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FRBSF Weekly Letter

The Tokyo Round

Like a stately ocean-liner reaching port at middle of night, the landmark international trade agreements that were signed in Geneva this April received little popular notice. Aside from those who were directly involved in the negotiations, few were familiar with the contents of these agreements or were aware of their significant implications for the world economy. Though signed, the agreements still await national ratification and implementing legislation in each of the signatory nations.

As legislative packages are submitted to national legislatures, the public in each country will have another chance to inspect the agreements' provisions and to assess the proposed changes in national laws and regulations governing the conduct of international trade. The U.S. legislative package, prepared by the White House Office of the Special Trade Representative, was submitted to Congress on June 19. Congress will have ninety working days (about 4½ months) to act on it.

Trade and growth

Trade has been a major engine of world economic growth, and in turn has been propelled by the growth of the world economy. During the thirty-five years from 1913 to 1948, the volume of world output increased at an average annual rate of 2 percent, while the volume of world trade grew by only ½ percent a year, in real terms. In contrast, during the quarter-century from 1948 to 1973, world output rose at a rate of 5 percent a year, while world trade expanded at 7 percent a year, again in real terms. During that remarkable period, the volume of world trade increased sixfold. The tremendous growth of trade in recent decades has meant expanding markets for producers and lower prices and widened choices for consumers all over the world.

Steady reductions in national barriers to trade have, until recently, contributed substantially to the vigorous growth of trade. Since 1947, under the auspices of the General Agreement on Tariffs and Trade (GATT), there have been seven rounds of multilateral negotiations, each culminating in a set of international agreements on the reduction of tariff barriers. The latest round, the so-called Tokyo Round, got its name from the ministerial meeting in Tokyo in September 1973, which launched this round of negotiations. Actual discussions, however, did not start until February 1975, after Congress authorized the President (under the Trade Act of 1974) to enter into negotiations.

Rising protectionism

The Tokyo Round took place against a background of mounting protectionism all over the world, especially in the advanced industrial countries, which had previously been the power-house for world economic growth and trade expansion. First, the inflation-recession of 1974-75 left the world economy in disarray. Subsequently, in order to combat inflation, most of the industrial countries outside the United States have tried hard to curtail domestic demand, and as a result have had to accept lower economic growth rates and the highest unemployment rates since the 1930's. The sluggish economic growth has led to weak world demand for exports and massive layoffs of workers.

Under heavy political pressure, national governments in these countries have in recent years imposed quotas, surcharges, or countervailing duties on imports, or have forced foreign governments to agree to various export-restraint arrangements. In addition, there has been a proliferation of government schemes — through direct sub-

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sidies, tax rebates, or subsidized credits — to win competitive advantages for exporters. These measures and counter-measures, if unchecked, could escalate into a serious threat to the continued growth of world trade and the world economy, similar to that which contributed so much to the disastrous decade of the 1930's.

Agreement provisions

The agreements that have emerged from the Tokyo Round negotiations are intended to stem and reverse this tide of protectionism, and to put the world economy back on the track it had successfully followed until recently. The agreements cover a wide array of areas, among which the major ones are the following:

1. **Tariff reductions.** Eighteen industrial nations agreed to reduce tariffs over an eight-year period, beginning January 1980, on several thousands of products valued at about $120 billion a year at the 1976 level of world trade. The average reduction came to about 33 percent, varying from 25 percent for the Common Market (EEC) countries, 31 percent for the U.S., and 50 percent for Japan. The average dutiable industrial tariff thus would be cut from roughly 8.3 to 5.7 percent for the U.S., 9.8 to 7.3 percent for the EEC, and 10.9 to 5.4 percent for Japan. The negotiators decided on an eight-year period for making these tariff reductions, primarily to allow a gradual phasing-in of the changes and thus more time for domestic adjustments. In fact, however, such precaution was probably unnecessary, as domestic industries are already exposed to much larger changes in competitive conditions, such as those resulting from fluctuating exchange rates.

2. **Non-tariff barriers.** For the first time since 1947, the major trading nations reached an agreement to restrict the use of non-tariff trade barriers. The agreement took the form of "codes of conduct" in several areas including:

**Customs valuation.* The code will ensure more uniform customs procedures for valuation of imports, and prevent the use of arbitrary valuation methods for protectionist purposes. The U.S. has agreed to give up the "American selling price" valuation method used on imports of certain chemicals, which has been a bone of contention in nearly every round of negotiations over the last thirty years.

**Government procurement.* The code lists the government agencies for each country that will take bids from foreign companies on supply contracts valued at more than $195,000. The code does not include defense products, most telecommunications equipment and some power-generating equipment. For the U.S., it would require a repeal of the Buy America Act, which now gives domestic suppliers a 6-percent price advantage (12 percent for small business firms) in bidding for Federal non-defense contracts.

**Subsidies and countervailing duties.* The code prohibits subsidies on exports of

manufactures and minerals, and limits subsidies on agricultural exports to those that do not injure other countries' trade. It contains an "illustrative list" of 12 types of impermissible subsidies, including tax remissions for exports and direct subsidies or grants on the basis of export performance. The code also limits the use of countervailing duties against foreign export subsidies to cases where a "material injury" to a domestic industry can be demonstrated. In accepting this limitation, the U.S. made a major concession, as thus far the U.S. has imposed countervailing duties on steel and other products merely on evidence of "dumping," i.e., with the export price being lower than the foreign domestic price.

The agreements, again, are subject to approval by national governments. For the United States, *tariff* reductions would require no additional Congressional action, because of the authority granted to the President by the Trade Act of 1974 prior to the start of the negotiations. But for the *non-tariff* codes, Congress under the terms of the Trade Act must accept a package of implementing legislation, without amendment, within a period of 90 working days. Because both the trade negotiations and the legislative drafting involved close consultation with political, industry and labor leaders, the prospects for final passage appear reasonably good.

Reverse the trend?

The Tokyo Round agreements, if ratified, would make an important start towards a reduction of trade barriers and a reversal of the protectionist trend that has hampered trade growth in the 1970's. Because of the treaties' technical nature, the public cannot be expected to be actively interested in all the details involved. Nevertheless, the public should at least take cognizance of the policy change that the agreements would imply.

Trade expansion means not merely enlarged opportunities for our exports, but also increased supplies of imports for consumers and greater national readiness to adjust to import competition. In this regard, it is worth noting that the agreements reflect considerable compromise with domestic special-interest groups in order to win the latter's political support. Thus, existing U.S. restrictions against imports of textiles, television sets and shoes — through "orderly marketing arrangements" with the exporting nations — have been expressly exempted from the liberalization agreements. Disappointed by these exemptions, which affect them the most, the developing countries *en bloc* have refused to sign the agreements. Some have denounced the agreements as a "private affair" of the rich nations' club, offering the world at large nothing more than "negotiated protectionism." The harsh stricture undoubtedly reflects a biased view; it nevertheless contains some grains of truth. It points to the considerable distance yet to be covered before the world economy is fully back on track towards a free-trade environment.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 6/27/79	Change from 6/20/79	Change from year ago @ Dollar	Change from year ago @ Percent
Loans (gross, adjusted) and investments*	127,492	− 38	+ 16,903	+ 15.28
Loans (gross, adjusted) — total#	105,117	184	+ 16,395	+ 18.48
Commercial and industrial	30,487	86	+ 3,094	+ 11.29
Real estate	38,173	194	+ 8,132	+ 27.07
Loans to individuals	22,043	93	NA	NA
Securities loans	1,762	− 73	NA	NA
U.S. Treasury securities*	7,404	− 257	− 874	− 10.56
Other securities*	14,971	35	+ 1,382	+ 10.17
Demand deposits — total#	40,957	− 1,595	+ 1,877	+ 4.80
Demand deposits — adjusted	29,650	− 652	+ 713	+ 2.46
Savings deposits — total	30,014	108	− 505	− 1.65
Time deposits — total#	51,338	1,066	+ 5,550	+ 12.12
Individuals, part. & corp.	42,515	962	+ 6,541	+ 18.18
(Large negotiable CD's)	18,211	954	+ 87	+ 0.48

Weekly Averages of Daily Figures	Week ended 6/27/79	Week ended 6/20/79	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (−)	57	− 9	20
Borrowings	150	16	74
Net free reserves (+)/Net borrowed(−)	− 93	− 26	− 54
Federal Funds — Seven Large Banks			
Net interbank transactions [Purchases (+)/Sales (−)]	− 315	+ 250	− 860
Net, U.S. Securities dealer transactions [Loans (+)/Borrowings (−)]	− 289	+ 184	− 440

* Excludes trading account securities.
\# Includes items not shown separately.
@ Historical data are not strictly comparable due to changes in the reporting panel; however, adjustments have been applied to 1978 data to remove as much as possible the effects of the changes in coverage. In addition, for some items, historical data are not available due to definitional changes.

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