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CONTENTS

CONTENTS

INTERNATIONAL ECONOMIC COMPARISONS

The U.S. economy begins the year on a strong note. Investment spending on durable equipment has bounced back after the 1986 tax reform, which repealed the investment-tax credit and allowed less accelerated depreciation. The trade deficit appears to be on a downward course in both real and nominal dollar terms. But projected moderation in the growth of consumer spending and exports are bound to slow U.S. economic expansion later in 1989 (see section on forecasts). The size of the Federal budget deficit continues to worry most economists.

Economic Growth

The annualized rate of real economic growth during the third quarter of 1988 was 3.9 percent in the United States, and 5.0 percent in the United Kingdom. The latest available data indicate that the rate of real economic growth (annualized) during the second quarter of 1988 was 4.9 percent in Canada, 3.5 percent in France, 3.1 percent in Italy, 5.6 percent in Japan, and 3.4 percent in West Germany.

Industrial Production

U.S. industrial production rose 0.5 percent in November after rising 0.5 percent in October and 0.1 percent in September 1988. The November gain reflected further increases in the output of materials, business equipment, and construction supplies. Output of consumer goods increased 0.3 percent in November, manufacturing output increased 0.5 percent, mining output increased 0.6 percent and the output at utilities increased 0.4 percent. U.S. industrial production in November 1988 was 5.1 percent higher than in November 1987.

Capacity utilization in U.S. factories, mines and utilities in November was 84.2 percent, the highest level in 9 years. Many economists fear that a capacity utilization rate above 85 percent might lead to shortages and rising prices in some industries.

The most recent available data on the seasonally adjusted annual growth rates of industrial production in other major industrialized countries are: Canada, 5.1 percent; France, 4.1 percent; Italy, 5.1 percent; Japan, 9.2 percent; the United Kingdom, 3.8 percent, and West Germany, 3.6 percent.

Prices

The seasonally adjusted U.S. Consumer Price Index increased 0.3 percent from October to November 1988. Consumer prices increased 1.6 percent in West Germany during the 1-year period ending in November 1988. During the 1-year period ending in October 1988, consumer prices increased 4.6 percent in Italy, 4.2 percent in Canada, 1.1 percent in Japan, 6.4 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) increased slightly, from 5.2 percent in October to 5.3 percent in November 1988.

Japan reported an unemployment rate of 2.5 percent in September, and France reported a rate of 10.2 percent. The national statistical offices of other countries reported the following unemployment rates in October: West Germany, 8.6 percent; Canada, 7.9 percent; Italy, 16.5 percent; and the United Kingdom, 7.7 percent. (For foreign unemployment rates adjusted to U.S. statistical concepts, see the tables at the end of this issue.)

Investment

The Department of Commerce estimates that capital spending on new plant and equipment in the United States amounted to $430.9 billion in 1988, compared with $389.7 billion in 1987. Real capital spending (adjusted for price changes) is estimated to have increased by 11.6 percent in 1988 compared to an increase of only 2.3 percent in 1987 and a decline of 3.9 percent in 1986. In the manufacturing sector, capital spending was estimated to have increased by 12.1 percent in current dollars from 1987 to 1988. Within the manufacturing sector, durable goods industries' spending was estimated to have increased by 9.9 percent. In durables, the largest estimated increases in capital spending occurred in nonferrous metals, blast furnaces-steel works, and electrical machinery. In the motor vehicles industry, spending was estimated to have declined by 4.6 percent.

The Budget Deficit

The following tabulation shows fiscal deficits as a percentage of GNP or GDP for major industrial countries. The U.S. fiscal deficit remained slightly above the average fiscal imbalances of other major industrial countries in 1985 and 1986, but well below the average in 1987.

	1983	1984	1985	1986	1987
United States	-5.6	-5.1	-5.3	-4.8	-3.4
Canada	-6.2	-6.7	-6.6	-4.8	-4.3
Japan	-5.6	-4.7	-3.9	-3.6	-3.3
France	-3.2	-3.3	-3.3	-2.8	-2.3
West Germany	-1.9	-1.6	-1.3	-1.2	-1.4
United Kingdom	-2.8	-3.1	-2.4	-2.2	-1.2
Italy	-13.9	-13.1	-13.8	-12.2	-11.6
Average excl. United States	-5.6	-5.4	-5.2	-4.5	-4.0

The U.S. budget deficit quoted in the above table includes the Social Security Fund surplus. According to Congressional Budget Office estimates, if this surplus were excluded, the deficit would swell from $155 billion to $260 billion in fiscal year 1988 and from $148 billion to $264 billion in fiscal year 1989.

Forecasts

Table 1 shows new macroeconomic projections for the U.S. economy in 1989 by four major forecasters, and the simple average of these forecasts. The forecasts represent percent changes over the preceding quarterly period at annual rates.

The four forecasters projected a decline in nominal and real GNP growth rates in 1989. They also predict a slight increase in unemployment rates due to a projected moderation in the pace of consumer spending and exports. Export growth rates are projected to slow, as the price effects of the dollar depreciation on export demand weaken. Inflation (measured by the GNP deflator index) is expected to rise in the second and third quarters and moderate in the fourth quarter of 1989.

In major industrial countries, the OECD projects encouraging rates of growth in private business investment as a percent of income. The projected growth rates in 1989 are: 0.25 percent for the United States, 1.5 percent for Japan, 0.25 percent for West Germany, 0.5 percent for France, 0.5 percent for the United Kingdom, 0.5 percent for Italy, and 1.75 percent for Canada. The OECD also projects that in 1989 the OECD countries' real income will grow between 2.5 to 3.0 percent, employment will expand slightly, and inflation will stabilize at around 3.75 percent.

U.S. TRADE DEVELOPMENTS

The seasonally adjusted U.S. merchandise trade deficit decreased by 3.7 percent from $10.7 billion in September to $10.3 billion in October 1988. The October deficit was 15.6 per-

Table 1

Projected quarterly percent changes of the GNP and other U.S. economic indicators for 1989

Indicator and quarter	Data Resources Inc.	Merill Lynch Economics Inc.	Wharton F.A. Inc.	UCLA Business Forecasting Project	Mean of 4 fore-casts
GNP (current dollars):					
January-March	8.5	8.8	9.0	10.2	9.1
April-June	5.3	6.3	6.1	7.6	6.3
July-September	5.0	3.8	5.5	4.5	4.7
October-December	5.4	2.2	5.9	3.0	4.1
GNP (constantdollars):					
January-March	5.0	3.5	3.6	5.6	4.4
April-June	1.1	1.3	1.3	2.4	1.5
July-September	0.7	-0.4	1.0	-0.6	0.4
October-December	1.3	-0.9	1.8	-1.7	0.1
GNP deflator index:					
January-March	3.4	4.4	5.2	4.4	4.3
April-June	4.2	5.0	4.7	5.0	4.7
July-September	4.3	5.1	4.4	5.1	4.7
October-December	4.0	4.8	4.0	4.8	4.4
Unemployment rate:					
January-March	5.4	5.0	5.5	5.0	5.2
April-June	5.4	4.9	5.7	4.9	5.2
July-September	5.5	4.9	5.8	4.9	5.3
October-December	5.5	5.1	6.0	5.1	5.4

Note.—Percent changes in the forecast represent compounded annual rates of change from preceding period. Quarterly data are seasonally adjusted.

Source: The Conference Board, Statistical Bulletin, vol.21, No. 10 October 1988.

cent lower than the $12.2 billion average monthly deficit registered during the previous 12-month period, and was 32.2 percent lower than the $15.2 billion deficit registered in October 1987. During the period from November 1987 to October 1988, the deficit was highest in December 1987 ($13.8 billion) and lowest in July 1988 ($9.8 billion). The cumulative January–October deficit declined from $142.9 billion in 1987 to $113.4 billion in 1988. The Department of Commerce projects that $136.0 billion will be reached for the year—a sharp drop from the 1987 record high of $170.0 billion.

The following tabulation shows the percentage changes in the January–October year-to-date figures for U.S. exports, imports, and the U.S. deficit.

Item	January–October, 1986 to January – October 1987	January–October, 1987 to January–October 1988
Exports	9.7	28.3
Imports	10.6	8.3
Deficit	11.9	-20.7

Seasonally adjusted exports in October 1988 declined by $300 million to $27.7 billion from $28.0 billion in September 1988. Imports, however, declined by $700 million, from $38.7 billion in September to $38.0 billion in October.

In manufactured goods, imports increased more than exports; consequently, the deficit in this sector increased from $11.4 billion in September to $13.6 billion in October. The biggest percent gains in exports of manufactured goods were registered in power-generating machinery, electrical machinery, automatic data processing equipment and office machinery, and specialized industrial machinery. Other manufacturing sectors registered substantial declines in exports or increases in imports. Imports registered increases in all sectors except in iron and steel mill products, and petroleum and petroleum products. The oil import bill fell from $2.2 billion in September to $2.1 billion in October. The agricultural trade surplus remained virtually unchanged at 1.4 billion.

On a regional basis, the United States experienced increases in its deficits with Canada, Western Europe, Japan, and the OPEC. The deficit with the Newly Industrialized Countries (NICS) declined slightly and the small deficit with the rest of the world became a surplus. The U.S. deficit with Japan increased by 34.1 percent from $4.1 billion in September to $5.5 billion in October. The deficit with Western Europe increased from $879 million in September to $1.1 billion in October. The deficit with Canada increased from $893 million in September to $961 million in October. The deficit with the NICS declined from $3.1 billion in September to $3.0 billion in October. The U.S. trade balance with the rest of the world showed a surplus of $113 million in October compared to a deficit of $21 million in September.

INTERNATIONAL TRADE DEVELOPMENTS

Uruguay-Round Review Yields Mixed Report Card

In spite of a 1-day extension of meetings, Uruguay Round negotiators failed to resolve key disputes on agriculture and intellectual property rights (IPR) at the Montreal midterm review attended by top-level trade officials. Meanwhile, successful agreements on services, tariffs, the GATT system, and dispute settlement will be considered tentative until negotiators can iron out the areas of disagreement at meetings set for April.

The most intractable differences at Montreal were between the United States and the European Community (EC) on agriculture issues. Agriculture, the worst sticking point, was a battle of wills between the two major traders with the EC refusing to adopt the ambitious U.S. program of the elimination of trade-distorting farm subsidies by the year 2000. At the same time, other countries were disturbed by the lack of compromise between the United States and the EC on agriculture. A group of agricultural exporting countries, including Argentina, Brazil, and Chile refused to sign off on other agreements as long as the two major traders were at odds on agriculture.

The EC is reportedly willing only to agree to "substantial" reduction, rather than elimination, of farm subsidies. These are virtually the same positions that have held agriculture talks at bay since the beginning of the Uruguay Round. These kinds of differences generate numerous disputes on agricultural products and have nearly precipitated outright trade wars between the United States and the EC throughout the 1980's. As such, agriculture has been among the United States' highest negotiating priorities for the round.

The deadlocks that were also evident in the areas of IPR, namely safeguards and textiles, aggravated the situation. On intellectual property, the Indian delegation, with some support from other countries, continued to maintain that the competent organization to deal with these matters is the World Intellectual Property Organization (WIPO) and that affordable medical care and economic development require access to pharmaceutical and other technologies. This has been the "hard line" argument put forth by India since even before the Uruguay Round discussions of the issue began. On safeguards and textiles, although full consensus was lacking, outstanding differences of safeguards and textiles were not considered as substantive as those on agriculture and IPR.

Final approval of agreements reached in other areas will also be on hold pending the outcome of the April meetings. Discussions on services have resulted in a framework to guide further negotiations that would aim, for the first time, to apply GATT principles to trade in services as well as goods. Also successful were a framework for tariff negotiations, an agreement on procedures to improve dispute settlement, and one on setting up a surveillance system under which the GATT could conduct reviews of member countries' trade policies. Agreed language in these and other areas is intended to serve as guidance for the negotiators for the duration of the trade round rather than as final accords. A final accord had been reached earlier, however, in tropical products, with implementation slated to begin as soon as possible. Almost a dozen different agreements were on the table covering most of the 15 elements of the Uruguay Round mandate. The Montreal ministerial-level meeting marked the mid point of the negotiations that began 2 years ago and are expected to be concluded in 1990.

The next meeting, scheduled for April, will be held by the Trade Negotiations Committee charged with oversight of all Uruguay Round negotiations. Whereas it is not formally a ministerial-level session, participants expect the meeting to be attended by high-level officials. The next formal ministers' level meeting is planned for the conclusion of the trade round.

For the Uruguay Round, as well as the discussion of specific issues, the GATT operates on the basis of consensus. This means that all 96 members must agree before reforms can go forward. The agriculture impasse has rekindled debate on the workability of this decision-making process. However, implementation problems could persist when any major trading partner refuses to go along with the majority, even if a measure can be passed with less than full consensus.

Canadian Election: The U.S.-Canada Free Trade Agreement is Likely to be Implemented.

On November 21, Canadian Prime Minister Brian Mulroney and his Progressive Conservative (PC) party were returned to office in Canadian Federal elections. This event was preceded by a campaign that was marked by serious divisions between the majority PC party and the two other major Canadian parties, the New Democrats and the Liberals. A party needs at least 148 seats in the House of Commons in order to have a mandate to set up a Government. In the previous Parliament the PC's held 211 out of the 281 seats. They were returned to majority status with 169 seats in the Parliament in mid-December.

Since the United States-Canada Free Trade Agreement (FTA) was the principal issue of the campaign, the election was widely recognized as a referendum on the pact by the Canadian electorate. Although, as some members of the opposition point out, a majority of Canadians voted "against" the FTA, it is expected that the agreement will eventually be passed by both houses of Parliament (*IER*, September 1988).

However, the implementation of the agreement on both sides of the border will not bring about the instant or complete cessation of trade hostilities anticipated in some quarters. For example, the agreement will not bring any revolutionary change in the way either country handles dumping and countervailing duty cases involving the products of the other.

Nonetheless, there will be some immediate changes. At the outset, such cases will be subject to appeal by a panel of binationally appointed reviewers. The binational panel will replace the present adjudicatory appeals process under each country's own trade laws. This binational appeal arrangement in antidumping and countervailing duty cases is slated to be in effect for five 5 years, although it could be extended for an additional two years.

Section 1907 of the FTA also calls for the establishment of a "working group" to "seek to develop a substitute system of rules for dealing with unfair pricing and government subsidization." The substitute system would be the ultimate phase in dealing with dumping and subsidy disputes under the FTA. Meanwhile, the operation of the interim binational appellate system is considered critically important because the experience gained from it will contribute greatly to the development of a viable "substitute system."

Any new system will require the approval of the legislative bodies in both countries. A smoothly functioning bilateral panel will go a long way toward providing the political leverage necessary for either country to muster the strength to pass the required changes for genuine binational trade rules. The FTA could even truly provide an example to the multilateral trade community of how to define and maintain certain subsidies.

Antidumping and countervailing duty cases constitute the most active area of trade disputes between the United States and Canada. Of 11 cases involving products from Canada handled by the International Trade Commission in 1987, 4 were instituted under the antidumping statute, and 3 under the countervailing duty (CVD) law. At the end of 1987, Canada had antidumping orders in effect against 16 products from the United States; CVD orders were in effect against one U.S. product. The reverse situation had 15 U.S. antidumping orders in effect against products from Canada; CVD orders numbered 4.

Japan Moves Closer to Tax Reform

On November 16, the lower house of the Japanese Diet passed a six-bill package intended to simplify Japan's tax structure and shift its revenue-raising emphasis from direct to indirect taxes. The action, along with a decision to extend the present legislative session until December 28, paves the way for final Diet approval of tax reform by yearend. The United States has much at stake in the Japanese action: revisions to Japan's commodity and alcoholic beverage tax systems could benefit U.S. exporters, whereas provisions to allow firms to collude to ensure full pass-through of a broad-based consumption tax could work against U.S. interests.

Prime Minister Takeshita has staked his political career on revision of Japan's antiquated tax code, the first such overhaul in more than 40 years. After nearly 4 months of negotiations, his proposed package of measures emerged relatively unscathed from Japan's lower legislative body. The package is expected to provide a net stimulus to Japanese economic activity of approximately \$20.8 billion, equaling about 4.2 percent of Japan's general account budget. The tax code will be considerably simplified, with the number of brackets for personal, corporate, and residence taxes reduced as of January 1, 1988. The reform package also improves the "fairness" of Japan's tax system by subjecting certain activities, such as stock and bond transactions below certain limits that yield capital gains, to tax for the first time. The package lowers income-related taxes for corporations and individuals, but imposes a wide-based consumption tax of 3 percent. These changes were thought to be necessary in light of demographic and business trends in Japan. In particular, the rapid aging of Japan's population means that income taxes have become a less potent source of central Government revenue.

The proposed consumption tax is a multistage, noncumulative tax similar to the value-added tax (VAT) employed in the EC. Although the tax will be levied at each stage of the distribution chain just as is the EC's VAT, adjustments for previously collected taxes will not be made on the basis of official tax receipts passed forward. Instead, they will be based on the purchasing firm's own accounting records. The tax will be levied on the margin between the buying cost and sales price. The 3-percent consumption tax will apply to most goods and services, including food, starting April 1, 1989.

At least two elements of the recently passed package are a source of concern for the United States. As presently framed, the tax bill would authorize the creation of cartels to discuss how to pass higher taxes on to consumers. Ostensibly aimed at smaller businesses, the exemption is tantamount to a waiver from antitrust immunity for all price-related collusive activities by business associations, as long as large firms do not account for more than one-third of the exempted association's members.

The collusive pass-through of taxes is tentatively slated to be allowed until March 31, 1991. Japan's Fair Trade Commission (JFTC) is in the process of developing guidelines for permitted and non permitted activities by trade associations seeking exemptions from the antimonopoly law for such purposes. Traditionally a weak agency in Japan, most analysts believe that the JFTC is unlikely to have sufficient resources to adequately analyze exemption applications or to monitor the day-to-day operations of such cartels.

The United States is concerned that such activity might lead to widespread price increases and anticompetitive behavior. The fact that small retailers were the leading proponents of this provision also makes the United States wary that it may slow reform of Japan's distribution system, an issue of growing concern to the United States (*IER*, Dec. 1988). Collection of the consumption tax will also favor small-scale operators, since, unlike larger retailers, they will be assessed taxes based on average receipts, rather than actual sales.

Second, the broad incentives included in Japan's tax reform package are not necessarily consistent with U.S. hopes that Japan will give Japanese consumers greater purchasing power, eliminate incentives for specific types of business investment and activities, and broadly stimulate economic activity in Japan. As presently crafted, Japan's tax reform bills will shift the burden of taxes towards consumers and away from producers. New taxes will be mostly regressive in nature. Furthermore, the package is not as stimulative as some foreign analysts had hoped. Central Government tax receipts have already risen sharply in recent years, a time when international considerations argued for greater fiscal accomodation.

U.S. suppliers do stand to gain from some aspects of Japan's tax reform scheme. Japan's taxes on alcoholic beverages are set to be lowered and the collection scheme changed to remove distortions that favored lower priced domestic and higher priced foreign (mainly European) spirits over U.S. wine, beer, and whiskey. U.S. exporters also welcome the removal of high excise taxes on larger automobiles and the elimination of the ad valorem tax on cigarettes and other tobacco products. Both provisions had worked against U.S. suppliers in favor of domestic ones.

The fact that tax-reform legislation is poised for passage by the Japanese Diet is a considerable achievement for the Takeshita government. Widespread opposition to a similar tax scheme was the downfall of Prime Minister Nakasone's Cabinet and strong voices against adoption of a large-scale indirect tax remain. A well-orchestrated attempt to build consensus with various interest groups begun by Takeshita in November 1987 meant that compromises on issues such as antitrust exemptions were made to dull the opposition by groups like Japan's politically influential small businesses. Some changes will clearly benefit U.S. exporters, and, as a matter of policy, the United States is reluctant to criticize Japan's efforts to simplify its tax code. At the same time, the U.S. Government has put Japan on notice that it will closely monitor implementation of the law to ensure that it does not harm U.S. export interests.

No Signs of Progress on the U.S.-Japan Rice Issue at Montreal

No progress appears to have been made towards opening Japan's market for rice during the recent midterm review of the Uruguay Round trade negotiations. In a November 18 letter, President Ronald Reagan urged Japan's Prime Minister Noboru Takeshita to propose opening Japan's rice market at the midterm review of the Uruguay Round of trade negotiations in Montreal beginning on December 5. Takashi Sato, Japan's Minister of Agriculture, Forestry and Fisheries had responded by saying that Japan would not negotiate bilaterally or raise the issue in Montreal. However, the United States continued to expect some movement on the part of the Japanese Government during the December talks.

The latest exchange over rice began on October 28, 1988, when U.S. Trade Representative Clayton Yeutter rejected a Section 301 petition filed by the Rice Millers' Association (RMA). The timing of the rejection was critical because it came just before the midterm review in Montreal where the United States planned to push its proposal for phasing out all restrictions on agriculture, and just before the end of the Presidential campaign. This was also the first section 301 petition to be filed since the enactment of the Omnibus Trade and Competitiveness Act of 1988, and it was viewed by some as a test of the Administration's willingness to enforce those provisions relating to a more aggressive use of U.S. unfair trade laws. In rejecting the petition, Ambassador Yeutter indicated that if there were not action on the rice petition at the midterm review in Montreal he would invite a resubmission. However, there have been no indications recently that he intends to do so.

A previous petition filed by the RMA in 1986 had also been turned down. In reference to the recent setbacks one RMA source said: "We've played out this chapter." The RMA is reassessing its options while waiting for the Bush administration to signal the direction it will take on this and other trade issues. The RMA says it is looking at several possible actions if no progress is made, including refiling its petition, becoming more involved in the Section 301 process, and going directly to Capitol Hill for support.

The RMA may also be waiting to see whether Japanese practices with regard to rice imports are identified as a trade liberalization priority under the "super 301" provisions of the trade bill.

The EC's Hormone Ban: One Year Later

One year ago, U.S. and EC officials struggled to negotiate a solution to a dispute over an impending EC ban on the sale of hormone-treated meat that threatened to hurt U.S. meat exports to the Community. On January 1, 1988, a ban on the use of hormones in EC meat production became effective. However, a settlement reached in November 1987 exempted U.S. meat exports from the ban for 1 year, until January 1, 1989.

Although the two trading partners have had 1 year to negotiate a permanent solution, the outlook for compromise remains grim. U.S. officials continue to argue that the hormone ban represents an unfair trade practice since scientific evidence indicates that growth hormones do not pose a health hazard. The EC, however, remains determined to implement the ban on U.S. exports as planned. EC officials argue that EC consumers staunchly support the prohibition, which is designed to ensure consumer safety. In fact, several EC member countries implemented bans on hormone-treated meat prior to any EC-wide action.

If the ban is implemented on January 1, 1989, the U.S. Government has warned that it will retaliate by restricting EC exports of food and beverage products to the United States worth about $100 million. The list of targeted EC exports was drawn up 1 year ago and reflected the estimated amount of U.S. meat sales that would be lost if the ban became effective. U.S. Government officials have also indicated they may invoke section 4604 of the new Omnibus Trade and Competitiveness Act of 1988 to temporarily block U.S. meat imports from the EC (estimated to cost the EC meat industry about $445 million). Evidence of a black market for banned hormones inside the Community has concerned U.S. officials that imports of EC meat could contain unauthorized or possibly unsafe products. Section 4604, the reciprocal meat inspection requirement, permits the United States to temporarily prohibit imports of any meat article produced in a foreign country that "applies standards for the importation of meat articles that are not related to public health concerns about end-product quality that can be substantiated by reliable analytical methods."

Although EC officials have refused to postpone implementation of the ban beyond January 1, in November they tabled a compromise package intended to lessen the negative impact of the ban on U.S. producers. The EC Commission proposed to both exempt meat imported for pet food (which accounts for over 20 percent of the value of U.S. meat exports to the EC) and to increase the U.S. quota on high-quality Hilton beef, which is additive and hormone-free beef from cattle raised on grass. However, the U.S. Government rejected the compromise in late November. Should the United States impose its planned retaliatory measures, the EC has warned that it will counterretaliate against nine U.S. products worth about $361 million. Furthermore, the EC Commission has threatened to implement the dispute settlement procedures of the GATT, arguing that U.S. measures would be unilateral and therefore would be illegal under GATT rules.

Efforts to resolve the issue at meetings scheduled in early December were precluded by the overriding concern to resolve the U.S.-EC dispute on agricultural subsidies at the Montreal meeting. In the meantime, the EC continues to block a U.S. request under the Standards Code to establish a technical-experts group to evaluate the effect of hormone usage on consumers. Following the Montreal meeting, an EC spokesman said the ban will become effective on January 1, but suggested that the panel could receive EC approval if it "doesn't rely just on scientific arguments but also on consumer-related and other arguments." However, given the entrenched positions of the two trading partners, a trade war appears imminent.

U.S.-Taiwan Currency Talks Likely Soon

According to recent reports, the United States will hold consultations with Taiwan on the exchange rate between the New Taiwan dollar and the U.S. dollar sometime after President-elect Bush takes office. The exchange rate has been a source of bilateral tension between the United States and Taiwan for several months. In a recent report to the Congress, the U.S. Treasury Department warned that progress toward reducing the bilateral U.S.-Taiwan trade deficit is being hampered by Taiwan's manipulation of its exchange rate. South Korea was also singled out for similar criticism by the report. The report concluded that "Taiwan and Korea are considered to be manipulating their exchange rates. . . to achieve a competitive advantage" for their export sales to the United States. The report stated that such manipulation "coupled with a lack of structural reforms to strengthen domestic demand and numerous trade restrictions, have frustrated multilateral efforts to reduce global imbalances."

In the U.S. view, the currency talks, which will also take place with Korea, will try to ensure that these countries "regularly and promptly" adjust the exchange rate between their currencies and the U.S. dollar to facilitate balance of payments adjustments and eliminate unfair trade advantages. In response to U.S. criticism, Taiwan authorities point out that the NT dollar has appreciated about 44 percent against the U.S. dollar since September 1985, whereas the South Korean Won has appreciated 29 percent in the same period.

According to U.S. trade statistics, the U.S. trade deficit with Taiwan has improved since last year. The deficit with Taiwan was about $9.5 billion during January–September 1988, compared with about $13.8 billion through September 1987. (The total 1987 deficit was about $17.6 billion.) The shrinkage of the deficit is attributable almost entirely to improved U.S. export performance. During the first 9 months of 1988, the dollar value of U.S. exports to Taiwan totaled more than $9 billion, more than double the level of the same period in 1987, whereas Taiwan's exports to the United States remained constant at about $18 billion. Meanwhile, the trade deficit with South Korea was the same during January-September 1988 as it was during the same period in 1987.

Rapid Inflation Continues in Brazil

The inflation of the cruzado, approaching an annual rate of 1000 percent, has led to the widespread conclusion that Brazil is once more on the threshold of an economic crisis. The outlook is also clouded by the controversial economic implications of a new constitution for Brazil that was passed this October. Constitutional provisions in question include costly, mandatory labor benefits that might hurt business; discriminatory treatment of foreign investment that might become an impediment to Brazil's economic development; and a mandatory ceiling on interest rates that would deprive the Central Bank of a major weapon against inflation. Brazil's Congress has yet to pass implementing regulations to the new constitution, and congressional action is bound to take an extended time. Waiting for this process prolongs economic uncertainty and could provoke continued capital flight from Brazil.

Neither is the picture reassuring in terms of recent economic development experience. Growth of Brazil's GDP is projected at 1.5 percent at best for 1988, down from 2.9 percent in 1987 and 8 percent in 1986. This implies further decline in per capita income for Brazilians, which may aggravate social and political pressures.

Nonetheless, Brazil's economy has its bright spots, most notably in the area of agriculture and trade (*IER*, October 1988). The country's trade surplus has continued to widen in 1988 to a projected $19 billion, compared with $11.2 billion in 1987. Agriculture contributed in large measure by providing both an abundant supply of exportable products and by reducing the need for imports.

Chronic inflation remains, however, Brazils most unsettling economic problem. Counting 1988, Brazil has had triple-digit inflation in 5 out of the last 6 years. During his less than 4-year-old administration, President Jose Sarney has already launched two sweeping economic programs aimed principally at conquering the upward spiral of prices. Both delivered only brief intervals of respite, followed by strongly accelerating price increases. The first program, a broad currency and economic package launched in February 1986 (the so-called "Cruzado Plan") relied heavily on price and wage freezes (*IER*, March, 1987.) The second package, launched in June 1987 and referred to as "The New Cruzado Plan," was designed to correct the weaknesses of the first plan, which were manifest in mass bankruptcies, capital flight from the country, and renewed inflation in the new currency.

However, problems persisted even after the "new Cruzado Plan." A debt-rescheduling agreement between Brazil and the International Monetary Fund (IMF), negotiated in June 1988 and signed in September, currently commits Brazil to an 18-month program through the end of 1989. This scheme is designed to deal with the new imbalances that have beset the economy since the "New Cruzado Plan," and promises to curb inflation and contain the public deficit. However, there are no indications that either could be brought under control. In fact, runaway inflation became a real threat following the accord with the IMF.

In November, the Brazilian Government reportedly adopted a program modeled after Mexico's "Pact of Solidarity" that was launched in December 1987 (*IER*, February 1988). Brazilian officials announced a new, 60-day inflation-fighting "social pact" based on a consensus of Government, business and labor, and featuring temporary price controls for basic products and services. Since the scheme relies heavily on voluntary compliance, critics attacked it as timid, and called for deficit-tightening fiscal measures of a "shock value" instead.

Budget-cutting measures currently under consideration include the suspension of certain tax incentives and subsidies for business. Among further inflation-fighting measures, officials reportedly are contemplating the curtailment of Brazil's "debt-for-equity" scheme, which had been adopted in April 1988. This program involved the exchange for cruzados of some $1.5 billion dollar-denominated foreign debt held by creditors willing to invest in the Brazilian economy. The scheme is considered inflationary because it pumps up the money supply.

Indonesia Reforms its Banking Sector

On October 27, Indonesia announced a package of reforms designed to remove many of the advantages enjoyed by its seven powerful state banks. This ends a 20-year freeze on the establishment of new banks by opening the banking system to competition from additional foreign and domestic banks. The reforms are aimed at encouraging the equity market, mobilizing domestic savings, increasing nonoil exports, and improving the effectiveness of the central bank's monetary policy.

The new measures will permit domestic and foreign banks to expand their branch network. The 11 foreign banks, all currently operating in Jakarta, will for the first time be permitted to open branches in six cities outside of Jakarta. However, the condition is that at least 50 percent of the banks' first year's loans go to export businesses. Restrictions on Indonesia's 63 domestic private banks will also be eased to permit them to open branches anywhere in the country (provided they have been sound for the previous 2 years).

Under the new provisions, additional foreign banks could open as joint ventures with Indonesian banks if their foreign share does not exceed

85 percent. (Participation in the joint ventures will, however, be initially limited to foreign banks that already have representative offices in Indonesia and that are based in countries that provide reciprocal arrangements for Indonesian banks.)

Additionally, the reform package includes measures that will relax the requirement that funds of state-owned enterprises must be deposited in one of the state banks. The new provisions permit 50 percent of these funds to be deposited in foreign or domestic private banks, with a maximum of 20 percent in any single private bank. This means that, for the first time, private banks can compete with state-owned enterprises for these deposits.

The banking reform will also streamline the complex procedures that have prevented many banks from attaining foreign-exchange licenses. The new regulations will be simplified and will permit all banks, instead of only state banks and selected private banks, to offer a wider range of services.

The banking reform is the first part of a major deregulation program designed to open up Indonesia's highly restrictive and inefficient economy. Deregulatory measures affecting trade, industry, and investment are expected to be made public shortly and provide a foundation for "Repelita V," the new 5-year economic development plan, to be announced in early 1989.

STATISTICAL TABLES

Industrial production, by selected countries and by specified periods, January 1985-October 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 May	June	July	Aug.	Sept.	Oct.
United States	1.9	1.1	3.8	8.7	7.1	4.0	4.5	7.1	6.4	3.6	14.0	3.5	2.6	4.4
Canada	2.8	.8	2.7	5.8	4.4	4.1	3.5	3.1	4.8	1.9	2.9	1.9	.9	(1)
Japan	3.7	-.3	3.4	15.2	15.7	13.5	-1.0	10.1	-24.7	47.8	-10.2	37.6	5.4	(1)
West Germany	3.8	2.2	.1	2.2	2.9	9.9	-4.0	6.1	-3.4	18.7	-17.6	45.3	-1.1	(1)
United Kingdom	4.7	2.3	3.9	6.3	3.8	-1.3	5.8	3.9	4.5	6.8	4.4	5.6	-5.3	(1)
France	6	.9	2.1	2.6	3.9	2.6	3.4	11.0	12.0	25.1	8.0	0	7.9	(1)
Italy	1.2	3.8	2.7	-10.8	14.0	10.0	-2.1	14.7	-27.0	19.8	39.9	31.3	-23.0	(1)

[1] Not available.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Dec. 2, 1988.

Consumer prices, by selected countries and by specified periods, January 1985-October 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 May	June	July	Aug.	Sept.	Oct.
United States	3.5	1.9	3.7	3.9	3.6	3.4	4.8	4.7	4.2	4.2	5.2	5.2	4.1	5.1
Canada	4.0	4.2	4.4	4.4	3.5	3.4	4.8	4.2	6.1	3.0	3.9	5.1	4.6	4.9
Japan	2.0	.6	.1	-.8	1.1	-2.1	2.8	.7	1.2	-2.3	-2.3	3.6	9.9	11.1
West Germany	2.2	-.2	.3	1.5	0	.7	1.8	2.0	1.8	.9	2.1	3.2	1.6	.6
United Kingdom	6.1	3.4	4.1	3.9	4.9	2.7	6.1	8.7	5.9	8.3	7.8	13.4	7.1	13.0
France	5.8	2.5	3.3	2.7	2.4	2.3	2.9	3.8	2.7	3.3	4.2	4.3	3.4	2.8
Italy	8.6	6.1	4.6	6.5	5.7	3.4	4.6	6.0	4.1	5.0	6.6	7.7	5.1	5.7

[1] Not available.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Dec. 2, 1988.

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

(In percent)

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

Trade balances, by selected countries and by specified periods, January 1985–October 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 May	June	July	Aug.	Sept.	Oct.
United States[1] ...	-132.8	-155.1	-170.3	-171.6	-171.9	-149.6	-133.1	-129.7	-117.1	-158.6	-113.7	-147.2	-128.1	-124.2
Canada	12.0	7.1	8.3	8.4	4.4	7.6	8.8	10.4	6.0	14.4	18.0	7.2	6.0	([2])
Japan	55.9	92.5	96.2	89.2	91.6	99.2	86.0	90.0	78.0	86.4	93.6	87.6	88.8	([2])
West Germany ...	25.4	52.7	65.7	62.8	74.0	64.8	76.4	72.8	60.0	97.2	70.8	79.2	68.4	([2])
United Kingdom ..	-2.6	-12.6	-16.9	-20.0	-21.2	-28.4	-32.4	-37.6	-37.2	-32.4	-54.0	-37.2	-21.6	([2])
France	-2.6	.1	-5.2	-4.4	-4.4	-2.8	-4.0	-7.6	-3.6	-2.4	-7.2	-16.8	1.2	([2])
Italy	-12.1	-2.0	-8.5	-6.4	-10.8	-12.0	-4.0	-10.4	0	-6.0	9.6	-4.8	-16.8	([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, Dec. 2, 1988, and *Advance Report on U. S. Merchandise Trade*, U.S. Department of Commerce, Dec. 14, 1988.

U.S. trade balance,[1] by major commodity categories, and by selected countries, and by specified periods, January 1985–October 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 May	June	July	Aug.	Sept.	Oct.
Commodity categories:														
Agriculture	9.6	4.5	7.0	2.1	3.2	3.0	3.3	3.1	1.2	.9	.9	.8	1.4	1.4
Petroleum and selected products, unadj	-45.9	-31.8	-39.5	-11.7	-10.1	-9.7	-9.9	-9.5	-3.6	-3.2	-3.1	-3.4	-3.0	-2.9
Manufactured goods	-102.0	-134.3	-146.1	-36.3	-36.2	-35.0	-35.5	-36.8	-11.0	-13.6	-12.8	-12.6	-11.4	-13.6
Selected countries:														
Western Europe ..	-23.3	-28.2	-27.9	-7.0	-6.9	-4.0	-3.9	-4.6	-1.2	-1.9	-2.3	-1.4	-.9	-1.1
Canada[2]	-21.7	-23.0	-11.5	-2.8	-3.1	-3.8	-4.1	-2.6	-1.1	-1.1	-1.1	-.4	-.9	-1.0
Japan	-46.5	-55.3	-58.0	-13.8	-14.5	-13.1	-12.9	-13.3	-4.4	-4.4	-4.4	-4.8	-4.1	-5.5
OPEC, unadj	-10.2	-8.9	-13.7	-4.6	-3.3	-2.6	-3.1	-2.8	-1.1	-1.1	-.9	-1.2	-.7	-.8
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	$16.40	$16.19	$15.77	$15.15	$14.60	$13.46

[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, Dec. 14, 1988.

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

(Percentage, annual rate)

Country	1985	1986	1987	1987 III	1987 IV	1988 I	1988 II	1988 III	1988 June	July	Aug.	Sept.	Oct.	Nov.
United States	8.3	6.5	6.8	6.8	7.6	6.7	7.6	8.1	7.9	7.3	8.7	8.2	8.4	8.8
Canada	9.7	8.6	8.4	9.2	9.0	8.7	9.2	10.1	9.3	9.6	10.2	10.5	10.6	(2)
Japan	6.5	4.9	3.9	3.7	3.9	3.8	3.8	4.2	3.8	4.0	4.2	4.3	4.1	(2)
West Germany	5.5	4.6	4.0	4.2	4.1	3.3	3.9	5.2	4.4	5.2	5.4	5.1	5.0	(2)
United Kingdom	12.1	10.8	9.8	10.0	9.2	8.9	8.7	11.7	9.9	10.9	12.2	11.9	12.1	(2)
France	10.0	7.7	8.2	7.9	8.5	7.9	7.5	7.6	7.3	7.4	7.6	7.7	7.9	(2)
Italy	15.0	12.8	11.3	11.9	11.6	11.0	10.8	(2)	10.9	11.3	10.9	(2)	(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, Nov. 29, 1988, and *Federal Reserve Statistical Release*, Selected Interest Rates, Board of Governors of the Federal Reserve System, Dec. 5, 1988.

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

(Percentage change from previous period)

Item	1985	1986	1987	1987 III	1987 IV	1988 I	1988 II	1988 III	1988 June	July	Aug.	Sept.	Oct.	Nov.
Unadjusted														
Index number	127.0	106.0	94.1	95.2	90.3	87.5	86.5	90.9	87.6	90.1	91.3	91.3	88.8	86.6
Percentage change	3.8	-16.5	-11.2	1.2	-5.1	-3.1	-1.1	5.1	1.7	2.9	1.3	0	-2.7	-2.5
Adjusted:														
Index number	121.7	100.9	90.2	87.0	87.4	84.9	84.1	88.8	85.2	87.9	89.2	89.3	87.2	85.3
Percentage change	1.8	-17.1	-10.6	-3.9	.5	-2.9	-.9	5.6	1.8	3.2	1.5	.1	-2.4	-2.2

[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, December, 1988.

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