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Summary of U.S. Economic Conditions

Data recently released by the U.S. Department of Commerce show a substantial increase in economic activity in the second quarter in spite of some soft spots in the economy. The increase in the U.S. industrial output for 6 successive months is an indication that the manufacturing sector is leading the recovery. Commerce reported that real GNP decreased at a revised rate of 0.5 percent in the second quarter of 1991. In the first quarter of 1991, real GNP decreased by 2.8 percent at an annual rate. In spite of the decline, the second quarter's revised estimates represent an appreciable pickup in economic activity over the first quarter annual rate of decline of 2.8 percent.

Major GNP components showed widespread advances in the second quarter. Real personal consumption expenditures, the largest GNP component and a key to economic recovery, increased $18.4 billion (2.8 percent) in the second quarter after a decline of $9.9 billion (1.5 percent) in the first. Consumer expenditures on durable goods strengthened, decreasing by only $1.3 billion (1.3 percent) after a sizable decline of $12.7 billion (11.7 percent) in the first quarter. Expenditures on nondurable goods increased $6.0 billion (2.7 percent) after a decline of $4.1 billion (1.8 percent). Investment spending also advanced. Nonresidential fixed investment declined at a lower rate, by $2.3 billion (1.8 percent) in the second quarter in contrast to a large decline of 22.6 billion (16.3 percent) in the first quarter. Spending on producers' durable equipment increased by $1.9 billion (2.0 percent) after a decline of $20.0 billion (18.4 percent) in the first quarter. Moreover, Federal Government spending increased by $6.9 billion (8.1 percent) compared to a decline of $0.4 billion in the first quarter. Federal spending on national defense declined by $6.0 billion (8.7 percent) and nondefense spending increased by $12.9 billion (79.4 percent).

In the foreign sector, Commerce's revised figures on U.S. trade show that the U.S. trade deficit fell 15.0 percent in the second quarter of 1991, to its lowest level in 8 years. The deficit declined to $15.2 billion in the second quarter from $18.4 billion in the first quarter. The decline was due to a $3.2 billion increase in nonagricultural exports. Total exports increased to $104.1 billion while imports increased by only $438 million to $119.7 billion. The small increase in imports was due to the recession in the United States and weak demand for imported goods. The 1991 second quarter deficit with Japan narrowed by $1.5 billion to $9.5 billion from $11.0 billion in the first quarter. The deficit with Canada fell to $2.2 billion from $2.5 billion in the first quarter. The economic recovery in Canada seems to have increased the demand for U.S. exports to Canada. Canada's GNP rose in the second quarter of 1991 at annual rate of 4.8 percent after four consecutive quarters of decline. However, the U.S. total trade deficit increased to $5.9 billion in July 1991 from $3.8 billion in June. (For more details on July trade figures, see the section on U.S. trade developments.)

Data for the months of July and August released by the U.S. Department of Commerce support the notion that the economic recovery is picking up. For instance, new orders for manufactured goods, a major component of the index of leading economic indicators, advanced by 6.2 percent in July 1991, the biggest increase since December 1970. The leading index itself advanced by 1.2 percent for the 6th consecutive month. Also, Commerce lowered its estimates of inventories held by U.S. companies; inventory reportedly declined by 0.3 percent in July to its lowest level in 2 years which could lead to more future orders for manufactured products, thus leading the economic recovery. Total industrial output posted gains at a faster pace for 4 successive months than previously estimated. Meanwhile, business sales increased for the 4th straight month.

The upswing in economic activity is expected, however, to be mild compared with past periods of strong expansion. To increase the pace of the economic recovery, the Federal Reserve lowered the discount rate by one-half percentage point to 5.0 percent and cut the Federal funds rate to 5.25 percent. The slowdown in inflation and the weakness in consumer spending illustrated by the decline in retail sales in August 1991 by 0.7 percent prompted the Federal Reserve's action. Lower interest rates are expected to encourage consumers and businesses to spend more. However, spending increases could be constrained by the high level of consumer and business indebtedness and the reluctance of banks to expand their lending.

Nevertheless, according to the most recent economic projections by the Federal Reserve for 1991 and 1992, a sound economic expansion accompanied by declining inflation and slightly declining unemployment is expected. Real GNP is expected to grow by 0.75 to 1.0 percent for 1991 as a whole and by 2.25 to 3.0 percent for 1992. A major factor contributing to the economic turnaround is the low level of business inventories. With inventories at such low levels, any increase in aggregate final demand is expected to considerably boost domestic production. Because the projected increase in domestic output will mainly reflect gains in the productivity of workers the Federal Reserve does not expect civilian employment to increase. The civilian jobless rate is expected to range from 6.75 to 7.0 percent in the remainder of 1991 and 6.25 to 6.5 percent in 1992. According to the Federal Reserve forecast, tight credit, the limited demand for new construction due to the overhang of vacant office space, restrictive fiscal policy, and the slow increase in consumer spending due to household debt burdens will continue to constrain the recovery.

Economic Growth

The annualized rate of real economic growth in the United States declined in the second quarter of 1991 by 0.5 percent. In the first quarter of 1991, the annualized rate of real economic growth declined by 2.8 percent rate. In the fourth quarter of 1990, the annualized rate of real growth declined by 1.6 percent. The annualized rate of real growth increased by 1.4 percent in the third quarter, 0.4 percent in the second quarter, and 1.7 percent in the first quarter of 1990. The real growth rate for all of 1990 was 0.9 percent.

The annualized rate of real economic growth in the second quarter of 1991 was -3.8 percent in the United Kingdom, -2.4 percent in Germany, 3.2 percent in France and 4.9 percent in Canada. The annualized rate of real economic growth in the first quarter of 1991 was 11.2 percent in Japan and 1.4 percent in Italy.

Industrial Production

Seasonally adjusted U.S. industrial production increased by 0.3 percent in August after revised gains of 0.6 percent in July and 0.8 percent in June 1991. The August 1991 increase resulted from a significant increase in the output of consumer goods other than motor vehicles, durable materials, and construction supplies and materials. The production of motor vehicles fell 9.3 percent in August 1991 after sharp increases for 5 successive months. U.S. industrial production increased at an annual rate of 1.7 percent in the second quarter of 1991 after falling sharply in the two preceding quarters. The August 1991 index was 2.0 percent lower than it was in August 1990. Capacity utilization in manufacturing, mining, and utilities increased in August 1991 by 0.1 percentage point to 80.0 percent.

Other major industrial countries reported the following annual growth rates of industrial production: for the year ending July 1991, Germany reported an increase of 3.8 percent, and Japan reported an increase of 2.4 percent; for the year ending June 1991, Italy reported a decline of 0.9 percent, France reported an increase of 0.2 percent, the United Kingdom reported a decrease of 5.6 percent, and Canada reported a decrease of 4.5 percent.

Prices

The seasonally adjusted U.S. Consumer Price Index rose by 0.2 percent in August 1991. The consumer price index rose by 3.8 percent during the 12 months ending August 1991.

During the 1-year period ending August 1991, consumer prices increased 4.1 percent in Germany and 6.3 percent in Italy. During the 1-year period ending July 1991, consumer prices increased by 5.5 percent in the United Kingdom, 3.4 percent in France, 6.0 percent in Canada and 3.5 percent in Japan.

Employment

The seasonally adjusted rate of unemployment in the United States remained unchanged at 6.8 percent in August from July 1991. The unemployment rate was 7.0 percent in June and 6.9 percent in May 1991.

In August 1991, Germany reported 6.4 percent unemployment and Canada reported 10.6 percent. In July 1991, France reported 9.5 percent; the United Kingdom reported 8.3 percent; Japan reported 2.2 percent and Italy reported 9.9 percent unemployment. (For foreign unemployment rates adjusted to U.S. statistical concepts, see the tables at the end of this issue.)

Forecasts

Table 1 shows macroeconomic projections for the U.S. economy for July 1991 to June 1992, by four major forecasters, and the simple average of these forecasts. Forecasts of all the economic indicators except unemployment are presented as percentage changes over the preceding quarter, on an annualized basis. The forecasts of the unemployment rate are averages for the quarter.

The average forecasts point to a moderate rebound in nominal and real GNP growth for the remainder of 1991 and the first half of 1992. There are many possible reasons for the moderation of the recovery in 1991 and 1992: the general slowdown in the world economy, particularly in the industrialized countries; the sluggish rise in consumer spending, particularly consumer spending on durable goods, because of high consumer debt; and the expected low level of investment because of reduced business expectations and the reduction in available credit caused by the Savings and Loan crisis. However, several dynamics appear to be working in favor of stronger growth in the second half of 1992. The decline in interest and inflation rates in most of 1991 may encourage a stronger rise in consumer and business spending in 1992. An expected surge in export growth as a result of the anticipated improvement in industrial countries' economic conditions should also increase foreign demand for U.S. exports in 1992. Moreover, the low level of inventories now held by businesses could prompt a strong buildup of business inventories once a recovery starts. The average of the forecasts predicts a slight decline in the unemployment rate in the second and third quarters of 1991 and a larger decline afterwards. Inflation (measured by the GNP deflator) is expected to dip in the remainder of 1991 and rise slightly in the first half of 1992.

Table 1
Projected quarterly percentage changes of selected U.S. economic indicators, July 1991-June 92

Quarter	*UCLA Business Fore-casting Project*	*Merrill Lynch Capital Markets*	*Data Resources Inc.*	*Wharton E.F.A. Inc.*	*Mean of 4 fore-casts*
	GNP Current Dollars				
1991					
July-September	4.0	7.3	5.7	8.9	6.5
October-December	5.9	7.0	5.2	6.7	6.2
1992					
January-March	7.5	6.9	6.8	6.9	7.0
April-June	7.1	6.5	6.1	6.7	6.6
	GNP Constant (1982) dollars				
1991					
July-September	2.0	3.7	3.4	2.6	2.9
October-December	3.6	3.4	2.6	4.4	3.5
1992					
January-March	4.6	2.9	3.0	3.8	3.6
April-June	4.2	2.6	3.3	4.2	3.6
	GNP deflator index				
1991					
July-September	2.0	3.5	2.2	0.3	2.0
October-December	2.2	3.4	2.6	2.2	2.6
1992					
January-March	2.8	3.9	2.9	2.9	3.1
April-June	2.8	3.8	2.7	2.4	2.9
	Unemployment, average rate				
1991					
July-September	6.9	6.9	6.8	6.8	6.9
October-December	6.7	6.9	6.8	6.9	6.8
1992					
January-March	6.4	6.8	6.6	6.8	6.6
April-June	6.2	6.7	6.4	6.7	6.5

Note.—Except for the unemployment rate, percentage changes in the forecast represent compounded annual rates of change from preceding period. Quarterly data are seasonally adjusted. Date of forecasts: September 1991.

Source: Compiled from data provided by The Conference Board. Used with permission.

Direct Foreign Investment in the United States

Direct foreign investment creates employment and increases the transfer of capital and technology to host countries. But it can also reverse capital and technology transfers and increase foreign influence in domestic affairs. Table 2 shows selected data on nonbank U.S. affiliates in 1989. (A U.S. affiliate is a business firm in the United States in which foreigners own 10 percent or more of assets.) The estimated book value of total assets of U.S. affiliates increased in 1989 by $201 billion or 17.0 percent to $1,402 billion after increasing by 27.0 percent in 1988. The largest investments of U.S. affiliates were made in services followed by investments in manufactures. The largest investments in services were made in finance except banking, insurance and wholesale trade. The largest investments in manufactures were made in chemicals, petroleum and machinery. Sales by U.S. affiliates increased $154 billion or 17.0 percent to $1,041 billion, after a 19.0 percent increase in 1988. Net income declined by 0.2 billion or 2.0 percent to $11.8 billion after a 54.0 percent increase in 1988. U.S. affiliates exports increased $15.0 billion in 1989 or 21.0 percent to $84.0 billion after a 45.0 percent increase in 1988. U.S. merchandise imports shipped to affiliates increased $1.4 billion or 9.0 percent to $170 billion after an 8.0 percent increase in 1988. The increase in affiliates imports over exports resulted in affiliates trade deficit of $86.0 billion. Employment by U.S. affiliates rose 596,000 or 16 percent to 4.44 million after a 19.0 percent increase in 1988. The share of U.S. affiliates in total U.S. nonbank labor force rose to 4.8 percent in 1989 from 4.3 percent in 1988. By country of ultimate ownership, affiliates with ultimate ownership in the United Kingdom had the largest employment in 1989, followed by affiliates with ultimate ownership in Canada and in Japan.

Table 2
Selected data on nonbank majority-owned U.S. affiliates by industry and country of ownership, 1989

Industry/ Country	*Total assets*	*Sales*	*Net income*	*Shipments Exports*	*Imports*	*Employ-ment*
	Billion dollars					*(000)*
All industries	1,402.2	1,040.9	11.8	84.3	169.7	4,440.1
Petroleum	91.4	91.7	2.5	2.0	14.1	135.3
Manufacturing	367.5	347.0	6.2	31.3	39.2	2,123.4
Food & kindred products	43.5	41.1	0.5	2.0	2.7	242.6
Chemicals and allied products	106.0	94.0	4.9	9.3	7.7	442.5
Primary and fabricated metals	46.4	50.6	0.8	3.6	4.9	279.6
Machinery	64.4	69.5	-0.2	10.8	13.7	513.2
Other manufacturing	107.2	91.8	0.1	5.6	10.2	645.6
Transportation equip.-	10.5	14.5	-0.7	1.0	5.1	63.7
Motor vehicles & equip.	7.6	11.5	-0.7	0.5	4.5	39.7
Wholesale trade	131.2	342.9	1.0	47.7	113.1	390.8
Motor vehicles & equip.	37.8	86.7	0.7	4.6	45.2	81.7
Retail trade	48.5	71.8	-0.3	1.5	2.7	818.0
Finance except banking	380.7	42.0	1.33	0	[1]	93.9
Insurance	171.1	55.4	2.14	0	0	111.6
Real estate	90.0	14.8	-0.13	3.0	2.0	37.8
Services	58.0	28.7	-1.02	0.3	0.2	404.9
Other industries	63.9	46.6	0.05	1.6	0.5	324.2
By country						
All countries	1402.2	1040.9	11.8	84.3	169.7	4440.1
Canada	201.0	117.5	3.64	6.0	10.8	755.3
Europe	685.9	537.9	5.91	37.4	58.7	2635.7
France	57.2	71.9	-0.22	13.6	7.4	264.2
Germany	87.4	92.8	0.85	6.0	16.8	435.5
Netherlands	86.7	68.1	1.00	2.9	7.7	316.0
Switzerland	101.0	59.2	0.62	4.3	4.8	254.8
United Kingdom	254.1	169.8	3.08	6.8	12.3	980.9
Latin America	34.4	33.2	0.49	2.6	6.1	226.6
Africa	6.5	5.6	0.04	0.7	0.8	17.9
Middle East	34.3	17.8	0.03	0.3	4.1	38.9
Kuwait	9.4	2.3	-0.09	([1])	([1])	12.3
Saudi Arabia	21.0	13.7	0.26	([1])	([1])	13.9
Asia & Pacific	403.9	314.6	0.26	36.9	88.6	734.6
Australia	50.7	26.4	0.06	0.5	0.7	153.9
Japan	328.1	267.0	0.81	32.2	82.6	504.3

[1] Suppressed to avoid disclosure of data of individual companies.

Source: U.S. Department of Commerce, Survey of Current Business, July 1991.

U.S. TRADE DEVELOPMENTS

The U.S. merchandise trade deficit increased in July 1991 (by $2.1 billion), due to the considerable increase in imports over the increase in exports. Seasonally adjusted U.S. merchandise trade in billions of dollars as reported by the U.S. Department of Commerce is shown in table 3.

When oil is included, the seasonally adjusted U.S. merchandise trade deficit in current dollars increased by 55.3 percent in July 1991, to $5.9 billion from $3.8 billion in June 1991. The July 1991 deficit was 15.8 percent lower than the $7.0 billion average monthly deficit registered during the previous 12-month period and 36.0 percent lower than the $9.2 billion deficit registered in July 1990. When oil is excluded, the July 1991 merchandise trade deficit increased threefold over that of the previous month.

In July 1991, both exports and imports increased, but imports increased considerably faster. Including oil, seasonally adjusted exports in current dollars increased by $300 million in July, to $35.3 billion, and imports increased by $2.4 billion, to $41.2 billion. Excluding oil, U.S. imports increased from June to July 1991 by $2.5 billion, to $38.2 billion. The U.S. oil import bill declined to $2.9 billion in July from $3.1 billion in June 1991.

Table 3
U.S. merchandise trade, seasonally adjusted

Item	Exports		Imports		Trade balance	
	June 91	July 91	June 91	July 91	June 91	July 91
Current dollars						
Including oil	35.0	35.3	38.8	41.2	-3.8	-5.9
Excluding oil	35.0	35.3	35.7	38.2	-0.7	-2.9
1987 dollars	32.7	33.2	36.4	39.0	-3.7	-5.8
Three-month-moving average	35.3	35.2	39.7	40.0	-4.4	-4.8
Advanced-technology products (not seasonally adjusted)	8.9	7.8	5.3	5.6	+3.7	+2.2

Source: *U.S. Department of Commerce News*, FT 900, September 1991.

In seasonally adjusted constant dollars, the trade deficit increased by $2.1 billion from June to July 1991. The trade surplus in advanced-technology products declined to $2.2 billion in July 1991 from $3.7 billion in June 1991. (Advanced-technology products as defined by the U.S. Department of Commerce include about 500 products from recognized high-technology fields-for example, biotechnology-out of a universe of some 22,000 commodity classification codes.)

Nominal export changes and trade balances in July 1991 for specified major exporting sectors are shown in table 4. Airplane parts was the only sector that recorded the most export increases in July 1991 over June. Other sectors recorded declines. Sectors that recorded the largest trade surpluses over the period January-July 1991 included airplanes, scientific instruments, airplane parts, specialized industrial machinery, organic chemicals, power-generating machinery, and general industrial machinery.

The U.S. agricultural trade surplus rose to $1.2 billion in July from $793 million in June 1991.

U.S. bilateral trade balances on a monthly and year-to-date basis with major trading partners are shown in table 5. The United States experienced increases in bilateral merchandise trade deficits in July 1991 with Japan, Canada, the Newly Industrializing Countries (NICs),[1] China, Germany and OPEC, a decline in trade surpluses with the EC, Western Europe, and an increase with the U.S.S.R. The deficit with Japan increased by $570 million. On a cumulative year-to-date basis, the United States experienced improvements in its bilateral trade balances from a year earlier with Germany, NICs, and OPEC and worsening with Japan, Canada, and China. U.S. trade surpluses with the EC and Western Europe increased markedly.

[1] NICs include Singapore, Hong Kong, Taiwan, and the Republic of Korea.

Crisis Shatters Yugoslav Economic Unity, But Foreign Investors See Reasons To Be Hopeful

Before mid-1990, Yugoslavia's six republics (Bosnia-Hercegovina, Croatia, Macedonia, Montenegro, Slovenia, and Serbia) and two autonomous provinces (Vojvodina and Kosovo), appeared to form a reasonably well- integrated national economy. It was common for residents and enterprises of one republic to hold property in another. Republics sold approximately one- third of their production in other republics. Analysts in the industrialized democracies perceived the relative weakness of central control over independent-minded republics and worker council-owned enterprises as a sign of strength through diversity, a source of economic dynamism reminiscent of a market economy.

But underneath the peaceful surface of national economic cooperation festered grave ethnic, economic, and political tensions. The relatively well-to-do republics of Slovenia, Croatia, and Serbia resented the central government's policy of taxing them heavily to support economic development in the three other, underdeveloped republics. Since this development policy did not produce the expected results, the underdeveloped republics considered the support inadequate and believed that they were being kept from development rather than helped by the more prosperous ones. The majority of the country considered the influence of Serbs, who accounted for 36.3 percent of the country's population, to be excessive in national affairs. Some of the country's ethnic groups, particularly the Muslims, the Albanians and the Turks, thought that they were underrepresented. Finally, a conflict between economic reformers and old school communists was growing throughout the country.

Table 4
Nominal U.S. exports and trade balances, not seasonally adjusted, of specified manufacturing sectors, January 1990-July 1991

Sector	Exports		Change			
	January-July 1991	July 1991	January-July 1991 over January-July 1990	July 1991 over June 1991	Share of total January-July 1991	Trade baances January-July 1991
	— Billion dollars —		——— Percent ———			Billion dollars
ADP equipment & office machinery	15.1	2.0	6.4	-13.3	6.2	-1.53
Airplanes	13.3	2.0	10.7	-23.9	5.4	11.40
Airplane parts	5.8	0.8	2.5	2.4	2.4	3.26
Electrical machinery	17.4	2.4	6.2	-8.6	7.1	-2.40
General industrial machinery	9.9	1.4	5.9	-2.1	4.1	1.31
Iron & steel mill products	2.5	0.4	41.9	-7.3	1.0	-2.59
Inorganic chemicals	2.4	0.3	11.8	-3.2	1.0	0.57
Organic chemicals	6.8	0.8	13.8	-2.4	2.8	1.83
Power-generating machinery	9.6	1.3	4.1	-7.6	3.9	1.31
Scientific instruments.	7.8	1.1	12.2	-9.9	3.2	4.02
Specialized industrial machinery	9.7	1.4	6.6	-0.7	4.0	2.97
Telecommunications	5.6	0.8	8.6	0	2.3	-6.66
Textile yarns, fabrics and articles	3.1	0.4	8.0	-8.7	1.3	-0.81
Vehicle parts	7.9	1.0	-7.5	-20.9	3.3	0.03
Other manufactured goods[1]	14.4	2.1	12.3	-1.4	5.9	-2.71
Manufactured exports not included above	57.1	7.8	10.8	-5.1	23.4	-42.49
Total manufactures	188.4	26.0	8.5	-7.8	77.2	-32.49
Agriculture	21.7	2.9	-7.6	10.8	8.9	8.53
Other exports	33.9	4.6	6.6	-2.8	13.9	-8.28
Total	244.0	33.5	6.6	-5.8	100.0	-32.24

[1] This is an official U.S. Department of Commerce commodity grouping.

Note.—Because of rounding, figures may not add to total shown.

Source: *U.S. Department of Commerce News (FT900)*, September 1991.

Table 5
U.S. merchandise trade deficits (-) and surpluses (+), not seasonally adjusted, with specified areas, January 1990-July 91

(In billion dollars)

Area or country	*July 1991*	*June 1991*	*July 1990*	*January-July 1991*	*January-July 1990*
Japan	-3.80	-3.23	-3.04	-23.00	-22.75
Canada	-0.46	-0.44	-0.92	-2.91	-2.79
Germany	-0.21	-0.13	-1.02	-2.19	-5.39
EC	+0.21	+1.87	-1.01	+11.03	+3.94
Western Europe	-0.01	+1.73	-1.33	+10.79	+2.40
NICs	-1.70	-1.00	-2.39	-6.02	-10.95
U.S.S.R	+0.12	+0.09	+0.08	+1.39	+2.05
China	-1.28	-1.02	-1.10	-5.90	-5.21
OPEC	-1.08	-1.03	-1.62	-8.77	-12.64
Total trade balance	-7.75	-3.87	-10.76	-32.24	-53.23

Note.—The difference between trade balances shown in total exports table and those shown in the above (country/area) table represents exports of certain grains, oilseeds, and satellites that are not included in the country/area exports.
Source: *U.S. Department of Commerce News (FT-900)*, September 1991.

These problems turned into a full-blown crisis at mid-1990, centering around three major, well-publicized elements: the confrontation between breakaway Slovenia and the central government, the aspirations for independence in Croatia, and the civil war between Serbian nationalists and the Croatian national guard. (For a thorough analysis of the causes and dimensions of the Yugoslav crisis, see the article by Bogoma Ferfila, "Yugoslavia: Confederation or Disintegration?" in *Problems of Communism*, July-August 1991, pp. 18-30.)

The crisis has had far-reaching economic consequences for the entire country. Federal legislation is reported to be ineffectual and the central government's control over monetary and fiscal affairs is considerably weakened. Moreover, the central government's ability to implement nationwide economic programs is in doubt. The opposing republics (Serbia versus Slovenia and Croatia) have mutually confiscated much of each other's property, boycotted some of each other's products, and levied heavy taxes on each other's goods. One newspaper account indicated that two-way trade between Serbia and Slovenia, amounting to $3.5 billion during 1990, is barely expected to reach one-tenth of this value during 1991. The decline of physical security and legal protection, and disruptions in transportation throughout the country have made the delivery of goods among the republics uncertain. In addition, the growing number of bankruptcies in the country and disruptions in the national banking system have made payments for the deliveries uncertain.

The country's larger manufacturing enterprises have been the most affected by the disruption of domestic economic cooperation, because they are highly dependent on other republics for raw materials and components. For example, it is reported that the manufacturer of the Yugo car, located in Serbia, uses a total of 11,000 components from 360 firms. One-third of these components come from Slovenia or Croatia. In the month of August, an inventory of 10,000 cars was said to be on the factory lot because components were not available.

Disruptions in national economic ties are largely blamed for the 17.4-percent drop in the entire country's industrial output from the first half of 1990 to the first half of 1991. The declines varied by area. The output fell by 9.6 percent in Vojvodina; by 10.2 percent in Slovenia; by 14.3 percent in Montenegro; by 15.4 percent in Serbia; by 20.2 percent in Macedonia; by 21.3 percent in both Croatia and Bosnia-Hercegovina; and by 27.0 percent in Kosovo. Above average declines were reported in coal processing (42.0 percent), machine building (36.0 percent), shipbuilding (34.0 percent), metalworking 22.0 percent, and oil refining (21.0 percent).

According to estimates of Yugoslavia's central government, violent confrontations and the disruption of the national economy will cost the country $20 billion in property damage and lost production during 1991. This figure roughly matches Yugoslavia's 1990 gross foreign debt, or 20 percent of its 1990 GDP. The Wharton Econometric Forecasting Associates (WEFA) estimates that the 1991 deficit in the country's current account will match 1990's $3.1 billion. Large annual current account deficits are expected to push gross foreign debt to $45 billion by 1996, higher than the $39 billion projected for Poland in that year. Although the authorities insist that the convertibility of the national currency will not be affected by the hostilities, the country's foreign currency reserves are reportedly depleted.

Foreign investors-who have committed a total of $3.2 billion to joint ventures and to the direct acquisitions of domestic firms by the end of the first quarter of 1991-are understandably worried. The massive infusion of foreign capital that followed the introduction of liberal investment rules in 1989 all but ceased by mid-1991. But according to a spokesman at Yugoslavia's Washington Embassy, foreign investors in Yugoslavia are not impatient with the situation since they brought their capital into the country with long-term profitability in mind. The President of the U.S.-Yugoslav Economic Council, representing the Council's 250 U.S. member firms interested in doing business with Yugoslavia, has confirmed this view and expressed optimism about the country's future.

Many Western analysts share the optimism of Yugoslavia's foreign investors concerning the country's ability to recover quickly once violent confrontations cease. Despite the discord that plagues the country, the majority of its 24 million people reportedly wishes to replace the single party system with political pluralism and parliamentary democracy, and to replace the bureaucratic, inefficient economic management with market economic management.

Although the central government's economic reform program has stalled, the economic reform process continues as individual republics pursue their own reforms. Particularly remarkable is the rise in small-scale private trade and manufacturing activities, which some analysts perceive as a reaction to the decline of supplies resulting from the disruption of interrepublican economic cooperation. Republics have embarked on their own privatization programs. The number of small- to medium-size industrial enterprises and commercial outlets divested from the communist-dominated workers' councils is reportedly in the thousands throughout the country. As a result of this increase in private economic activities, the level of consumption in the country appears to have declined considerably less than the officially reported output measures.

Foreign merchandise trade has not been affected as much as was earlier feared. According to the central government, the 8.1-percent decline in Yugoslavia's exports from the first half of 1990 to the first half of 1991 may be attributed to the decline in shipments to the former members of the Council for Mutual Economic Assistance (Bulgaria, Cuba, Czechoslovakia, Hungary, Mongolia, Poland, Romania, the Soviet Union, and Vietnam). (See *IER*, June 1991, pp. 10-12.) Exports to the industrialized and developing countries increased by 10 percent, but the estimated 50-percent decline in shipments to the former CMEA area, representing about 30 percent of the country's $8.6 billion in exports during January-June 1991, pulled down overall export performance. Officials point to efforts by Yugoslav firms to substitute foreign markets for the declining domestic ones as the major cause for the significant increase in exports to the industrialized and developing countries. (Yugoslavia's imports declined by 4.6 percent to $9.7 billion over the same period. No estimates were available to identify the role of the former CMEA countries in this decline.) U.S. trade with the country dropped by 11.5 percent from $612.2 million during January-June 1990 to $541.7 million January-June 1991. Even so, U.S. trade with Yugoslavia was 37.4 percent higher than U.S. trade with Poland, the largest U.S. trading partner among the emerging market economies of Central and Eastern Europe.

The republics continue to abide by the common national tariffs. Slovenia reportedly agreed to keep customs duties only for goods destined to Slovenia but transfer to the central government duties collected on goods destined elsewhere in the country. The central government pledges to continue its policy of trade liberalization. The trade-weighted tariff rate is roughly 9 percent during 1991 and 90 percent of all imports by transaction value are currently free from quantitative restrictions or licencing requirements.

Finally, many analysts argue that even if the republics abolished the Socialist Federal Republic of Yugoslavia today, the importance of economic ties among them would necessitate the recreation of an economic federation or common market among them tomorrow. These analysts claim that the economic recovery that is projected to begin in the new democracies of Central and Eastern Europe during 1993 will catalyze the joint process of reestablishing national economic cooperation and starting the economic recovery in Yugoslavia.

Corn Gluten Feed: U.S.-EC Trade Issue

Last year, EC corn producers tried to persuade the EC Commission to ask the GATT to investigate so-called unfair subsidies to producers of corn gluten feed in the United States. They were unsuccessful. Instead, U.S. producers of corn gluten feed have encountered a different snag. In May, U.S. shipments of corn gluten feed were refused entry to a Dutch port on the grounds that they were not eligible for duty-free entry into the EC. About $655 million in annual U.S. exports to the EC could be affected by the Dutch action.

Corn gluten feed is used in animal feed and is a byproduct from the processing of corn to produce cornstarch. EC imports are eligible for duty-free treatment. However, EC customs officials claim that the U.S. shipments under question are a mixture of two ingredients-corn gluten feed and corn germ meal. Although these two components are nondutiable, together the mixture is dutiable at a tariff of over $200 per ton. EC officials assert that the current definition of corn gluten feed permits diverse residues to account for only 5 percent of corn gluten feed to qualify for duty-free treatment. European representatives claim that microscopic testing indicates that U.S. shipments of corn gluten feed contain as much as 40 percent of corn germ meal. Furthermore, certain EC member states suspect fraud by U.S. grain companies in the current dispute. However, U.S. producers argue that corn germ meal results from the milling process and that U.S. corn gluten feed shipments are not different from those shipped over the past decades.

One issue in the current dispute is clarifying the definition of corn gluten feed, which involves finding an acceptable method of analysis of the product. Reportedly, the EC agreed to the U.S. demand that chemical analysis be used rather than microscopic analysis. Chemical analysis identifies the starch, protein, and fat content of the product. The microscopic testing method identifies the components directly but is based on higher technology and is only used by a few EC member states.

The dispute now centers on defining an acceptable fat content for corn gluten feed. The United States has proposed a 5 percent maximum fat content and a minimum 28 percent starch content. The United States has also offered to have industry establish a certification program to ensure that future U.S. shipments to the EC comply with regulations. The EC, however, insists that the fat content cannot rise above 3.5 percent. Although the average fat content of U.S. corn gluten feed is 3.5 percent, the fat content of the U.S. product sometimes lies closer to 5 percent. Therefore, the U.S. Government has responded that such a cap would significantly cut U.S. exports to the Community and would "seriously impair" the zero tariff binding. U.S. exports of corn gluten feed to the EC were $655 million in 1990, which accounted for almost all of U.S. exports of the product, valued at $662 million in 1990.

With little progress in sight, what appeared to be a technical customs issue now is being raised to the "political" level. The U.S. Government recently requested consultations with the EC under article XXIII.I of the GATT. Should these consultations prove unsuccessful, the administration is considering initiating a section 301 case and requesting dispute settlement under the GATT. If the administration finds under section 301 that the EC practice has violated U.S. trade rights, it may impose retaliatory measures. In the meantime, the U.S. National Corn Growers Association and the U.S. Feed Grains Council have each urged the administration to prepare to retaliate. Moreover, the United States is also facing EC efforts in the Uruguay Round to curb imports of corn gluten feed through a "rebalancing of concessions." Under the rebalancing concept, the EC would impose duties on products that currently enter the Community duty free-such as corn gluten feed-in exchange for lowering its trade barriers in other agricultural sectors. It now appears that the current dispute is only one in a series of bilateral problems stemming from EC efforts to curb imports of one of the few agricultural products that enter the Community without restraints.

Laying the Groundwork for Free Trade in the Western Hemisphere: An Update

In recent months, Latin American and Caribbean nations have intensified their efforts to liberalize and harmonize their trade regimes.[2] This increased level of attention appears to be driven largely by the desire to implement regional trade accords that will complement the U.S.-proposed Enterprise for the Americas Initiative (EAI).[3]

In proposing the EAI, President Bush established as a long-term goal the creation of a free-trade area covering the countries of North America, Central America, the Caribbean, and South America. To this end, the President stated that the United States was willing to enter into free-trade agreements with other eligible countries in the hemisphere, particularly with groups of countries associated for the purpose of trade liberalization. The United States, Canada, and Mexico began trilateral negotiations for a North American Free-Trade Agreement (NAFTA) in June 1991 as the first step in this process.

The second step is the negotiation of trade and investment framework agreements with other countries in the hemisphere. These nonbinding agreements create the mechanisms to initiate dialogue on common areas of concern and to begin work towards removing impediments to trade and investment flows. The United States already has negotiated trade and investment framework agreements with 29 Central American and South American countries, including Chile, Colombia, Costa Rica, Ecuador, El Salvador, Honduras, Panama, Peru, Nicaragua, and Venezuela. The United States currently is negotiating a framework agreement with Guatemala. (Mexico and Bolivia signed similar bilateral agreements with the United States before the EAI was announced.) Two multilateral agreements have been negotiated-one with Argentina, Brazil, Paraguay, and Uruguay (see the discussion of the Southern Cone countries below) and one with the 13-nation Caribbean Community (see the discussion of the Caribbean Community below).

Trade Agreement Update

The U.S. administration estimates that the process of moving towards hemispheric free trade will take 10 years or longer. According to U.S. Trade Representative Carla Hills, Latin American and Caribbean countries need to be prepared to meet several criteria to negotiate free-trade agreements with the United States. These criteria would require that countries:

- Eliminate tariff and nontariff barriers, according to specified schedule, on trade between the negotiating parties;
- Provide market access for trade in services;
- Provide standards for treatment of investment, including the elimination of local content and performance requirements;

[2] For a discussion of prior efforts, see "Liberalizing Trade in Latin America and the Caribbean: An Update," *IER*, April 1991.

[3] The EAI, first proposed by President Bush on June 27, 1990, is a plan to promote economic cooperation with Latin American nations in the areas of trade, investment, and debt relief. The "Enterprise for the Americas Initiative Act of 1991" was transmitted to Congress Feb. 26, 1991. Both houses of Congress have passed portions of the bill related to debt reduction for eligible countries.

- Take measures to protect intellectual property rights; and
- Restrain government activities such as subsidies, state trading, and the use of foreign exchange restrictions and controls.

Most of the nascent Latin American and Caribbean regional trade agreements and trade associations are years away from full implementation. However, almost all of the countries in the region are pressing ahead with plans to liberalize their trade regimes and harmonize their trade policies on a regional basis. A summary of recent developments along these lines follows.

Central America.—Central American governments are concerned that a NAFTA and hemisphere-wide free trade will erode the trade benefits the United States grants to Central America under the Caribbean Basin Economic Recovery Act (CBERA).[4] To enhance Central America's attractiveness as a NAFTA trading partner and to lay the groundwork for Central American participation in a hemispheric free-trade area, Central American leaders have established the immediate goal of lowering internal barriers to trade within the region. They also plan to improve the transportation infrastructure and streamline customs regulations to facilitate trade among countries in the region. Once internal barriers have been dismantled, the Central American leaders hope to negotiate a free-trade agreement with the United States on a multilateral basis.

In their 10th annual summit meeting in July 1991, the Presidents of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua formally approved a timetable for liberalizing trade within Central America. The Presidents agreed to a phased elimination of duties on most basic agricultural products imported from other countries in the region by December 31, 1991. Remaining duties on agricultural products are scheduled to be phased out by June 1992. Effective December 31, 1992, tariffs on most nonagricultural products traded regionally are scheduled to be reduced to a maximum of 20 percent. These products will have a minimum 5 percent tariff, with intermediate tariff levels of 10 percent and 15 percent for selected articles. The Central American Presidents agreed to draw up a list of "essential" products to be granted an extended period to phase in duty reductions, as well as a limited list of products to be exempted from the 20 percent ceiling.

The Central American leaders allowed Panama to participate in the annual summit meeting as a full member for the first time. In the past, Panama had been allowed only observer status. Unlike the other Central American countries, Panama's economy is based largely on services such as banking and tourism rather than agricultural production. Panama will be allowed to participate in the Central American regional economic integration process.

In separate developments, the Governments of El Salvador and Guatemala signed a bilateral free-trade agreement scheduled to become operative in October 1991. Under this agreement, each country will phase in the complete removal of tariff and nontariff barriers to the other's products.

Mexico and Central America.—In January 1991, the Central American Presidents of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua met with the President of Mexico to lay the groundwork for a Mexico-Central America free-trade area. Central American leaders view closer ties with Mexico as one way for countries in the region to position themselves to benefit from a NAFTA. The Mexican and Central American leaders agreed in principle to gradually reduce barriers to trade within the region. Their goal is to have a Mexico-Central American free-trade zone in place by 1996. Formal talks on trade liberalization between the Central American countries (including Panama) and Mexico began in July 1991. Central American negotiators reportedly have requested an undetermined transitional period during which Central American products would receive nonreciprocal preferential treatment in the Mexican market.

Venezuela, Central America, and the Caribbean.—The Venezuelan Government is seeking to improve that country's access to North American markets, particularly in the event a NAFTA is established. Venezuela was an observer in the initial Mexico-Central America discussions in January 1991. Since that time, Venezuela's discussions with Central America have followed a separate track. In July 1991, the Central American countries approved a Venezuelan-proposed trade agreement. The agreement calls on Venezuela to eliminate its tariffs on Central American products. A small list of products will retain a 20 percent tariff, which is scheduled to be phased out within 5 years. The Central American countries committed to reduce their tariffs on Venezuelan products to 20 percent within 5 years, and to zero after 10 years. In a separate development, Venezuela signed a trade agreement with the Caribbean Community (see the discussion of the Caribbean Countries below) in July 1991. This agreement reportedly permits duty-free entry of certain Caribbean products into Venezuela for an initial period of 5 years.

Mexico and Chile.—To lay the groundwork for an eventual free-trade agreement with the United States, the Government of Chile is pursuing the immediate goal of a free-trade agreement with Mexico. Mexico and Chile first agreed to work towards establishing a bilateral free-trade agreement in October 1990. The two countries are scheduled to sign an agreement finalizing the terms of the free-trade pact before the

[4] The Caribbean Basin Economic Recovery Act became operative in 1984 and was extended and expanded in 1990. Under the act, the United States grants non-reciprocal duty-free or reduced-duty entry for specified products from designated eligible Caribbean Basin countries in Central America, the Caribbean, and South America.

end of 1991. Such an agreement originally had been scheduled to be signed in July 1991.

In addition to duty-free trade for most bilaterally-traded products, the Mexico-Chile free-trade agreement reportedly will allow each country to impose a uniform 10 percent tariff on imports from the other country that compete with similar domestic products effective January 1, 1992. The 10 percent tariff is scheduled to decline by 2.5 percent annually until tariffs are completely eliminated in 1996. Duties on more sensitive items, including chemicals and petrochemicals, glass, ceramics, wood and wood derivatives, some textiles, grapes, and poultry, will be reduced more slowly, arriving at a final tariff of 2 percent in 1998. Products exempt from duty reduction or duty elimination are to include petroleum and petroleum products and military equipment.

Southern Cone Countries.—In late 1990, the Presidents of Argentina, Brazil, Paraguay, and Uruguay finalized their plans to create a common market. Their goal was to draft a regional trade accord that would facilitate the conclusion of a free-trade agreement with the United States and become a blueprint for other Latin American nations. On March 26, 1991, the four Presidents signed a treaty to mutually reduce tariff barriers and to integrate their economies by 1995, creating a Southern Cone common market (MERCOSUR is the Spanish acronym, MERCOSUL is the Portuguese acronym). The MERCOSUR countries signed an EAI framework agreement with the United States in June 1991-the first such multilaterally negotiated agreement.

Effective January 1, 1995, the MERCOSUR countries are to share a common external tariff (specific details are to be determined at a later date) and to coordinate fiscal, foreign exchange, and customs policies (a common unit of currency is not envisioned by the agreement). The free movement of goods, services, capital, and labor throughout the region also is scheduled to become effective January 1, 1995. Paraguay and Uruguay, the least developed countries in the group, will be allowed until January 1, 1996, to reduce tariffs on certain products. The MERCOSUR countries have not yet resolved several sensitive issues, including harmonizing their rules governing intellectual property protection.

The MERCOSUR charter establishes a 5-year waiting period for any new countries wishing to join the organization. Bolivia and Chile are two likely candidates for entry into this sub-regional group. In response to recent overtures from Bolivia, MERCOSUR leaders are investigating ways to link Bolivia to the organization.

Andean Countries.—In May 1991, the Presidents of Bolivia, Colombia, Ecuador, Peru, and Venezuela signed an agreement in which they committed to work towards the creation of a regional free trade zone. Their goal is to enhance Andean region attractiveness as an investment site for the location and development of export-oriented industries and activities. A free trade zone is scheduled to become effective in January 1992 for Bolivia, Colombia, Peru, and Venezuela. Ecuador will gradually reduce its duties on other Andean products to zero, creating a five-nation free trade zone by 1993. Each country will be allowed to maintain a list of 50 products for which duties will remain in force. A customs union with a common external tariff is scheduled to become fully operative in 1993 for Colombia, Venezuela, and Peru, and be extended to Bolivia and Ecuador by December 31, 1995.

Caribbean Countries.—Caribbean nations are concerned that a NAFTA will erode the trade privileges the United States currently grants to Caribbean Basin products under the CBERA. Caribbean governments view any erosion of trade privileges granted by the United States as particularly devastating in view of their concerns that the approach of the European single market in January 1993 will result in lower European demand for Caribbean products. Many Caribbean officials doubt that Caribbean products will be able to compete with low-cost duty-free Mexican products in North American markets. Moreover, Caribbean officials are concerned that investors will prefer Mexico, rather than the Caribbean, once a NAFTA becomes operative. In light of these concerns, the 13 English-speaking nations comprising the Caribbean Community (CARICOM)[5] negotiated a multilateral framework agreement with the United States in July 1991.

In July 1991, CARICOM agreed to implement a common external tariff which was scheduled to become effective in October 1991 but has again been postponed. (The effective date for CARICOM's common external tariff was originally January 1991. That date was postponed to March 1991.) CARICOM's common external tariff will establish low duties, with a minimum of 5 percent, on nonmember imports that do not compete with the goods produced within the community. Nonmember imports that compete with CARICOM products and which are likely to injure domestic industries will face duties ranging as high as 45 percent.

Cuba.—In view of the collapse of Cuban trade agreements with Eastern Europe and diminished Soviet economic assistance, the Cuban Government has been looking to expand economic ties with other Latin American and Caribbean countries. Cuban President Fidel Castro has publicly supported Latin American economic integration efforts, but continues to denounce U.S. policies in the hemisphere, including the EAI. Cuba has not officially requested admission into any of the newly forming Latin American and Caribbean regional trade associations. The Cuban Government has made significant progress, however, in promoting joint ventures with Mexican investors. A CARICOM technical delegation visited Cuba in April 1991 to pursue cooperative agricultural research projects.

[5] CARICOM members are: Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts-Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

Agreements Reached with Japan on Construction Services and Semiconductors

Amid an increasing Japanese surplus and continuing bilateral trade frictions, the United States and Japan reached agreement on two important issues this summer. A summary of developments relating to the agreements on construction services and semiconductors follows.

Major Projects

On June 1, 1991, the United States and Japan concluded an agreement that will allow U.S. firms to bid on an additional 23 Japanese construction projects worth $26.7 billion. Seventeen of the new projects, worth approximately $6.4 billion have alreadybeen approved for construction while another six will be open to U.S. participation, if and when they are approved. The agreement came within hours of a May 31 deadline that had been set by the Office of the U.S. Trade Representative (USTR) for avoiding sanctions. USTR had previously announced on April 26 that it would bar Japanese contractors or subcontractors from Federal or Federally funded building and public works procurements by certain government agencies "until Japan makes significant improvements in its procurement policies."[6] The U.S. appropriation for the defense, mass transit, highway and other construction projects to be covered under the sanctions totalled $221 billion during FY 1991. However, there was some uncertainty about how much the sanctions would have affected Japanese firms, since the bulk of Japanese construction contracts in the United States has been on private projects worth approximately $2.5 billion.

In May 1988, the United States and Japan signed an agreement that allowed U.S. firms to compete on 17 major public, private and "third sector" projects in Japan totalling $23 billion over 10 years. ("Third sector" projects are those managed by private sector organizations but funded wholly or partially by the government). The original agreement included three different tracks of procedures or measures for bidding on projects (*IER*, November 1989 and May 1988). The United States pressured Japan during the past year to expand the 1988 Major Projects agreement to include all construction projects (although a list of only 27 was presented during the May negotiations), to add a new track of procedures to cover projects with a design component, and to take efforts to eliminate bid rigging in connection with awarding construction contracts. In response to U.S. demands, five of the projects included in the June 1991 agenda are "third sector projects". Under the new agreement, the Government of Japan promised to take further steps to prevent bid rigging and to develop guidelines for improving the bidding process and access to information about future projects. A new procurement track for design-and-build contracts was also added to the 1988 agreement. This track covers procurement of a combination of design and consulting services with the supply, manufacturing and/or installation of goods. In addition, an independent Procurement Review Board was established to handle complaints by potential suppliers relating to contract awards.

While the agreement was welcomed by U.S. negotiators, U.S. businessmen and some Congressmen were less optimistic about the prospects for an increase in U.S. participation in Japan's market. U.S. firms have won only approximately $324 million in contracts under the May 1988 agreement. (*IER*, November 1989 and May 1988). According to some analysts, the reasons for the relatively lackluster performance of U.S. firms in Japan's construction market includes inexperience in that market, difficulties in obtaining Japanese partners, and financial problems in the U.S. market. Korean firms, by contrast, have been making some inroads by adopting a long-term view of the Japanese market. While U.S. firms have attempted to enter Japan's construction market alone by winning orders covering design, materials procurement and construction work, Korean firms, by contrast, have entered into tie-ups or joint ventures with Japanese companies, with the hope of improving their construction skills and acquiring Japanese technology. Companies from both countries continue to contend with the exclusionary effects of dango (mutual consultation system involving rotation of winning bids to participants) and bid-rigging. While the 1988 agreement and the latest one are intended to familiarize U.S. firms with Japan's bidding system, the imbalance between U.S. and Japanese participation in each others' construction markets continues to persist.

Semiconductors

On June 4, the United States and Japan reached a consensus on the terms of a new semiconductor agreement, which was then signed on June 11, 1991. The new agreement will replace a 1986 accord that was set to expire on July 31, 1991. The 1986 agreement was intended to end dumping of Japanese semiconductors in the United States and third-country markets and to increase U.S. market access in Japan (*IER*, June 1988). The major issues that emerged during the negotiations leading to the latest pact were how to incorporate the market-access objectives of the existing agreement; revisions to the pricing provisions of the agreement; and what to do about the remaining $165 million in retaliatory tariffs imposed by the United States on imports of certain Japanese electronics products.

The market access issue was addressed through language stating that "the Government of Japan recognizes that the U.S. semiconductor industry expects

[6] See USTR press release, April 26, 1991 and Docket No. 301-69A, USTR. USTR had determined on November 21, 1989 that Japanese construction procurement practices were "unreasonable and burden or restrict U.S. trade." However, retaliation was postponed until 1991 because USTR hoped that progress could be achieved through further negotiations.

that foreign market share will grow to more than 20 percent of the Japanese market by the end of 1992 and considers that this can be realized." However, the agreement also said that both governments recognize that this does not represent a guaranteed market share. Indications of potential future controversies regarding the issue arose almost immediately after the agreement was signed. Some analysts and industry officials praised the agreement for stating the 20 percent numerical goal publicly and held it up as a model for other agreements. Japanese officials, however, stated that they viewed the 20 percent figure as only an indication of expectations, not a guarantee of market share. These two positions mirrored a disagreement that arose as a result of the same type of wording contained in a side letter to the 1986 agreement.

U.S. and Japanese methods for calculating U.S. market share in Japan have differed since the original agreement was signed. Based on U.S. calculations, which include only sales of foreign chips in the open market in Japan, U.S. semiconductor producers claim that the U.S. share of Japan's market rose from approximately 8.6 percent in 1987 to 13 percent at the end of 1990. By contrast, Japan claims that the U.S. share is closer to 18 percent. U.S. figures exclude shipments by IBM Japan and other captive sales of U.S. firms to their Japanese subsidiaries, and semiconductors made by Japanese producers for sale under foreign producers' names in Japan. Japanese figures do not. Under the new agreement, the two countries agreed to include both methods for calculating market share. Periodic reviews will be conducted to reconcile the differing figures.

A fast-track antidumping mechanism that had been proposed by the consortium of semiconductor manufacturers and users (SIA-CSPP) was adopted. The system used by the Department of Commerce under the old agreement to assess fair-market value for imports of DRAMS (dynamic random access memories) and EPROMS (erasable programmable read-only memories) from Japan was eliminated. In its place, the agreement commits Japanese semiconductor producers to continue to keep track of cost and pricing data that must be submitted to the Department of Commerce in the event that a dumping case is filed.

The 100 percent U.S. tariffs on imports of $165 million of Japanese personal computers and other consumer electronics products imposed in 1987 in retaliation for Japan's failure to live up to the agreement's market access goals were used as a bargaining chip by U.S. negotiators in entering into discussions with the Japanese. As a precondition to signing any agreement, however, Japan called for the removal of the sanctions. Under the agreement reached on June 4, the United States agreed to eliminate the sanctions on August 1 when the new accord was scheduled to take effect.

Reaction to the new agreement was mixed. Representatives from the U.S. domestic industry-the Semiconductor Industry Association (SIA) and the Electronics Industry Association (EIA)-praised the agreement and Japanese company efforts to promote "designing-in" of foreign semiconductors in Japanese products. The two groups announced a number of joint activities such as the formation of a steering committee to monitor implementation of the agreement and promotional activities to encourage "design-ins". These activities are important in attempting to expand U.S. sales to some of Japan's largest semiconductor purchasers in the consumer and automotive electronics sectors. Managed trade proponents, inside and outside of the U.S. Government, criticized the pact as being too vague in its market-share commitments, while supporters of free trade in the United States and Japanese semiconductor producers were uneasy about the agreement's market share provisions. Industry representatives in both countries indicated that the key to more U.S. sales in Japan is further changes in behavior and attitudes of Japanese and U.S. companies-including more receptivity to foreign products by Japanese firms and more willingness by U.S. firms to meet Japanese product requirements.

Canada Terminates Memorandum of Understanding on Softwood Lumber: What Happens Now?

On September 3, Canada announced that it was terminating a bilateral Memorandum of Understanding (MOU) affecting trade in softwood lumber, a leading U.S. import from Canada. The MOU resulted from a negotiated settlement to a protracted bilateral trade dispute that had overshadowed U.S.-Canadian relations during the first half of the eighties. The Canadian action has brought cries of protest from the U.S. industry and has cast a shadow over ongoing negotiations of the United States, Canada, and Mexico for a North American Free Trade Agreement. The U.S. Government is currently considering a range of options in response.

Background

Canadian softwood lumber producers' steadily increasing share of the U.S. softwood lumber market, even during the recessionary period of 1982, was the main issue in the softwood lumber dispute between the United States and Canada in the early 80s. In Canada, most natural resources, including timber, are owned by the provinces. The substance of the U.S. complaint was that the fee Canadian timber producers paid the provinces to cut down trees-known as stumpage-was artificially low. The low stumpage fees charged for such timber, U.S. industry argued, constituted an implicit subsidy to Canadian softwood lumber producers.

Recognizing that the balance of incentives between cutting and replanting was, in fact, altered by low stumpage fees, but denying that this was any basis for a countervailing duty (CVD) case, the Canadians attempted to negotiate a solution to the softwood lumber impasse in the face of the almost certain imposition of a U.S. CVD on Canadian softwood lumber. An agreement was struck, and it consisted of an MOU between Canada and the United States signed on December 30, 1986. Under the agreement, the Canadian Government would impose up to a 15 percent export charge to offset the low provincial stumpage rates and to act as a substitute for a U.S.-imposed CVD. The MOU envisioned that this export surcharge would gradually be replaced by higher stumpage fees. The understanding established an inverse relationship between the export charge and the stumpage fees, with the goal of eliminating the export charge over time as stumpage fees were raised. The agreement outlined the transitional steps necessary to increase the stumpage fees and do away with the export charge. The United States' right to monitor and approve any changes in export charges and the steps to higher stumpage fees was specified in the agreement. The settlement decision required the coalition of U.S. industry lumber producers who had initiated the CVD case to withdraw their petition. This was done, effectively terminating the case prior to a final determination and the imposition of a CVD. All this took place at a time when a free trade agreement (FTA) was under serious negotiation by both countries.

Termination

On September 3, 1991 the Government of Canada announced that the MOU on softwood lumber would be terminated on October 4, 1991. Under the terms of the MOU, either party could terminate the agreement unilaterally, as long as 30 days written notice was given. The September announcement by the Canadian Embassy constituted the required notice.

In a fact sheet accompanying the announcement, the Canadians outlined their rationale for the decision. Three reasons were cited: (1) the MOU has served its purpose; (2) there is no subsidy to Canadian lumber producers; and (3) the Canadian share of the U.S. softwood market is diminishing.

One of the purposes of the MOU was to allow for an increase in stumpage and other charges by provinces in softwood lumber production to more fully reflect resource replenishment costs, paving the way for the gradual reduction or elimination of the export charge. In response to increased public concern with the question of forest management and renewal, a number of Canadian provinces have enacted policies since 1986 that have increased the share of resource replenishment costs borne by the softwood industry. For example, the province of British Columbia, which accounted for nearly 80 percent of Canadian exports of softwood lumber to the United States in 1990, has increased stumpage and other forestry charges. As a result, lumber produced in the province is no longer subject to the federally-imposed export charge mandated by the MOU.

The changes enacted by the provinces have resulted in the value of export charges levied by federal authorities dropping from \$400 million in 1987 to approximately \$40 million at present, a fraction of its original level. Only 8.4 percent of softwood lumber exports in 1990 were subject to the full levy. Given the continued public pressure for responsible stewardship of declining natural resources, Canada expects that the trend of passing on resource costs to the private sector will continue. As a result, it maintains that the purpose of the MOU has been served and its continuation is no longer necessary.

In its statement of reasons for the termination of the MOU, the Canadian Government also argued that there is no subsidy to Canadian lumber producers. Citing recent studies by the U.S. Forest Service and the U.S. General Accounting Office in which a method for reporting on timber sales was developed, the Canadian Government argued that when the U.S. methodology was applied to the forestry accounts of the major Canadian provinces, it showed that the revenues collected by the provinces exceeded expenses. Given this surplus of revenues over timber program expenses, the Canadians maintain that there is no subsidy to Canadian producers.

Canada's share of the U.S. market has declined from a high of 32.8 percent in 1985 to 26.8 percent in 1990. That decline continued into the first quarter of 1991 bringing the Canadian share of the U.S. market to its lowest level in 13 years. Canadian exports to the United States have declined by over 2.5 billion board feet since the signing of the MOU in 1986, when Canadian exports to the United States totalled 14.1 billion board feet. These facts are offered to support the Canadian contention that the competitiveness of U.S. lumber producers has been "significantly enhanced" since the MOU was signed. The 20 percent appreciation in the value of the Canadian dollar since 1986 has also been a factor in Canada's declining market share-a fact that was acknowledged in the Canadian announcement.

Reaction to the Canadian decision has been predictable. Canadian producers hailed the decision, while U.S. industry spokesmen denounced the Canadian action. Some U.S. lawmakers, including Senators Baucus and Adams of Washington and Packwood of Oregon, called for swift U.S. retaliation. In a letter to President Bush, 67 Senators urged that action be taken to convince Canada to overturn its decision. U.S. Trade Representative Carla Hills publicly stated earlier in the year that any change in the 1986 agreement would be opposed.

The immediate reaction to the termination of the MOU and the export charges by USTR was contained in a statement released on September 3. The office regretted Canada's action and said it would be "considering all options, including imposition of a U.S. import tax, if appropriate, to offset any existing subsidies." U.S. lumber industry spokesmen maintain that even though the amount of softwood lumber covered by the agreement is small relative to what was formerly covered, the MOU must be preserved as a way of monitoring Canadian forest management policies.

Any official U.S. reaction awaits the outcome of the U.S. Government inter-agency review process, however. A U.S. response could come before the October 4 termination of the MOU. Among the options open to either the USTR or the private sector includes initiation of another CVD case, a 301 case, or possible action under the terms of the U.S.-Canada FTA. The FTA was not in effect at the time of the original dispute and the MOU. However, the softwood lumber MOU was folded into the FTA when it was finalized in 1987. Article 2009 of the FTA officially recognizes and accepts the MOU. A "legislative remedy" to the problem could be taken independently by Congress.

The 1986 MOU laid to rest a number of fears at the time. Its termination in 1991 is stirring concerns once again about the effectiveness of the bilateral dispute settlement process under the U.S.-Canada trade pact. The Canadian action looks likely to reignite a longstanding political battle and may cast a pall over current negotiations between Canada, Mexico and the United States toward a broader North American FTA.

STATISTICAL TABLES

Industrial production, by selected countries and by specified periods, January 1988-June 1991

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

Country	1988	1989	1990	1990 IV	1991 I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.
United States	5.4	2.6	1.0	-7.2	-9.6	1.6	-6.5	-9.7	-7.7	5.9	8.3	8.2
Japan	9.5	6.2	4.5	6.9	-0.5	-2.5	17.1	-6.3	-22.3	5.8	27.4	-27.9
Canada	4.4	2.3	0.3	4.8	-1.3	-5.8	1.1	-6.3	-7.3	-7.4	-3.3	-2.2
Germany	3.2	5.3	5.9	6.7	0.6	(1)	(1)	-10.3	(1)	53.7	-24.5	(1)
United Kingdom	3.7	0.3	-0.8	-6.8	-1.1	-4.6	-7.7	21.2	1.1	-25.6	-4.5	42.3
France	4.1	3.6	1.1	-10.2	1.3	(1)	2.8	-11.0	-27.8	52.2	-6.2	(1)
Italy	6.9	3.9	-0.7	-8.1	3.9	-3.5	6.7	-13.4	2.1	-22.1	17.0	24.1

[1] Not available.

Note.—Data presented for Germany includes information only for what was once West Germany. When data for the combined Germanys are available they will be used.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, August 27, 1991.

Consumer prices, by selected countries and by specified periods, January 1988-July 1991

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

Country	1988	1989	1990	1990 IV	1991 I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.
United States	4.1	4.8	5.4	7.0	3.5	2.1	5.5	2.7	-0.9	2.7	3.6	2.7	2.7
Japan	0.7	2.3	3.1	6.0	4.7	0.3	12.5	-2.5	1.8	-1.2	1.2	1.6	7.0
Canada	4.0	5.0	4.8	6.9	11.5	2.5	33.2	-2.7	5.1	2.8	1.2	5.5	(1)
Germany	1.3	2.8	2.7	4.2	1.4	3.2	2.1	1.7	1.6	2.9	4.3	6.4	-1.2
United Kingdom	4.9	7.8	9.5	6.1	4.3	4.1	4.5	4.4	5.3	2.3	3.7	7.3	(1)
France	2.7	3.5	3.4	4.4	2.4	1.9	4.7	2.2	1.1	1.4	2.8	2.9	(1)
Italy	5.0	6.6	6.1	6.9	6.9	6.2	6.8	8.6	4.7	5.9	6.4	7.2	5.1

[1] Not available.

Note.—Data presented for Germany includes information only for what was once West Germany. When data for the combined Germanys are available they will be used.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, August 27, 1991

Unemployment rates, (total labor force basis)[1] by selected countries and by specified periods, January 1988-July 1991

Country	1988	1989	1990	1990 IV	1991 I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.
United States	5.4	5.2	5.4	5.8	6.4	6.7	6.1	6.4	6.8	6.5	6.8	6.9	6.7
Japan	2.5	2.3	2.1	2.1	2.1	2.1	2.0	2.0	2.1	2.1	2.0	2.1	(1)
Canada	7.7	7.5	8.1	9.1	10.1	10.3	9.6	10.2	10.4	10.1	10.2	10.5	10.4
Germany	6.2	5.6	5.2	4.8	4.5	4.5	4.5	4.5	4.4	4.4	4.5	4.5	4.6
United Kingdom	8.2	6.4	6.4	6.7	8.1	9.1	7.7	8.1	8.5	8.9	9.2	9.4	9.7
France	10.1	9.9	9.2	9.2	9.2	9.6	9.2	9.2	9.3	9.4	9.6	9.7	9.8
Italy[2]	7.8	7.7	6.9	6.8	6.8	6.9	(3)	(3)	(3)	6.9	(3)	(3)	(3)

[1] Seasonally adjusted; rates of foreign countries adjusted to be comparable with U.S. rate.

[2] Many Italians reported as unemployed did not actively seek work in the past 30 days, and they have been excluded for comparability with U.S. concepts. Inclusion of such persons would increase the unemployment rate to 11-12 percent in 1986-1990.

[3] Italian unemployment surveys are conducted only once a quarter, in the first month of the quarter.

[4] Not available.

Source: *Unemployment Rates in Nine Countries*, U.S. Deapartment of Labor, September 1991.

Money-market interest rates,[1] by selected countries and by specified periods, January 1988-August 1991

(Percentage, annual rates)

Country	1988	1989	1990	1990 IV	1991 I	1991 II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.
United States	7.8	9.3	8.3	8.1	6.8	6.1	7.2	6.5	6.5	6.1	6.0	6.1	5.9	5.6
Japan	4.4	5.3	6.9	7.5	7.7	([2])	([2])	7.7	7.7	7.6	([2])	([2])	([2])	([2])
Canada	9.6	12.2	13.0	12.3	10.5	9.2	11.1	10.4	9.9	9.6	9.1	8.8	8.8	([2])
Germany	4.3	7.0	8.5	8.9	9.1	9.0	9.3	9.0	9.1	9.1	8.9	9.0	9.1	([2])
United Kingdom	8.9	13.3	14.8	13.8	13.1	11.5	13.9	13.1	12.4	11.8	11.4	11.2	11.1	([2])
France	7.9	9.2	10.3	10.1	9.7	9.3	10.3	9.6	9.4	9.2	9.2	9.6	9.6	([2])
Italy	11.0	12.7	12.7	13.0	12.7	11.7	11.1	12.3	12.4	11.9	11.5	11.5	11.9	([2])

[1] 90-day certificate of deposit.
[2] Not available.

Note.—Data presented for Germany includes information only for what was once West Germany. When data for the combined Germanys are available they will be used.

Source: *Federal Reserve Statistical Release, September 9, 1991 Economic and Energy Indicators*, Central Intelligence Agency, August 27, 1991.

Effective exchange rates of the U.S. dollar, unadjusted for inflation differential, by specified periods, January 1988-August 1991

(Percentage change from previous period)

Item	1988	1989	1990	1990 IV	1991 I	1991 II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.
Unadjusted:														
Index[1]	88.0	91.3	86.5	81.7	82.8	87.7	82.2	81.1	87.4	86.8	87.3	89.0	88.9	87.8
Percentage change	-6.5	6.4	-5.3	-4.2	1.3	5.6	0	-1.3	7.2	-.7	.6	1.9	-.1	-1.2
Adjusted:														
Index[1]	87.4	91.8	88.1	84.1	85.2	89.6	84.9	84.0	85.1	89.1	89.3	90.5	90.2	88.8
Percentage change	-4.8	6.8	-4.0	-3.1	1.3	4.9	.2	-1.1	1.3	4.5	.2	1.6	-.3	-1.6

[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, September 1991.

Trade balances, by selected countries and by specified periods, January 1988–July 1991

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

Country	1988	1989	1990	1990 IV	1991 I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.
United States[1]	-118.5	-109.1	-100.5	-104.4	-69.6	-52.2	-88.5	-66.0	-48.8	-54.0	-57.4	-45.5	-70.7
Japan	94.9	77.4	63.2	66.0	87.6	96.8	81.6	78.0	96.0	92.4	91.2	106.8	([3])
Canada	8.2	5.9	9.3	9.6	8.8	([3])	2.4	7.2	10.8	9.6	13.2	([3])	([3])
Germany[2]	72.9	72.0	60.4	32.8	11.2	-1.6	-3.6	25.2	10.8	10.8	-6.0	-8.4	([3])
United Kingdom	-37.5	-39.3	-32.0	-23.2	-21.6	-14.4	-30.0	-16.8	-18.0	-18.0	-19.2	-7.2	([3])
France	-5.5	-7.0	-9.4	-13.6	-10.4	-5.2	-13.2	-8.4	-9.6	-4.8	-3.6	-7.2	([3])
Italy	-11.1	-13.0	-11.8	-17.2	-4.4	-16.8	-20.4	-6.0	13.2	-24.0	-19.2	-8.4	([3])

[1] 1986, exports, f.a.s. value, adjusted; imports, c.i.f. value, adjusted. Beginning with 1987, figures were adjusted to reflect change in U.S. Department of Commerce reporting of imports at customs value, seasonally adjusted, rather than c.i.f. value.

[2] Imports, c.i.f. value, adjusted.

[3] Not available.

Note.—Data presented for Germany includes information only for what was once West Germany. When data for the combined Germanys are available they will be used.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, August 27, 1991 and *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, September 19, 1991

U.S. trade balance, [1] by major commodity categories, and by specified periods, January 1988–June 1991

(In billions of dollars)

Country	1988	1989	1990	1990 IV	1991 I	II	Jan.	Feb.	Feb.	Mar.	Apr.	May	Jun.
Commodity categories:													
Agriculture	13.9	17.9	16.3	4.2	4.4	2.8	1.2	1.6	1.6	1.0	1.0	.8	1.1
Petroleum and selected product—(unadjusted)	-38.1	-44.7	-54.6	-16.2	-10.4	-10.0	-4.5	-2.8	-3.1	-3.3	-3.3	-3.4	-3.3
Manufactured goods	-146.1	-103.2	-90.1	-24.3	-14.7	-10.5	-5.8	-5.7	-3.2	-3.6	-3.3	-3.6	-3.5
Selected countries:													
Western Europe	-12.5	-1.3	4.0	.6	5.7	5.1	1.1	1.4	3.2	2.1	1.3	1.7	-.01
Canada[2]	-9.7	-9.6	-7.5	-2.8	-1.4	-1.0	-.4	-.5	-.5	-.2	-.3	-.4	-.4
Japan	-51.7	-49.0	-41.0	-11.7	-10.3	-8.9	-3.5	-3.2	-3.6	-3.3	-2.4	-3.2	-3.8
OPEC (unadjusted)	-8.9	-17.3	-24.3	-7.1	-4.3	-3.3	-2.0	-1.3	-1.0	-1.0	-1.3	-1.0	-1.1
Unit value of U.S. imports of petroleum and selected products (unadjusted)[3]	$18.12	$16.80	$20.34	$28.20	$19.57	$16.44	$22.98	$18.58	$17.15	$16.40	$16.55	$16.39	$16.08

[1] Exports, f.a.s. value, unadjusted. 1986-88 imports, c.i.f. value, unadjusted; 1989 imports, customs value, unadjusted.

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

[3] Beginning with 1988, figures were adjusted to reflect change in U.S. Department of Commerce reporting of imports at customs value, seasonally unadjusted, rather than c.i.f. value.

Source: Advance Report on U.S. Merchandise Trade, U.S. Department of Commerce, September 19, 1991.

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