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CONTENTS

CONTENTS

International Economic Indicators

The consensus that had existed among private forecasters that the U.S. GNP will grow at a 3 percent rate in 1985 has been broken by upward revisions of the recent performance of the economy. The recent revision of the fourth quarter U.S. GNP growth from 3.9 percent to 4.9 percent played a major role in lifting the sights of forecasters. From the powerful year-end momentum and early 1985 data it appears that the economies of several industrialized nations have gotten off to a good first quarter start in 1985.

The effect of the strong dollar and high interest rates on the world economy, however, remain a critical concern both in the United States and other Western nations. In the international debate over the issue, the following arguments are often heard on the harmful effects of the strong dollar and high U.S. interest: The strong dollar hurts U.S. exporters and exposes domestic producers to intense foreign competition. By engendering protectionism, particularly in the United States, it threatens world trade. It contributes to inflation in Europe by pushing up dollar-denominated raw material and energy prices. High U.S. interest rates soak up badly needed investment capital in the partner countries and destroy overseas U.S. assets. They also cause U.S. borrowing from abroad on such a scale that, if it continues, in a few years U.S. external debts will exceed the combined debts of the developing world. High U.S. interest rates aggravate the worlds debt problem.

Arguments are often heard that the situation is not as bad as one may think: Tight monetary policy, despite its manifestations in the strong dollar and high interest rates, is the cutting edge in the fight against inflation. High import demand as a result of the strong dollar puts pressure on U.S. producers to reduce their costs, thus helping to improve productivity in the United States. By helping maintain a high level of demand for imports, the strong dollar fuels economic expansion in the partner countries. The capital inflow prompted by high U.S. interest rates relieves pressure from domestic funds in financing the U.S. budget deficit.

Industrial production

U.S. industrial production in January 1985 rose 0.4 percent, following a 0.5 percent gain in December 1984. U.S. industrial output in January was 5.1 percent above its level 1 year ago.

The annual rates of industrial growth in the key industrial countries, calculated by taking the latest available monthly output data over the output level in the corresponding month 1 year before, were as follows: Canada, 5.6 percent; Italy, -0.4 percent; Japan, 8.4 percent; the United Kingdom, -1.2 percent; and West Germany, 4.1 percent. French industrial production stagnated last year, with output in November 1984 down to its November 1983 level.

Employment

The rate of unemployment in the United States was 7.2 percent in February (on a total labor force basis including military personnel). January's rate was 7.3 percent. Seasonally adjusted unemployment rates in January as reported by national statistical organizations were as follows: Canada, 11.2 percent; France, 11.2 percent; Italy, 13.7 percent; the United Kingdom, 13.0 percent; and West Germany, 9.2 percent. Japan's rate of unemployment was 2.6 percent in December. (For foreign unemployment rates adjusted to U.S. statistical concepts, see tables at the back of this issue.)

Total employment in the United States rose 8.3 percent in the 5-year period 1980-1984. During the same period, employment in West Germany declined 4.2 percent; in France, 3.2 percent, and in the United Kingdom, 3.6 percent. Against this, U.S. productivity over this period increased by only 5.6 percent, while productivity in West Germany increased by 10.3 percent; in France by 10.2 percent, and in the United Kingdom, by 13.3 percent.

The EEC Commission is urging the United Kingdom and the Federal Republic of Germany to accelerate their economies in order to reduce unemployment. France and Italy, embarking later than the two other key industrial nations of Europe on restrictive macroeconomic policies, must give priority to the fight against inflation.

External balances

The monthly deficit in U.S. merchandise trade rose to a seasonally adjusted $10.3 billion in January 1985 from $8.0 billion in December 1984. The volume of U.S. capital good imports increased by 29 percent in 1984, and the volume of imported consumer goods by 35 percent, according to Data Resources. The U.S. current account deficit was an estimated $98 billion in 1984 ($41 billion in 1983).

The Federal Republic of Germany closed 1984 with a current account surplus of $6 billion. The country's current account showed a $16 billion deficit in 1980. (More than two thirds of Germany's trade is European: 48 percent with EC nations and 22 percent with the rest of Europe including CEMA countries). Italy's foreign trade performance, however, was much less successful in the past year: Increasing by 67.5 percent over its 1983 level, Italy's merchandise trade deficit registered a record $9.5 billion in 1984.

Prices

The U.S. consumer price index rose 0.2 percent in January 1985, the same as in December 1984. The annualized rate of inflation during these months was 3.6 percent which is lower than the 4.0 percent rate for the year 1984.

In January 1985, the annualized rate of consumer-price inflation was 3.7 percent in Canada; 8.6 percent in Italy; 5.0 percent in the

United Kingdom, and 2.1 percent in West Germany. France's consumer prices rose at a 6.7 percent rate in December; Japan's at 2.4 percent.

The European Commission's latest annual report says that the Community's overall performance in controlling inflation parallels that of the United States. In 1984, the EC's annual rate of domestic cost inflation was 4.0 percent, according to the Commission's latest estimates. The OECD predicts that 1985 rates of inflation will be 6.5 percent in France, 5.25 percent in the United Kingdom and 2.0 percent in West Germany.

Forecasts

In the recently published "Economic Report of the President," the Administration reasserted its forecast that the U.S. real GNP will grow at an annual rate of 4 percent during the years 1985-1988, slowing slightly during the period 1989-1990. The Chemical Bank of New York expects the U.S. real GNP to grow at an annual rate of 4.9 percent during the first quarter of 1985.

The Commerce Department expects the U.S. merchandise trade deficit (c.i.f. basis) to rise from $123 billion in 1984 to $140 billion in 1985. Predictions of other analysts for the 1985 U.S. merchandise trade deficit (also c.i.f.) range from $133 billion to $152 billion. The Chemical Bank of New York expects the $98 billion deficit on U.S. current account to rise to $115 billion in 1985. Some private analysts believe that if the current trend continues, the U.S. current account deficit will be a staggering $300 billion in 1990.

The Bank of France forecasts current account surpluses for France in the years ahead, enabling the country to move out of the red and to reduce its external indebtedness. Some private analysts, however, expect a further increase in France's estimated $0.2 billion 1984 current account deficit.

Japanese car manufacturers estimate--according to news reports--that they will sell cars at an annual rate of 2.7 million during first 3-month period following the expiration of their voluntary restraint on sales in the United States at the end of March. This volume would be sharply higher than the prevalant 1.85 million annual rate and could increase the share of Japanese cars in the U.S. market from 18 percent to more than 25 percent.

A critical assumption for restoring the financial viability of the developing world is that developing country exports must rise by an average annual 5.5 percent in real terms, according to IMF Managing Director J. de Larosiere. The implication of this for the industrialized countries is "a firm rejection of protectionism," said Mr. Larosiere. In sharp contrast with the optimistic tone of spokesmen for multilateral organizations and Western central banks, some private analysts see new signs of crisis in the leading debtor nations.

International Trade Developments

<u>Trade ministers from the United States, Japan, the European Community and Canada met February 9-11 for the Ninth Quadrilateral Trade Ministers' Conference in Kyoto, Japan</u>

The Ninth Quadrilateral Trade Ministers' Conference ended February 11 in Kyoto, Japan, with an agreement to begin laying the groundwork for a new round of multilateral trade negotiations in 1986. Trade representatives from the four major free-world economies--the United States, Japan, the European Community, and Canada--agreed to schedule a high-level meeting of the General Agreement on Tariffs and Trade (GATT) at the earliest possible date to set up a preparatory committee responsible for studying ways to start the proposed round. "The year of 1985 is a crucial year to maintain and strengthen the trade system," said the Japanese International Trade and Industry Minister. "We all agreed to effectively roll back protectionism swiftly this year when the world economy is performing favorably."

The purpose of the new round of trade talks is to further reduce tariffs and non-tariff trade barriers after the Tokyo Round tariff commitments are fully implemented in 1987. This new round will be the eighth in a series of talks since the GATT was established after World War II to liberalize and stimulate world trade.

If the proposed talks are going to result in the expansion of world trade and the strengthening of the global economy, the trade ministers stressed that as many GATT members as possible, both industrialized and developing, should participate in the preparatory discussions. While the results of the meeting represented a more "positive attitude" towards new GATT talks on the part of the European Community, developing countries are still reluctant to endorse a new round since they believe that the items included on the agenda will be of interest only to the industrialized nations. So both developed and developing countries can benefit, the trade ministers advocate coverage of a wide variety of issues. Of particular interest to the United States are services trade, problems related to agricultural trade, and the protection of intellectual property, especially vital to trade in high-technology goods.

The trade representatives also agreed to adopt a "general" and "macro" approach during the preparatory stage to sustain the world economic recovery. Policies aimed at checking high interest rates, maintaining stable exchange rates, and promoting structural adjustment will be pursued.

The 3-day conference was attended by U.S. Trade Representative William Brock, European Community Commissioner Willy de Clercq, Canadian Minister of International Trade James Kelleher, and Japanese Minister of International Trade and Industry Keijiro Murata. It was the ninth in a series of meetings that was initiated by Brock to discuss problems related to the operation of the trading system on an informal basis. The next quadrilateral meeting is expected to take place in Toronto in July.

EC is hesitant to enter into new round of trade talks

Recent press statements from officials of the European Community (EC) indicate that the EC has a generally noncommittal and apprehensive attitude toward a new round of multilateral trade talks. The Europeans' hesitation is in contrast with the attitude of the United States, Canada, and Japan who favor launching a new round to liberalize trade in services and high-tech products. Two problems account for Europe's reticence.

First, the timing for a new round is off from the European perspective. The EC is preoccupied with internal economic and trade problems and the upcoming accession of Spain and Portugal to the EC. The EC's belated and less vigorous response to world economic growth has made some of the members cautious. In addition, the EC Commission, and France in particular among the member states, fear domination of international trade in services, high-tech, and other industrial products by the United States and Japan. The EC Commission is attempting to address Europe's decline of industrial competitiveness at home and abroad by improving internal conditions of competition, eliminating internal trade barriers, promoting cross-frontier R&D efforts and business collaboration, opening up public procurement, and otherwise offering economies of scale to member state firms. For now, the EC Commission seems more interested in bolstering internal trade than liberalizing world trade. It is in no mood to further subject European industry and agriculture to new import competition when the internal market is already saddled by sagging industrial competitiveness, internal trade barriers, and excess farm produce.

Spanish and Portuguese accession and renegotiation of the Mediterranean trade accords will occur in 1986 or 1987. The Tokyo Round began after British accession, at a time when the EC was free to look outward. A new round beginning in 1986 or 1987 have to be dealt with simultaneously with enlargement. The costs of incorporating new members--in terms of time and energy, demands for internal trade concessions to lessen the shocks of expansion, and negotiations with nonmembers--could direct the EC's attention away from a new round and make it difficult to offer the concessions its major trading partners would expect.

Second, the EC countries are not in agreement on the need for and content of a new round. Unanimity among members will be required before the EC makes a firm commitment to a new round and to an agenda.

Some EC members believe they have less to gain (or less than the United States and Japan) in a negotiating round focused on trade barriers in high-technology, services, and agriculture than they had in previous rounds. While the British and Germans generally support a new round that would include services and high-tech, the French are skeptical both of a new round in principle and inclusion of services and high-tech in particular.

While agriculture is high on the U.S. list of topies for trade negotiation, EC members will unite in opposition to outside pressure for wholesale changes in the Common Agricultural Policy (CAP). The EC Commission and members view the CAP as central to the EC's survival and will continue to view export subsidies and other CAP programs as "nonnegotiable." For Europe, preservation of the CAP has become an article of faith.

In spite of the problems from the EC's perspective, some EC sources indicate that they believe momentum may be building for a new round and that, in time, the EC will give its consent if certain of its concerns are met.

First, the EC would like further clarification of the definition of high-tech and services trade to be used in a new round and the overall place trade in these areas will have in the GATT. Before it makes a commitment, it wants to know which high-tech and services items would be subject to negotiation under a new round. The EC believes it cannot assess its position on a new round without such definitions. It appears to be waiting for the United States to lead in a multilateral effort to clarify these issues.

Second, EC Commission sources indicate that the EC is very concerned about the recent U.S. proclivity toward bilateralism in international trade. If the United States can show that a new round would counter this trend, then the EC could see an advantage in participating.

Internal problems listed here will not necessarily determine EC foreign trade objectives because the EC Commission is not monolithic. For example, while the EC Commission's Directorate for Internal Market and Industrial Affairs may push for protection of the internal market to allow time to improve the conditions of intra-EC trade and raise industrial competitiveness, the External Relations Directorate may be less concerned with such matters and more disposed to endorse a new round. Finally, since the new EC Commissioners took office on January 1, 1985, it is too early to discern what direction they might take on a new round. The Commission will probably continue to go slow on starting a new round to buy time to work out internal differences and arrive at a common position--a process that could take longer than the United States would prefer.

Counterfeit-busting in Taiwan

Increased publicity about Taiwan as a major producer of counterfeit goods has sparked a flurry of activity by authorities intent on improving the nation's international image. At stake is the country's standing in the international community, its ability to attract foreign investment and technology transfers, and international trade. Foreign governments have long appealed to Taiwan authorities to take firm action against infringers of copyrights and patents, and some have even threatened to revoke the country's preferential status or suspend imports. Saudi Arabia, for example, decided last March to stop all imports of Taiwan-made auto parts because many were counterfeit.

One of Taiwan's industrial objectives is to produce sophisticated computer and electronics goods. But to accomplish this the island must attract technology from abroad and ensure its adequate protection for both foreign and local firms. As a step in this direction, a new copyright law is expected to be approved by the Executive Yuan early this year, marking the most significant step in anti-counterfeiting activities since the trademark law passed in 1983. (Taiwan is not party to any international agreements protecting intellectual property rights.) The proposed copyright legislation would increase the number of items eligible for protection, including computer software, sound tracks, lectures, musical instruments, artistic performances, and scientific and engineering designs. However, it provides copyright protection for foreigners only, and does not provide exclusive translation rights for foreign authors. New unfair competition and patent laws are also reportedly under consideration by the Ministry of Economic Affairs (MOEA).

The new copyright legislation calls for stiffer penalties for offenders including larger fines and mandatory jail sentences to replace the slap on the wrist they used to receive. Taiwan has not yet followed through on its commitment to establish a special administrative court for handling counterfeiting cases and current legal procedures are complex and time consuming. Several recent criminal and civil suits against local counterfeiters were thrown out of the appeals court because the firm was unregistered in Taiwan. However, the new legislation will supposedly give unregistered foreign complaining firms access to Taiwan courts.

The anti-counterfeiting effort was initiated in 1981 with the establishment of the National Anti-Counterfeiting Committee (NACC) to assist in investigating faked commodities. To further discourage violators, Taiwan now requires verification of permission to use a foreign trademark or brand. Although some observers have argued otherwise, Taiwan authorities assert that its efforts to interdict counterfeiters have been effective, and public attitudes toward counterfeiting are changing as local producers come to recognize the importance of establishing their own brands abroad.

Taiwan's economy has grown rapidly during the past two decades and local producers intent on expanding their productive capacity have invested little in R&D. Taiwan authorities are concerned about infringement of intellectual property rights, not only because of the damage they inflict upon the victims, but also because such shortcuts resulting in quick profits can destroy the incentive for domestic R&D. However, Taiwan's major motivation behind the crackdown is to protect the reputation of its exports. Over half of its GNP in 1984 was derived from exports, and before the 1981 crackdown other nations threatened to enforce quotas on Taiwan-made products to check the flow of counterfeit goods.

Taiwan is also taking steps to improve the standing of Taiwan-made goods in the international community. It has offered rewards for the country's best designed products and a development incentive fund was established that will cover up to half the cost of developing new products.

To protect the reputation of Taiwan-made garments in world markets, MOEA has decided that in the future, all garments bearing trademarks must undergo a trademark investigation by the Taiwan Textile Federation (TTF). To assist in this effort, TTF is making arrangements to purchase information from the Japan Institute of Invention and Innovation on trademarks registered in the United States, Japan, Britain, West Germany, Canada, the Netherlands, Belgium, Luxembourg, and France in the past 10 years.

Brazil and Mexico: similar features in economic performance and policies

Brazil and Mexico--the largest debtor countries in the world--have displayed many similar characteristics in their economic performance in recent years. More than any other nation, the United States has stimulated their recoveries in 1984, absorbing the bulk of their exports. But the United States questions certain trade and investment policies that these countries share.

Performing well in international trade.--Both countries had good trade records in 1983 and 1984. At an estimated $13 billion, Brazil virtually doubled its merchandise trade surplus in 1984 over 1983. The surplus was fostered principally by soaring exports of manufactures. The United States, registering a deficit of $4.6 billion with Brazil in 1984, accounts for the largest share of this surge. The particular products Brazil destined for export--automotive items, footwear, steel items, paper products etc.--reached the U.S. market in sharply increased quantities.

Mexico also maintained a positive merchandise trade balance in 1984, totaling an estimated $13.5 billion--only slightly less than in 1983. Softening oil prices put a lid on export earnings, but Mexico's foreign sales of manufactures soared, especially to the United States. U.S. statistics show a merchandise trade deficit with Mexico of $6.3 billion, with imports surging in all major categories of manufactures.

Disagreements on trade and foreign investment with the United States.--U.S. criticism of policies implemented by Brazil and Mexico continued to center on trade barriers both countries use to shelter their industries. In 1984, as in prior years, the Commerce Department was busy investigating allegations of subsidized exports by Brazil and Mexico. The International Trade Commission examined the effect of the questioned imports from Brazil on the competing U.S. industry. (Because Mexico is not a signatory to the GATT Subsidies Code and no equivalent bilateral subsidies' agreement exists, proof of injury to a U.S. industry is not necessary for issuing a countervailing duty order on imports from Mexico.) These two U.S. agencies also dealt with allegations of less-than-fair value sales from Brazil and one from Mexico.

Both Brazil and Mexico were among those countries that stepped up their steel exports to the United States in recent years. Many investigations conducted under U.S. unfair trade practice statutes involved Brazilian and Mexican steel. Brazil and Mexico were also among those countries that concluded steel export restraint agreements with the United States at the end of 1984.

Government regulation of foreign investment was another major area of disagreement between the United States and both Brazil and Mexico. In 1984, Brazil issued a decree codifying extensive controls over its foreign-dominated computer industry (IER, December 1984). Mexico issued regulations during the year that covered several facets of production, sales, and investment in their foreign-dominated pharmaceutical industry. U.S. objections, (along with protests from other foreign countries) focused on the discriminatory nature of these regulations, and their detrimental effects on U.S. interests in Brazil and Mexico.

Meanwhile, U.S. objections were also based on broad policy differences with both countries about foreign investment in general. According to the U.S. position, capital shortages and foreign debt could be greatly relieved in these countries if they allowed foreign investment to respond to market forces. (It should be noted, however, that over the years Brazil has been much more hospitable to direct foreign investment than Mexico and even presently confines controls to only a few selected areas.)

Shortcomings in domestic economic performance aggravate the debt burden.--While in 1984 both Brazil and Mexico recovered from recessions, their debt crises ($100 billion and $96 billion foreign debt, respectively) are far from over. New clouds began to gather recently when the International Monetary Fund (IMF) suspended the release of $1.5 billion of credits to Brazil for missing many of its economic goals. This also resulted in the suspension of negotiations under way between Brazil and creditor banks. In 1984, Brazil was unable to control its budget. Inflation ran at an annual rate of some 220 percent, compared with an originally targeted 40 percent.

Although Mexico's problems came nowhere near those of Brazil, the IMF became critical of Mexico's weakness in the same areas: trimming the budget and controlling inflation. Until recently, Mexico was widely praised for meeting its austerity goals under an IMF-approved adjustment program. Final data on Mexico's budget deficit in 1984 are still under dispute. Mexican planners originally stipulated that the budget deficit shall not exceed 5.5 percent of GDP during the year. However, preliminary data indicate that the 1984 budget deficit will reach 6.9 percent of the GDP and final data may show an even higher figure.

Mexico had significantly more control over inflation than Brazil. Nonetheless, Mexican inflation ran at a 59 percent annual rate in 1984, well above the goal of 40 percent. Apparently signaling a tougher stand toward debtor countries not living up to their commitments, the IMF now requests new austerity goals, which Mexico appears reluctant to accept. A delay of an agreement with the IMF on Mexico's 1985 economic program reportedly is holding up access to

$1.2 billion in credits from the IMF. Moreover, until an agreement is in place, the final approval of Mexico's $50 billion debt-restructuring pact negotiated with foreign banks last year might also be delayed.

<u>Wine trade measures challenged in the GATT</u>

Under both the antidumping and subsidies codes of the GATT, the European Community (EC) is challenging the U.S. grape growers' newly granted power to petition the ITC in wine cases. The ammended definition of industry in the U.S. Tariff and Trade Act of 1984 includes a temporary (2 year) exception which grants grape growers standing to file countervailing and antidumping cases with the U.S. International Trade Commission (ITC) against imports of wine and grape products. The EC charges that this interpretation of the domestic wine industry violates the international standards for defining industry for the purpose of unfair trade actions which generally requires that an industry consists only of producers of a "like product." Simply put, this principle implies that wine manufacturers may file a case only against imports of wine but not grapes, and grape growers may file against imports of grapes, but not wine.

To the consternation of the European Community, this measure managed to pass Congress in a compromise to defeat a more broadly-based proposal to allow any domestic producer of a raw agricultural product to petition the ITC against subsidized or dumped imports of goods made by processing the agricultural product concerned. Though the first proposal was defeated, the EC remains displeased with the outcome because of the importance of wine industries to the economies of France and Italy. Critics of the wine provisions argue that they could cause "wine wars" of protectionism and retaliation between the United States and the EC.

Though a "wine war" has been averted thus far, GATT disputes on the new legislation are just in the initial phases. In November of 1984, the EC put the issue on the agenda of meetings of the subsidy and antidumping code committees and requested consultations with the United States. Both bilateral consultations and special sessions of the code committees aimed at conciliation of the problem resulted in an impass. Now, the EC is poised to request a panel investigation under the code provisions if the grape growers formally file a petition with the ITC.

The EC is not alone, however, in its concern over the U.S. provision. Our other trading partners in the GATT also fear its possible precedent- setting effect if other antidumping or subsidy code signitories follow suit and change their domestic laws in a similar fashion.

Results of new Canadian investment policy

The recent announcement of a new emphasis in official review of foreign investment in Canada (IER, January 1985) has resulted in two significant American acquisitions of Canadian energy companies. Although the Government proposal to change the name of the Foreign Investment Review Agency (FIRA) to Investment Canada is still before Parliament, the agency's more positive image as an advocate of "job-creating investment" in Canada has already borne fruit. An 11-percent unemployment rate has stimulated government efforts to liberalize investment and acquisition policy in Canada.

FIRA announced in February that two U.S. companies, Texaco and Chevron, will be allowed to acquire several Canadian corporations. The acquisitions resulted indirectly from successful public tender offers in the United States. In 1984, Texaco took over the Getty Oil Co., and Chevron acquired Gulf Corp. As a result of the FIRA action, a number of Canadian oil, gas, mining, and mineral companies formerly controlled by Getty and/or Gulf came under Texaco and/or Chevron control. Under Canadian law, indirect acquisition of control of a Canadian business enterprise whose gross assets are greater than $Can 15 million is subject to FIRA review.

Government approval resulted from certain undertakings given by the U.S. companies. Texaco promised to increase both Canadian ownership of its Canadian subsidiary and exploration expenditures in Canada. The company will sell in Canada one issue of 12 million voting shares of Texaco Canada Inc. by yearend 1987. (At the time of the announcement, Canadian ownership of Texaco Canada was 10 percent.) Texaco also undertook to make capital and exploration expenditures of not less than $1.7 billion by December 31, 1988.

Chevron promised to offer its shares of Gulf Canada Ltd. for sale to Canadian-controlled purchasers until April 30, 1985. Were this to come about, it would constitute the largest instance of "Canadianization" ever, Gulf Canada's shares being valued at over $2 billion. If no Canadian-controlled purchaser can be found, Chevron promised to increase Canadian ownership of its combined businesses in Canada by at least 20 percent. This commitment is to be met by the end of 1989.

On February 21 it was announced that Texaco had successfully issued and sold over 14 million shares of Texaco Canada Inc. to Canadians. The share issue was worth $Can 485 million and increased Canadian ownership of Texaco Canada to 22 percent. The share issue was greater by 2 million than the commitment previously given by Texaco.

Sinclair Stevens, the Minister responsible for the administration of the Foreign Investment Review Act, saw the Texaco and Chevron undertakings as an indication of the success of the Government's more positive attitude toward foreign investment.

<u>Restraints on auto imports to end, but balance sheets of U.S. makers look good</u>

A recently released Commerce Department analysis predicts U.S. makers will be able to meet the Japanese challenge and continue investment plans when restrictions end in 1985.

On March 1, the Reagan Administration officially announced that it would not seek continued restrictions on imports of Japanese autos in the year beginning April 1985. The decision, widely anticipated in industry and Washington circles, seems for the moment to have put the contentious auto import issue to rest. Some U.S. legislators are continuing to press for legislation that would restrict Japan's auto shipments, but these proposals have thus far failed to garner widespread support in the face of record profits by U.S. makers in 1984. Indeed, a recent Commerce Department study on the prospects for America's big four automakers paints a fairly optimistic picture of the U.S. industry's outlook in the near term.

The report, prepared by the Commerce Department's Office of Automotive Affairs and Consumer Goods and released in early February (<u>Automotive News</u>, February 4, 1985) apparently added weight to the argument put forth by many top-level economic advisors that the U.S. industry is now able to meet the Japanese auto challenge. The report suggests that U.S. automakers will continue to perform well in 1985, barring a severe recession in the United States or a sharp rise in Japanese imports (neither of which is likely). The Department is less sanguine about the outlook for two of the major four makers--Chrysler and American Motors. In 1985, Chrysler will have a tax liability for the first time in years. American Motors, meanwhile, continues to lag behind the other makers in terms of sales, profits, and inventory adjustment.

The report also suggests that the financial and operating structure of the U.S. auto industry has improved dramatically since the 1980-82 recession. These changes have put the industry in a good position to continue investment plans into 1985 and generate generous dividends for stockholders. For example, the industry has implemented aggressive working capital management programs. These programs were designed to reduce receivables and inventories while stretching out payments. That enhances the industry's cash flow, making it possible for the industry to finance capital expenditures, debt repayments, and dividends in 1985 without resorting to substantial borrowing as such spending rises, as is expected. However, Commerce cautioned that the cash generated in 1985 may not be sufficient to keep the U.S. makers from resorting to the money markets next year.

U.S. makers widened their operating profit margins from 7.10 percent in 1978 to 7.17 in the first three quarters of 1984, the Commerce Department study showed. Returns to sales, meanwhile, rose from 4.03 percent in 1978 to 6.38 percent in the first three quarters of 1984. U.S. makers improved their debt-equity ratios in 1984 too: the ratio of long-term debt to stockholder's equity improved from 0.25 on December 31, 1983 to 0.16 percent on September 30, 1984. That ratio was still much higher than the 0.11 registered in 1978, a banner year for U.S. makers.

Industry analysts have suggested that the benefits to consumers from lifting auto import restrictions are not likely to surface until well into 1985. Japanese cars are in very short supply throughout most of the country, as are most popular American cars, and it will take a good 6 to 8 months to build up dealer inventories. Only then, the analysts suggest, will consumers be able to begin bidding down prices of new cars.

Japanese makers, particularly larger companies, are likely to resist the temptation to boost their shipments of cars to the United States. They are well aware that such a development would invite fresh criticism in the Congress and Administration. However, some analysts remain concerned that new Japanese suppliers, such as Isuzu, Suzuki, and Mitsubishi, will rush to fill the supply gap. Larger Japanese companies would then have a choice of losing market share, entering the fray themselves, or pushing for official guidance to mute their challenger's ambitions.

Nearly non-stop negotiations with Japan about telecommunications continue

U.S. and Japanese officials continue to haggle over draft ordinances that will implement the break up of NTT's monopoly on the supply of telecommunications equipment and services in Japan. The nearly non-stop talks have grown progressively more heated, as witnessed by the last-minute cancellation by Undersecretary of Commerce Lionel Olmer of meetings scheduled for late February. Secretary of Commerce Malcolm Baldrige ordered Olmer to cancel the meetings when it became clear that Commerce officials would not receive, by the start of talks, background information Japan had promised to provide. After a week of intense horsetrading, the two sides agreed to reschedule the meeting for the first week of March, and Japan agreed to provide the draft ordinances. Prime Minister Nakasone has personally promised President Reagan that American officials will be given the draft ordinances far enough in advance of their effective dates for U.S. Government and industry analysts to evaluate and comment on them. However, working level Japanese officials have been much less willing to discuss the specifics of the ordinances.

Nevertheless, the U.S. side is still very concerned about some aspects of the rules which will fundamentally alter the terms of competition in Japan's telecommunications market. Those rules are slated to become effective on April 1--just two weeks from today. The ordinances will implement the legislation making Japan's telecommunications giant, Nippon Telephone and Telegraph, a private company. As a result, Japan's telecommunications equipment and services market will be opened to competition for the first time.

The breakup of Japan's telecommunications system potentially could offer numerous new opportunities to both U.S. and Japanese firms. The United States has been carefully monitoring developments over the past year leading to NTT's privatization, especially the specifics of how the break-up will be implemented, in order to prevent trade problems down the line. U.S. officials have had several specific concerns: (a) whether the new NTT would continue to honor its commitment under the bilateral government procurement agreement not to discriminate against American products; (2) whether U.S. firms would be able to compete freely in Japan's newly deregulated telecommunications services market; (3) whether Japanese customers would be free to purchase interconnect equipment (phones, modems, and answering machines) from foreign suppliers; and (4) how such equipment would be certified as being in conformity with Japan's product standards. U.S. problems with Japan's proposed regulations on value-added networks were cleared away in 1984, and in February 1985 NTT indicated that it would continue to allow U.S. firms to bid on contracts for telecommunications equipment through 1986 (when the bilateral agreement expires). However, U.S. officials remain very concerned about Japan's proposed standards certification procedures for telecommunications equipment. At the present time, it appears that an industry trade association will be handed the task of testing and certifying interconnect equipment. U.S. suppliers fear that this could effectively keep them out of the customer-provided equipment market. Furthermore, equipment may have to receive up to five different certification marks, including ones from NTT, MITI, and the industry association. This would be extremely time consuming and costly.

Agreement on standards and certification requirements, long an area of contention in U.S.-Japan trade relations, progressed significantly in 1983 and 1984 as a result of persistent U.S. efforts that began in 1980. However, the detailed nature of these discussions and the many stumbling blocks along the way heightened U.S. appreciation for the difficulties in working through this kind of administrative barrier to imports in Japan. Discussions also confirmed that standards certification problems were indeed a major impediment to increased U.S. sales of manufactured goods. U.S. officials hope to avoid such problems in the telecommunications equipment area by carefully scrutinizing the ordinances implementing the NTT breakup before they go into effect, but time is running short.

Trade highlights for 1979-1984

The value of U.S. trade increased sharply over the last 5 years. Imports grew from $205.9 billion in 1979 to $323.0 billion in 1984; exports rose from $178.6 billion to $212.1 billion. After adjusting for inflation, imports increased by 22.6 percent over the 5-year period while exports fell 8.9 percent. Interestingly, four industries appeared among the top five leaders in both import and export growth between 1979 and 1984. These industries are: office, computing, and accounting machines; electronic components and accessories; motor vehicles and parts; and refined petroleum products.

The U.S. trade balance worsened for three of these industries over the last 5 years, as has the overall U.S. merchandise trade balance. Net exports (exports minus imports) declined by $3.9 billion in electronic components, $21.6 billion in motor vehicles, and $7.4 billion in petroleum products. However, the motor vehicle industry was the only one of the group that also showed a significant decline in employment between 1979 and 1984.

Table 1 shows the import and export changes for these four industries in both current dollars and constant 1981 dollars. Table 2 provides the change in real net exports for each sector using constant 1981 dollars. Dividing this value by the output-per-worker ratio in 1981 yields a rough estimate of the potential employment effect of the trade changes.

Table 1.--Nominal and real changes in exports and imports for selected industries, 1979-84

(millions of dollars)

Industry	Change in Value of Exports: Current dollars	Change in Value of Exports: Constant 1981 dollars	Change in Value of Imports: Current dollars	Change in Value of Imports: Constant 1981 dollars
Office and computing machines	7,918	8,893	7,670	8,231
Electronic components	3,586	2,590	7,468	6,337
Motor vehicles and parts	2,722	-1,478	24,330	14,832
Petroleum Refinery products	2,771	2,113	10,124	4,170

Table 2.--Net export changes and trade-related employment effects for selected industries, 1979-84

Industry	Change in net exports: Millions of 1981 dollars	Output per worker: Thousands of 1981 dollars	U.S. employment change (Thousands): Trade-related	U.S. employment change (Thousands): Overall
Office and computing machines	662	97.6	6.8	113.8
Electronic components	-3,748	60.4	-62.0	150.4
Motor vehicles and parts	-16,310	168.2	-97.0	-173.1
Petroleum Refinery products	-2,057	1976.6	-1.0	-9.9

Note.--Trade-related Employment Change = Change in Net Exports (in 1981 dollars) / Output per Worker in 1981

(The use of this measure assumes that $1 of imports displaces $1 of domestic production and that the output per worker ratio was constant between 1979 and 1984. Any increase in domestic productivity or the capital intensity of production would result in a reduced trade-related employment effect.)

Exports of office, computing, and accounting machines (SIC 357) increased by $7,918 million between 1979 and 1984, creating 91,100 jobs. Imports increased by $7,670 million which resulted in a potential loss of 84,300 positions. The net trade-related employment gain was 6,800 jobs while overall industry employment increased by 113,800 jobs.

The increase in exports can be largely explained by further penetration of U.S. goods into expanding Canadian and European markets. For instance, annual U.S. sales of office, computing, and accounting machines to Canada, the United Kingdom, the Netherlands, West Germany, and Ireland increased over the past 5 years by $1,409 million, $1,194 million, $492 million, $486 million, and $411 million, respectively. The improvement in net exports to these countries was: Canada, $898 million; United Kingdom, $1,046 million; Netherlands, $368 million; Ireland, $368 million; and West Germany, $337 million. Exports to Japan increased by $635 million while imports rose by $3,662 million, creating a net U.S. export loss of $3,027 million. U.S. net exports to Taiwan dropped by $506 million between 1979 and 1984. The increase in Taiwan imports can be explained by U.S.-owned firms deciding to locate overseas in order to benefit from cheap labor.

Between 1979 and 1984, annual exports of electronic components and accessories (SIC 367) increased by $3,586 million, but imports rose by $7,468 million over the same period. The potential trade-related employment decrease of 62,000 positions was more than offset by a demand-induced increase in domestic production which resulted in an overall employment increase of 150,400 jobs in this sector. The trend in the electronic components industry has been to ship domestically manufactured components such as semiconductors and integrated circuits to South Korea and Taiwan for finishing and assembly. These processes are extremely labor-intensive and can be more cheaply performed in low-wage countries. Usually, the final products are returned to the U.S. market. Annual net imports from South Korea rose by $347 million over the past 5 years; net imports from Taiwan increased by $311 million during that same period. Nevertheless, Japanese electronic components accounted for 61 percent of the net U.S. import increase in this sector.

Annual exports in the motor vehicle industry (SIC 371) nominally increased by $2,722 million during the last 5 years while imports rose by a whopping $24,330 million. Of the overall decline of 173,000 jobs in the automobile industry from 1979 to 1984, fewer than 97,000 could be related to increased imports. Annual net exports from Japan increased by $8,678 million during this period, but this influx constitutes only 40 percent of the overall gain in net imports for the motor vehicle sector. Net imports from Canada rose by $7,067 million, and net imports from West Germany increased by $1,375 million. Due to declining gasoline prices and other factors, U.S. consumption of mid-size and large automobiles has increased substantially. Canadian subsidaries of Chrysler and General Motors are mainly responsible for producing these vehicles. Rising new car prices and the switch to larger cars have boosted demand for Canadian-made replacement parts. Net imports of these parts have increased by more than $1.3 billion over the past 3 years although the U.S. still maintains a $1.0 billion trade surplus with Canada in this area.

The petroleum refinery products industry (SIC 291) witnessed an increase in yearly imports of $10,124 million during the period from 1979 to 1984 while imports of crude petroleum and natural gas (SIC 131) declined by $8,862 million. Large gains in crude prices since the mid 1970's have resulted in a decline in U.S. crude consumption. In 1979, refining capacity in the United States was 17.4 million barrels per day, and the utilization rate was 86.0 percent. For 1984, refining capacity dropped to 16.0 million barrels per day, and the utilization rate was only 76.2 percent. Weak prices for petroleum products over the last 4 years have forced the closing of many small, less efficient U.S. refineries. Refineries in Europe and the Western Hemisphere, operating in the face of excess world capacity, have benefitted from both the cost advantage provided by their use of heavier crude and, in some cases, from government support. Also, refined petroleum prices are not covered by OPEC cartel agreements. OPEC countries therefore effectively avoid their export quotas on crude oil by shipping refined petroleum at low prices.

In 1984, Venezuela accounted for 18.5 percent of U.S. gasoline imports and 25.2 percent of distillate imports. Other countries in the Western Hemisphere such as the Virgin Islands, Canada, and Mexico were responsible for 35.9 percent of gasoline imports and 44.5 percent of distillate imports. Additionally, the Netherlands refined 8.5 percent of U.S. imported gasoline and 9.7 percent of distillates. Imports of Dutch products have increased over 265 percent in the last 5 years.

When demand for products increases due to a rebounding economy, both imports and domestic production typically rise. Under these circumstances, a declining sectoral trade balance does not necessarily imply lost jobs. Employment losses are typically sustained in industries which are experiencing declines in comparative advantage through increasing costs or relative inefficiencies in the use of technology. When the economy is strong, jobs are created in other sectors to offset the losses from these industries. Although declining international competitiveness may have contributed to a drop in employment in the automotive sector, rising domestic demand created enough job opportunities in office and computing machines and electronic components to increase overall employment for these sectors from 1979 to 1984.

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

Country	1981	1982	1983	1983 III	1983 IV	1984 I	1984 II	1984 III	1984 Aug.	1984 Sept.	1984 Oct.	1984 Nov.	1984 Dec.	1985 Jan.
United States	2.6	-8.1	6.4	21.8	10.1	11.4	8.6	6.4	1.5	-7.0	-3.6	5.2	7.5	4.9
Canada	0.5	-10.0	5.7	18.5	13.8	2.4	3.3	13.1	-5.6	-24.9	-0.8	29.8		
Japan	1.0	0.4	3.5	14.0	10.3	13.5	11.6	6.1	8.5	-11.5	46.8	4.1	-4.8	
West Germany	-2.3	-3.2	0.4	4.9	9.0	2.5	-10.9	16.5	-27.1	-14.9	66.9	-22.0		
United Kingdom	-3.9	2.0	3.3	5.7	3.3	-2.4	-7.9	0.4	1.2	19.6	16.4	-2.3		
France	-2.6	-1.5	1.1	3.1	1.0	7.4	-4.0	9.5	9.3	-36.2	19.9	-16.5		
Italy	-1.6	-3.1	-3.2	-4.9	17.6	4.5	2.1	7.7	19.1	14.6	-25.7	-13.0		

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

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

Country	1982	1983	1984	1983 IV	1984 I	1984 II	1984 III	1984 IV	1984 Aug.	1984 Sept.	1984 Oct.	1984 Nov.	1984 Dec.	1985 Jan.
United States	6.2	3.2	4.0	4.4	5.0	3.7	3.6	3.9	5.5	4.3	4.3	2.7	2.3	2.4
Canada	10.8	5.8	3.7	4.2	5.7	2.7	3.1	3.3	1.9	2.9	2.0	5.8	6.4	10.7
Japan	2.6	1.8	2.3	3.6	3.6	1.0	1.2	3.5	-3.5	4.6	10.0	4.0	6.7	4.0
West Germany	5.3	3.6	2.0	3.0	2.8	2.0	0.5	2.9	0.2	1.4	7.3	2.5	1.3	
United Kingdom	8.6	4.6	4.7	6.1	4.4	3.0	5.5	5.9	12.5	6.2	7.7	3.5	2.6	
France	12.0	9.5	6.9	8.6	7.3	6.2	7.3	6.5	7.9	7.1	8.2	6.5	5.7	
Italy	16.4	14.9	8.9	11.1	11.1	10.4	8.0	5.9	8.2	3.5	4.2	5.1	13.2	10.9

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

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

Country	1982	1983	1984	1983 IV	1984 I	1984 II	1984 III	1984 IV	1984 Sept.	1984 Oct.	1984 Nov.	1984 Dec.	1985 Jan.	1985 Feb.
United States	9.7	9.6	7.5	8.5	7.9	7.5	7.4	7.2	7.4	7.4	7.1	7.2	7.4	7.3
Canada	11.0	11.9	11.3	11.1	11.4	11.4	11.2	11.1	11.8	11.3	11.2	10.8	11.2	
Japan	2.4	2.7	2.8	2.6	2.8	2.7	2.8	2.7	2.8	2.8	2.7	2.6		
West Germany	5.9	7.3	7.4	7.3	7.2	7.4	7.5	7.3	7.5	7.4	7.3	7.3	7.4	
United Kingdom	12.2	13.1	13.4	13.0	13.2	13.3	13.6	13.5	13.8	13.5	13.4	13.6	13.6	
France	8.7	8.8	10.0	9.1	9.5	10.0	10.2	10.3	10.2	10.2	10.3	10.4		
Italy	4.8	5.3	5.6	5.6	5.5	5.6	5.5	5.6						

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

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

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

Country	1981	1982	1983	1984	1984				1984					1985
				IV	I	II	III	IV	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
United States-1/	-27.5	-31.6	-57.5	-77.6	-104.8	-104.3	-128.8	-94.0	-102.0	-135.6	-94.8	-104.4	-82.8	-106.8
Canada	6.1	14.4	14.4	14.8	14.4	16.4	16.4	17.6	13.2	18.0	20.4	16.8	13.2	
Japan	20.1	18.6	31.5	34.8	40.0	43.2	40.4	53.6	31.2	50.4	49.2	61.2	52.8	
West Germany	11.9	21.1	16.6	12.4	18.8	12.8	20.0	23.6	20.4	21.6	26.4	26.4	20.4	
United Kingdom	7.9	4.1	-0.8	0.8	-0.4	-6.8	-8.4	-6.0	-9.6	-12.0	-13.2	-2.4	-2.4	
France	-9.3	-14.0	-5.9	-0.8	-6.0	-4.8	1.6	-1.2	4.8	1.2	-4.8	1.2	-1.2	
Italy	-15.9	-12.8	-7.9	-3.2	-9.6	-12.8	-6.4		-9.6	-7.2	-12.0	-26.4		

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

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

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

Item	1982	1983	1984	1983	1984				1984					1985
				IV	I	II	III	IV	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
Commodity categories:														
Agriculture	21.6	20.0	18.4	5.4	5.2	4.4	4.0	4.6	1.4	1.6	1.2	1.6	1.8	1.4
Petroleum and selected products, unadj	-54.6	-49.1	-52.5	-13.2	-13.1	-13.4	-13.2	-12.8	-4.2	-4.1	-4.6	-4.5	-3.7	-3.7
Manufactured goods	-4.9	-31.3	-78.9	-11.2	-19.0	-18.1	-25.1	-17.5	-6.6	-8.1	-5.7	-6.4	-5.4	-6.6
Selected countries:														
Western Europe	7.6	1.2	-14.1	0.2	-3.6	-2.9	-4.5	-2.6	-1.0	-1.6	-.3	-1.6	-.7	-1.6
Canada	-12.6	-12.1	-20.1	-3.7	-4.3	-5.1	-5.3	-5.7	-1.2	-2.0	-1.6	-2.0	-2.1	-1.1
Japan	-17.0	-19.6	-33.8	-6.2	-7.0	-7.8	-11.0	-7.9	-2.9	-3.6	-2.8	-2.6	-2.5	-3.4
OPEC, unadj	-8.3	-8.2	-12.3	-3.1	-2.6	-3.7	-3.7	-2.5	-1.3	-1.0	-1.0	-.9	-.6	-.6
Unit Value (per barrel) of U.S. imports of petroleum and selected products, unadj	$31.48	$28.60	$28.11	$28.43	$28.31	$28.45	$27.98	$27.69	$27.90	$27.64	$27.79	$27.78	$27.49	$27.19

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

Money-market interest rates
(Percent, annual rate)

Country	1982	1983	1984	1983 IV	1984 I	1984 II	1984 III	1984 IV	1984 Sept.	1984 Oct.	1984 Nov.	1984 Dec.	1985 Jan.	1985 Feb.
United States	12.4	9.1	10.4	9.4	9.7	10.9	11.5	9.4	11.3	10.4	9.2	8.6	8.1	8.7
Canada	14.4	9.5	11.3	9.5	10.0	11.4	12.5	11.2	12.2	12.0	11.1	10.4	9.7	10.6
Japan	6.8	6.8	6.3	7.6	6.4	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3
West Germany	8.8	5.7	6.0	6.1	5.9	6.0	6.0	5.9	5.8	6.1	5.9	5.8	5.8	6.1
United Kingdom	12.2	10.1	9.9	9.4	9.2	9.2	11.1	10.1	10.8	10.6	9.9	9.7	11.6	13.7
France	14.6	12.4	11.7	12.3	12.4	12.3	11.4	10.7	11.0	10.8	10.5	10.7	10.4	10.6
Italy	20.0	18.0	17.1	17.5	17.5	17.0	16.8	17.0	17.3	17.1	17.1	16.9	15.8	15.8

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

Source: Statistics provided by Federal Reserve Board.

Effective exchange rates of the U.S. dollar, unadjusted and adjusted for inflation differential
(Index numbers, 1980-82 average=100; and percentage change from previous period)

Item	1982	1983	1984	1983 IV	1984 I	1984 II	1984 III	1984 IV	1984 Sept.	1984 Oct.	1984 Nov.	1984 Dec.	1985 Jan.	1985 Feb.
Unadjusted:														
Index number	109.8	114.2	122.3	116.4	117.2	118.8	125.1	128.2	127.3	128.5	126.8	129.4	132.0	136.4
Percentage change	10.4	4.0	2.5	0.1	0.7	1.4	5.3	2.5	2.7	0.9	-1.3	2.1	2.0	3.3
Adjusted:														
Index number	109.8	112.4	118.3	114.3	114.4	114.9	120.8	123.0	122.6	123.6	121.6	123.9	126.2	130.8
Percentage change	9.0	2.4	1.9	0.2	0.1	0.5	5.1	1.8	2.3	0.8	-1.6	2.2	1.9	3.6

Note.--The foreign-currency value of the U.S. dollar is a trade-weighted average in terms of the currencies of 15 other major nations. The inflation-adjusted measure shows the change in the dollar's value after adjusting for the inflation rates in the U.S. and in these other nations; thus a decline in this measure suggests an increase in U.S. price competitiveness.

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

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