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CONTENTS

INTERNATIONAL ECONOMIC COMPARISONS

The year 1988 promises some progress in reducing trade imbalances among the industrialized countries. The projected slowdown in the growth of U.S. personal consumption expenditures should cause the Nation's imports to decline. Moreover, the weakened dollar combined with Japanese and West German measures to stimulate their domestic spending should boost U.S. exports. Although economists continue to worry about whether or not growth in exports and investment will be sufficient to offset expected declines in consumer expenditures, the consensus view remains that the U.S. economy will be free from recession in 1988. (For some calculations on this issue, see the section on Economic growth under Forecasts below.)

The stock market crash in October 1987, the abrupt fluctuations of investor optimism and pessimism that followed, and the prevailing tensions in global trade and finances have prompted numerous comparisons between 1929 and 1987. Most economists are convinced, however, that a 1930's style protracted downturn cannot happen again. The desire to avoid another Great Depression has guided the evolution of economic institutions in the United States and other Western nations since the war. In a historical perspective, the present institutions and practices of international economic relations are a reassuring change from the narrowminded nationalism that characterized global economic affairs in the 1930's.

Industrial Production

U.S. industrial production rose by 0.2 percent in December 1987, following increases of 0.4 percent in November and 0.9 percent in October. A survey by the National Association of Purchasing Management indicated that 50 percent of U.S. industrial plants were operating at 90 percent of their capacity or more at yearend 1987. This was the best capacity utilization figure in 8 years.

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, 7.4 percent; France, 1.0 percent; Italy, 0.9 percent; Japan, 9.3 percent; the United Kingdom, 3.5 percent; the United States, 5.4 percent; and West Germany, 0.8 percent.

Investment

U.S. investment in nondefense public goods (roads, bridges, airports, etc.) has grown less rapidly since 1971 than the Nation's labor force. Consequently, the stock of public capital per worker (measured in constant 1982 dollars), declined from $15,600 in 1971 to $14,000 in 1986. A study prepared at the Federal Reserve Bank of Chicago suggests that—contrary to prevailing belief—the national economy would benefit from an increase in the share of public capital projects in total investment.

According to Professor Feldstein, 75 percent of the foreign investment in the United States in 1987 came from foreign central banks, the remainder from private investors. Real yields on Government bonds toward yearend 1987 were 4.7 percent in the United States, 4.6 percent in West Germany, and 3.5 percent in Japan. The relatively high U.S. and West European rates reflect investors' fear of losses through inflation or further depreciation of the dollar.

Economists point out that foreigners' concern about the profitability of capital expansion projects tied to their exports caused steeper drops in overseas stock prices than in the United States following Black Monday. By the end of November 1987, U.S. stock prices were 28.4 percent below their previous peak, West German stock prices were 38.2 percent lower, French stock prices 34.9 percent, British stock prices 33.3 percent, and Japanese prices 18.6 percent.

Employment

The rate of unemployment in the United States (on a total labor force basis including military personnel) declined from 5.8 percent in November to 5.7 percent in December.

During the second half of 1987, employment in U.S. nonfarm establishments increased by 1.4 million. This is nearly as much as a whole year's normal growth since the 1982 recovery, but only one-half as much as the increase in employment during the first half of 1987.

The national statistical offices of other countries reported the following unemployment rates for November 1987: 8.2 percent in Canada, 14.3 percent in Italy, 9.5 percent in the United Kingdom, and 8.9 percent in West Germany. The October rate was 2.8 percent in Japan. The September rate was 10.5 percent in France. (For foreign unemployment rates adjusted to U.S. statistical concepts, see the tables at the end of this issue.)

Prices

The U.S. Consumer Price Index rose at a seasonally adjusted annual rate of just 0.1 percent in December 1987. For the full year, prices increased by 3.7 percent. In comparison, prices increased by 1.9 percent in 1986 and by 3.6 percent in 1985. The 1987 rate of inflation was consistent with the consensus forecasts made earlier in the year.

During the 1-year period ending in November 1987, average prices rose 4.2 percent in Canada, 5.2 percent in Italy, 4.1 percent in the United Kingdom, 4.5 percent in the United States, and 1.0 percent in West Germany. The rate of inflation during the 1-year period ending in October 1987 was 3.1 percent in France and 0.7 percent in Japan.

Forecasts

Economic growth

The Organization for Economic Cooperation and Development (OECD) predicts that real growth in the combined economies of the 24-member countries will decelerate from 3.0 percent in 1987 to less than 2.0 percent in 1989. The OECD says U.S. real growth will decline from 2.75 percent in 1987 to 2.50 percent in 1988 and to 2.00 percent in 1989. The OECD expects real economic growth in the other 23 countries as a group to decrease from 2.75 percent in 1987 to 2.25 percent in 1988 and to 2.00 percent in 1989. For the West German economy, the OECD foresees 1.50 percent real growth in both 1987 and 1988, and 1.25 percent growth in 1989. For Japan, its projections call for 3.5 percent growth in both 1987 and 1988, and 3.0 percent in 1989. Accompanying the reduced pace of economic expansion, the OECD forecasts a mild increase in unemployment in the leading industrialized countries over the next 2-year period. OECD growth forecasts for the individual countries are consistent with the consensus forecasts made in these countries.

In the United States, most projections for economic growth assume a decline in the rate of personal consumption expenditures and a matching increase in personal savings during the rest of the 1980's. The rate of growth of U.S. consumption expenditures measured in constant 1982 dollars decelerated from 4.0 percent in 1985 to 3.4 percent in 1986 and to an estimated 1.8 percent in 1987. Analysts at the investment bank Goldman and Sachs predict that the stock market crash last October will increase the average U.S. savings rate by 3 percentage points in 1988. This agrees with the OECD's forecast that U.S. consumer spending will be about $35 billion less in 1988. Although economists welcome this trend as progress toward eliminating the Nation's external and internal imbalances, they worry that the decline in consumer spending, which accounts for two-thirds of U.S. Gross National Product (GNP), will severely constrain growth.

If the Nation's GNP increases by 2.0 percent in 1988—as many private economists forecast—the output of goods and services will increase by $90 billion. Under this scenario, if the share of consumption in total GNP remains constant, consumption will grow by $60 billion. However, if consumption increases by only $30 billion—and if private investment compensates for the decline in government spending—then net exports will have to improve by $30 billion, or nearly 25 percent, to make up for the slack. If the slack is equally split between an increase in exports and a decline in imports, exports will have to increase by 3.4 percent and imports will have to decline by 2.7 percent in 1988. These changes in trade are quite plausible, given recent adjustments in exchange rates.

Interest rates and stock prices

Financial forecasters believe that the top priority of U.S. monetary policy is maintaining low interest rates in 1988 to prevent a recession. In light of projected reductions in the Federal budget and trade deficits, many analysts consider such a policy sustainable. This suggests higher prices of stocks and a decline in long-term bond rates. At the same time, recent encouraging monthly trade statistics notwithstanding, some economists forecast further depreciation in the dollar during the next 12-month period. This would put pressure on monetary policy makers to increase interest rates, or lead to expectations of higher future interest rates, relatively low prices of stocks, and higher long-term bond rates in 1988. Both the higher and lower interest rate scenarios are plausible; time will tell which of them is more accurate for 1988.

Employment

Some labor specialists contend that the U.S. economy will generate only 1.5 million jobs in 1988, roughly one-half of the number generated in 1987. They assume that slower economic growth and increasing labor productivity, resulting partly from tougher management, will moderate the demand for labor. They also assume that a demographic shift towards an older population will reduce the growth of the supply of labor. With respect to the various economic sectors, gains in U.S. manufacturing, which are a result of the dollar's depreciation and the consequent increase in the competitiveness of U.S. goods both home and abroad, will not offset stagnation in the service and retail trade sector. Furthermore, some economists contend that the October crash of stock prices will aggravate the risk of layoffs in 1988, because it hurt the ability of companies to raise money by selling stock.

U.S. TRADE DEVELOPMENTS

The deficit in U.S. merchandise trade shrank from $17.6 billion in October to $13.2 billion in November 1987. The November deficit was 8.9 percent lower than the $14.5 billion average deficit for the previous 12-month period and 14.4 percent lower than the $15.4 billion deficit registered for November 1986. U.S. exports increased by 9.4 percent from October to November and imports declined by 6.0 percent.

The $3.3 billion decline in the manufactures trade deficit from October to November accounted for three-fourths of the $4.4 billion overall decline in the monthly deficit. Exports of aircraft and parts, new passenger cars, chemicals, office machinery and automated data processing (ADP) equipment, power generating machinery, general industrial machinery, and telecommunications equipment showed noteworthy gains. Imports of clothing, footwear, motor vehicles and parts, electrical machinery, telecommunications equipment, aircraft and parts, office and ADP equipment and parts, and power-generating machinery showed significant declines.

The oil import bill decreased from $4.3 billion in October to $4.0 billion in November. The volume of oil imports dropped from 233.1 million barrels to 215.1 million barrels, and the average price of imported oil declined from $18.62 per barrel to $18.55 per barrel. Increased exports of cotton, animal feeds, raw tobacco, and soybeans, and sharply reduced imports of coffee explain the $257 million increase in the U.S. agricultural trade surplus from October to November.

The U.S. deficit has declined in trade with Japan, the 12-nation European Community (EC), Canada, the Organization of Petroleum Exporting Countries (OPEC), and the non-OPEC developing countries. In trade with Japan, the cumulative deficit for the first 11 months of 1987 was $55.0 billion, only slightly higher than the $54.7 billion deficit registered for the corresponding period of 1986. In a similar 11-month comparison, the cumulative deficit was lower in trade with Canada and the EC, but it was higher in trade with the members of OPEC and the East Asian Newly Industrialized Countries (EANIC's). (The EANIC's include Hong Kong, Singapore, and Taiwan.) The increase in the deficit from the first 11 months of 1986 to the corresponding period of 1987 was $6.1 billion in trade with the EANIC's, and $3.8 billion in trade with members of OPEC. Many analysts believe that the depreciation of the dollar alone will not substantially improve the U.S. balance with those countries because many of them have currencies that are partially pegged to the dollar. These countries also depend heavily on their sales to U.S. markets.

Table 1 shows that during the last quarter of 1987 the dollar reached its lowest quarterly level in 3 years. From the first quarter of 1985 through the third quarter of 1987, the volume of imports increased by 17.4 percent and the volume of exports rose by only 5.1 percent, even though import prices rose by 5.9 percent and exports prices rose by only 2.7 percent over the period.

Table 1
Volume and unit value indexes for total U.S. exports and imports, and exchange rate index, quarterly, 1985-87

(1977 = 100.0)

Period	Volume: Exports	Volume: Imports	Unit value: Exports	Unit value: Imports	Trade-weighted value of the dollar [1]
1985:					
January-March	117.8	143.2	157.0	160.1	135.0
April-June	113.8	151.7	157.2	159.2	133.3
July-September	106.4	146.2	155.1	158.9	131.0
October-December	111.6	152.1	154.2	160.9	127.1
1986:					
January-March	113.4	162.0	155.7	157.4	123.5
April-June	109.7	163.4	156.1	152.5	119.6
July-September	107.2	166.4	157.0	152.2	118.0
October-December	117.2	165.2	157.1	156.1	119.5
1987:					
January-March	117.1	161.0	156.9	158.5	115.1
April-June	125.9	168.9	158.3	163.3	112.0
July-September	123.8	168.1	161.3	169.5	113.3
October-December	(2)	(2)	(2)	(2)	[3]110.1

[1] The inflation-adjusted index based on bilateral exchange rates with 101 U.S. trading partners.
[2] Data unavailable.
[3] Statistics for December 1987 are not yet available. This statistic is based on October and November data.
Sources: Trade statistics: Office of Business Analysis, Department of Commerce; Exchange rate index: Federal Reserve Bank of Dallas.

The latest figures have generated optimism that the U.S. trade deficit may begin to decline without a recession or damage to international trade. Nonetheless, the road to balanced trade is full of dangers. For example, the decline in the value of the dollar can lead to inflationary pressures at home. It can also reduce economic growth of our trading partners and thus their demand for U.S. goods.

If the trade deficit does not decline significantly in 1988 and certain countries can be identified as the source of the problem, it will be hard to prevent the growth of public sentiment for protection. On the other hand, if the trade deficit declines substantially over a short period of time, the struggle for shrinking world markets could trigger trade wars. On the other hand, if the trade deficit declines faster than the Federal budget deficit, interest rates could start to climb, putting economic expansion in jeopardy. Even if the long-term process of restoring equilibrium to world trade and finances progresses smoothly, the world community may have learned that large, enduring trade imbalances can endanger the economic health of nations.

INTERNATIONAL TRADE DEVELOPMENTS

U.S. Soybean Producers File Section 301 Complaint Against EC

On December 16, the American Soybean Association (ASA) lodged an official complaint against the European Community (EC) alleging unfair subsidization of its domestic production of oilseeds (which includes soybeans). The complaint was filed with the United States Trade Representative (USTR) under section 301 of the Trade Act of 1974. On January 5, 1988, USTR Clayton Yeutter initiated an investigation in response to the ASA's request.

The ASA argues that EC subsidies on oilseed production and processing discriminate against the use of U.S.-grown soybeans in the Community because they eliminate the price difference between cheaper soybean imports and higher priced EC soybeans. Specifically, the ASA charges that the EC's processing subsidies are inconsistent with the General Agreement on Tariffs and Trade (GATT) because they impair the duty-free bindings granted to U.S. soybeans and soybean meal by the EC during the Dillon Round of trade negotiations in 1962. According to the ASA, U.S. producers have watched their EC market gradually erode, from U.S. exports worth $3.5 billion in 1982 to $2.1 billion in 1986. The ASA claims that EC support for its oilseed growers far outweighs the U.S. level—facing a world market price of $6 per bushel, the U.S. Government guarantees its farmers about $4.77 per bushel, whereas the Community support level lies closer to $15 per bushel.

After months of preparation and consultations with the Administration, during the summer the ASA debated whether or not to postpone filing the section 301 case pending the outcome of an EC Commission proposal to implement a consumption tax on oils and fats. U.S. officials argued that the consumption tax would further reduce EC imports of U.S. soybeans, which are crushed in European mills into vegetable oil and oilseed meal. The controversial tax would have been imposed on fats and oils from both foreign and domestic sources. However, U.S. officials charged that the tax, which would take the form of a flat tax, would dramatically increase the price (in percentage terms) of relatively inexpensive imported oils and fats compared with the relatively more expensive European products. (See *IER*, August 1987.)

The ASA closely monitored the progress of the consumption tax throughout 1987. At the semiannual EC summit in June, Community leaders failed to reach a consensus and postponed consideration of the future of the tax until the December summit meeting. In September, the ASA agreed to delay the filing of the section 301 petition pending the outcome of the December summit. At the December meeting, EC officials did not vote on the tax because of internal opposition. However, because the EC summit leaders failed to reject the tax outright, the ASA decided to launch the official trade complaint. In addition, the ASA claims that the EC has not yet made "meaningful, substantive" cuts in the oilseeds production subsidies. EC officials have countered, however, that in July soybean price supports were reduced by 3 percent and further curbs on oilseed production are being considered during ongoing talks to reform the budget. Moreover, they claim that the erosion of the U.S. market in Europe has been largely caused by an increase in imports of cheaper soybeans from Brazil and Argentina.

EC Releases GATT Services Proposal

The EC presented a proposal in December to formalize rules governing world trade in services. The proposal, for consideration by the GATT Uruguay Round Group on Negotiations on Services (GNS), was released December 4 and is expected to be discussed at the first 1988 meeting of the GNS on January 27-29. EC External Relations Commissioner Willy de Clerq said that the goal of the proposal "is to establish exactly the same kind of system for services as was established for goods in 1947 at GATT." To that end, the proposal applies such familiar GATT concepts as nondiscrimination, national treatment, transparency, and standstill and rollback to trade in services. Commissioner de Clerq noted that the importance of trade in services to the EC exceeds that of any other GATT member as the EC exports twice the dollar value in services as the United States and four times that of Japan.

Included in the EC plan are calls for phasing out national rules discriminating against foreign suppliers of services, granting foreign suppliers of services treatment equal to that given domestic firms, and imposing a "standstill" on the creation of new restrictions to trade in services. The standstill would be followed by compilation of an inventory of regulations affecting services trade. Then, barriers that are obstacles to trade would be identified, and the negotiation of their elimination would proceed. The proposal recommends that after a services agreement is implemented, a permanent Committee of the GATT be created to distinguish whether future services regulations are appropriate or discriminatory.

The principle of transparency would be applied in four different ways under the EC proposal. The first method requests all governments to notify all regulations affecting services trade that are maintained by other countries. A second way of promoting transparency calls for the publication of regulations affecting services, including prior notification of new regulations. The third method provides for an exchange of information among governments on the effect of regulations on firms. The EC also proposed that a continuous assessment be made of the actual effects of a services agreement.

The EC proposal noted that the key goal of negotiating an agreement to liberalize trade in services is to boost world services trade and economic growth and respect the policy objectives of services regulations. According to the EC, phased liberalization of services markets would be the main approach to facilitating international competition. In cases of national monopolies or industries highly concentrated in a few firms, the EC proposal calls for the creation of a special set of principles of behavior.

The GNS is expected to take up discussion of the EC proposal at its first 1988 meeting on January 27–29. At a November meeting of the group, the United States tabled an extensive proposal for a framework agreement on trade in services (*IER*, January 1988). Switzerland also presented a proposal on services trade in December. The Swiss plan includes "optional most-favored-nation treatment" that would incorporate a variety of bilateral services negotiations under the GATT to allow adherence by other GATT members.

The Third Summit of ASEAN Members Promises New Intra-ASEAN Trading Opportunities

The Association of Southeast Asian Nations (ASEAN), consisting of Brunei (it joined the original five members in 1984), Indonesia, Malaysia, the Philippines, Singapore, and Thailand, held its third summit of heads of state on December 14–15 in Manila. The summit endorsed a package of initiatives to push ASEAN toward more meaningful economic cooperation. Under the plan, the leaders hope each nation's domestic industry—through exposure to increased regional competition—will increase in efficiency and international competitiveness.

Although ASEAN's explicit objective is to foster economic, social, and cultural cooperation, its most prominent successes have been as a political bloc with regional security as its main priority. (A desire to reduce regional tension in the 1960's and a sense of vulnerability to aggressive Communist forces in the 1970's pushed diplomacy to the forefront of the organization's agenda.) Economic cooperation has made little headway among ASEAN members since the organization was formed in 1967. The ASEAN members, with the exception of Singapore, produce and export mainly primary commodities that tend to compete with, rather than complement, the products of their ASEAN partners. The bulk of intra-ASEAN trade has been accounted for by Singapore's imports of crude oil and exports of refined petroleum products.

In 1983, intra-ASEAN trade accounted for about 20 percent of ASEAN's total trade, but then this share began to decline; in 1985, it accounted for only 18 percent. (In contrast, the EC's internal trade accounts for about 50 percent of that region's total trade.) Thus, creation of a common market arrangement similar to that of the EC or formation of an ASEAN free-trade area are considered unrealistic goals by ASEAN economic ministers. Increased economic cooperation, rather than integration, is the means to trade liberalization these nations favor.

The four agreements signed on December 15 are to:

1. eliminate ambiguity in intra-ASEAN investment rules;

2. place 50 percent of intra-ASEAN trade under the existing preferential trading arrangements after 5 years (currently only 5 percent of the trade is covered by such arrangements);

3. raise existing tariff margin-of-preference on items currently receiving preferential treatment from 20 to 25 percent to 50 percent and give a minimum of 25 percent margin-of-preference to items newly added to the list of preferentially traded goods; and

4. freeze and gradually eliminate nontariff barriers on intra-ASEAN trade.

A key obstacle to liberalizing intra-ASEAN trade in the past has been the extensive exclusion lists of sensitive items from preferential trading arrangements. Each ASEAN member is permitted to exclude such items from its granting of trade concessions. Thailand's exclusion list covers 63 percent of all of its intra-ASEAN traded products; Indonesia, 54 percent; Malaysia, 39 percent; and the Philippines, 25 percent. Singapore and Brunei have virtually no tariffs. Therefore, preferential trading arrangements were modest and allowed only narrow tariff preferences for a small number of products relatively unimportant to intra-ASEAN trade (e.g., snow plows). If implemented in full, the new protocol on tariffs will cut the exclusion lists of each country to not more than 10 percent of traded items. The items remaining on the exclusion lists should not account for more than one-half of the total intra-ASEAN trade. Trade in such key commodities as oil, rubber, sugar, rice, and manufactured items will be liberalized.

Leaders of the ASEAN believe increased economic cooperation is needed to cope with the economic problems plaguing the region. However, the December 15 accords are more expressions of intent rather than firm decisions to make changes. The key indicator of the commitment of each nation to the goals agreed to at the summit will be their willingness to keep to the strict 5-year timetable for boosting to 50 percent the items traded inside the preferential trading arrangement system.

Investment Canada Leads Effort to Attract Foreign Capital

In 1985, Canada established a new government agency, Investment Canada (IC), to replace the Foreign Investment Review Agency (FIRA). FIRA's mission was to regulate foreign investment in Canada and to review most foreign investments entering the country; however, FIRA developed a reputation over the years as being the watchdog over foreigners interested in establishing a position in the Canadian market. Between 1964 and 1971, Canada ranked fourth among destinations for foreign direct investment (FDI) from the OECD countries. Investment in Canada accounted for 14 percent of OECD-based FDI during the period. However, by 1980, Canada was only the seventh largest recipient, accounting for only 4.8 percent of total OECD FDI. FIRA's reputation was inimical with Canadian long-term interests, and even resulted in a U.S. complaint to the GATT regarding certain aspects of FIRA's operation. The trend was later mitigated, however, with the establishment of IC, which was charged with promoting investment in Canada and developing a more inviting environment for foreign investors. During its first 9 months of operation (from June 30, 1985, to Mar. 31, 1986), IC viewed its own priority as "creating a positive perception of Canada as a place to do business and as a preferred location for investment."

In the fiscal year that ended March 31, 1987, Canada received $Can7.5 billion in foreign direct investment. This was an all-time record for Canada and occurred in only the second year of operation of the new agency. Previously, FDI had ranged between $Can3.4 billion in 1985 and $Can4.8 billion in 1981. The IC report also notes the changing sources and destinations of international investment. Whereas FDI once came mainly from the United States and the United Kingdom, today five more sources are notable: Japan, West Germany, France, The Netherlands, and Canada. Not surprisingly, Japan is now the world's largest exporter of direct investment capital.

Of the investment proposals from abroad that came to Canada in FY 1986–87, only one-fourth required detailed review by IC. However, this number of investments represented 89 percent of the asset value of investments for the fiscal year. The United States was the source of 64 percent of the investments (57 percent in asset value terms), with the EC next in importance.

Part of the success of foreign investment in Canada can be attributed to IC's investment counselors. In FY 1986–87, counselors were placed in Canadian missions in London, Paris, Bonn, Tokyo, New York, and Los Angeles. Specialists are also employed in Hong Kong and The Hague. Recent press reports have drawn attention to Canadian efforts in Hong Kong to "capitalize" on the situation created by the 1997 return of control of the British crown colony to China. More than 20,000 Canadian immigrant visas were reportedly issued to residents of Hong Kong in 1987. Although some are issued to people with relatives in Canada, others are for investors, entrepreneurs, and independent skilled migrants. The category for investors requires $200,000 for a Government-approved project, whereas entrepreneurs must put about $100,000 into a new business employing Canadians.

The agency recognizes the competitive atmosphere surrounding potential foreign investments and is spearheading efforts to attract the new forms of technology-intensive investment that characterize the international marketplace.

The Mexican Government Confronts a New Setback in the Economy

As recently as September 1987, Mexico showed signs of emerging from its economic crisis (*IER*, October 1987). Heartening developments at the time included a $10-billion jump in foreign-exchange reserves during the last 12 months; the strengthening of the world petroleum market on which Mexico heavily depends; a strong performance by Mexican nonoil exports; and the repatriation of domestic capital that had previously left the country. The Mexican stock market enjoyed a boom that made it the fastest-rising major exchange in the world.

However, developments in the last quarter of the year revived grave concerns about the economy. The world oil market showed new signs of weakness. The Mexican stock market collapsed in early October, far exceeding in depth the crash of the New York stock market 2 weeks later. Following a second wave of panic selling, which coincided with the plunge of markets around the world, Mexican shares lost on the average about three-fourths of their value.

Plummeting stock prices triggered renewed capital flight from Mexico, moving the Government to halt the outflow by withholding dollars from exchange markets. In mid-November, this contributed to sending the free rate of the peso down to 2,500 to the U.S. dollar, or by 45 percent. (Mexico has a dual exchange-rate system with a free and a controlled rate.) The currency recovered slightly during the remainder of the year to a range of 2,200 to 2,400 to the dollar. Subsequently, officials began to adjust the peso's controlled rate downward, setting it in mid-December at 2,200 to the dollar. (The controlled rate, determined by the Government, is used for some 80 percent of all hard-currency transactions in Mexico.) This action virtually eliminated the long-standing gap between the peso's free and controlled rates.

The plunge in the peso's value made imports more expensive and precipitated price increases on the retail level at a time when inflation was already running at a record annual rate of 144 percent. The Government attempted to cushion the cheap peso's inflationary effect by proceeding steadfastly with the import liberalization program promised in its 1986 accession agreement to the GATT. The trade-related measures that Mexican officials announced on December 4, 1987, included the removal of prior import permit requirements for additional products; the reduction of import duties for more tariff items; and the elimination of all so-called official prices for imports (prices imposed above market value), effective January 1988. The Administration carried out Mexico's trade liberalization program throughout 1987 at an accelerated pace.

Additional measures with an anti-inflationary effect included major budget cuts and tax hikes that the Mexican Government announced in mid-December as part of a new, sweeping austerity program. Officials raised taxes and reduced budget expenditures mostly in response to projections that the 1987 public sector deficit would rise to a record 17 percent or more of the Mexican Gross Domestic Product (GDP). However, even though one of its declared objectives was to slow inflation, the austerity package also contained sharp price increases—75 to 80 percent for most products and services provided by the Government, such as cane sugar, fertilizers, gasoline, rail and airfares, telephone, and electricity. Responding to concerns of organized labor that these price hikes would trigger a new round of steep inflation, Mexican officials also agreed to a wage increase for organized labor and to indexation of wages (and of certain prices) beginning March 1, 1988.

Mexico's latest economic measures are formally known as "The Pact of Economic Solidarity," suggesting that they represent a compromise between the four main sectors of the economy: Government, business, labor, and farmers. Each of these sectors was compelled to reduce their demands to share the burden of new austerity imposed in the new pact. The likely net effect of the package on the Mexican economy is hotly disputed. Most agree, however, that in the short run the program is bound to cause an increase in inflation and a simultaneous economic slowdown.

STATISTICAL TABLES

Industrial production

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

Country	1984	1985	1986	1986 II	1986 III	1986 IV	1987 I	1987 II	1987 July	Aug.	Sept.	Oct.	Nov.	Dec.
United States	11.2	2.0	1.0	-2.1	1.9	3.3	3.2	4.3	14.9	3.7	-0.9	10.6	4.6	2.4
Canada	8.8	4.3												
Japan	11.1	4.6	-.4	.9	-2.1	-2.4	5.6	-.8	12.1	-7.3	44.5	15.9		
West Germany ...	3.3	3.9	2.2	10.2	-4.5	-.1	-2.8	-.5	-22.7		-9.8	-5.6	-18.0	
United Kingdom ..	1.3	4.7	2.0	.6	5.6	.5	4.0	2.9	30.4	9.9	-11.8	11.0		
France	1.7	.8	.7	6.2	5.4	-5.1	-1.3	8.1			12.2	-10.8		
Italy	3.3	1.2	2.7	6.0	-12.8	7.3	11.5	6.7	6.8	-19.2	9.9	33.7		

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Dec. 31, 1987.

Consumer prices

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

Country	1984	1985	1986	1986 II	1986 III	1986 IV	1987 I	1987 II	1987 July	Aug.	Sept.	Oct.	Nov.	Dec.
United States	4.3	3.6	1.9	-1.7	2.6	2.7	5.3	4.9	2.9	5.8	2.4	4.6	3.5	
Canada	4.3	4.0	4.2	3.0	4.7	4.9	3.5	5.6	5.9	.9	0	4.4	5.3	
Japan	2.3	2.0	.6	.9	-2.0	-.1	-2.2	5.0	-5.8	1.2	15.3	0	-2.3	
West Germany ...	2.4	2.2	-.2	-1.0	-.5	-1.5	.9	1.4	3.6	-1.0	-2.9	2.0	0	
United Kingdom ..	5.0	6.1	3.4	.7	2.4	6.5	5.7	1.9	4.6	3.6	3.6	6.0	6.0	
France	7.7	5.8	2.5	1.7	2.6	3.2	5.2	2.3	2.8	2.9	1.4	2.9	1.4	
Italy	10.6	8.6	6.1	5.0	5.0	3.2	4.1	4.3	7.1	3.3	9.0	11.3	3.2	

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Dec. 31, 1987.

Unemployment rates

(Percentage; seasonally adjusted; rate of foreign countries adjusted to be roughly comparable with U.S. rate)

Country	1984	1985	1986	1986 III	1986 IV	1987 I	1987 II	1987 III	1987 July	Aug.	Sept.	Oct.	Nov.	Dec.
United States	7.5	7.2	7.0	6.9	6.9	6.7	6.2	6.0	6.0	6.0	5.9	6.0	5.9	5.8
Canada	11.3	10.5	9.6	9.7	9.4	9.6	9.1	8.8	9.1	8.8	8.6	8.4	8.2	
Japan	2.8	2.6	2.8	2.9	2.9	3.0	3.1	2.8	2.8	2.8	2.8	2.8		
West Germany ...	7.4	7.5	7.2	7.2	7.0	7.1	7.2	7.3	7.6	7.3	7.3	7.2	7.2	
United Kingdom ..	11.7	11.3	11.1	11.2	10.9	10.6	10.3	9.8	10.0	9.8	9.5	9.4	9.1	
France	9.9	10.4	10.7	10.8	10.8	11.2	11.3	11.2	11.2	11.2	11.0	10.9	10.8	
Italy	5.9	6.0	6.3	6.0	6.6	6.7	6.7	6.8						

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, January 1988.

Trade balances

(Billions of U.S. dollars, f.o.b. basis)

Country	1984	1985	1986	1986 II	1986 III	1986 IV	1987 I	1987 II	1987 June	July	Aug.	Sept.	Oct.	Nov.
United States [1] ...	-107.3	-133.6	-149.6	-139.6	-155.6	-166.8	-144.4	-148.0	-169.2	-164.4	-169.2	-151.2	-192.0	-140.4
Canada	16.0	12.8	7.3	7.6	6.4	8.0	9.2	8.4	1.2	4.8			9.6	
Japan	43.9	55.8	92.5	89.6	104.8	104.0	110.4	94.0	88.8	92.4			93.6	
West Germany ...	18.8	25.4	52.6	51.6	60.4	57.2	64.4	62.0	63.6	62.4			121.2	132.0
United Kingdom ..	-5.7	-2.6	-12.4	-9.6	-17.2	-14.8	-6.8	-15.6	-14.4	-18.0			-9.6	-13.2
France	-2.8	-2.6	.1	-4.4	-8.8	1.6	-4.0	-8.8	-7.2	-6.0			-57.6	-8.4
Italy	-11.0	-12.1	-2.1	.0	1.6	-.8	-6.8	-12.0	-21.6	-14.4			-7.2	

[1] Exports, f.a.s. value, unadjusted; imports, customs value, unadjusted. Beginning with 1986, figures include previously undocumented exports to Canada. Data for individual quarters do not reflect similar adjustments.

Note.—Beginning with January 1986, the U.S. Department of Commerce stopped reporting export and import data on a seasonally adjusted basis. U.S. data for prior periods have been changed accordingly. This does not affect the comparability of U.S. and foreign trade balances on anannual basis.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Dec. 31, 1987.

U.S. trade balance, by major commodity categories and by selected countries

(Billions of U.S. dollars, customs value basis for imports)

Item	1984	1985	1986	1986 III	1986 IV	1987 I	1987 II	1987 III	1987 June	July	Aug.	Sept.	Oct.	Nov.
Commodity categories:														
Agriculture	18.4	9.6	4.5	.5	2.3	1.4	1.3	2.1	.3	.7	.6	.8	.8	1.1
Petroleum and selectedproducts, unadj	-52.5	-45.9	-31.8	-7.2	-6.8	-7.6	-9.0	-11.7	-3.5	-4.1	-4.2	-3.4	-3.8	-3.4
Manufactured goods	-78.9	-102.0	-134.3	-36.1	-34.7	-32.7	-34.9	-36.3	-12.7	-13.3	-12.2	-10.8	-14.4	-11.1
Selected countries:														
Western Europe	-14.1	-23.3	-28.2	-7.3	-6.3	-5.2	-6.6	-7.0	-2.5	-3.5	-2.1	-1.4	-2.6	-2.0
Canada [1]	-20.1	-21.7	-23.0	-5.9	-5.4	-3.2	-2.3	-2.8	-.5	-.6	-.9	-1.3	-1.3	-1.2
Japan	-33.8	-46.5	-55.3	-13.5	-15.0	-13.6	-14.5	-13.8	-5.0	-4.8	-4.6	-4.4	-5.5	-4.5
OPEC, unadj	-12.3	-10.2	-8.9	-2.1	-1.8	-2.4	-2.8	-4.6	-1.2	-1.6	-1.6	-1.4	-1.5	-1.0
Unit value (per barrel)of U.S. imports ofpetroleum and selected products, unadj ...	$28.11	$26.59	$15.02	$11.41	$12.60	$15.55	$17.23	$17.99	$17.77	$18.15	$18.33	$17.49	$17.51	$17.54

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

Note.—Beginning with January 1986, the U.S. Department of Commerce stopped reporting export and import data on a seasonally adjusted basis. U.S. data for prior periods have been changed accordingly. This does not affect the comparability of U.S. and foreign trade balances on an annual basis.

Source: *Summary of U.S. Export and Import Merchandise Trade*, U.S. Department of Commerce, November 1987.

Money-market interest rates (90-day certificate of deposit)

(Percentage, annual rates)

Country	1984	1985	1986	1986 III	1986 IV	1987 I	1987 II	1987 III	1987 July	Aug.	Sept.	Oct.	Nov.	Dec.
United States	10.7	8.3	6.5	6.0	5.8	6.1	6.8	6.8	6.5	6.6	7.3	8.0	7.2	7.7
Canada	11.3	9.7	8.6	6.1	8.4	7.4	8.0	9.2	9.2	9.2	9.2	9.3		
Japan	6.7	6.5	4.9	4.7	4.4	4.1	3.7	3.7	3.7		3.7	3.8		
West Germany ...	6.0	5.5	4.6	4.5	4.7	3.9	3.7	4.2	3.9	4.0	4.6			
United Kingdom ..	9.9	12.1	10.8	9.9	11.3	10.5	9.3	10.0	9.4	10.3	10.2			
France	11.7	10.0	7.7	7.2	7.6	8.2	8.1	7.9	7.9	7.9	7.9			
Italy	15.9	15.0	12.8	11.4	11.2	10.9	10.7	11.9	11.1	12.3	12.4			

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; percentage change from previous period)

Item	1984	1985	1986	1986 III	1986 IV	1987 I	1987 II	1987 III	1987 July	Aug.	Sept.	Oct.	Nov.	Dec.
Unadjusted														
Index number	122.4	127.1	106.0	102.8	102.7	97.1	94.1	95.2	96.0	95.7	93.9	93.5	90.0	87.4
Percentage change	7.2	3.8	-16.6	-3.7	-.1	-5.5	-3.1	1.2	1.3	-.3	-1.9	-.4	-3.7	-2.9
Adjusted:														
Index number	119.6	122.5	101.5	96.9	98.3	93.4	90.5	91.6	92.6	92.2	90.0	90.5	87.3	84.5
Percentage change	6.1	2.4	-17.1	-2.2	1.4	-5.0	-2.9	1.2	1.5	-.3	-2.4	.5	-3.5	-3.2

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

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

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