them. Since that time, the U.S. deficit with these countries has been the most rapidly rising component of the overall U.S. trade deficit. This deterioration in U.S. trade performance came primarily as a result of increased U.S. imports of manufactured goods from those countries. Exports to Brazil and Mexico have also dropped in the wake of the severe balance of payments difficulties confronting these countries since 1980.

The ITC report, Publication No. 1632, can be obtained by calling 523-3771.

GATT members agree on new trade dispute procedures

As a result of widespread complaints that the GATT dispute settlement process is slow and cumbersome, the GATT Contracting Parties (CP's) have agreed to try out changes aimed at streamlining the process. For the United States, which resorts frequently to the GATT to redress its trade problems, the action is welcomed. The changes, to be in effect for one year, are intended to promote more timely settlement of disputes. They amend existing rules for selection of panel members and submission of information--two areas frequently identified as bottlenecks.

Adopted at the November annual session of the GATT CP's, the proposal aims to improve upon rather than depart from the 1979 "Understanding" on dispute settlement procedures negotiated during the Tokyo round. According to the 1979 guidelines, disputes should be resolved in less than a year--30 days for formation of a panel and three to nine months for completion of a panel's work are recommended. However, failure to meet these deadlines is a frequent source of delay. Few cases are resolved within a year, most cases are settled within two years, and some have taken longer. A case brought by the European Community (EC) concerning U.S. DISC legislation took over 8 years to resolve. Two U.S. cases complaining of EC citrus preferences and subsidies on canned fruits also dragged on for over two years.

Reaching agreement on panel composition has been one major stumbling block. Also, progress has at times been hindered when countries are slow to submit information solicited by the panel. In the new proposal, the CP's agreed that the present process of choosing qualified individuals from country delegations not involved in the dispute should continue. However, in the event that disputing parties cannot agree on such delegates, they may choose from a standing roster of panelists whose nomination may not be opposed by the parties except for "compelling reasons." Furthermore, if the parties come to a deadlock, GATT's Director General would have the authority to appoint persons from the roster after consulting with the parties. To improve the timeliness of panel work, the proposal also directs panels to give disputants a schedule with precise deadlines for submission of information, urging all interested parties to respect those deadlines.

The proposal fails to address other widely-noted drawbacks of the panel procedures such as adoption of and follow-up on recommendations. Even when panels have completed their work within the recommended period, formal adoption of panel reports by the CP's has sometimes added months to the timeframe for resolution of disputes. Since decision-making under the GATT is based on consensus, a GATT member found in violation of the rules by the panel can block adoption of the panel report indefinitely. Once the CP's recommend remedial action, monitoring of actions to implement the recommendations has been considered weak by many GATT members. Procedural solutions to tackle these problems are the subject of proposals that will be considered by the Council during the next few months. Such proposals urge the GATT Secretariat to monitor compliance with rulings of the CP's more systematically.

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

Country	1981	1982	1983	1983 III	1983 IV	1984 I	1984 II	1984 III	1984 July	Aug.	Sept.	Oct.	Nov.	Dec.
United States	2.6	-8.1	6.4	21.8	10.1	11.4	8.6	6.4	11.5	1.5	-7.0	-5.0	5.2	7.4
Canada	0.5	-10.0	5.7	18.5	13.8	2.4	3.3	13.1	60.3	-5.6	-24.9	-0.8		
Japan	1.0	0.4	3.5	14.0	10.3	13.5	11.6	6.1	3.1	8.5	-11.5	46.8	2.0	
West Germany	-2.3	-3.2	0.4	4.9	9.0	2.5	-10.9	16.5	242.4	-27.1	-14.9	66.3		
United Kingdom	-3.9	2.0	3.3	5.7	3.3	-2.4	-7.9	-0.4	-12.4	1.2	19.6	9.9	-2.3	
France	-2.6	-1.5	1.1	3.1	1.0	7.4	-4.0	9.5	57.3	9.3	-36.2	19.9	-16.5	
Italy	-1.6	-3.1	-3.2	-4.9	17.6	4.5	2.1	7.7	-15.0	19.1	14.6	-26.7		

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, February 1, 1985.

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

Country	1982	1983	1984	1983 IV	1984 I	1984 II	1984 III	1984 IV	1984 July	Aug.	Sept.	Oct.	Nov.	Dec.
United States	6.2	3.2	4.0	4.4	5.0	3.7	3.6	3.9	3.5	5.5	4.3	4.3	2.7	2.3
Canada	10.8	5.8	3.7	4.2	5.7	2.7	3.1	3.3	7.0	1.9	2.9	2.0	5.8	6.4
Japan	2.6	1.8	2.3	3.6	3.6	0.9	1.2	3.5	6.5	-3.5	4.6	10.0	4.0	6.7
West Germany	5.3	3.6	2.0	3.0	2.8	1.7	0.5	2.9	-0.6	0.2	1.4	7.3	2.5	1.3
United Kingdom	8.6	4.6	4.7	6.1	4.4	2.8	5.5	5.9	2.1	12.5	6.2	7.7	3.5	2.6
France	12.0	9.5	6.9	8.6	7.3	6.3	7.3	6.6	6.7	7.9	7.1	8.2	6.5	5.7
Italy	16.4	14.9	8.9	11.1	11.1	10.6	8.1	5.7	6.2	8.2	3.5	4.2	5.1	13.2

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, February 1, 1985.

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

Country	1982	1983	1984	1983 IV	1984 I	1984 II	1984 III	1984 IV	1984 Aug.	Sept.	Oct.	Nov.	Dec.	1985 Jan.
United States	9.7	9.6	7.5	8.5	7.9	7.5	7.5	7.2	7.5	7.4	7.4	7.1	7.2	7.4
Canada	11.0	11.9	11.3	11.2	11.3	11.4	11.3	11.2	11.2	11.8	11.3	11.3	10.8	
Japan	2.4	2.7		2.6	2.8	2.7	2.8		2.8	2.8	2.8	2.7		
West Germany	5.9	7.3	7.4	7.3	7.2	7.4	7.5	7.3	7.5	7.5	7.4	7.3	7.2	
United Kingdom	12.2	13.4	13.5	13.0	13.2	13.3	13.6	13.6	13.7	13.8	13.5	13.6	13.6	
France	8.7	8.8		9.0	9.5	10.0	10.2		10.2	10.2	10.2	10.3		
Italy	4.8	5.3	5.6	5.5	5.5	5.6	5.5	5.6						

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

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

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

Country	1981	1982	1983	1983		1984			1984					
				III	IV	I	II	III	July	Aug.	Sept.	Oct.	Nov.	Dec.
United States-1/	-27.5	-31.6	-57.5	-65.2	-77.6	-104.8	-104.8	-128.8	-148.8	-102.0	-135.6	-94.8	-104.4	-82.8
Canada	6.1	14.4	14.4	13.2	14.8	14.4	16.4	16.4	19.2	13.2	18.0	20.4	16.8	
Japan	20.1	18.6	31.5	33.2	34.8	40.0	43.2	40.4	39.6	31.2	50.4	49.2	61.2	
West Germany	11.9	21.1	16.6	15.2	12.4	18.8	12.8	20.0	19.2	20.4	21.6	26.4	26.4	20.4
United Kingdom	7.9	4.1	-0.8	2.4	0.8	-0.4	-6.8	-8.4	-2.4	-9.6	-12.0	-13.2	-2.4	-2.4
France	-9.3	-14.0	-5.9	-1.6	-0.8	-6.0	-4.8	1.6	-1.2	4.8	1.2	-4.8	1.2	-1.2
Italy	-15.9	-12.8	-7.9	-10.0	-3.2	-9.6	-12.8	-6.4	-2.4	-9.6	-7.2	-12.0	-26.4	

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

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, February 1, 1985.

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

Item	1982	1983	1984	1983	1984				1984					
				IV	I	II	III	IV	July	Aug.	Sept.	Oct.	Nov.	Dec.
Commodity categories:														
Agriculture	21.6	20.0	18.4	5.4	5.2	4.4	4.0	4.8	1.1	1.4	1.5	1.2	1.7	1.9
Petroleum and selected products, unadj	-54.6	-49.1	-52.5	-13.2	-13.1	-13.4	-13.2	-12.8	-4.9	-4.2	-4.1	-4.6	-4.5	-3.7
Manufactured goods	-4.9	-31.3	-78.9	-11.2	-19.0	-18.1	-25.1	-16.7	-9.4	-6.6	-9.1	-5.1	-6.1	-5.5
Selected countries:														
Western Europe	7.6	1.2	-14.1	0.2	-3.6	-2.9	-4.5	-3.1	-1.7	-1.0	-1.8	-1.0	-1.6	-.5
Canada	-12.6	-12.1	-20.1	-3.7	-4.3	-5.1	-5.3	-5.4	-1.8	-1.2	-2.3	-1.5	-1.8	-2.1
Japan	-17.0	-19.6	-33.8	-6.2	-7.0	-7.8	-11.0	-8.0	-4.3	-2.9	-3.8	-2.8	-2.5	-2.7
OPEC, unadj	-8.3	-8.2	-12.3	-3.1	-2.6	-3.7	-3.7	-2.3	-1.4	-1.3	-1.0	-1.0	-1.0	-.3
Unit Value (per barrel) of U.S. imports of petroleum and selected products, unadj	$31.48	$28.60	$28.11	$28.43	$28.31	$28.45	$27.98	$27.69	$28.41	$27.90	$27.64	$27.79	$27.78	$27.49

Source: Summary of U.S. Export and Import Merchandise Trade, U.S. Dept. of Commerce, December 1984.

Money-market interest rates
(Percent, annual rate)

Country	1982	1983	1984	1983 IV	1984 I	1984 II	1984 III	1984 IV	1984 Aug.	1984 Sept.	1984 Oct.	1984 Nov.	1984 Dec.	1985 Jan.
United States	12.4	9.1	10.4	9.4	9.7	10.9	11.5	9.4	11.5	11.3	10.4	9.2	8.6	8.1
Canada	14.4	9.5	11.3	9.5	10.0	11.4	12.5	11.2	12.4	12.2	12.0	11.1	10.4	9.7
Japan	6.8	6.8	6.3	7.6	6.4	6.3	6.3	6.3	6.4	6.3	6.3	6.3	6.3	6.3
West Germany	8.8	5.7	6.0	6.1	5.9	6.0	6.0	5.9	6.0	5.8	6.1	5.9	5.8	5.8
United Kingdom	12.2	10.1	9.9	9.4	9.2	9.2	11.1	10.1	11.1	10.8	10.6	9.9	9.7	11.6
France	14.6	12.4	11.7	12.3	12.4	12.3	11.4	10.7	11.4	11.0	10.8	10.5	10.7	10.4
Italy	20.0	18.0	17.1	17.5	17.5	17.0	16.8	17.0	16.5	17.3	17.1	17.1	16.9	15.8

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	1982	1983	1984	1983 IV	1984 I	1984 II	1984 III	1984 IV	1984 Aug.	1984 Sept.	1984 Oct.	1984 Nov.	1984 Dec.	1985 Jan.
Unadjusted:														
Index number	109.8	114.2	122.3	116.4	117.2	118.8	125.1	128.2	124.0	127.3	128.5	126.8	129.4	132.0
Percentage change	10.4	4.0	2.5	0.1	0.7	1.4	5.3	2.5	-0.1	2.7	0.9	-1.3	2.1	2.0
Adjusted:														
Index number	109.8	112.4	118.3	114.3	114.4	114.9	120.8	123.0	119.9	122.6	123.6	121.6	123.9	126.2
Percentage change	9.0	2.4	1.9	0.2	0.1	0.5	5.1	1.8	0.1	2.3	0.8	-1.6	2.2	1.9

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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