INTERNATIONAL ECONOMIC REVIEW

DECEMBER 1985

In This Issue:

OFFICE OF ECONOMICS

U.S. INTERNATIONAL TRADE COMMISSION

WASHINGTON, D.C. 20436

OFFICE OF ECONOMICS
John W. Suomela, Director

The INTERNATIONAL ECONOMIC REVIEW is a monthly staff publication of the Office of Economics, U.S. International Trade Commission. The REVIEW is not an official Commission publication: the opinions and conclusions it contains are those of the authors, and do not necessarily reflect the views of the Commission or of any individual Commissioner. The REVIEW is produced as part of the Commission's international trade monitoring program. Its purpose is to keep the Commission informed about significant developments in international economics and trade, and to maintain the Commission's readiness to carry out its responsibility to provide technical information and advice on international trade matters to policymakers in the Congress and the Executive branch. The REVIEW is available to Government officials outside the Commission on a request basis. Inquiries or comment on items appearing in the REVIEW may be made directly to the author, or to:

Editor, International Economic Review
Trade Reports Division/OE, Room 323
U.S. International Trade Commission
701 E Street NW, Washington, DC 20436
Telephone (202) 523-1995

CONTENTS

International Economic Indicators

Yearend economic forecasts point to moderately favorable U.S. and global growth for 1986. Business analysts, half of them expecting a recession in 1986 only 3 months ago, now all but rule out an economic downturn next year. With unusual unanimity, business forecasters predict that U.S. real GNP growth will be around 3.0 percent in 1986. The Congressional Budget Office forecasts 3.6 percent and the Administration 4.0 percent for the growth of U.S. real GNP in 1986. In 1985, however, the Administration's projection for a 3.0-percent real GNP growth is unlikely to materialize. Even with the strong 4.3-percent growth of real GNP during the third quarter, the U.S. economy would need an improbable uptick of 5.7 percent during the fourth quarter to achieve the 3.0 percent average real growth for 1985.

Many analysts are hopeful that reduction in the Federal deficit under the Gramm-Rudman-Hollings budget-balancing plan will lead to lower interest rates next year. This is expected to stimulate consumer and capital spending and make the dollar cheaper, a necessary condition for forcing a retreat in the massive U.S. trade deficit. Critics say that this new policy is fraught with dangers. Drastic budget cutting is untested by experience and has never been subject to serious theoretical scrutiny. Some analysts predict that vigorous public resistance provoked by cuts in the budget next year will lead to a scratching of the plan. Some predict that budget cuts will lead to a large tax increase that will halt the U.S. economic recovery. Political pressure for the budget-balancing law came in part from Western trading partners who have criticized the United States for permissive fiscal policies that menace global economic health.

Despite budget problems, the United States remains a major source of funds for financing development in the poor countries, maintaining multilateral organizations, and providing humanitarian aid. U.S. contributions for development and for the maintenance of multilateral organizations will exceed 1984's $8.7 billion in 1985, according to the Agency of International Development. U.S. contributions totaled $8.1 billion in 1983. Japan increased its contributions from $3.8 billion in 1983 to $4.4 billion in 1984. France's contributions remained $3.8 billion in both years. West Germany gave $2.8 billion in 1984, a reduction from 1983's $3.2 billion. Contributions from the United Kingdom amounted to $1.4 billion in 1984, down from $1.6 billion in 1983. As a result of significant U.S. aid to relieve the African famine this year, U.S. Government financed humanitarian food donations will be over one billion dollars in 1985.

Industrial production

U.S. industrial production in November grew 0.4 percent following a revised 0.4 percent decline in October. Showing a seesawing pattern of minor expansions and contractions, U.S. industrial output has changed little during the past 3 months. Factory utilization rate in the United States, however, declined for the fifth straight month to 80.2 percent in October. U.S. Government sources put the blame largely on imports.

The annual rates of industrial growth in the major industrialized countries, calculated by comparing the latest available monthly output with the output in the corresponding month of the previous year, were as follows: Canada, 3.8 percent; France, 0.0 percent; Italy, -0.1 percent; Japan, 1.8 percent; the United Kingdom, 5.6 percent; the United States; 1.8 percent; and West Germany, 2.6 percent.

U.S. military research accounts for 70 percent of U.S. Government spending on industrial R&D, according to the General Accounting Office (GAO). The corresponding figures are 15 percent for West Germany and only 5 percent for Japan. Over a 3-year period, the United States spent $225 million on electronics research, whereas Japan spent only $45 million. This situation, however, does not signify an uncontested U.S. superiority in industrial R&D. By extending U.S. defense contracts to European and Japanese firms, U.S. military research bolsters the international competitiveness of both U.S. civilian industries and their foreign competitors. There may also be a sizeable portion of U.S. military research that cannot be applied in civilian industries.

Investment

U.S. investments (direct and financial) in the European Community (EC) declined by $77.5 billion over 1981-1984, while EC investments in the United States increased by $103.1 billion over the same period, according to data recently released by the EC Secretariat. In 1983-84, capital exports from the EC to the United States exceeded capital transfers within the EC. In addition to higher rates of growth and interest in the United States over the period, and European confidence in the U.S. economy, a decline in the rate of return on investments in Europe, and restrictions on the capital movements within the EC can be cited as reasons.

Employment

The rate of unemployment in the United States (on a total labor force basis including military personnel) was 7.0 percent in October, the same as in September. The national statistical offices of other countries reported the following unemployment rates for October: Canada, 10.3 percent; France, 10.8 percent; Italy, 13.1 percent; the United Kingdom, 13.1 percent; and West Germany, 9.2 percent. Japan's unemployment rate was 2.7 percent in September. (For foreign unemployment rates adjusted to U.S. statistical concepts, see tables at the back of this issue.)

External balances

The deficit in U.S. merchandise trade for the first 10 months of 1985 totaled $118.1 billion, 12.4 percent greater than the deficit during the corresponding period of 1984.

Negotiations between the authorities of the European Community (EC) and the Japanese Government over quantitative targets for short-term EC import volumes from Japan so far have yielded no agreement. Japan's annual surplus in trade with the EC exceeded $10 billion during the past 2 years.

Developing country export earnings are declining in dollar terms and foreign debts are growing even though new private lending to the developing world is very low. Latin America's debt totals $350 billion at present.

Prices

In October, the U.S. consumer price index rose 0.3 percent following 0.2-percent increases for each of the five preceeding months. The rate over the 1-year period ending in October was 4.2 percent in Canada, 5.0 percent in France, 8.5 percent in Italy, 5.4 percent in the United Kingdom, 3.2 percent in the United States, and 1.7 percent in West Germany. The rate over the 1-year period ending in September was 1.7 percent in Japan.

Consumer prices in the 24 member nations of the Organization for Economic Cooperation and Development (OECD) rose an average of 4.3 percent over the 12-month period from October 1984-September 1985. This was the lowest annual rate since December 1969.

World market prices of industrial commodities have fallen 30 percent since March 1984 in terms of the 5 leading industrial nations' currencies. A glut in many vital commodities may be one of the reasons.

Forecasts

Analysts agree that U.S. interest rates will play a critical role in causing or avoiding a new U.S. and consequently global recession in 1986. A decline in interest rates can stimulate spending on consumption and investment and lead to a reduction in the trade deficit. But some analysts say that an inability of the U.S. Government to reduce the Federal budget deficit, a rekindled inflation and a flight of foreign investors from the dollar could force U.S. authorities to keep interest rates damagingly high in 1986.

World trade will grow, at best, by 3 percent in 1985, compared with 9 percent in 1984, according to the General Agreement on Tariffs and Trade (GATT). The organization has also reported a growing trend towards bilateral trade arrangements, managed trade, and competitive export subsidies in world trade.

Predictions about the future of the U.S. trade imbalance with Japan contrast sharply. The president of a major Japanese corporation said that the imbalance will be eliminated during the next 3-5 years. But there is a widespread belief among both U.S. and Japanese observers that the imbalance will not be corrected for a long time. Japan's economy will by necessity remain export oriented and the measures to open its domestic markets to imports will bring results slowly.

The London-based Middle Bank predicts that real GNP in the United Kingdom will rise 2.5 percent in 1986 and 2.0 percent in both 1987 and 1988. The Bank projects a steady decline in U.K.'s consumer price inflation to slightly over 2 percent by 1988. Official U.K. sources foresee 5.5 percent inflation by the end of this year and 3.75 percent by the end of next year.

There is an opinion, widely shared internationally, that despite the relief action initiated by the United States for debt-ridden countries, only an international monetary reform accompanied by a concerted effort by the industrialized countries to stimulate growth in the debtor countries can lead to a solution of the world debt problem. Analysts suggest that the issue of stronger coordination between developed country economic policies and an international monetary reform will move to the limelight in 1986.

International Trade Developments

Gorbachev's economic strategy takes shape

Since coming to power in March, Gorbachev has publicly criticized economic policy under Brezhnev and admitted that Soviet economic growth has slowed since the late 1970's. In his speeches, especially a major speech on science and technology in June, Gorbachev has stressed the need for intensification, modernization, and efficiency. In Soviet terminology, intensification means achieving growth through increased factor efficiency rather than by increasing inputs of land, capital, and labor, i.e., extensive methods. As Gorbachev has pointedly noted, intensification is not a new goal and much remains to be done in improving the efficiency of the Soviet economy. Under the heading of modernization, Gorbachev includes computerization and robotization of the Soviet economy as well as the reequipping of Soviet factories with more productive, energy-saving equipment.

The draft of the guidelines for the Twelfth 5-Year Plan (1986-1990) and for the period through the year 2000 that was published in Pravda on November 9 was a revision of an earlier draft that Gorbachev found unacceptable. The drafting of the plan was probably well under way when Gorbachev became General Secretary. In a speech presenting the revised version of the plan to the Plenum of the Central Committee of the Communist Party on October 15, Gorbachev explained that drafting the plan had been difficult due to the technical complexity of the task and because some cadres still adhered to extensive development strategies. The revised plan, which Gorbachev said was "mainly" in keeping with the Party's requirements, will be ratified at the Party Congress in February 1986.

The plan calls for Soviet national income to increase by 19-22 percent by 1990 and to almost double by the year 2000 through increases in labor productivity. These goals imply average annual growth rates of roughly 4 percent, an increase over the 3.2 percent projected for the Eleventh 5-Year Plan (1981-1985). Similarly, industrial output is to be increased by 21-24 percent by 1990 and to double by the year 2000.

Key elements of Gorbachev's economic strategy include changes in investment policy, an overhaul of planning and administration, and greater attention to what he terms the "human factor."

Gorbachev's investment strategy has two critical elements. First, investment in the industrial sector is to be concentrated in industries he views as critical to the scientific-technological revolution--machine tools, electronics, robotics, and instruments. Second, the plan mandates a shift away from the construction of new factories to the reconstruction and retooling of existing factories. Half of all capital investments in industrial construction is to be devoted to the latter purpose and the rate at which obsolete machinery and equipment is withdrawn from use is to be doubled during 1986-1990. These policies are intended to reduce downtime in Soviet factories and the amount of fuel and other raw materials used in production.

The details of the changes that Gorbachev is seeking in economic management and planning remain sketchy, but they combine both decentralization and centralization. The plan calls for an increase in the rights and responsibilities of the basic economic units in industry--enterprises and production associations, which are small groups of enterprises. Managers are to receive fewer targets (indices) from the ministries, and labor collectives are to have greater independence in using funds left at the disposal of enterprises. These changes imply a corresponding reduction in the size and role of the ministries. At least in theory, their focus is to be shifted from detailed supervision of enterprises to what Western management specialists would call strategic planning. At the same time, new organizations are to be created to manage groups of related sectors. Improvements in planning and price setting are also mandated.

The plan also touches upon a third element of Gorbachev's economic strategy: the human factor. It stresses the need to improve labor discipline and technical qualifications among both workers and managers and to link remuneration more closely with results. Like those of his predecessors, Gorbachev's speeches are filled with exhortations for Soviet citizens to work harder and better. However, Gorbachev's actions suggest a qualitatively new approach. He has aggressively pursued the campaign against corruption among party and government officials and workers that was begun under his patron, former General Secretary Andropov, but reportedly deemphasized by Chernenko. In addition, a number of ministers and other high-level officials, including the head of Gosplan, the organization responsible for planning the Soviet economy, have been dismissed. Some of the personnel changes may well have been motivated by the ill health of the incumbents and Gorbachev's need to place allies in key positions, but there does seem to be a new emphasis on technical competence and hard work as qualifications for the top jobs in the Soviet system.

A profile of U.S. trade

The significance of leading trading countries in the world economy is measured by their share in world trade. An examination of the shares of major trading blocks shows that the highest share levels were achieved by the EC, but that the EC share is slipping in the favor of the United States and Japan. One might conclude that, although the EC has been dominant in world trade, it has been losing in competitiveness compared with the United States and Japan. Japan's gain in trade market share reflects the determinantion of Japanese exporters to capture market share and to use the benefits of mass production. The U.S. gain reflects its success in trade with developing countries, and its competitive advantage in technologically intensive products. Such goods predominate in U.S. exports to industrial and developing countries, while the EC and Japan supply primarily advanced and low-technology products.

Table 1, and graphs 1-2 show market shares 1/ of specified major trading countries and areas with their trading partners grouped as: world, industrial countries, oil-exporting countries, and non-oil developing countries, from 1966 to 1984.

1/ A market share is a country's exports expressed as a percent of its trading partners' imports.

Table 1.--Market shares 1/ of specified principal trading partners, in selected years within the period 1966-1984

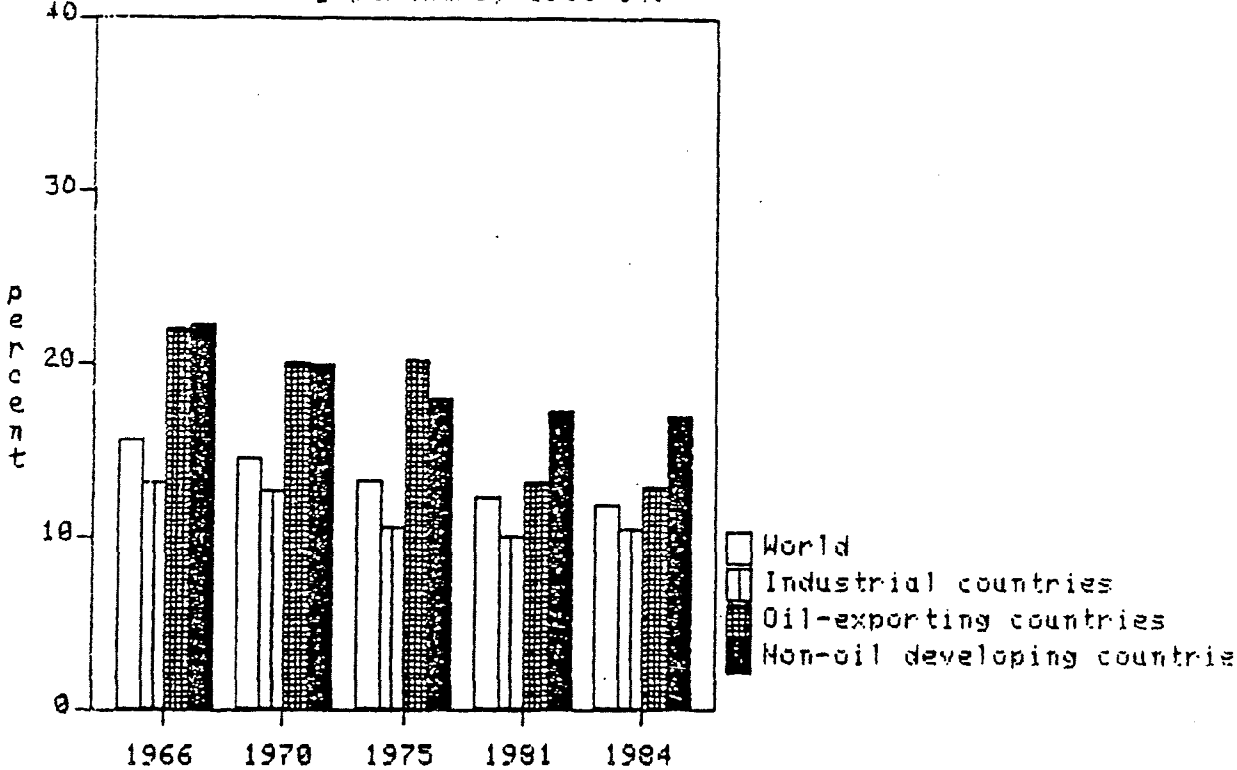
Trading partners	1966	1970	1975	1981	1984 2/
	Percent				
Industrial countries:					
World	71.1	73.7	69.4	63.8	65.6
Industrial countries	67.7	70.3	63.2	61.1	67.9
Oil-exporting countries	81.0	79.0	89.2	72.7	74.2
Non-oil developing countries	69.4	72.3	65.6	57.3	58.6
United States:					
World	15.6	14.5	13.2	12.2	11.8
Industrial countries 3/	13.1	12.6	10.5	10.0	10.4
Oil-exporting countries 4/	22.9	20.0	20.2	13.1	12.8
Non-oil developing countries	22.2	19.9	17.9	17.2	16.9
EC:					
World	36.4	38.0	36.7	32.1	31.6
Industrial countries	36.3	37.9	35.8	33.3	35.0
Oil-exporting countries	43.9	41.1	44.7	37.2	37.4
Non-oil developing countries	30.6	31.9	28.7	22.1	21.2
Canada:					
World	5.1	5.6	4.2	3.8	4.8
Industrial countries	5.6	6.3	4.7	4.6	6.2
Oil-exporting countries	1.7	1.8	1.3	1.3	1.4
Non-oil developing countries	1.9	2.1	1.5	1.3	1.5
West Germany:					
World	10.3	11.5	11.0	9.2	9.3
Industrial countries	10.7	11.7	10.6	9.7	10.5
Oil-exporting countries	10.6	9.9	13.2	9.7	9.1
Non-oil developing countries	7.8	9.1	8.7	6.3	6.2
Japan:					
World	5.0	6.5	6.8	7.9	9.2
Industrial countries	3.3	4.3	3.7	5.4	7.5
Oil-exporting countries	7.9	10.1	16.2	14.5	14.9
Non-oil developing countries	8.4	11.2	10.6	10.9	13.0

1/ Market shares are defined as a country or area's exports expressed as a percent of trading partners' total imports.
2/ Estimated.
3/ United States, Canada, Australia, Japan, New Zealand, Austria, Belgium, Denmark, Finland, France, Germany, Iceland, Ireland, Italy, Netherlands, Norway, Spain, Sweden, Switzerland, United Kingdom.
4/ Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, United Arab Emirates, Venezuela.

Source: Compiled from IMF Official Statistics.

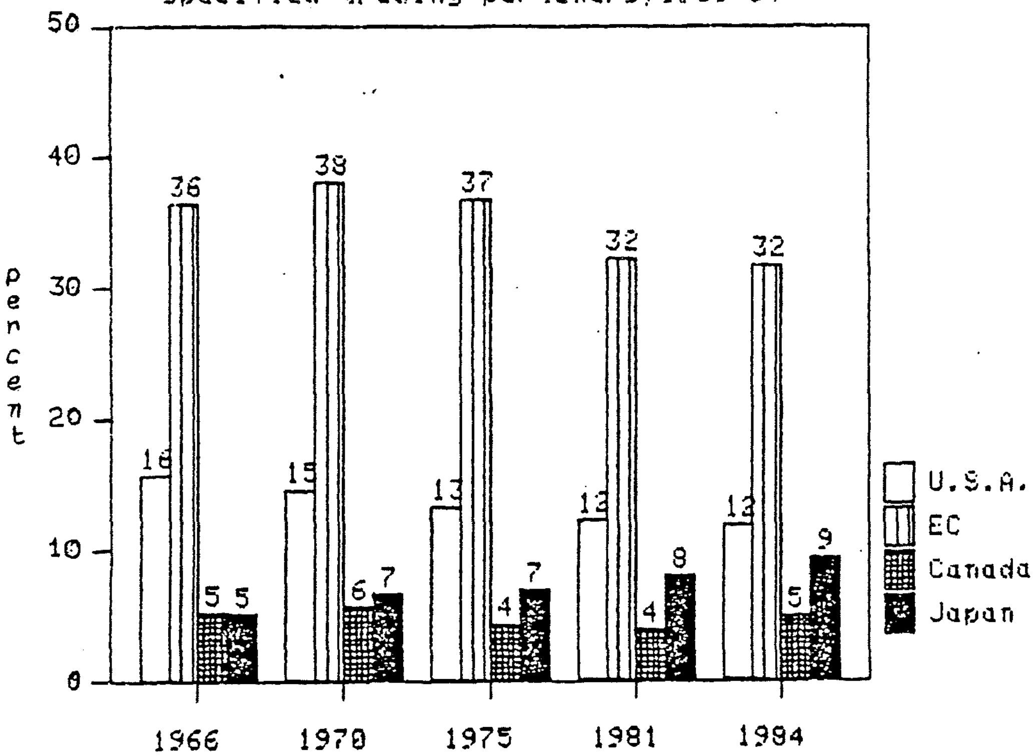
Graph 1

U.S.market shares in trade with specified trading partners, 1966-84.



Graph 2

Market shares in world trade of specified trading parteners,1966-84



The United States accounted for 15.6 percent of world trade in 1966 and 11.8 percent in 1984. The decline in the U.S. market share (3.8 percent) was lower, however, than the decline in the market share of the EC (4.8 percent). and also lower than the decline in the market share of the industrial countries as a whole (5.5 percent). 1/ Canada and West Germany suffered a lower loss in their world trade market shares, 0.3 and 1.0 percents respectively. In contrast, Japan's market share in world trade increased by 4.2 percent, from 5.0 in 1966 to 9.2 percent in 1984.

The EC accounted for a larger share in world trade than the United States, 36 percent in 1966 and 31.6 percent in 1984, a decline of 4.8 percent. The EC market share declined relatively slightly with industrial countries (1.3 percent); however the decline was steeper in the EC trade with oil-exporting countries (6.5 percent) and with non-oil developing countries (9.4 percent).

Industrial countries accounted for the bulk of world trade, 71.1 percent in 1966 and 65.6 percent in 1984, a decline in this group's market share of 5.5 percent. Although inter-trade increased slightly (0.2 percent), the group experienced steep declines in its trade with both oil-exporting countries (6.8 percent) and non-oil developing countries (10.8 percent).

Canada accounted for 5.1 percent of world trade in 1966 and 4.8 percent in 1984. While Canada's market share in world trade declined slightly, it's share in trade with industrial countries increased (0.6 percent). Canada's loss of market share in trade with oil-exporting and non-oil developing countries was relatively small.

West Germany's market share in world trade declined from 10.3 in 1966 to 9.3 percent in 1984. Germany's loss of market shares with the other three groups ranged from less than 1 percent to 1.6 percent.

Japan's market share expanded with all the four groups. Japan's market share in world trade expanded from 5.0 percent in 1966 to 9.2 percent in 1984 (4.2 percent). Japan's trade expanded by 4.2 percent in trade with industrial countries, 7.0 percent in trade with oil-exporting countries, and 4.6 percent in trade with non-oil developing countries.

Tables 2-3 show the percentage increase in the export shares of the United States, the EC, and Japan by classes of goods, and in trade of technology-intensive goods. The U.S. share in trade with industrialized countries increased by about 1 percent in capital goods and consumer durables but declined in trade of primary goods, consumer goods, and foodstuffs. The EC share declined in all shown classes of goods, the decline was greatest in trade in capital goods and consumer durables (5.7 percent) and consumer goods (2.7 percent). Japan experienced a relatively large expansion in its market share in capital goods and consumer durables (16.6 percent), but had a significant decline in trade of consumer goods (9.3 percent). U.S. share in trade with developing countries grew in all classes of goods except foodstuffs. The EC's share also grew except in consumer goods. The largest

1/ See footnote 3 of table 1 for listing of industrial countries.

Table 2.--Percent change in export trade of specified trading partners by classes of goods, 1966-1984.

	Primary products	Capital goods and consumer durables	Consumer goods	Foodstuffs
		Trade with industrialized countries		
U.S.	-1.1	+0.9	-0.4	-0.7
EC	-0.3	-5.7	-2.7	-0.9
Japan	-2.2	+16.6	-9.3	-1.8
		Trade with developing countries		
U.S.	+0.1	+0.2	+0.7	-0.4
EC	+1.2	+4.9	-0.1	+1.2
Japan	-0.9	+9.3	-7.1	-0.1

1984 figures are estimates.
Source: Calculated from data published in Intereconomics, March/April 1985

Table 3.--Percent changes in export trade of specified trading partners in technology-intensive goods, arranged in decending order by degree of intensity 1966-1984.

	Technology -intensive	High-technology	Advanced technology	Low-technology
		Trade with industrialized countries		
U.S.	+2.4	+3.5	-1.1	-3.7
EC	-0.6	+0.1	-0.7	-8.9
Japan	-0.1	+1.2	+0.7	+3.5
		Trade with developing countries		
U.S.	+2.7	+2.5	+0.2	-2.2
EC	+1.5	+0.8	+0.7	+5.7
Japan	+0.5	+0.9	+0.6	+0.7

1984 figures are estimates.
Source: Calculated from data published in Intereconomics, March/April 1985.

increase in the EC share with developing countries was in trade in capital goods and consumer durables (4.9 percent). Japan's market share with developing countries declined in all classes of goods except in trade in capital goods and consumer durables which grew by 9.3 percent.

The U.S. share in trade with industrial countries increased in technology-intensive and high-technology goods but decreased in low-technology goods, an indication of U.S. comparative advantage and the shift towards the production and trade of technology-intensive products. The EC share in these products declined in almost all categories, while Japan seems to have gained in exports of low technology products more than in high technology products. U.S. trade with developing countries in these products increased in all categories except low-technology goods. The EC's gain was greater in low-technology goods, while Japan's gain was diversified but relatively small.

Prospects for U.S. technology transfer to China improve

Two events took place this month that were instrumental in clearing the way for a significant increase in U.S. technology exports to China. On December 11, the period required by law for congressional review of the U.S.-Chinese nuclear cooperation agreement came to an end and the pact became effective. This means that U.S. companies will be able to compete on contracts to sell nuclear equipment and technology to China. However, although both the House and Senate passed a resolution approving the agreement, a number of members have continued to express their opposition. The second event was an announcement by COCOM (the international Coordinating Committee for Multilateral Export Controls) that 27 of the 120 categories of commodities on its control list will no longer be subject to clearance before sale to China. The export items removed from COCOM control include certain types of computers, telecommunications equipment, semiconductor production equipment, and scientific instruments.

Estimates of the potential value of U.S. sales of nuclear equipment, technology, and materials to China vary considerably. If the Chinese import all of the 10 large reactors they want to build, rather than gradually developing their own manufacturing capability, the value of the actual nuclear exports by all suppliers might amount to about $4 billion over a decade. Exports of design and engineering services, electrical generating equipment, transformers, and other plant components could raise the figure to $7 billion. The other countries from which China can purchase complete nuclear power plants are Canada, France, the United Kingdom, West Germany, Sweden, Japan, and the Soviet Union, but the greatest competition for U.S. firms is likely to be France, West Germany, and, in the near future, Japan. China and Japan have not yet concluded negotiations on a nuclear cooperation agreement. In addition, major components for nuclear plants can be manufactured by Holland, Italy, Spain, Brazil, and Czechoslovakia. The awarding of contracts by China may depend to a large extent upon cost and the financing arrangements. For well over a year, Framatome of France and the General Electric Co. of Great Britain have been expected to conclude final arrangements on a contract to construct China's first large nuclear power facility, the two-reactor plant at Daya Bay in Guangdong Province. However, these negotiations are currently stalled over China's demand for an overall 15-percent price cut.

The effect the new COCOM rules will have on U.S. exports to China are far more certain and immediate. Earlier this year, the United States instituted several procedural changes that have expedited its processing of the large number of applications for licenses to sell advanced equipment and technology to China. However, most U.S.-approved licenses still required the approval of COCOM, which meant that U.S. technology sales to China have remained subject to lengthy delays due to the backlog of applications that COCOM has accumulated. During 1984 alone, COCOM received applications to review 3,200 sales to China from its member countries. COCOM's processing of applications is slow partly because its staff is small, but also because its unanimity rule requires that every member country (the NATO countries except Iceland plus Japan) must approve each sale subject to its review. With the removal of 27 categories of exports to China from the COCOM control list, the increase in U.S. technology transfer to this market should become apparent shortly.

<u>New trade round moves closer after annual meeting of the GATT</u>

The annual meeting of the General Agreement on Tariffs and Trade (GATT) ended one step closer to the beginning of a new round of multilateral trade negotiations. On November 28, the 90 member nations of the GATT agreed to convene a committee to prepare the negotiations scheduled to begin in the fall of 1986.

A compromise on the contentious issue of trade in services--such as insurance, banking and telecommunications--paved the way for the consensus decision to set up a preparatory committee in January. The U.S. objective regarding services is to negotiate a comprehensive set of rules to govern international trade in services. The United States first proposed GATT negotiations on services alongside of goods trade in 1982, but a group of developing countries has consistently opposed the U.S. proposal.

At the annual GATT meeting in November, five Third World countries--Brazil, India, Yugoslavia, Argentina and Egypt--continued to oppose the inclusion of services in future GATT talks. In response, with the support of the majority of the participants, the United States prepared ~~to~~ call for a vote to force the new round forward. This break with GATT's tradition of consensus decisionmaking led the organization's chairman to negotiate behind the scenes to ward off the vote and seek a compromise. The result was a vaguely worded communique, agreed to by all GATT participants, that called for the preparatory committee to discuss "the subject matter, modalities for, and participation in the multilateral trade negotiations." No preconditions were imposed on the scope of the talks. The agreement mandated the preparatory committee to prepare an agenda for the new trade round by mid-July 1986. This outline would subsequently be submitted to the GATT ministerial-level meeting scheduled in September 1986. (An existing GATT committee that has been exchanging information on trade in services will continue to operate and will not preclude discussions on services within the preparatory committee.)

Both sides claimed they had succeeded in their aims. The United States announced that the agreement represented a commitment to discuss everything, including services. On the other hand, the Brazilian ambassador interpreted the communique as meaning that nothing had been decided. He stated, with the support of other developing countries, that "We have succeeded in having a preparatory committee formed without any preconditions, and that is what we set out to do. There is no change in our position, which is that GATT is about trade in goods, not services."

No substantive issues were thus resolved. The compromise on services, while it opened the way for the consensus decision to set up a preparatory committee, has not closed the issue on trade in services. The United States has stated that it will pursue bilateral trade pacts, such as the U.S.-Israel Free Trade Agreement and the ongoing discussions with Canada, rather than participate in GATT negotiations that do not incorporate services. Regardless of the lack of substantive agreement, the agreement on procedure signals a willingness among the participants to seek compromises. Since the scope of this round--including such controversial topics as trade in agricultural goods and export subsidies in addition to services--will be much wider than previous rounds, compromise will play a vital role in accomplishing any forward movement.

Growth versus austerity in Latin American debtor countries

Latin American debtor countries have exhibited many similarities in their economic performance, policies, and accomplishments while they struggle to resolve their debt crisis (IER, March, 1985). More recently however, these countries appear divided on how much austerity they should accept in exchange for foreign financial assistance.

Latin American countries generally cooperate with their foreign creditors in order to maintain normal political and commercial relations in the hope of an ultimate financial recovery. However some--such as Brazil, Columbia, Peru, and Venezuela--insist on limiting their current sacrifices and following a growth-oriented policy. Given the rapid population growth in Latin America, economic growth is necessary for controlling the mounting social pressure in these countries. That is why President Garcia of Peru hit a responsive note when, earlier this year, he began limiting debt service payments to 10 percent of his country's export earnings. More recent developments indicate that Mexico and Brazil--the two most indebted Latin American countries--are drifting toward opposing sides of the "growth versus austerity" issue.

Mexico.--In his November 15 annual budget message, Mexican President Miguel de la Madrid announced that he intends to embrace the austerity measures recommended by foreign bankers and the IMF. He said that in 1986 the Mexican economy would grow by no more than 1 percent and may even shrink by as much as 1 percent. This compares with this year's projected growth rate of 3.9 percent and a 3.7-percent growth rate attained in 1984.

The slowdown, de la Madrid said, is necessary to reduce Mexico's budget deficit and to restrain inflation. Neither diminished in 1985 as expected. Severe cuts in public spending and new taxes would lower the budget deficit in 1986 to 4.9 percent of the GDP. (This year, Mexico's budget deficit is expected to account for 9.6 percent of its GDP, exceeding significantly the stipulated 5.5 percent.) Inflation is targeted to decline from 60-65 percent in 1985 to 40-50 percent in 1986.

The Mexican President's budget message was reportedly preceded by an intense struggle between a fiscally conservative group and a more politically oriented pro-growth group within the government. Although the conservative view has apparently prevailed, the issue remains highly controversial. Following the President's budget pronouncement, demonstrators took to the streets chanting "we pay or we eat," echoing political opposition demands to limit or suspend debt servicing. The government rejects this idea, maintaining that unilateral action would have disastrous consequences for Mexico.

Suffering from declining oil revenues, serious damage caused by the September earthquakes, and shortcomings in economic performance (<u>IER</u>, October 1985), Mexico is in great economic distress, and social pressures are mounting. Notably, workers' purchasing power has been sliced by one third since 1982. Already burdened by a $96 billion foreign debt, the Administration declared that its disaster-stricken country needed $4 billion in new loans during 1986.

While a model debtor in years following the 1982 debt crisis, Mexico this year failed to comply with specified conditions for foreign financial support. On these grounds, in September, the IMF revoked a 3-year loan agreement with Mexico (1983-85). The recent Mexican budget proposal is apparently intended to regain the trust of the IMF at the threshold of new credit negotiations.

<u>Brazil</u>.--Unlike the Mexicans, Brazil's new Government--in office only since March--is unwilling to carry out policies that would bring about economic stagnation. While proclaiming its readiness to honor the country's $104 billion foreign debt, President Jose Sarney is committed to allow the economy to grow at least 5 percent annually in years to come. This is the rate needed to create enough jobs for the 1 million Brazilians who enter the work force each year.

The Sarney Government inherited from its predecessor a country weakened by a severe 3-year long recession (1981-83) from which it just began to emerge in 1984. When Sarney took over, Brazil was also burdened with the largest foreign debt among all developing countries, the Federal budget was out of control and inflation ran at an annual 220 percent.

In the last weeks of the outgoing administration the IMF suspended the release of $1.5 billion under its 3-year financial support agreement with Brazil (1983-85). Explaining its action, the IMF cited Brazil's failure to meet agreed-upon conditions of fiscal and monetary discipline. Unlike Mexico, Brazil had been frequently out of compliance with the IMF accord under its previous administration.

However, determined to fuel the country's incipient recovery, the present government also declined to cut the fiscal deficit as IMF officials have urged. Inflation, while slowing somewhat in the summer months of 1985 flared up again in the fall, continuing at an annual rate of more than 200 percent. These developments led to the postponement of new credit negotiations with the IMF, and the long-awaited rescheduling of Brazil's $45 billion commercial debt.

Late in November, Brazil's Finance Minister met in Washington with the IMF Managing Director and the U.S. Secretary of the Treasury. Following discussions, the Minister announced that although his government will abandon enlisting the IMF in efforts to manage the country's foreign debt, he expects that agreements with commercial banks on debt rescheduling will not be jeopardized.

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

Country	1982	1983	1984	1984		1985			1985					
				III	IV	I	II	III	June	July	Aug.	Sept.	Oct.	Nov.
United States	-7.2	5.9	11.6	6.4	-2.3	2.1	1.3	1.6	2.0	-1.9	9.1	-1.0	-4.9	4.9
Canada	-10.0	5.3	8.8	13.1	0.7	0.7	4.3		20.0	23.6	-0.8			
Japan	0.4	3.5	11.1	6.1	11.6	-2.6	11.2	-0.4	-21.6	22.7	-14.4	-12.9		
West Germany	-3.2	0.3	2.4	16.5	5.5	-3.0	11.5		43.9	0	-25.4			
United Kingdom	2.1	3.9	1.2	0.4	3.4	9.9	9.0	-1.2	-3.3	-11.5	3.4	19.4		
France	-1.5	1.1	2.3	9.5	-9.5	-3.0	3.1	8.4	-16.6	43.5	0	-16.4		
Italy	-3.1	-3.2	3.1	7.7	-6.9	7.4	1.1	-3.1	39.3	-37.4	11.9	9.1		

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, December 6, 1985.

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

Country	1982	1983	1984	1984		1985			1985					
				III	IV	I	II	III	May	June	July	Aug.	Sept.	Oct.
United States	6.2	3.2	4.3	3.7	3.5	3.3	4.2	2.4	2.4	2.4	2.4	2.4	2.4	3.7
Canada	10.8	5.8	4.3	3.3	3.3	5.3	4.0	3.4	1.9	3.1	3.1	4.1	4.0	2.2
Japan	2.6	1.8	2.3	1.3	3.3	2.3	1.1	2.2	-1.0	7.9	4.2	-2.0	-3.4	7.0
West Germany	5.3	3.3	2.4	0.6	2.8	3.5	2.7	-0.1	1.4	-0.9	-1.1	-0.3	1.8	-0.3
United Kingdom	8.6	4.6	5.0	5.5	6.0	7.1	9.4	2.8	5.5	4.5	0.6	2.7	1.8	1.3
France	12.0	9.5	7.7	7.3	6.5	5.8	6.3	4.2	6.6	6.1	3.4	3.0	2.3	2.8
Italy	16.4	14.9	10.6	8.0	6.0	10.2	10.5	7.1	9.1	9.2	6.5	7.1	2.3	6.8

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, December 6, 1985

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

Country	1982	1983	1984	1984		1985			1985					
				III	IV	I	II	III	June	July	Aug.	Sept.	Oct.	Nov.
United States	9.7	9.6	7.5	7.4	7.2	7.3	7.3	7.2	7.3	7.3	7.0	7.1	7.1	7.0
Canada	11.0	11.9	11.3	11.6	11.2	11.1	10.6	10.3	10.5	10.4	10.3	10.1	10.3	
Japan	2.4	2.7	2.8	2.8	2.7	2.6	2.6	2.5	2.6	2.4	2.4	2.8		
West Germany	5.9	7.5	7.8	8.0	7.8	7.9	8.0	7.9	7.9	7.9	7.9	7.9	7.9	
United Kingdom	11.8	12.8	13.0	13.2	13.0	13.1	13.3	13.5	13.4	13.5	13.7	13.4	13.2	
France	8.4	8.6	10.1	10.3	10.4	10.5	10.5	10.5	10.4	10.5	10.5	10.4	10.3	
Italy	4.8	5.3	5.9	5.8	5.6	6.0	5.9	6.2						

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

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

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

Country	1982	1983	1984	1984 III	1984 IV	1985 I	1985 II	1985 III	1985 May	June	July	Aug.	Sept.	Oct.
United States-1/	-31.6	-57.5	-107.9	-124.4	-96.4	-114.8	-135.2	-127.6	-135.6	-144.0	-110.4	-104.4	-168.0	-122.4
Canada	14.4	14.4	15.9	16.4	17.6	16.4	13.6	9.2	14.4	10.8	2.4	9.6	15.6	
Japan	18.6	31.5	44.1	40.0	53.6	46.4	52.0	56.8	56.4	54.0	56.4	60.0	55.2	
West Germany	21.1	16.6	18.8	20.0	23.6	17.6	26.0	27.2	25.2	21.6	32.4	20.4	27.6	
United Kingdom	4.0	-1.6	-5.5	-8.4	-6.4	-5.6	-1.2	-2.4	3.6	-3.6	-1.2	-3.6	-3.6	
France	-14.0	-5.9	-2.8	1.6	-1.6	-4.4	-1.6	-2.8	-1.2	2.4	-4.8	0	-3.6	
Italy	-12.8	-7.9	-10.8	-6.4	-14.8	-15.2	-14.4	-2.8	-8.4		-7.2	-2.4	0	

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

Source: Economic and Energy Indicators, U.S. Central Intelligence Agency, December 6, 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	1984 III	1984 IV	1985 I	1985 II	1985 III	1985 May	June	July	Aug.	Sept.	Oct.
Commodity categories:														
Agriculture	21.6	20.0	18.4	4.0	4.6	3.3	2.1	1.7	.5	.5	.5	.7	.5	.9
Petroleum and selected products, unadj	-54.6	-49.1	-52.5	-13.2	-12.8	-9.5	-12.8	-11.0	-4.1	-4.5	-3.7	-3.3	-4.0	-4.0
Manufactured goods	-4.9	-31.3	-78.9	-25.1	-17.5	-23.2	-24.2	-24.9	-8.0	-8.5	-6.9	-6.9	-11.1	-7.6
Selected countries:														
Western Europe	7.6	1.2	-14.1	-4.5	-2.6	-4.5	-6.0	-5.7	-2.4	-2.3	-1.6	-1.1	-3.0	-1.5
Canada	-12.6	-12.1	-20.1	-5.3	-5.7	-4.9	-5.3	-4.7	-1.6	-1.7	-1.2	-1.4	-2.1	-2.0
Japan	-17.0	-19.6	-33.8	-11.0	-7.9	-10.2	-11.8	-12.0	-3.9	-4.2	-3.7	-3.5	-4.8	-3.0
OPEC, unadj	-8.3	-8.2	-12.3	-3.7	-2.5	-1.3	-2.8	-2.4	-1.1	-.9	-.6	-.5	-1.3	-1.1
Unit Value (per barrel) of U.S. imports of petroleum and selected products, unadj	$31.48	$28.60	$28.11	$27.98	$27.69	$26.96	$27.09	$25.98	$27.34	$27.02	$26.19	$26.05	$25.72	$25.97

Source: Summary of U.S. Export and Import Merchandise Trade, U.S. Dept. of Commerce, October 1985.

Money-market interest rates
(Percent, annual rate)

Country	1982	1983	1984	1984 III	1984 IV	1985 I	1985 II	1985 III	1985 June	July	Aug.	Sept.	Oct.	Nov.
United States	12.4	9.2	10.7	11.5	9.4	8.6	8.6	7.7	7.4	7.6	7.8	7.8	7.9	7.8
Canada	14.4	9.5	11.3	12.5	11.2	10.6	9.9	9.1	9.6	9.3	9.2	8.9	8.7	8.9
Japan	7.2	6.8	6.7	6.3	6.3	6.5	6.3	6.3	6.3	6.5	6.5	6.3	6.5	7.3
West Germany	8.8	5.7	6.0	6.0	5.9	6.1	6.0	4.9	5.7	5.3	4.8	4.7	4.8	4.8
United Kingdom	12.2	10.1	9.9	11.1	10.1	12.8	12.6	11.5	12.4	12.0	11.2	11.4	11.5	11.5
France	14.6	12.4	11.7	11.4	10.7	10.6	10.5	9.7	10.8	10.0	9.8	9.4	9.3	9.0
Italy	20.0	18.2	15.9	16.8	17.0	15.8	15.4	14.4	15.0	14.4	14.4	14.4	14.2	14.3

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	1984 III	1984 IV	1985 I	1985 II	1985 III	1985 June	July	Aug.	Sept.	Oct.	Nov.
Unadjusted:														
Index number	109.8	114.2	122.3	125.1	128.2	135.1	131.3	125.0	130.4	125.8	124.0	125.3	118.9	116.9
Percentage change	10.4	4.0	7.1	5.3	2.5	5.4	-2.8	-4.8	-1.1	-3.5	-1.4	1.0	-5.1	-1.7
Adjusted:														
Index number	109.8	112.4	118.3	120.8	123.0	128.8	124.3	119.4	123.5	120.2	118.5	119.5	112.0	112.1
Percentage change	9.0	2.4	5.2	5.1	1.8	4.7	-3.5	-3.9	-0.9	-2.7	-1.4	0.8	-6.3	0.1

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.

UNITED STATES
INTERNATIONAL TRADE COMMISSION
WASHINGTON, D.C. 20436

OFFICIAL BUSINESS

ADDRESS CORRECTION REQUESTED

Postage And Fees Paid
U.S. International Trade Commission

Permit No. G-253

U.S. MAIL

ADDRESS CHANGE

☐ Remove from List
☐ Change as Shown
Please detach address label and mail to address shown above.