World Economic Survey

1983

Current Trends and Policies in the World Economy

8
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2
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1970
1975
1980
1983

World output growth, 1970-1983
(per cent per year)

United Nations

E/1983/42
ST/ESA/131

Department of International Economic and Social Affairs

WORLD ECONOMIC SURVEY 1983

Current Trends and Policies in the World Economy

UNITED NATIONS

New York, 1983

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PREFACE

Each year, in accordance with General Assembly resolution 118 (II) of 31 October 1947, the Economic and Social Council, at its second regular session, holds a general discussion on international economic and social policy. In the general discussion, as specified by the Assembly, the Council considers a survey of current world economic conditions and trends in the light of its responsibility under Article 55 of the Charter of the United Nations to promote the solution of international economic problems, higher standards of living, full employment and conditions of economic and social progress and development. The *World Economic Survey 1983* has been prepared to assist the Council in its deliberations at its second regular session of 1983. In the preparation of the *Survey*, the provisions of General Assembly resolution 37/203 of 20 December 1982 have been taken into account. The *Survey* is intended to provide the basis for a synthesized appraisal of current trends in the world economy, particularly as they affect the progress of developing countries. It is accordingly hoped that the *Survey* will also be of interest and use to other United Nations bodies, to Governments and to the general public.

Annual surveys prepared by the regional commissions complement the *World Economic Survey* by providing a more extensive and detailed analysis of current trends at regional and national levels.

The *Survey* has been prepared in the Office of Development Research and Policy Analysis of the Department of International Economic and Social Affairs of the United Nations Secretariat and is based on information available to the Secretariat as of 31 March 1983.

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Explanatory notes

The following symbols have been used in the tables throughout the report:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (-) indicates that the amount is nil or negligible.

A blank in a table indicates that the item is not applicable.

A minus sign (-) indicates a deficit or decrease, except as indicated.

A full stop (.) is used to indicate decimals.

A slash (/) indicates a crop year or financial year, e.g. 1970/71.

Use of a hyphen (-) between dates representing years, for example, 1971-1973, signifies the full period involved, including the beginning and end years.

Reference to "tons" indicates metric tons and to "dollars" ($) United States dollars, unless otherwise stated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

Details and percentages in tables do not necessarily add to totals, because of rounding.

Forecast magnitudes are rounded to the nearest half percentage point or half billion dollars.

The following abbreviations have been used:

CMEA	Council for Mutual Economic Assistance
CFF	Compensatory Financing Facility
EEC	European Economic Community
FAO	Food and Agriculture Organization of the United Nations
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GNP	Gross national product
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
ODA	Official development assistance

OPEC Organization of Petroleum Exporting Countries

SDR Special drawing rights

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries.

The term "country" as used in the text of this report also refers, as appropriate, to territories or areas.

For analytical purposes, the following country classification has been used:

Centrally planned economies: China, Eastern Europe and Union of Soviet Socialist Republics

Developed market economies: North America, southern and western Europe (excluding Cyprus, Malta and Yugoslavia), Australia, Japan, New Zealand and South Africa

Developing countries: Latin America and the Caribbean area, Africa (other than South Africa), Asia (excluding China and Japan) and Cyprus, Malta and Yugoslavia

For particular analyses, developing countries have been subdivided into the following groups:

Capital surplus countries: Brunei, Iran, Iraq, Kuwait, Libyan Arab Jamahiriya, Qatar, Saudi Arabia and United Arab Emirates

Deficit countries, subdivided into the following two subgroups:

Other net energy exporters: Algeria, Angola, Bahrain, Bolivia, Congo, Ecuador, Egypt, Gabon, Indonesia, Malaysia Mexico, Nigeria, Oman, Peru, Syrian Arab Republic, Trinidad and Tobago, Tunisia, United Republic of Cameroon and Venezuela (in the text these countries are identified as the deficit energy exporters)

Net energy importers: All other developing countries

The designations of country groups in the text and the tables are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage reached by a particular country or area in the development process.

Chapter I

THE ELUSIVE WORLD RECOVERY

1983: The current outlook

Introduction

The world economy remained in the grip of recession during 1982 and is only now beginning in a few places to show some signs of recovery. The unexpectedly severe contraction in demand that ensued from the anti-inflationary policies set in train by major industrial countries in 1979 and 1980 had brought about a sharp curtailment in the growth of world production and trade in 1981, and the deflationary impact of such policies was aggravated in 1982. In the developing countries as a group, output failed to increase for the first time in the post-war period. During the year, the recessionary conditions in fact spread to embrace a number of the energy-exporting developing countries which, in preceding years, had been centres of growth in the world economy. In the developed market economies as a group, total output actually contracted in 1982. In the centrally planned economies, economic growth remained positive but at the greatly moderated pace of the preceding year.

The recession has brought about a worsening of living conditions for large groups of people in most societies, and an aggravation of social tensions and cleavages. In the developed market economies, as well as in some of the more industrialized developing countries, unemployment among urban industrial workers has reached record levels for the post-war period. More generally in developing countries, while the first brunt of international recession has been borne by those in export activities, the inescapable policies of retrenchment have affected the well-being of many segments of the population. In present circumstances, the search for a means of livelihood among such groups as rural migrants and youth is almost inevitably doomed to failure; and the outlet of international migration previously seized upon by skilled and semi-skilled workers in many parts of the world has generally been closed. It is another international dimension of the situation that Governments in the developed market economies have come under strong, and increasing, pressure to adopt more protectionist stances. National sentiments have been gaining ground, intensifying demands for defensive or retaliatory actions and weakening support for the larger international framework of rules and institutions.

The volume of international trade declined by between 1 and 2 per cent in 1982 after having experienced virtually no growth in 1981. Flagging domestic activity in major industrial countries brought about a contraction in demand for the exports of other countries, both developed and developing. Responding to the same cause, the prices of primary commodities continued to weaken. As pressure on their balance of payments mounted, many developing countries as well as a number of developed market and centrally planned economies introduced direct or indirect measures to reduce demand for imports, including food imports. For a number of developing countries, the situation was worsened by the concurrence of heavy debt service payments which themselves were partly engendered by the progressive shift towards shorter-term lending as the world economic outlook deteriorated. Thus, a cumulative deflation of demand for internationally traded goods set in, and it has not yet ceased.

There were a few favourable developments. In many parts of the world, food production was very largely unaffected by the global recession, and - for the world as a whole - the modest gain in output during 1982 kept pace with the increase in population. Growth in high-technology activities, particularly those linked to service industries, continued unabated. In the major industrial countries the rate of inflation declined, in a few countries rather rapidly, as cost pressures eased. Nominal interest rates fell, particularly for short-term loans, from the unprecedentedly high levels of 1981.

In the early months of 1983, some signs of recovery in the developed market economies began to emerge. The Governments of the major industrial countries have indicated their intention to implement measures which would bring about a sustainable improvement in economic growth and world trade. The recovery in developed market economies, however, is not expected to be strong, at least in the near future. Fears of a revival of inflation and of the persistence of budget deficits in the next several years are restraining both policy-makers in Governments and decision-makers in enterprises. There is, moreover, little abatement of the turbulence affecting international monetary and financial markets, and demands for protectionist measures remain insistent. For many developing countries, international reserves are at unprecedentedly low levels, export earnings are unlikely to recover strongly in the coming months, and the outlook for 1983 accordingly remains bleak (see table I-1).

The current situation has forcefully reminded countries of how much more interrelated their economies have become. It is evident that the restrictive policies of the powerful countries have had onerous consequences for the weak; it is also striking that this weakening of the poorer countries has posed a threat both to the viability of financial institutions serving the strong, and to the recovery of world production and trade. It is not novel that for individual developing countries, the external environment has virtually eliminated any room for manoeuvre in economic policy; but it is notable that the vigour of recovery in individual developed countries, large as well as small, is also very severely constrained by current external circumstances. Recovery in leading industrial countries could be seriously endangered if their exports to developing countries were further reduced as a consequence of contracting financial flows. 1/

With so many countries substantially integrated into the international economy, the prospects for the recovery of investment and growth within individual countries depend, to a significant degree, on a generalized improvement in world markets. The major developed market economies have recognized the need for some co-ordination of policies to promote recovery; no single country, even the largest, can reflate alone. As it stands now, great uncertainty surrounds the nature of unco-ordinated recovery. If it cannot be translated into healthy and sustained growth, the interdependence that links together the developing and developed countries will increasingly be seen as an impediment to growth and as cause for pursuit of alternative patterns of industrialization.

Table I-1. World production: a/ percentage annual change, by country group, 1976-1983

	1976-1980	1981	1982 b/	1983 c/
World	3.9	1.4	0.2	2
Developed market economies	3.5	1.3	-0.3	2
Centrally planned economies	4.3	2.2	2.6	3.5
Developing countries	5.2	0.7	-0.7	2
Net energy-importing	5.1	1.6	0.9	2.5
Net energy-exporting	5.2	-0.4	-2.6	1
Surplus countries	3.5	-8.3	-7.4	...
Other countries	6.2	4.1	0.1	...

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on official national and international sources.

a/ Gross domestic product for market economies; net material product for centrally planned economies.

b/ Preliminary estimates.

c/ Secretariat forecasts: based on Project LINK country models and other institutional forecasts for developed market economies; 1983 plan figures for centrally planned economies; Secretariat forecasts for developing countries.

Retrenchment in the developing countries

Because of the continuing deterioration in the external environment and the intensification of domestic difficulties, the economic performance of most developing countries in 1982 was worse than the poor record of 1981. 2/ The per capita income of the group fell by close to 3 per cent. Growth in agricultural output was weak and, in any event, insufficient to compensate for the decline in industrial activity.

The unprecedented decline in industrial activity reflects depressed global demand conditions. Demand for exports generally remained weak, and in a large number of countries export revenue fell considerably. In numerous countries, ongoing efforts to bring inflation under control or to cope with increasing foreign exchange constraints militated against any action to stimulate domestic demand. Nor did private investors - in those developing countries where they play an important role - abandon their already cautious attitude. As a consequence, aggregate demand sagged and investment tended to fall.

Supply constraints also contributed to the constriction of domestic production. As external payments difficulties worsened, imported inputs became scarce. Over the course of 1982, the intensity of the adjustment process changed radically in many of these countries. As the continued weakening in export earnings was followed by rapidly dwindling international reserves and diminishing access to credit, a further slow-down in imports became inescapable. From a gradual, usually programmed, reduction in the expected level of imports, many countries had to shift to emergency cuts, mostly ad hoc measures of import restriction. For the first time in the last 20 years, real imports of developing countries actually declined in 1982, reinforcing the contraction in world demand.

While developing countries reduced their real imports, they continued to increase their real exports, though at a reduced pace. Thus, the very substantial adjustment efforts undertaken by the net energy-importing developing countries since the second half of the 1970s were continued. 3/ As in earlier years, however, these efforts were very largely frustrated by a deterioration in the terms of trade; they worsened by some 3 per cent in 1982, the fifth consecutive year of decline. As a consequence, the balance of trade - and hence the current account deficit - did not improve to any significant extent during the year.

For the least developed countries and food deficit countries in general, the situation became particularly precarious. The very tight external payments position often prevented any significant increase in food imports, while stagnant or decreasing family incomes seem to have worsened nutritional standards in many areas. In other net energy-importing developing countries, similar problems have emerged, particularly among urban groups.

Gross domestic product decreased significantly in the net energy-exporting developing countries. Weakening demand in international oil markets led to a drop in the volume of exports and to substantial cutbacks in oil production. The cutbacks were heavily concentrated in surplus countries. The reductions in production in Kuwait, Qatar, Saudi Arabia and the United Arab Emirates ranged from 20 to 30 per cent. None the less, other economic activities still experienced considerable growth, both in these countries and in other net energy-exporting countries.

The weakened market for oil substantially reduced import demand and the payments surpluses of the net energy-exporting developing countries. While in 1980 and 1981, their import volume had increased by nearly 20 per cent and 25 per cent respectively, contributing to the growth in trade among developing countries, it virtually stagnated in 1982. Export revenues, on the other hand, fell abruptly. As a consequence, there was a widespread deterioration in their current account balances. The group's surplus, which had been nearly $40 billion in 1981, turned into a small deficit in 1982. Although by the end of 1982 the international reserve situation was still very comfortable in the majority of these countries, policies veered towards further retrenchment, particularly in some of the countries with large current account deficits.

As a result of weakening export receipts and the growing cautiousness in international financial markets, the balance of payments tightened for most developing countries in 1982. For several of the countries with a large external debt, the situation became critical in the second half of the year. The debt service ratio - amortization plus interest payments as a share of exports - had been gradually increasing in this group of countries since 1974. By 1981, for half of the 15 largest debtors, 4/ this ratio had reached levels of 40 per cent or more. In the two largest debtors the ratio was above 60 per cent. As a significant part of this debt was on commercial terms with maturities that had progressively shortened and with floating interest rates that had risen, and as there was some bunching of repayments, debt service payments due in 1982 increased rapidly. At the same time, the extension of new commercial bank credit began to slow down, causing in the second half of the year a serious liquidity squeeze in a number of countries, and leading in some cases to the postponement of payments on principal. International financial markets were shaken, and some sources of commercial credit dried up. The highly publicized international liquidity squeeze prompted banks to attempt to limit their exposure to developing countries in general. This increased uncertainties and magnified the problem, making further retrenchment necessary in some countries.

The weakening of domestic demand, as well as policies initiated before 1982, led to an easing of inflation in most developing countries. The rate of increase in consumer prices fell significantly in two thirds of these countries. In several, it was halved with respect to the previous year. But in a number of developing countries caught in a vicious circle of devaluation, increases in consumer prices and wage hikes, inflation accelerated markedly in 1982. By the end of 1982, there were about a dozen developing countries, mostly in Latin America, whose rate of inflation was well above 50 per cent; in half of them it was close to 100 per cent. 5/

Recovery plagued with uncertainties

The weakening of aggregate demand was arrested in some developed market economies in early 1983. In the United States, a number of indicators began to point to a measure of recovery. The financial position of many corporations has improved, and the supply of domestic credit has grown very significantly. The recent easing of financial conditions has led to a significant pick-up in expenditure on some durable goods. Residential construction and car sales have increased at a fast pace. However, on the whole, consumption expenditures have remained weak, owing to higher unemployment and a cautious attitude on the part of wage earners. The real possibility of unemployment has made many people save more rather than add to consumption. Business confidence has also not yet improved

sufficiently. Investment continues to be adversely affected by a cautious business attitude and large capacity underutilization. Private investment planned for 1983 is below the level of 1982.

In the face of the high levels of unemployment and extensive underutilization of capacity, recently enlarged fiscal deficits in developed market economies have helped to sustain aggregate demand. Most Governments, however, have been leaning towards some tightening of fiscal policies and the positive addition to aggregate demand of budget deficits in 1983 is generally expected to be small. Nor is the outlook hopeful for increased exports. Flagging aggregate demand in general, and contraction in many developing countries, particularly those experiencing severe balance-of-payments pressures, will adversely affect the exports of industrial countries.

For the developed market economies as a whole, demand is unlikely to provide a substantial impetus to growth. Unless there is a very significant change in business confidence and consumer attitudes, growth in the combined gross domestic product of these countries may well remain below 2 per cent in 1983.

The lack of confidence in the underlying strength and stability of national economies largely explains the caution of business and consumers. While prices and wages have been advancing much more slowly in recent months, fears that inflation might be re-ignited are very present. The high levels of unemployment, which are unlikely to experience any early reversal, also underline the economic pessimism. Even with a moderate recovery in 1983-1984, the rate of unemployment might increase by 1 per cent or more in several industrial countries. As a consequence, unemployment is becoming a central concern and is likely to remain a persistent political, social and economic issue at least until the end of the decade.

Prevailing uncertainties are partly reflected in high real long-term interest rates. As pointed out in the World Economic Survey 1981-1982, recovery in 1982 hinged on an early and significant drop in interest rates. This did not materialize in the first half of 1982. While short-term interest rates in the United States did fall appreciably in the second half of the year, long-term rates, particularly real rates, have remained high (see table I-2). This again is having an important bearing on recovery.

There is no clear-cut explanation of why real rates have remained so high during a period of protracted recession. Among the factors which appear to be relevant are the lagged effects of the very restrictive monetary policies pursued in the United States up to the third quarter of 1982, the efforts of corporations to improve their liquidity position by converting short-term into long-term debts and lingering uncertainties in international financial markets. But probably of greater, and less transient, importance is the concern about what is seen to be insufficient progress in coming to grips with expected fiscal deficits. On the basis of present tax and expenditure policies, budget deficits are expected to increase in some major industrial countries over the next several years, even though recovery would raise tax revenues and reduce expenditure on unemployment benefits. Over the last decade or so, the expenditure of general government has risen strongly relative to gross domestic product in most developed market economies. The extension of social security and social welfare systems on the assumption of a continuation of high rates of economic growth, combined with the increasing numbers of the elderly, are among the reasons accounting for the past expansion of expenditure. As economic growth has slowed, the share of government expenditure in gross domestic product has risen sharply. 6/

Table I-2. Nominal and real long-term interest rates in the United States a/

(Percentage)

Period	1965-1969	1970-1974	1975-1979	1980	1981	1982	
						Jan-June	July-Dec
Nominal	5.7	7.7	8.7	11.9	14.2	14.8	12.8
Real b/	2.0	1.8	1.3	2.4	4.4	7.1	7.0

Source: Department of International Economic and Social Affairs, United Nations Secretariat, based on Economic Report of the President (Washington, D.C.: United States Government Printing Office, 1983).

a/ Average yield on Moody's long-term Aaa corporate bond issues. Yields on these bonds are highly correlated with yields on dollar-denominated international bonds issued by United States and European companies.

b/ Nominal yields adjusted by the rate of change of the United States GNP deflator.

Without some adjustment in budgetary policies, budget deficits are expected to increase even though substantially higher rates of capacity utilization were to prevail. Besides the fear that such deficits might be monetized and reignite inflation, this gives rise to the expectation that public borrowing will continue to make heavy claims on private saving, keeping long-term interest rates high. But high real interest rates are a factor behind the weak investment activity and are clearly an impediment to sustained recovery.

Two other factors are also affecting global investor confidence: these are exchange rate volatility and increasing protectionism. Export activities, and particularly new investment in such activities, are hindered by unexpected and frequent exchange rate movements and by protectionist moves that increasingly evade traditionally accepted rules.

At the Versailles summit in June 1982, an intensification of monetary co-operation among the seven larger developed market economies was agreed upon. It was hoped that closer co-operation would lead to increased currency stability. However, the implementation of this agreement has proved elusive, and fears of unexpected and significant exchange rate fluctuations have not subsided. Nor have protectionist pressures eased. Developments in 1982 confirmed that a further erosion in the rules of the game was taking place. Not only have new lines of activity been affected by protection, but protection has also taken new forms. More important perhaps, has been the insistence of several industrial countries on achieving a balance on bilateral trade with other industrial partners. All these moves tend to inhibit international trade and to deter investment decisions. They are hindrances to growth and structural adjustment. Nevertheless, given the adverse employment outlook, protectionist pressures are unlikely to diminish in the near future.

Bleak outlook for developing countries

Despite the prospects of a mild recovery in the main industrial countries, the outlook for developing countries is bleak. A number of forces are at work that are at present restraining growth in developing countries, so that the slight improvement in the prospects for the developed market economies does not translate into a significantly better outlook for developing countries. In fact, a further decline in per capita output appears to be in store for a considerable number of individual countries in 1983 as well as for the group as a whole.

At the beginning of 1983, developing countries are experiencing serious difficulties which may impede any quick response to recovery in the industrial countries. Policies to restrain imports and aggregate demand instituted in the last two to three years are not likely to be abandoned in 1983, as the conditions which gave rise to their adoption will most probably continue to affect the attitudes of policy-makers.

At the moment, policy-makers' room for manoeuvre has been considerably reduced by the continuing impact of an adverse external situation. Even if some of the characteristics of the external environment were to turn more favourable, the legacy of a long period of increasingly adverse external developments would continue to limit the ability of policy-makers to change the tilt of policies in a more expansionary direction. For one thing, balance-of-payments difficulties - particularly in view of the debt situation - are unlikely to be alleviated. Moreover, the reserve position of a large number of countries is extremely precarious, and any increase in export revenues is likely to be used to improve liquidity positions rather than to add to imports.

Secondly, the debt-servicing problems that a number of countries experienced in the course of 1982 will not disappear in 1983. In fact, the solutions adopted in some cases could contribute to recurrence of the problem in the coming two years, since a significant component of the package to help some countries in debt-servicing difficulties involved the short-term roll-over of the principal coming due. 7/ Even if export earnings rise somewhat, which is not a foregone conclusion, debt-service ratios in a number of countries will remain high. Moreover, banks have already indicated their unwillingness to continue to expand lending to developing countries at past rates, so that further retrenchments in lending are likely to take place. While in some cases banks will have no alternative but to roll over maturing debt and even provide new loans, the rates of growth of net lending will undoubtedly decline and, wherever possible, banks will be looking for possibilities to reduce their exposure in developing countries.

Thirdly, the likely behaviour of government revenues narrows the scope for stimulative government policies. In most developing countries, revenues are highly dependent on foreign trade through import tariffs and taxes on export earnings and profits. Even if export earnings were to recover, the improvement is not expected to be strong enough to reverse the large budget deficits incurred in 1982. In the energy-exporting countries, oil revenues are expected to decline again. In addition, both energy importers and deficit energy exporters are expected to continue to cut back on their imports in an effort to improve their external payments situation and to make room for servicing their external debts. Therefore, further erosion in import-related government revenues might take place.

Not only is the recovery in the developed market economies expected to be very moderate by past standards, but it is also likely to be unsynchronized. While there are already signs in the United States that the recession has bottomed out - despite some lingering problems such as high prospective budget deficits and stubbornly high long-term interest rates - most European countries are still caught in the quagmire of increasing unemployment and stagnating or declining output. Although, as expected, the economy of the United States is expected to be in an upswing in the first half of 1983, it would take some time before the impulses emanating from that country have an effect on the European economies. This lack of synchronization translates into continued overall economic weakness for the major industrial centres considered as a whole. Thus the impetus that the recovery can give to developing countries is reduced.

Apart from the usual lags, an additional element which might adversely affect the transmission of growth impulses from the developed to the developing countries is an apparent increase in the viscosity of the transmission process. For example, while demand may pick up in the major industrial centres, high levels of unemployment and low international food prices make it unlikely that recent protectionist actions will be reversed. Therefore, developing countries will continue to encounter difficulties in increasing their exports in key product lines such as food, textiles, clothing, footwear, steel and consumer electronics. As noted above, the retrenchment of commercial bank lending is most likely to force countries to reduce the level or restrain the growth of their real imports, regardless of whether their exports experience some recovery or stay depressed.

A number of other key variables in the external environment affecting developing countries are unlikely to show a turn for the better. For example, developing countries cannot expect any improvement in workers' remittances. In some countries - for example, India, Pakistan, Egypt, Yugoslavia, and Turkey - workers' remittances have played an important role in the past as an additional source of foreign exchange. High or even increasing unemployment in the industrial countries and the disappearance of the oil-led boom in OPEC member countries imply that such remittances, which peaked in 1980, are likely to be reduced further in 1983.

Barring a significant shift in the policies of the major donors, the levels of ODA will at best remain unchanged, particularly in real terms, since persistent budget deficits in developed countries and falling export earnings in OPEC countries are factors often advanced against increasing ODA flows. The further likely retrenchment in ODA flows will particularly affect the lower-income countries, whose export earnings are highly concentrated on primary commodities, the prices for which are expected to remain roughly at their current low levels.

The situation of the handful of high-inflation developing countries is particularly precarious and their outlook is highly constrained. In these countries, the room for manoeuvre in economic policies is even more restricted than in other developing countries, since the top priority concerns of policy-makers must include the attainment of a greater degree of internal equilibrium. While restrictive policies alone are unlikely to solve the problem, the policy package would necessarily have to include the maintenance of demand-restraining measures for an extended period of time.

The outlook for the energy-importing countries may improve somewhat in the course of the year. Lower average interest rates, weak oil prices, and modest

increases in primary commodity prices should bring some relief to the balance of payments. In addition, current account deficits are expected to show a marked decline in relation to export earnings, which should set the stage for an improvement in these countries' credit-worthiness. However, the factors mentioned above are likely to override these somewhat less pessimistic elements in the view of policy-makers. In addition, the agreements reached with the IMF and the private banks in the course of 1982 and in early 1983 call for decisive adjustment measures; therefore, if countries in serious payments difficulties are to be able to continue drawing on credit lines from these sources, they will have to show progress towards meeting the adjustment objectives specified in these agreements. In sum, the 1983 growth rate for the energy-importing countries is expected to be moderately higher in aggregate than in 1982. Nevertheless, the group's growth will lag considerably behind historical experience.

For the energy-exporting countries which have been significant capital importers, the short-term outlook is not promising. There is a distinct possibility that the economic performance of these countries may deteriorate further, mainly on account of falling oil prices and export revenues. As in a number of energy importers, deflationary adjustment policies, particularly in countries with high debt-servicing ratios, may have to be maintained or even intensified.

Even the capital-surplus countries have adopted considerably more cautious policies in the wake of the appreciable decline in their financial surpluses. As a result, the energy-exporting countries as a group have ceased to be a growth pole in the world economy. While this has affected the exports of a broad range of countries, retrenchment in the energy exporters has had particularly adverse effects on the group of more industrialized developing countries which had come to rely increasingly on them as markets for their exports of manufactures and service contracts.

Overall, the short-term outlook for most developing countries is bleak. The first half of this decade is likely to be one of stagnation rather than development. For the second half of the decade, many uncertainties still persist. The main uncertainty relates to investment, which under current circumstances is unlikely to rise sufficiently to provide for a substantial acceleration of the growth rates. Though growth rates may improve somewhat, given present international policy stances, the developing countries are very unlikely to approach the 7 per cent growth target set in the International Development Strategy for the Third United Nations Development Decade before the end of the 1980s.

Adjustment in developing countries: a new phase

The intensity and duration of external disturbances since the late 1970s have progressively affected the policies pursued by developing countries to deal with their growing external imbalances. In the aftermath of the disturbances of the mid-1970s, the adjustment policies of developing countries contained an element of demand restraint to slow down the growth of imports. However, the availability of external financial resources gave most countries enough breathing space to spread out the adjustment period over a number of years and to emphasize supply-side adjustments in the policy mix they adopted to reduce their large current account deficits. Thus the expansion of exports and investments in selected sectors such as energy and agriculture was actively promoted. These policies were based upon

the expectation that shortfalls in export earnings would prove to be temporary and that export markets would remain open. In the current situation, conditions are very different. With a bleak export outlook, a drastic reduction in the availability and a change in the quality of financial flows, adjustment efforts tend to emphasize demand and import restraint. In a large number of countries imports have fallen in real terms, affecting current industrial production and medium-term growth prospects.

Adjustment in energy-importing countries

In the last few years, the energy-importing developing countries have experienced a series of severe external disturbances which have resulted in a sharp and continuous deterioration in their terms of trade and in acute pressures to reduce imports. In the 1978-1982 period, the terms of trade of this group of countries are estimated to have worsened by about 25 per cent, with only a marginal recovery expected in 1983-1984. The disturbances that accounted for the deterioration in the terms of trade were the increase in the prices of imported manufactures (1978-1980), the sharp rise in oil prices (1979-1981), and the slide in the prices of primary commodities that began towards the end of 1979 for tropical beverages and became a generalized phenomenon by the end of 1980. In addition, countries that had been borrowing in international capital markets were adversely affected by the sharp increase in interest rates. Average rates paid by the energy-importing countries rose from 7 per cent in 1979-1980 to almost 10.5 per cent in 1981-1982. Interest charges on floating-rate debts to banks reached the unprecedented level of 17 per cent in 1981-1982. Finally, international credit markets tightened progressively as the unfavourable effect of the recession on developing countries' external accounts became more apparent.

Some countries began to take measures to deal with these adverse external developments as early as 1979. Since then the policy stances of a growing number of countries have turned increasingly restrictive. During 1982, efforts to reduce trade deficits were intensified: import volume is estimated to have declined by 3 per cent, while export volume rose by perhaps 3 per cent. For the 1978-1982 period as a whole, import volume rose at an average annual rate of about 3 per cent; on the other hand, export volume increased at a rate of nearly 8 per cent. As can be seen in table I-3, had trade prices remained constant at their 1977 levels, the trade deficit of these countries would have all but disappeared by 1982. 8/ These calculations reveal the efforts that energy-importing developing countries have exerted to correct their external imbalances. The cost has been a sharp reduction in their growth rates up to 1980 and falling per capita output in 1981 and 1982. In spite of the adjustment efforts made, their combined trade and current account balances recorded large deficits. Only in 1982 did these deficits show any tendency to decline.

Table I-3. Net energy-importing developing countries: trade balances in real and nominal terms, and growth rates of real output and income, 1977-1982

(Trade balances in billions of dollars; growth rates in percentages)

	1977	1978	1979	1980	1981	1982 a/
Export, f.o.b. (constant 1977 prices)	102.0	113.0	121.7	132.7	145.4	147.7
Imports, c.i.f. (constant 1977 prices)	130.3	140.6	148.2	150.3	158.4	149.8
Real trade balance (constant 1977 prices)	-28.3	-27.6	-26.5	-17.6	-13.0	-2.1
Trade balance in current dollars	-28.4	-39.0	-53.4	-74.9	-76.4	-61.9
Growth rate of real per capita GDP b/	3.3 (4.1)	2.6 (1.4)	1.3 (0.6)	2.2 (0.4)	-0.6 (-1.4)	-1.1 (-1.7)

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International Financial Statistics and other international sources.

a/ Preliminary estimates.

b/ Figures in parenthesis refer to growth rates of real per capita GDP adjusted for changes in the terms of trade. Both sets of growth rates are expressed in 1977 prices and exchange rates.

The policy package adopted to effect the required balance-of-payments adjustment has been heavily slanted toward demand restraint and the control of imports by whatever means were available. 9/ Given the adverse external situation, countries found they had progressively less room to stimulate investment in order to institute an orderly process of import substitution or to expand exports. While export promotion efforts have continued - and in some countries they have yielded growth rates in export volumes that are substantially above the expansion of world trade - the clouded outlook for world trade and the need to bring about relatively quick external adjustment have precluded heavy reliance on such policies. Therefore, most countries have had little choice but to attempt to compress imports

as rapidly as possible. For this purpose, a combination of measures including tariff increases, devaluations and discretionary import controls has been used in various proportions by different countries. The imports of capital equipment, which can be compressed without affecting current production, have been particularly affected. The decline in investment rates and in the imports of investment goods cannot but have adverse consequences on medium-term growth prospects. Moreover, the unplanned nature of the import controls that have been required to deal with external imbalances may eventually have unforeseen effects on resource allocation.

Adjustment policies during the ongoing world economic downturn contrast markedly with the policies adopted in response to the recession of the mid-1970s. During the earlier period, capital flows behaved in a counter-cyclical fashion and developing countries were able to sustain growth even in the face of a sudden contraction in aggregate demand in the developed economies. Even though growth rates declined somewhat, they did so much less than in the industrial countries. Investment, both public and private, was not only maintained, but in some critical areas - e.g., in energy and production for export - was significantly stepped up. Discretionary import controls were generally avoided, and most countries relied on export promotion policies to correct the temporary swelling of their current account deficits. While GDP in the developed countries was practically stagnant in the two-year period 1974-1975, that of the energy-importing developing countries rose by 4.5 per cent per annum.

This achievement was made possible by favourable conditions as regards external capital flows. ODA from developed countries and from OPEC member countries increased strongly in real terms, thereby helping the low-income countries to weather the crisis. Countries which were considered credit-worthy by the international banks had little difficulty in obtaining sizeable medium- and long-term credits with which to finance their current account deficits. Both supply and demand factors were then favourable to borrowing developing countries. Moreover, nominal interest rates on such loans were much lower than in recent years. On the one hand, the international banks had an ample availability of loanable funds, originating mainly in the deposits of a significant portion of the current account surpluses of the oil-exporting countries. On the other hand, the general expectation was that the recession would be temporary, and that demand and prices for the commodities exported by the borrowing countries would soon strengthen. Therefore, real interest rates in terms of the expected prices for the borrowers' exports were very low or perhaps even negative. With the exception of a few countries, the levels of foreign indebtedness were comparatively low, and even those countries that had relatively high debt-servicing to export ratios were in a favourable position to take advantage of a recovery in the developed countries. Thus the recycling process went smoothly. In the two years that followed the recession, the exports of the energy-importing countries expanded rapidly and their combined current account deficit fell dramatically.

External conditions have been considerably more adverse during the ongoing recession. In the first place, the external pressures that developing countries have had to absorb have been more intense and protracted. There is less confidence in the future growth of export earnings and, therefore, in the capacity to service debt. Secondly, interest rates have been high. Thirdly, trends in international capital flows have been increasingly pro-cyclical. Between 1978 and 1981, ODA flows deflated by import prices declined by about 15 per cent; and although the information is still very sketchy, there are no indications that these trends were

in any way significantly reversed in 1982. Governments in the major industrial countries have been making efforts to reduce large and growing budgetary deficits, and ODA allocations in several countries have suffered substantially. For their part, the oil-exporting developing countries, many of which have seen their current account surpluses turn into large deficits, have been hard pressed to sustain their already large aid programmes.

As regards flows from private capital markets, retrenchment in medium-term lending by banks and the need to resort increasingly to short-term financing led to a progressive worsening of liquidity positions. In combination with falling export earnings, these developments resulted in very rapid increases in debt-servicing ratios. In some of the more heavily indebted countries, the situation reached crisis proportions in the second half of 1982. 10/

The energy-exporting countries

In contrast to the energy-importing countries, where the process of deflationary adjustment has been under way for several years, the energy exporters were faced with the need to effect an abrupt policy shift as the external environment turned adverse in the course of 1981. On the strength of rising oil export earnings, brought about mainly by the price increases of 1979-1981, imports rose very sharply through most of 1981. As discussed in detail in the following chapters, the much higher level of oil prices prevailing since 1979 was maintained in the face of a deepening world economic recession by sharp production cut-backs. Most of the drop has been concentrated in the capital-surplus countries (see table I-4). In 1980-1981 the loss of output stemming from the Iran-Iraq conflict accounted for a large share of the drop in total production. In 1982 most of the decline was the result of the deliberate reductions in Saudi Arabia's oil production.

Table I-4. Net energy-exporting developing countries: rates of change in the volume of oil output and in average oil prices, 1979-1982

(Percentage)

	1979	1980	1981	1982
Oil output	3.1	-10.1	-13.4	-12.4
Capital-surplus countries	2.1	-14.7	-18.9	-20.1
Deficit energy exporters	5.3	- 0.4	- 3.9	- 1.2
Average oil prices	44.1	65.8	11.5	- 4.8

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Oil and Gas Journal; United States Department of Energy, Weekly Petroleum Status Report; and Petroleum Intelligence Weekly.

As regards the deficit energy exporters, the position of different countries has varied. OPEC member countries have generally followed collectively agreed policies of scaling down production, while other oil exporters have generally increased output, in some cases quite substantially. The combined oil production of these countries has tended to decline, but by substantially less than that of the capital-surplus countries. 11/

Until 1981, the impact of shrinking demand was masked by the very sharp increase in prices. Beginning in the first quarter of 1981, however, prices began to weaken, and the downward movement in the volume of exports was reinforced by falling prices. It thus became increasingly evident that earlier expectations of rapid increases in export earnings would not be realised.

The capital-surplus countries were in a position to absorb a substantial fall in export earnings without incurring current account deficits, and at any rate they could fall back on their large stock of accumulated international reserves and foreign investments. This was not the case for the deficit energy exporters. Apart from a few exceptional years when oil prices rose very sharply (1974 and 1980), these countries have consistently been capital importers. In fact, on the basis of their favourable export prospects, some of these countries had been borrowing very heavily from the international banks. When exports failed to increase according to earlier expectations, the more heavily indebted countries in this group found themselves progressively unable to obtain medium-term credit, and the proportion of their debts maturing within a year grew very sharply. As oil export earnings plummeted and interest rates on bank loans remained high, a number of these countries were faced with the inability to service their debts in the second half of 1982.

Other countries within the group were in a more favourable external financial position. Since they had not borrowed heavily from the banks before the eruption of the crisis, their debt-service ratios were still rather low. None the less, given the poor prospects for the oil market, they were also affected by the retrenchment under way in loans to developing countries from the international banks. As a result, most of the deficit energy exporters have been unable to avoid taking drastic action to hold back mounting current account deficits.

The result has been a sudden and dramatic deterioration in economic performance. As shown in table I-5, the pace of increase in the imports of the deficit energy exporters began to slow down noticeably in mid-1981. As balance-of-payments difficulties mounted, a steep decline in imports set in. 12/ Even the capital-surplus countries adopted more cautious import policies in the course of 1982.

Table I-5. Net energy-exporting developing countries: rates of change in the value of imports, 1980-1982

(Percentage change from corresponding quarter of preceding year)

		Capital-surplus countries a/	Deficit energy exporters b/
1980	First quarter	60.5	28.9
	Second quarter	44.8	43.6
	Third quarter	33.8	43.2
	Fourth quarter	4.3	33.7
1981	First quarter	15.4	24.5
	Second quarter	32.3	20.7
	Third quarter	16.0	10.8
	Fourth quarter	27.7	14.6
1982	First quarter	13.9	4.8
	Second quarter	10.0	-5.3
	Third quarter	-	-14.5

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International Financial Statistics.

a/ Excluding Brunei.

b/ Excluding Angola and Congo.

The sudden and dramatic reversal of import growth rates reflects the policy shifts that were imposed upon the deficit energy exporters by rapidly mounting balance-of-payments pressures. Many of the policies which had been instituted earlier by the energy-importing countries were increasingly adopted by the deficit energy exporters beginning around mid-1981. Although some countries continued to pursue relatively expansionary policies well into 1982, most countries had no option but to effect a dramatic policy reversal as their export earnings were increasingly eroded by the recession, prospects for a prompt recovery vanished, and

international capital markets tightened. Ambitious development plans were scaled down, new projects were abandoned, and generally deflationary fiscal and monetary policies were adopted. While the timing of the crisis has varied from country to country, practically all countries, particularly those with very large populations (e.g., Mexico, Nigeria and, more recently, Indonesia) have been affected. As a result, during 1982 the real imports of the group as a whole may have declined by about 5 per cent, after advancing by over 20 per cent in 1981. During 1980-1981 this group of countries had managed, on average, to realize rates of growth of GDP in the range of 4 to 5.5 per cent; in 1982, preliminary figures indicate that their aggregate GDP was stagnant.

Further adjustment: the dangers ahead

As argued above, under present circumstances a large number of developing countries will have little choice but to maintain, and in some cases intensify, the adjustment policies that are already in place. This implies either a further reduction in import levels or maintaining them at their currently reduced levels. The question arises whether this situation can be allowed to continue for long and whether such policies will be sufficient for the countries with high current account deficits to ride out their balance-of-payments problems.

The large falls in imports in 1982 had severe consequences for growth and adversely affected living standards. Moreover, despite sharp declines in aggregate output and imports, a large number of developing countries were unable to avoid critical balance-of-payments situations. They had to resort to drawing down reserves to dangerously low levels, to emergency loans from official and private sources, and to moratoria on the repayment of debt coming due. By March 1983, however, the situation appeared manageable since the largest debtors had already negotiated a financial programme with the IMF and with other important creditors. The future, none the less, remains uncertain and fraught with difficulties.

There are still several developing countries which are facing acute payments problems and which have not yet negotiated a financial programme with their creditors. These are mostly low-income and medium-size developing countries and countries whose private debt is not large enough to jeopardize the situation of commercial banks. Their payments difficulties could be eased substantially through renegotiation of official debt. Even so, these countries are unlikely to be able to avoid some further compression of imports. Weak oil prices will also put further pressures on the financial situation of a number of energy exporters which will also require some financial accomodation and probably further adjustment. Still, unless oil prices drop well below the benchmark established in March 1983, they are unlikely to cause a major disruption in international financial markets. In effect, while lower oil prices will intensify financial strains for many energy exporters, such strains will subside somewhat in energy-importing countries.

The overall picture, however, does give cause for concern. Lagging imports will continue to depress output and incomes. A second or third year - even a fourth year in some countries - of falling living standards can become a reality. Under such pressures, the social and political fabric of several countries could be disrupted, with consequences difficult to foresee. The danger of a new financial crisis still lingers on. In many countries retrenchment is rapidly reaching the limits of tolerable social, political and economic pressures. Therefore, in the absence of a decisive recovery in export earnings these countries are unlikely to be able to improve their trade balance and reduce or close their external financial gap. The situation could become particularly serious for countries with high

debt-servicing ratios. Recent negotiations to help countries facing severe debt-servicing problems have in the main postponed payments in the hope that exports will improve. Meanwhile, outstanding debt continues to increase, even in those countries in which current account deficits have been reduced. 13/ As a consequence, if exports do not recover vigorously, debt-servicing obligations might again outpace current ability to pay. Non-payment by certain countries might become unavoidable and the international financial system, after being weakened by 1982 developments, might again be shaken.

Requirements for sustained recovery

The task which confronts policy-making is not simply how to induce a measure of recovery - something which has already begun to happen - but how to translate recovery into sustained and vigorous economic growth. A weak recovery will fail both to eradicate the large-scale unemployment now affecting the developed market economies and to restore to developing countries the prospect of a pace of development more commensurate with that envisaged in the International Development Strategy. Sustained recovery will be assured only when conditions come to favour a steady revival of fixed investment. The central question is how to combine policies that will both promote recovery in the next several months and lay the grounds for a revival of investment and growth in the years immediately ahead.

In an increasingly interdependent world, however, domestic policies can be effective only within the framework of a favourable external environment. Though global recovery cannot take place without a revival of economic activity in the major industrial countries, even these countries cannot act alone; some concordance in policies affecting current accounts and capital flows is needed. For many developing countries, a lessening of strains in the international monetary and financial system would restore to them some room for manoeuvre in domestic policy. For all countries, an improved trading environment is a condition for strong recovery. More generally, a greater measure of economic co-operation among countries is a shared requirement for sustained revival of the world economy.

Reviving investment in developing countries

Nowhere is the external environment more important than in the developing regions. The efforts by many developing countries to increase saving and investment were decisively supported by a gradually improved external environment during the 1960s and most of the 1970s. The rate of investment increased and overall growth picked up significantly until almost the end of the 1970s. Over virtually two decades, growth in output and trade, and increases in fixed investment and capital inflows, went hand in hand. Thus, by the end of the 1970s the rate of investment in most developing countries was well above that of the early 1960s and economic structures had changed substantially. Furthermore, an increased rate of investment allowed for some flexibility in resource allocation and the needed structural adjustments. In particular greater productive capacity in areas such as energy, food and export activities was increasingly being put in place.

The situation changed for many developing countries at the end of the 1970s, and for other developing countries in the early 1980s. Following the very abrupt change in the international economic environment in 1979, the growth in fixed investment started to decline. At the beginning it was mostly in energy-importing

developing countries that the rate of investment began to recede. By 1982, however, a large number of energy-exporting developing countries were revising investment plans downwards. The reversal of these trends is crucial. Sluggish investment is not only seriously affecting growth prospects in the short term, but also preventing a faster pace of structural and technological change.

Although further efforts by developing countries to increase saving, to seek out sound investment projects and to support technological innovation can make a significant contribution, a turnaround in the international financial and trading environment is vital to a decisive revival of investment. There are three main reasons for this. First, developing countries import most of their machinery and capital equipment; unless their import capacity improves considerably, investment will continue to be severely constrained. Secondly, the saving rate in these countries is partly dependent upon export performance; growing exports can lead to a significant increase in the financial resources for investment. Thirdly, an improved international environment would increase confidence, permit policy-makers to adopt bolder policies, and open up new avenues for investment in trade-related activities.

Stepping up investment in the centrally planned economies

In most centrally planned economies, investment activity also continues to be restrained by fears of aggravating external imbalance as well as by fears of straining domestic markets for consumer goods. This is especially the case in the smaller and more open Eastern European countries, whose policy flexibility has been measurably restricted by the debt-servicing burden, turmoil in international financial markets, and the ongoing deterioration in their terms of trade. So far these economies have been unable to implement the policies envisaged in their current medium-term socio-economic plans for 1981-1985. Until these constraints are eased, there will be little improvement in reversing infrastructural bottlenecks or in speeding up the growth of factor productivity.

A strong recovery in international markets - in particular import-demand from Western Europe - and an easing of tensions in financial markets would contribute significantly to the growth prospects of these countries. 14/ However, improvement in economic performance also has a regional dimension: a co-ordinated economic recovery programme based on specialization and assured procurements of basic fuels and raw materials from within the group of planned economies would alleviate a number of other constraints that are at present making for weak investment and slow growth prospects.

Sustaining recovery in developed market economies

A main cause, as well as effect, of the deterioration in the growth performance of the developed market economies that has occurred since the early 1970s has been the decline in the growth of fixed investment. In present circumstances, with substantial underutilization of capacity in most branches of industry, high long-term interest rates and doubts about the strength of the recovery, there is generally little incentive to invest in new capacity. It is true that the change over recent months in the thrust of monetary policy in the United States should, by putting downward pressure on interest rates, strengthen the cyclical upturn in demand, particularly for durable goods; it should also contribute to easing the financial strains of corporations and thus bolster confidence somewhat; and it should allow partner countries more scope for

reflation, particularly through monetary policy. Policy-makers in the developed market economies are none the less generally reluctant to pursue more vigorous expansionary policies. They are deterred by the fear that such policies might adversely affect business expectations about medium-term prospects, which could induce greater hesitation in the making of present investment decisions. But without more vigorous expansionary policies, recovery will lack strength, levels of demand will not be sufficient to bring present productive capacity into full use, and the incentive to undertake new investment will remain weak.

The main economic concern about the future which complicates the link between investment and present demand management policies is the fear of a recrudescence of inflation. Expectations of accelerating inflation could discourage investment decisions because they increase uncertainties about the future returns on investments; not only does accelerating inflation alter the expected yields on different kinds of investment, both fixed and financial, but it is also seen as likely to bring about reversals in demand management policies which would dampen economic activity and lower profits.

With the presently extensive underutilization of productive resources, there seems little likelihood that expansionary demand management policies would generate demand pressures sufficient to accelerate markedly the prevailing upward movement of prices and wages. Certainly as recovery gets under way, some price increases are likely, and indeed desirable. In particular, prices in most international commodity markets should regain some of the losses sustained in recent years. To some extent, the slowing of inflation in the developed market economies over the last two years has been a consequence of falling world commodity prices, a trend which has had an important bearing on the retrenchment forced on most developing countries and on the debt-servicing crises that have threatened the international financial system. While it will erase some of the apparent progress made in the developed market economies in containing inflation, a recovery in commodity prices is much needed.

In considering the risk of a resurgence of inflation over the next few years, the important question is not the trend in commodity prices but the size of wage settlements and the behaviour of enterprises in fixing prices. The rate of increase in nominal wages has fallen substantially in most developed market economies over the last year or so, and the pace of advance is now no higher than it was in the 1960s. A number of Governments have introduced general or partial measures which will restrain large increases in the immediate future. But these steps are temporary. Further, the great many enterprises which are not subject to intense price competition from other domestic or from foreign producers are likely to seek to improve their profitability and their liquidity by raising prices as business conditions improve. There is thus still a need to develop a more complete and permanent set of measures which will subject the price-setting of enterprises and wage settlements to greater external discipline and restraint. Steady and pragmatic use of a range of measures running from action to discourage oligopolistic pricing behaviour to the exercise of direct controls, would reduce the likelihood that recovery could lead to a new acceleration of inflation. The consequent benefit would be large. It would enlarge the room for manoeuvre by policy-makers, make possible higher levels of capacity utilization and employment, and improve the prospects for investment and growth in the medium term. Indeed, a higher rate of investment would itself contribute significantly to a reduction in inflation: by bringing about a higher rate of increase in labour productivity, it would reduce the pace of advance in wage costs per unit of output.

Measures to dampen cost inflation and to make possible a more vigorous growth in demand would greatly encourage investment decisions. Investment, however, is also deterred by the currently high real long-term interest rates and by the fear that they may continue indefinitely. While the present high rates have been partly caused by the lagged effects of a restrictive monetary policy, they also reflect an expectation that budget deficits may increase even after recovery has taken place. The persistence of large budget deficits into a period of high levels of economic activity would, through public borrowing, make heavy claims on private saving, thus restricting the resources available for financing productive investment and maintaining the upward pressure on interest rates. The adjustment of budgetary policies to remove the prospects of persistent, and large, structural deficits in future years is another condition of strong revival in investment.

While fears of a revival of cost inflation and of persistent budget deficits complicate the task of policy-makers, they are not an argument for inaction. Investment will continue to languish if recovery remains weak. Early stimulatory action is called for, particularly in those developed countries where inflation and pressures for wage increases have eased. Monetary stimuli can be quickly deployed. But changes in policies, particularly monetary policy, can easily lead to pressures on the exchange rate, unless the timing of such measures is more or less synchronized among countries, and economic agents have a broadly similar interpretation of the reasons for the policy change. This reinforces the need for the international co-ordination of policies. The summit meeting at Williamsburg, Virginia, in May of this year provides a fresh opportunity for progress in this field.

Policy actions can change the outlook very significantly. A fragile recovery is not the only plausible scenario for developed market economies. Under certain conditions, the pace of growth could be significantly stepped up and could be sustained. These conditions include restraint in price setting, wage settlements more in line with productivity increases, progress in bringing prospective fiscal deficits gradually under control, and more predictable and better co-ordinated policies among the major industrial countries. Such policies would lead to further abatement of inflationary expectations and to the revival of investment. A strong recovery in growth and increased confidence could have an important cumulative effect on investment, particularly since the long slow-down has not halted the creation of opportunities for innovation generated by scientific or technological advances. Moreover, if protectionism is kept at bay, international trade could also gather momentum. As each factor reinforces the other, the ensuing upswing might last well beyond the mid-1980s. 15/

Lessening international financial strains

If developing countries are to participate soon in recovery, and if global recovery is to be sustained and vigorous, further action on the international financial front is needed. Continued retrenchment in developing countries, which today account for one quarter of world imports, can only hamper global recovery. At the present moment, the very tight restraint on imports which many countries are compelled to exercise in order to meet other, immediate, payments obligations could be eased by an improvement in their short-term liquidity position. A lengthening in maturity of the external debt of a number of developing countries would also do much to make more foreign exchange available for the purchase of imports. For the lower-income countries, a reversal in the trend of ODA is critical for sustaining their capacity to import.

An improved liquidity position is needed to tide developing countries over their short-term payments difficulties. The less restrictive monetary policy of the United States will have some positive effect on total international liquidity, the more so if other reserve currency countries follow suit. However, the consequences of such relaxation for the liquidity position of a large number of countries is likely to be small, at least in the near future. Of much more immediate practical significance would be an early allocation of SDRs. The Interim Committee of the IMF agreed in February to consider this issue at its next meeting in September this year. If early action were taken by the IMF to make a substantial SDR allocation, the reserve position of developing countries would be significantly enhanced precisely at a time when it is most needed.

The recent decisions of the Interim Committee on quota increases, when ratified, and of countries participating in the General Arrangements to Borrow, will improve the financial position of the IMF. The availability of additional resources to make possible orderly adjustments in external payments is not only important for individual countries but also provides an assurance against disruption of the international financial system. However, resources should also be used as fully as possible to lessen the degree of retrenchment forced upon countries by the world recession. If countries are to make greater use of such resources, current borrowing limits expressed as a multiple of quotas should at the very least not be reduced for any of the Fund's credit facilities. Moreover, the appropriateness during periods of world recession of the conditions attached to the use of Fund resources needs to be reassessed. 16/

A substantial increase in other official flows is also required. The World Bank has recently put forward a programme to accelerate disbursements over the next two years, to expand lending for structural adjustment, and to give increased flexibility to countries in the use of certain project loans. These steps will help developing countries to cope with current problems. However, since this will be realized by advancing the use of resources available during the Bank's current lending programme, there is a need to increase resources in order to prevent lending from falling short of planned levels in 1985-1986.

While global recovery would go a long way towards easing the current debt-servicing problems of developing countries, some of the present difficulties are likely to persist. With assistance from the IMF, the Bank for International Settlements and certain developed countries, a number of developing countries have been helped to surmount their immediate debt-servicing problem. But the benefits of the rescue operations conducted so far may prove to be transitory if more lasting measures are not also taken. The crisis that has confronted a number of countries in recent months was brought on not only by the unusually deep and protracted recession, but also by the increasingly short-term character of their external debt. The recent debt reschedulings provided immediate relief but did not change the structure of the debt. It is in response to this fact that a number of more systematic debt conversion mechanisms have been proposed. 17/ At the heart of most of these proposals is the search for a means to transform the short-term debt of countries experiencing serious temporary debt-servicing difficulties into long-term debt. They do differ, however, in how the burden should be shared between creditors and debtors.

Action along the lines of the suggested mechanisms could avoid a recurrence of the recent debt-servicing crises, which could again happen if the recovery in export earnings of debtor countries were seriously delayed or very weak. Besides

shoring up confidence in the international financial system, such action could also strengthen recovery by easing the extent of the retrenchment which these countries have had to pursue.

From the longer-term point of view, it is a lengthening in the average maturity, not only of existing debt, but also of new financial flows, that is called for. In the World Economic Survey 1981-1982, attention was called to the increasing payments pressures and constraints on growth stemming from the shortening in the average maturity of international financial flows. It was also indicated that there was a clear possibility that the net flow of private international credit might diminish because commercial banks were becoming increasingly concerned about their rapidly growing exposure. It is therefore important to make further use of the existing channels for long-term financing, most especially the multilateral financial institutions, and to search for new financial modalities. 18/

The vast majority of low-income countries have been particularly affected by current developments. Five consecutive years of deteriorating terms of trade have left these countries with a much-reduced import capacity. There have been widespread declines in per capita incomes, particularly since 1980. Since ODA constitutes a very substantial component of financial flows to these countries, an erosion of such assistance has very adverse consequences for living standards and ongoing development programmes. At the very least, ODA, and particularly food aid, should immediately rise to levels that ensure no further worsening of poverty and malnutrition. An early resumption of growth in the low-income countries would also be significantly aided by increased resources for the IBRD-IDA and the soft loan windows of regional development banks. In this context, special attention should be paid to implementing the immediate action component of the Substantial New Programme of Action for the 1980s for the Least Developed Countries. 19/

The need for an improved trading environment

An improved trading environment is an essential component of a programme to ensure a strong and self-sustained recovery. The record of the post-war period has shown that vigorous long-term world economic growth goes hand in hand with progressive trade liberalization. At present, the case for an open trading system is at least as compelling as it was in the late 1940s: the world economy is now more interdependent, in terms of both trade and financial flows, and the problems of trade and international finance are now inextricably woven together. The time has come for decisive action to begin to dismantle the trade barriers that have been erected over a number of years.

Failure to take action in this regard is likely to cause world trade to lag behind the expansion of output. Trade in a growing number of products is now constrained by quantitative limits which, if not lifted, will hamper the export performance of countries in all major regions of the world economy. As noted a number of times in this Survey, the drift of trade policies since the late 1970s has been increasingly to limit the expansion of imports through a variety of quantitative restraints to trade, often affecting the exports of individual countries which are seen to be threatening output and employment in particular sectors. 20/ These measures have affected both trade among developed market economies and their imports from certain developing countries and centrally planned economies.

For developing countries, a recovery in export earnings is critical. The modest rates of growth forecast for economic activity in the developed market economies do not suggest that export earnings will improve significantly in the course of 1983 or 1984. The additional trade barriers erected in recent years are a further reason for such an expectation since they have multiplied the impediments to the transmission of growth between countries. But, given the growing degree of interdependence of the world economy, continuing stagnation in developing countries could become a serious drag on the recovery process. Moreover, the uncertainties generated by the financial crisis of the more heavily indebted countries would not be dispelled. Protracted debt-servicing problems in developing countries would put additional strains on the international financial system. Therefore, it is of particular importance for this group of countries that their exports expand at rates significantly faster than those of output in the major industrial centres. This could be aided by a dismantling of the protectionist measures introduced in recent years.

It is indeed questionable whether sustained world growth is possible in the context of the current trading environment. The recovery in the industrial countries in the short term is widely expected to be based on consumer expenditures, particularly on durable goods. Moreover, most forecasts coincide in predicting moderate rates of expansion of total output. In this environment, unemployment is likely either to remain at its current high levels or even to increase. The relative weakness of aggregate demand and pressures to maintain trade restrictions imply that investment is unlikely to recover. Therefore, in a longer-term context, steps to improve the trading environment and to ensure a rapid expansion of trade are likely to be an important ingredient in the revival of investment. At the heart of economic growth is the responsiveness of investment and other productive resources to changes in the pattern of demand and relative prices, to technological advances, and to changes in international competitiveness. A strong expansion in investment activity is unlikely to take place unless structural change is encouraged, 21/ and an essential element of such change is to bring about the contraction of industries that have become permanently uncompetitive. Largely in response to pressures from the industries themselves, Governments have often sought to protect or assist declining industries through such measures as orderly marketing arrangements, voluntary export restraints, the invoking of anti-dumping legislation, or direct subsidies to support present output. The need for measures to avoid undue disruption of markets and to assist in the orderly redeployment of resources has long been widely recognized. 22/ But too often, the thrust of governmental action has been to delay rather than to ease adjustments.

For all countries, it is critical that resort to arbitrary, *ad hoc* protectionist measures be halted. These measures are now important contributors to the poor investment climate that prevails both in developed and in developing countries. Quantitative and discretionary limits on imports are bound to affect most adversely the weakest members of the international community, since they have apparently less to offer as a *quid pro quo* in negotiations geared to the gradual establishment of a managed trading system. Therefore, developing countries stand to lose more than any other group of countries from current trends in the trading policies of the major industrial countries. What is less clearly recognized is that these policies are also bound to backfire on the countries that resort to them: they could put a brake on world economic recovery and seriously hamper growth in the long term.

Concluding note: recovery and international co-operation

The analysis above indicates that a change in the thrust of policies can make a substantial difference in shaping the strength, spread and duration of the recovery. In an environment in which there is a broad acceptance of the need for restraint in price setting, in which wage settlements are more in line with productivity increases and the rising trend in the structural component of the fiscal deficit is halted or reversed, expansionary demand management policies can have a very significant effect on growth in the developed market economies without re-igniting inflation. Under such conditions, investment could regain a certain momentum and through its multiplier effects reinforce the thrust of expansionary policies. Gradually, in the present situation of pervasive unemployment the cumulative effect on demand can lead to subsequent gains in real output.

However without greater international co-operation, the efforts of individual countries to revive output and investment may yield - in the end - meagre results. Most countries require growing export markets and a stable international monetary and financial system to recover. Even capital-exporting countries need an improved, and more predictable, international climate.

No doubt, attempts to formulate policies directed to the attainment of domestic objectives and to the creation of a more stable international economic environment do give rise to conflicts. It is not an easy task. But this is not a sufficient reason for unilateral actions that ignore the interests of partner countries. In a world of increasing interdependence, actions which adversely affect the interests of other countries often give rise to economic changes or to retaliatory actions which, in turn, harm the interests of the originator. If, in the process of policy formulation and discussion of different courses of action, more attention was paid to such repercussions as well as to long-term effects of policy alternatives, decisions would be improved and global interests would be better served.

Recent experience has shown that without a measure of international co-ordination of macroeconomic policies, the volatility of exchange rates, interest rates and short-term capital flows tends to increase. This heightens uncertainties and deters investment. Thus, efforts at improving consulations, particularly in regard to exchange rates and their determinants, must be strengthened. Since a favourable investment climate also requires adherence to and effective respect for trade rules, protectionism in any of its forms should be resisted. Furthermore, non-tariff barriers built over the last dozen years should be gradually dismantled.

Co-operation between individual developing countries, international agencies and the Governments of some industrial countries has proved effective in tackling the financial emergencies of the recent past. Nevertheless, more broadly-based international co-operation is needed. Global liquidity should be enhanced soon. An early decision by the IMF on SDR allocations could be decisive in reversing the recent fall in total international reserves. A quick implementation of the recent agreement of the Interim Committee on quota increases is necessary to improve the financial position of the IMF. This action should be accompanied by a maintenance of present multiples determining effective access in order to enable developing countries to draw more resources from the Fund.

The revival of investment in developing countries also requires a growing flow of long-term capital. There is a need to increase the volume of ODA and to

increase the transfer of resources channelled through the IBRD and the regional development banks. The low-income countries, already faced with particular difficulties in overcoming their poverty and economic stagnation, have been especially hard hit by recent trends. Declining prices for their primary commodities have very adversely affected export revenues. Since in these countries ODA constitutes a main element in financing the imported component of fixed investment, a substantial increase in ODA flows is particularly important for them. Measures to lengthen the maturities of the outstanding debt of developing countries in general would increase financial flexibility and lessen uncertainties; therefore, such measures could be decisive in stepping up fixed investment.

At the time of writing, a number of international meetings are fast approaching which provide opportunities to advance the scope and intensity of international co-operation along lines outlined above. While also dealing with structural reforms in the international economic system, some of which have been dealt with in this report, the sixth session of the United Nations Conference on Trade and Development to be held in Belgrade in June will seek agreement on a wide range of measures for reactivating the world economy and accelerating the process of economic development.

Co-operation among developing countries and East-West economic co-operation are important to support recovery efforts. During the 1960s and, more particularly, the 1970s, co-operative actions based on mutual advantage resulted, in many cases, in considerable progress. The new avenues of economic co-operation among developing countries explored since the early 1970s, especially in the financial area and in joint production ventures, have proved particularly effective. There is ample scope in the years ahead for further fruitful co-operation in these areas as well as in more traditional areas such as trade. 23/

Notes

1/ The degree to which the developed market economies and the developing countries have become more interrelated is indicated by trends in trade shares. In 1981 and 1982, the developed market economies shipped about 25 per cent of their merchandise exports to the developing countries compared to under 19 per cent 10 years ago. The trend in imports of industrialized market economies from the developing countries also rose from the early 1970s, when it averaged 18 per cent. It reached 29 per cent though in 1980 and 1981. For the first half of 1982, it was down to 26 per cent.

2/ Of the 81 developing countries for which there is updated information on gross domestic product, only 52 experienced a positive rate of growth in 1981. In 39 of the 52, the rate of growth declined significantly in 1982.

3/ This point is discussed more fully in the next section.

4/ Developing countries with debt service payments ranging from $2 to $20 billion due in 1982 were: Algeria, Argentina, Brazil, Chile, Egypt, Indonesia, Mexico, Morocco, Nigeria, Peru, Philippines, South Korea, Turkey, Venezuela, Yugoslavia.

5/ Though their number is small, events in these countries have significant implications for the world economy, since they account for about 30 per cent of the gross domestic product and 20 per cent of the imports of developing countries.

6/ In the United States, the current and projected increase in military expenditure accentuates the present upward shift; this, however, does not account for the rising share of public expenditure in gross domestic product over the last decade as a whole, since the share of military expenditure declined for a number of years after the early 1970s.

7/ Another very important component of this package was an increase in official bilateral and multilateral flows, which have augmented official debt.

8/ It should be noted that imports as shown in table I-4 are c.i.f. On an f.o.b. basis, the trade balance valued at 1977 prices was in surplus in 1982.

9/ Economic policy in developing countries is discussed at length in chapter III.

10/ For a detailed analysis of the debt problem, see chapter II.

11/ Exports, of course, have fallen more than production, since domestic consumption has undoubtedly risen rather rapidly. However, available data on the volume of exports are very incomplete.

12/ It should be noted that the figures in table I-6 are derived from import values, not volumes. Since import prices rose sharply up to mid-1981 and have subsequently declined somewhat, the fall in the rates of change in import values overstates the deceleration in the growth of real imports.

13/ As long as the current account deficit exceeds grants, net direct investment and the net use of reserves, it increases the outstanding debt.

14/ For further analysis of the interrelationship between trade, external financing and medium-term growth in centrally planned economies, see United Nations, "Medium-term Growth and Trade in the Light of the Socio-Economic Development Plans of Eastern Europe and the Union of Soviet Socialist Republics for 1981-1985", Supplement to World Economic Survey 1981-1982 (United Nations publication, Sales No. E.82.II.C.2).

15/ For a further discussion of the main factors that condition medium-term growth in developed market economies, see World Economic Survey 1981-1982 (United Nations publication, Sales No. E.82.II.C.1), pp. 8-14.

16/ A specific case in point is the functioning of the Compensatory Financing Facility (CFF). Developments in commodity markets in recent years have shown that the present CFF fails to serve as a device for counter-cyclical financing. This is discussed more fully in chapter II.

17/ Some of the modalities proposed are the following:

(a) Transformation of the maturity of the debt of developing countries through the intermediation of a new or existing international agency (e.g., the World Bank). Such an agency would set up a facility to provide long-term loans

(10 to 15 years) on commercial terms to developing countries in difficulty for the amount of their debt coming due in the next two to three years. ("International financial co-operation for development: report by the UNCTAD secretariat", Proceedings of the United Nations Conference on Trade and Development, Fourth Session, Vol. III, Basic Documents (United Nations publication, Sales No. E.76.II.D.12), document T/188, pp. 71-81).

(b) A new international institution established by the Governments of the industrial countries would issue long-term bonds to banks in exchange for the debts of developing countries. It would then proceed to re-schedule the debts of developing countries on a one-time basis (Peter B. Kenen, The New York Times, 6 March 1983; and Felix Rohatyn, Business Week, 28 February 1983).

(c) Creation of a temporary facility in the IMF of at least SDR 20 billion (or perhaps, use of an enlarged GAB facility), so that the Fund could play a role in restoring the credit-worthiness of countries that find themselves in difficulty. (John Williamson, "Global economic strategy" Washington, D.C.: Background paper, Conference on Global Macroeconomic Policy, Institute for International Economics, 22-23 November 1982; and Pedro-Pablo Kuczynski, "Latin American Debt", Foreign Affairs, Winter 1982/83).

18/ In this regard, the World Bank's decision to test a new set of co-financing arrangements in 1983 and 1984 may be noted (see IMF Survey, 24 January 1983), as the potential for co-financing through the World Bank and the regional development banks may be of particular significance in the private lending environment of the 1980s. Additional new financing modalities are discussed in the Report of the Task Force on Non-Concessional Flows to the IBRD/IMF Development Committee (May 1982).

19/ Report of the United Nations Conference on the Least Developed Countries (Paris, 1-14 September 1981). United Nations publication, Sales No. E.82.I.8, para. 72.

20/ For a detailed description and analysis of these policies, see Seamus O'Cleireacain, "Some notes on recent changes in commercial policy of developed market economies", Supplement to World Economic Survey 1981-1982 (United Nations publication, Sales No. E.82.II.C.2).

21/ In the period between the late 1940s and the early 1970s, when rapid economic growth was associated with even faster expansion in world trade, investment in export and export-related industries in both developed market and developing economies has recently been estimated to have amounted to between one fourth and one third of total fixed investment. See Jan Tumlir, "The need for new initiatives to oil the growth mechanism", The Financial Times, 4 January 1983.

22/ For discussion of such measures, see Supplement to World Economic Survey 1978 (United Nations publication, Sales No. E.81.II.C.1), pp. 19-28.

23/ This topic figures prominently in the agenda of the sixth session of UNCTAD. A more detailed analysis of formal and informal avenues of economic co-operation among developing countries appears in Supplement to World Economic Survey 1983.

Chapter II

INTERNATIONAL TRADE AND FINANCE

An overview

The global recession is having serious repercussions on international trade and finance. During 1981-1982, and particularly in the latter year, recessionary impulses emanating from the developed market economies spread rapidly to developing countries in the form of weakening rates of growth of real exports and, especially, deteriorating terms of trade. Moreover, the emphasis on monetary policies to combat inflation in the major industrial centres led to very high nominal and real interest rates, which contributed to the payments difficulties of developing countries. At the same time, during the course of 1982, the international banks became increasingly unwilling to continue to expand lending to most developing countries, and particularly to those countries that were experiencing difficulties in meeting their external payments. As a result, the volume of imports of developing countries contracted, adding momentum to the recessionary forces at work in the world economy. In several countries financial strains became so severe that most external payments were delayed. In the second half of the year, the international financial system was shaken by simultaneous problems in several large debtor countries.

Although they are less affected by developments in international markets than developing countries, the centrally planned economies also had to deal with the same broad set of problems: weak world markets for their exports, deteriorating terms of trade for the Eastern European countries, high interest rates on their external debt, and the drying up of international bank financing. The countries most affected by these developments were those of Eastern Europe, and they too had to prune their real import levels very substantially.

Trade in oil and in manufactured goods was particularly affected by the recession. The volume of trade in oil contracted by about 15 per cent, as the combined impact on consumption of the prolonged recession and the price increases of recent years continued to make themselves felt throughout the world economy, but particularly in the industrial countries. Trade in other raw materials was also sluggish, although it does not appear to have declined as steeply as trade in oil. The lengthening recession and high interest rates worked against any move to replenish stocks at the user level. The sharp fall in industrial production, the drop in the levels of private non-residential investment in the developed market economies, and the postponement of investment projects in developing countries affected trade in manufactures, particularly machinery and equipment.

The decline in the volume of world trade was accompanied by a generalized contraction in the levels of international reserves. The most adverse effects were felt by the developing countries and some centrally planned economies. In the absence of sufficient counter-cyclical balance-of-payments financing at a time of severe pressures on their external accounts, international reserves fell sharply in these countries.

The liquidity crisis of a number of developing and centrally planned economies was brought to a head by the progressive loss of confidence on the part of the international banks in these countries' ability to service their debts. At a time

of increasing balance-of-payments difficulties, net new flows of bank credit to developing countries began to recede in 1980, and in the course of 1982 the decline was particularly steep. For some countries, these problems were compounded by the unwillingness of banks to roll over maturing medium-term debts contracted during the mid-1970s or even short-term credits arranged in the past two years, when the market for syndicated medium-term loans began to tighten and high interest rates drove some countries to arrange credits at the short end of the maturity spectrum.

Thus the problem of extremely high ratios of debt-service payments (interest and amortization) to export earnings in a number of highly indebted developing countries and also in a few centrally planned economies looms large over the world economy at the present moment. Toward the end of 1982 and in early 1983, the most pressing financing needs of some of these countries were met on an ad hoc and emergency basis. However, without a sustained recovery in export earnings and a resumption of adequate levels of predictable medium-term and long-term capital flows, many developing countries and a number of centrally planned economies will have no option but to continue to restrict their imports, adversely affecting economic activity in the developed market economies and in other developing countries as well.

Growing protectionist pressures and a number of actions undertaken in 1982 are also complicating the world trading environment and are affecting the possibilities of recovery in both developed and developing countries. The gradual erosion in the open trading system that has taken place in recent years may dampen the recovery in the export earnings of developing countries and thus hamper their capacity to resolve their current external payments difficulties. A further deterioration in the world trading environment would place unsurmountable roadblocks in the way of a solution to the debt problem and could endanger the stability of the international financial system. Moreover, increasing quantitative limits to trade in important sectors (e.g., textiles, steel, electronic products) could cause the expansion of world trade to lag behind any recovery in the industrial countries. Therefore, external impulses to growth are being weakened by the intensification of protection, especially for developing country exports of manufactures.

A related problem that continued to affect developments in international trade and finance during 1982 was instability in exchange rates, which led to currency misalignments. In the course of the past two years, protectionist pressures have been partly accentuated by currency overvaluation. The sharp appreciation of the dollar in real effective terms was accompanied by measures in the United States to protect a number of traditional manufacturing sectors from import competition and by increasing demands from other affected sectors for similar measures. More generally, sharp fluctuations in exchange rates contributed to heighten uncertainties, which may have had an adverse impact on investment and international trade and specialization. They may have also magnified destabilizing capital movements.

Two critical issues

Protectionism: further retreat from an open trading system

Protectionist pressures in developed market economies are on the rise, and a number of further trade-restricting measures were taken in 1982. Since the late 1970s the tendency towards trade liberalization that characterized the

international economy over the preceding four decades has been increasingly jeopardized. A new style of protectionism has been gradually emerging. This new protectionism is more sectoral in scope, more discriminatory and less transparent: it focuses on specific activities, is directed at specific suppliers and relies heavily on non-tariff mechanisms. Moreover, it is geared not only to the defence of domestic markets through import restraints but also, in certain cases, to the capture of foreign markets by means of export subsidies; and, to an increasing degree, it takes place outside the GATT framework. 1/

Unemployment in developed market economies has substantially raised domestic demands for further protection. Although many such demands are still being resisted, the policy response in several cases has been to erect new trade barriers. A notable exception was Japan, which took steps to open up its market to foreign goods by easing import standards and customs procedures and by accelerating the implementation of the tariff cuts it had agreed in the Tokyo Round.

By early 1983, non-tariff barriers in developed market economies were becoming an increasingly important factor inhibiting trade. Thus, in spite of the continuing implementation of the tariff reductions agreed in the Tokyo Round and the fact that there have been attempts to liberalize trade further in new areas, the general drift in trade policies gives cause for great concern. If protectionist trends in developed market economies persist, the world trading environment could be qualitatively altered. The change could be particularly harmful for developing countries and centrally planned economies; and it could result in greater emphasis on import substitution strategies, which usually have a strong protectionist bias.

Pressures to institute trade barriers in specific industries are caused in most cases by the loss of markets for a product or certain product lines. In many instances it is a response to a temporary or permanent shift in the competitive position of any one industry. Technological innovations, rapid wage increases or abrupt changes in input prices (for example, energy) can cause such a shift. To some extent, the loss of competitiveness in certain industries may be prompted by currency misalignments, as recently observed in the United States. But the most important factor behind the dwindling markets for certain products and the recent surge in protectionist sentiment in the developed market economies has been the marked global slow-down in economic activity.

It is in the above context that many of the recent protectionist actions have been taken. During 1982, a large number of new protective measures were introduced in the areas of trade in textiles and clothing, footwear, steel, automobiles and consumer electronics. Trade in agricultural products was also affected by new protectionist actions and discriminatory supportive measures. The effect of the new measures was to slow trade flows among developed market economies, as well as their imports from developing countries and centrally planned economies.

Actions affecting textiles, clothing and footwear are of special concern to developing countries, which have become increasingly important exporters of these products. In late 1981 it was agreed to extend the Multi-Fibre Arrangement (MFA) until July 1986. The MFA now covers some 85 per cent of trade in textiles and clothing and contains more than 3,000 quotas for different countries and different products. These quotas do not allow for any significant increase in developing country exports of textiles and clothing. 2/ In addition, the United States imposed curbs on 32 categories of textile imports from China (in retaliation for

which China has banned imports of soybeans, cotton and chemical fibres from the United States). Australia set new tariffs and quotas on yarns and textile imports, and Norway extended its policy of global import quotas. Canada and Australia tightened their controls on the imports of footwear. The EEC imposed anti-dumping duties on yarn imports from Turkey, and Greece restricted imports of jute from India and Bangladesh. A particularly worrisome development is that bilateral actions both within and outside the MFA have progressively tended to accommodate trade among developed countries, and the exports of developing country suppliers have suffered accordingly.

After a lengthy dispute, the EEC entered into an agreement to limit its steel exports to the United States. Under the three-year agreement (November 1982 - December 1985), the EEC will reduce its steel shipments to the United States by about 1 million tons to an average of 5.5 per cent of the United States market for ten categories of steel. The United States has initiated anti-dumping or countervailing proceedings against steel imports from Romania, the Republic of Korea, Venezuela, Argentina and Brazil. The EEC, in turn, took action to reduce its imports of steel by over 10 per cent, mainly from Japan, the German Democratic Republic, Romania, Brazil and the Republic of Korea. Australia and Canada also restricted their steel imports.

In the area of automobiles, the United States renewed its annual quota on Japanese imports. Actions to restrain Japanese imports were also taken by Canada, the Federal Republic of Germany and the Benelux, while most other countries - including Italy, France and the United Kingdom - retained the restrictions they already had in place. In anticipation of future actions, Japan is actively pursuing joint ventures with local automobile manufacturers in Europe and North America.

Agriculture became more protected in 1982. While maintaining its quotas on the imports of meat and dairy products, the United States set import quotas that will reduce sugar imports by about 25 per cent from their 1980 level; it also increased threefold its import duties on raw sugar. Having failed to persuade the EEC to discontinue subsidies on its farm exports, the United States decided to subsidize its own, selling 1 million tons of wheat to Egypt at prices well below those of the Common Market. Meanwhile, the EEC took actions to curb the imports of manioc, bran and meat.

Another disturbing development was the resort to administrative delays to restrain imports from individual countries. After introducing administrative impediments, France is now in the process of negotiating an agreement restraining imports of Japanese video recorders. Notwithstanding, at the same time, Japanese corporations are beginning production of video recorders in various European countries.

The limited success of the GATT Ministerial Meeting (24-29 November 1982) in resolving outstanding trade disputes is symptomatic both of the seriousness of the problems confronting the international trading system and of the faltering commitment to global solutions to these problems. The signatories of the Ministerial Declaration did commit themselves to resisting protectionist pressures and to making efforts towards further trade liberalization (particularly in agriculture, tropical products and textiles); however, they failed to resolve such issues as bilateral "reciprocity" (the imposition of measures - or the threat to do so - to compensate for perceived differences in the restrictiveness of the trading

regimes of specific partners) and "selectivity" (the prerogative to single out specific sources of supply as targets for protective actions).

The controversy over these issues raises serious doubts about whether the principles on which GATT is founded are still generally accepted. As regards a number of sensitive areas (safeguards; trade in agriculture, clothing and textiles), Ministers undertook to set up machinery to continue to study possible solutions to trade conflicts arising in these areas. Although no immediate measures were taken to begin to roll back non-tariff trade barriers, there was agreement to study the consequences of phasing out the MFA and returning to normal GATT rules in textiles and clothing after the expiration of the current MFA in 1986.

While commitments to maintaining an open trading system are important, at the present moment what matters most is that these commitments be backed by concrete actions to reduce barriers to trade, particularly in those areas which the GATT Ministerial Meeting decided to keep under close review. Action to bring trade in agriculture and textiles more into agreement with GATT rules would be of special significance to developing countries.

Shortcomings in the international monetary system

The contraction in international liquidity and the continuing wide fluctuations in exchange rates among major currencies have brought to the fore the inadequacies of the international monetary system that emerged with the demise of the fixed exchange rate regime established at Bretton Woods. The domestic policies of individual major industrial countries and the operations of only incompletely-supervised private international banks have become the major determinants of key international monetary variables such as exchange rates, interest rates and international reserves. No automatic mechanism has served to bring such unco-ordinated actions into a coherent and appropriate whole in the interest of an efficient and stable world monetary system. Indeed, perhaps the single most important drawback of the present system is its limited arrangements for joint official oversight and co-ordination in the interests of the international community.

This failing is clearly in evidence in the area of exchange rate determination. Exchange rate movements have come to be unduly influenced by speculative capital flows in response to interest rate differentials, expectations about future exchange rate changes, and considerations of security in maintaining the value of capital assets. These capital flows have tended to overwhelm any effects stemming from changes in underlying trading conditions, with the result that exchange rate misalignment, from the point of view of changing cost and price relationships, has become an increasingly frequent phenomenon. Large fluctuations in exchange rates imply also large movements in the prices of tradable relative to non-tradable goods and in the prices of the same product from different countries. The result is to disrupt the orderly expansion of world trade and of investment geared to the production of goods for the export market. The link between exchange rate misalignment and protectionist pressures has already been noted in the course of this chapter.

There is, therefore, a need to bring exchange rates under greater international supervision. Undoubtedly, the advent of floating exchange rates was partly the consequence of the reluctance of individual countries to give up autonomy over their macro-economic policies. More stable exchange rates would thus

require a concerted effort to achieve a greater degree of policy harmonization. In addition, a move could be made to the establishment of exchange rate target bands which would correspond to an appropriate notion of equilibrium from the point of view of underlying trading conditions. This would lessen uncertainty and the role of private speculators in the determination of parameters as important for the entire world economy as exchange rates. Such bands could be periodically modified, much in the manner in which currency re-alignment takes place at present within the European Monetary System, in response to changes in countries' relative prices and costs. Agreement among the major industrial countries with regard to exchange rates and how to defend agreed levels or targets could pave the way for the attainment of a greater degree of macro-economic policy co-ordination. The substantial overall reduction in inflation and in the dispersion of inflation rates among major industrial countries is already providing an environment in which greater exchange rate stability can be achieved.

The behaviour of international reserves provides yet another illustration of the shortcomings of the international monetary system. The erratic nature of the processes by which international liquidity is created and distributed has become increasingly apparent since the early 1970s. While in the 1960s the world's international reserves grew at an annual rate of 4.5 per cent, during the period 1971-1981, this rate rose to 13.5 per cent. In 1982, a contraction in world reserves helped to intensify the deflationary forces at work in the international economy.

The international liquidity crisis has affected the developing countries and the centrally planned economies with particular vigour. Although the developed market economies may experience balance-of-payments difficulties, the convertibility of their currencies and their access to international capital markets imply that they are unlikely to face problems of international liquidity. The fall in their international reserves during 1982 reflected partly lower demand for international liquidity stemming from the decline in their trade volumes and prices.

The creation and distribution of international liquidity is at present a complex process which depends largely on the interaction of policies in key reserve-currency countries (particularly the United States) and the decisions of the international banking system. Collective international decision-making through the IMF has only a very limited influence: SDR allocations represent only a very small fraction of total international liquidity, and since the mid-1970s balance-of-payments financing for a large number of countries has been provided mainly by the international banks and only secondarily by the IMF. A re-assessment of the adequacy of current mechanisms governing the supply of international liquidity would necessarily encompass the broader issues of the role of international financial intermediaries, both official and private; the set of principles, rules, and norms governing access to external credit for balance-of-payments purposes; and also the more general issue of balance-of-payments adjustment.

In fact, international action to relieve liquidity constraints would be a key element of a policy package geared to stimulate world trade and hence to achieve a sustainable world economic recovery in the next few years. The sharp weakening of world trade in the last two years was due partly to the external financial constraints affecting a large number of developing countries and also some of the

centrally planned economies. Thus a relaxation of these constraints could lead to a strengthening in their demand for imports, thereby reinforcing world economic recovery.

Recent events have brought to the fore a basic fallacy of composition in current approaches to the issue of financing versus adjustment. When a single country in balance-of-payments difficulties is made to undertake deflationary policies, this will usually have a negligible impact on the world economy. However, when a large number of countries, owing to depressed world demand conditions, face similar balance-of-payments difficulties and all of them are simultaneously instituting strong adjustment measures, the result is to reinforce the downward spiral in the pace of world economic activity and to ultimately increase the domestic costs of adjustment for each country considered individually.

The above discussion suggests two ways in which decisive action by the international community could help to improve the operation of the international monetary system and of the adjustment process. The first one refers to bringing the creation and distribution of international liquidity under more effective international control. This could be done to some extent through an expansion of the role of the SDR. Under present circumstances, a limited step in this direction would be prompt agreement on a substantial new SDR allocation.

Another way of improving the operation of the international monetary and financial system would be to bring about a decisive shift in the mix of balance-of-payments financing between private and official multilateral sources in favour of the latter. In recent years, insufficient resources and the conditionality attached to IMF lending has relegated the Fund to the role of lender of last resort. Access to unconditional financing from the Fund for countries facing payments difficulties due to factors beyond their control needs to be improved. While IMF financing did grow rather sharply in 1981-1982, and a number of large commitments will be drawn upon in the course of 1983, these amounts are still small when compared to those provided by the international banks.

The accords reached in February 1983 are steps in the right direction but fall short of a comprehensive solution. The Interim Committee approved an increase in fund quotas of 47.5 per cent; and the resources of the General Arrangements to Borrow (GAB) were expanded to about $19 billion and were made available to all Fund members under certain conditions. 3/ In addition, Saudi Arabia expressed its willingness to provide resources to the Fund, in association with the GAB, and for the same purposes as those of the GAB. Nevertheless, some shortcomings still remain. First, the increase in quotas will not be fully proportional but will take into account recent changes in the relative positions of member countries in the world economy, thereby reducing the share of developing countries in total quotas. Second, access to Fund resources is limited to a multiple of quotas - currently 150 per cent annually or 450 per cent over three years - and it is not yet clear whether these multiples will be maintained or reduced by the Fund's Executive Board. Third, the recent quota increase could well be insufficient for the needs arising before the next quota review takes place.

Borrowing limits set at multiples of quota have been required because quota increases have not kept pace with the need for reserve-related financing. After peaking in 1967 at 14.5 per cent, the ratio of quotas to imports for the capital-importing developing countries declined to about 5 per cent in 1982. An increase in quotas of less than 50 per cent, which will go into effect by the end

of 1983 at the earliest, requires a maintenance of the present multiples so that access in relation to imports is not adversely affected in the next few years.

One way of improving the counter-cyclical character of Fund drawings is to further liberalize the Compensatory Financing Facility (CFF). Lending from this facility carries relatively low conditionality, and its purpose is to compensate countries in balance-of-payments difficulties for shortfalls in their export earnings or for overages in their cereal import bill due to causes beyond their control. Despite the fact that during 1981-1982 the balance-of-payments difficulties encountered by developing countries were due to a large extent to recession-induced declines in their export earnings, less than 20 per cent of their drawings from the Fund were from the CFF. The remaining 80 per cent of drawings were made under arrangements with varying degrees of conditionality. It is noteworthy that in 1982 the aggregate export shortfall for the capital-importing developing countries, as estimated using the Fund's formula, was $16 billion ($6.5 billion for the deficit energy exporters and $9.5 billion for the energy importers). 4/ By contrast, net drawings from the CFF amounted to only $1.5 billion.

Export shortfalls bear little relationship to the size of quotas, and in the past they have frequently exceeded quotas. 5/ Therefore, one of the major shortcomings of the CFF is the quota limit placed on drawings (100 per cent of quota in the case of export shortfalls, or 125 per cent if cereal import overages are added to export earning shortfalls). Since export earnings are likely to remain depressed in 1983, quota limits on CFF drawings need to be relaxed soon. At the end of 1982, over one-third of the countries which had loans outstanding had already reached their quota limit or were within 20 per cent of it, eliminating the possibility of their making further significant drawings soon. As of that date, the African energy-importing countries had already drawn up to 56 per cent of their combined Fund quotas. The recently-agreed enlargement of quotas will not help, since it will not come into effect before the end of 1983. Moreover, the increase in quotas will not solve the basic problem, since in many cases export shortfalls are likely to continue to exceed the new quota limits.

The usefulness of the CFF as an anti-cyclical instrument is also limited by the way export shortfalls are calculated, by the fact that increases in the import bill due to factors beyond a country's control are taken into account only in the case of cereal imports, and by an inflexible repayment period (3 to 5 years). The first shortcoming arises from the need to forecast export earnings two years ahead in order to estimate trend exports, which are then subtracted from actual exports to obtain export shortfalls. Under the current formula, the shortfall for a given year is therefore highly sensitive to the timing of an expected recovery in export earnings. The longer exports are expected to remain depressed, the lower the estimated shortfall. This issue is particularly important at the present time, given the lengthening of the international business cycle and the greater synchronization and variability of commodity price movements.

These inadequacies themselves suggest the ways in which they could be remedied. In the first place, shortfalls could be calculated in terms of the purchasing power of exports rather than nominal export earnings. Second, in the estimation of trends, forecasts could be made under the assumption of a reasonable recovery in export earnings. If such a recovery does not materialize, countries could be allowed to draw again (which in many cases would require the relaxation of quota limits on drawings). This would be analogous to the situation that now

prevails in the case of better-than-forecast export performance, in which case countries are required to make repayments ahead of schedule. Third, the possibility of a protracted period of poor export earnings also points to the need to tie repayments to export recovery rather than keeping to an inflexible timetable.

Developments in international trade

1982: retrogression in the volume of world trade

Since the onset of the recession in the developed market economies in late 1979, the expansion in the volume of world trade had been progressively weakening (see table II-1). However, until 1981 there were still some regions which imparted considerable stimulus to the world economy through the dynamic growth of their imports. Thus imports into the energy-exporting developing countries rose during this period by over 20 per cent per annum in real terms. And even the energy-importing developing countries, which were already experiencing severe balance-of-payments difficulties and a major slow-down in the pace of their economic growth, were able to manage rates of real import growth averaging almost 3.5 per cent per annum. During the course of 1982, the international recession deepened, and the volume of world trade declined by about 1 per cent.

The trade volumes of developing countries were particularly affected by the recessionary conditions prevailing in the world economy during 1982. Reflecting the steep decline in energy consumption in the developed market economies, the exports of the net energy-exporting developing countries contracted sharply. Within this group, the capital-surplus countries absorbed a large proportion of the decline in export volumes. The imports of these countries appear to have continued to expand, albeit at sharply reduced rates, owing to more cautious investment policies in the face of large reductions in their financial surpluses. As regards the deficit energy exporters, the payments imbalances which had already surfaced in 1981 intensified in the course of 1982. Worsening terms of trade, declining or stagnant export volumes, and high debt servicing obligations in some countries induced the members of this group either to institute or to intensify policies whose overall effect was to restrain imports drastically.

Imports into the energy-importing developing countries appear to have fallen in real terms by about 5.5 per cent. At the beginning of the year, most of the countries in this group were already experiencing severe balance-of-payments difficulties. Although their real imports had risen by over 5 per cent in 1981, most of the increase was concentrated in seven relatively industrialized countries or territories (Brazil, Hong Kong, Israel, Republic of Korea, Singapore, Turkey and Yugoslavia) which had been able to raise their export volumes, particularly of manufactures, very significantly. During 1982, balance-of-payments constraints forced practically all of the energy-importing countries to curtail imports rather sharply, sometimes by resorting to *ad hoc* import and exchange controls, large devaluations, and the imposition of emergency tariffs. Thus the spread of the global recession was more broadly felt in 1982 than in the preceding two years and affected the exporters of both primary commodities and manufactures.

Table II-1. World trade: annual rates of change in volume and prices, a/ 1971-1984

(Percentage)

	1971-1980	1980	1981	1982 b/	1983 c/	1984 c/
Volume of exports						
World	5.5	2.1	0.8	-1.5	2	4
Developed market economies	6.3	4.2	2.1	-2	2	4
Developing countries	3.0	-4.5	-3.6	-4.5	3.5	5.5
Capital surplus countries	0.8	-17.4	-18.4	-16.5	-	5
Other net energy exporters	0.2	-6.8	-8.4	-3	5	7
Net energy importers	7.2	9.1	9.6	1.5	4	5
Centrally planned economies d/	6.7	2.4	0.4	4.5	2	2
Volume of imports						
World	5.2	1.0	1.7	-1.5	2	4
Developed market economies	4.6	-1.5	-2.2	-1	2.5	3.5
Developing countries	6.5	8.1	14.7	-3.5	-0.5	5.5
Capital surplus countries	18.0	15.5	30.1	7	5	7
Other net energy exporters	8.7	18.3	22.2	-8	-3	5
Net energy importers	3.5	1.5	5.4	-5.5	-1.5	5
Centrally planned economies d/	7.4	3.8	0.7	0.5	1.5	2
Unit value of exports						
World	14.0	19.4	-2.7	-4.5	-	...
Developed market economies	11.9	13.4	-4.1	-3.5	2.5	...
Developing countries						
Capital surplus countries	33.6	70.1	11.4	-4.5	14.5	...
Other net energy exporters	26.3	51.8	6.1	-7	-11	...
Net energy importers	11.5	12.2	-3.5	-7	0.5	...
Centrally planned economies d/	10.2	12.4	0.8	-0.5	2.5	...
Unit value of imports						
World	14.1	21.1	-2.5	-4.5	0.5	...
Developed market economies	14.4	22.4	-2.9	-5	-	...
Developing countries						
Capital surplus countries	13.1	15.0	-3.5	-4	2	...
Other net energy exporters	13.9	17.2	-3.0	-4	1	...
Net energy importers	16.5	25.5	-0.8	-4.5	-1.5	...
Centrally planned economies d/	9.6	10.8	-0.4	-1.5	5	...

Table II-1. (continued)

	1971-1980	1980	1981	1982 b/	1983 c/	1984 c/
Terms of trade						
Developed market economies	-2.1	-7.3	-1.3	1.5	2.5	...
Developing countries						
Capital surplus countries	18.1	47.9	15.3	-1	-16	...
Other net energy exporters	10.9	29.6	9.3	-3	-12	...
Net energy importers	-4.3	-10.6	-2.8	-3	2	...
Centrally planned economies d/	0.6	1.4	1.2	1	-2.5	...

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International Financial Statistics, and calculations and forecasts made by the Secretariat.

a/ Rates of change in prices estimated from unit value indices expressed in dollars.

b/ Preliminary estimates, rounded to the nearest half of a percentage point.

c/ Forecasts.

d/ Centrally planned economies of Europe only.

The volume of exports of the energy-importing developing countries experienced a very sharp deceleration in 1982 as compared with rates recorded in recent years. None the less, the rate of increase of 1.5 per cent recorded in 1982 must be considered an important accomplishment in view of the negative overall trends in world trade. The reasons for the relatively satisfactory performance of developing country exports during recent years are various. For one, a growing number of countries have adopted active export promotion policies. Secondly, the more industrialized developing countries have become competitive exporters of a growing rate of manufactured goods. Since their share in the markets of the industrial countries is still small in most product lines, they have been able to expand their exports rapidly without encountering major difficulties. This, of course, has not been the case with a growing number of products (particularly textiles), of which developing countries have become important suppliers and which have been increasingly affected by protectionist actions. Thirdly, until 1982, trade among developing countries had grown very rapidly, and other developing countries, particularly among the energy exporters, now constitute important markets for those developing countries which have become exporters of manufactures. Thus the growth in the exports of the energy-importing developing countries has been highly concentrated in countries exporting manufactures.

The variables making for high export growth from this group of countries weakened considerably in the course of 1982. In spite of the competitive advantage which some developing countries enjoy in a growing number of markets for manufactures in the industrial countries, their exports could not remain immune to the effects of protectionist measures and the protracted recession in the latter countries. The contraction in the growth of non-fuel imports into the developed market economies has been sharper than that of their GNPs. Trade among developing countries was also adversely affected during 1982 by the growing and generalized foreign exchange stringency that developing countries experienced in the course of that year.

Real imports into the developed market economies declined by about 1 per cent in 1982. This represented the third year of declining import volumes for this group of countries and reflected generally weak markets and continued adjustment of oil consumption (and imports) to the price increases of 1979-1981. There were significant differences in the behaviour of import volumes as between countries. The severe recession in Canada caused imports to slump by about 13 per cent. On the other hand, import volumes in France, Italy and the United Kingdom, which recorded above-average output growth rates, rose in absolute terms. The depreciation of the yen helped to keep Japanese imports practically constant despite a rate of growth of GDP of about 3 per cent.

On the other hand, the real exports of the developed market economies dropped by almost 2 per cent. One major reason for this weak export performance was the effect of the recession on intra-group trade. But perhaps the principal factor was the considerable decline in the volume of exports to the deficit developing countries. In fact, exports to developing countries appear to have fallen substantially more than trade among industrial countries. Thus the impact on developed country trade of the recession in developing countries attests to the growing importance of the latter as markets for the exports of the former.

A large share of the decline in the export volumes of the developed market economies appears to have been concentrated in the United States, whose exports fell by over 10 per cent, owing to the loss of competitiveness brought about by the strong appreciation of the dollar during 1981 and 1982 and to declining import demand in developing countries that are important trading partners of the United States (particularly Mexico and some South American countries). Exports also declined in Japan and France, in the former owing partly to the imposition of restrictions on imports by other developed market economies. On the other hand, improving competitiveness as a result of currency depreciation helped the Federal Republic of Germany and Italy to record positive rates of growth of export volume.

Because of differences in the relative importance of trade in their economies and in the commodity composition of their exports and imports, the trade experience of the Eastern European countries differed markedly from that of the USSR or the Asian centrally planned economies. Development plans for 1982 generally emphasized the priority of correcting external imbalances, especially the containment and gradual compression of convertible currency debt. There was therefore little room for substantial gains in import volume for the Eastern European countries. Similarly, China imposed import restraints as one element of its ongoing adjustment policies. By contrast, the Soviet Union had counted on some increase in its imports in view of the harvest setbacks of 1981 and demanding pipeline construction projects. On the other hand, export promotion was to be pursued with determination in all planned economies, the Eastern European ones in particular.

In the wake of unanticipated developments, some of the Asian and nearly all of the Eastern European countries curtailed their import volumes more drastically than they had envisioned. On the one hand, their liquidity problems in their trade with the convertible currency area were accentuated by a virtual cut-off from international financial markets, which also affected other planned economies that would not otherwise have encountered payments problems. On the other hand, Eastern Europe had to face a curtailment in the availability of key commodities, particularly oil, from the USSR. While import retrenchment extended to all partner groupings, the sharpest import cuts were administered by the Eastern European countries most severely affected by the financial crunch (Poland and Romania) to their trade with convertible currency countries. The Soviet Union's substantial machinery and equipment imports boosted import volume by perhaps 6-7 per cent, which was however nearly completely offset by the sharp retrenchment on the part of Eastern Europe. China's import volume also contracted by about 10-12 per cent.

In spite of weak world demand, only modest domestic output growth of readily exportable products and tensions in the international political environment, the centrally planned economies (and particularly the Eastern European countries) none the less recorded a strong increase in export volume amounting perhaps to 4 per cent. This gain resulted in part from the near-recovery in Poland's exports. However, the major impetus to export growth came undoubtedly from the export promotion to which the Eastern European countries resorted in an effort to come to grips with severe external constraints. While it worked to correct the external imbalance, the kind of export promotion that these countries resorted to exacerbated domestic bottlenecks in material supplies in a number of countries and accentuated shortages in consumer markets.

In the past, during periods of economic expansion, world trade tended to grow considerably more rapidly than world output. By contrast, there is a distinct possibility that trade will fail to make a significant contribution to world economic growth during the recovery that is expected to begin in the course of 1983. Imports into the developed market economies are likely to expand moderately, as a result of the relatively mild recovery expected in these countries and the protectionist barriers erected in recent years. While imports into the capital-surplus developing countries might grow again in 1983, balance-of-payments constraints will continue to have a significant bearing on the capacity of other developing countries to expand their imports. Therefore, the recovery in these countries' import levels is likely to be postponed until 1984. Trade prospects for the Eastern European countries are similar, since they are expected to continue with their efforts to reduce their external debt. The Soviet Union and China are exceptions to this general picture: below-plan crops in 1982 and low cereal inventories will require further substantial imports by the former, and the latter is planning a sharp increase in imports as part of its modernization programme.

Further weakening in the prices of primary commodities

The experience of recent years confirms that primary commodities are the most vulnerable sector of the world economy. In the case of the vast majority of primary commodities, the main impact of disinflation and recession has been a drastic reduction in prices; as regards oil, while prices have receded somewhat from their peaks in the first quarter of 1981, adjustments to falling demand have been effected mainly by reducing export volumes sharply.

The most significant characteristic of recent movements in the prices of primary commodities is their synchronization: practically all commodity prices have moved down sharply since the onset of the current global recession. The extent of the fall in prices can best be appreciated by comparing their levels in the most recent trough with those achieved in the latest peak during 1979-1980.

Table II-2. Percentage fall in the indices of market prices of principal commodity exports of developing countries from their latest peaks a/

Commodity group	Peak month	Trough month	Percentage fall
Food	October 1980	October 1982	62
Tropical beverages	September 1979	August 1982	39
Vegetable oilseeds and oils	July 1979	October 1982	49
Agricultural raw materials	February 1980	December 1982	31
Minerals, ores and metals	February 1980	June 1982	34
Crude petroleum	February 1981	March 1983	17

Source: For non-fuel commodities, United Nations Conference on Trade and Development, Monthly Commodity Price Bulletin; for crude petroleum, Department of International Economic and Social Affairs of the United Nations Secretariat.

a/ All indices are expressed in terms of dollars.

On a year-to-year basis, the price indices of all major non-fuel primary commodity groups fell abruptly both in 1981 and in 1982 (see table II-3). As the recession deepened and became more protracted, an increasing number of commodities was affected. The price declines during the current recession have been so pronounced that the terms of trade for all major commodity groups relative to manufactures exported by the developed market economies have deteriorated more sharply than during any other economic downswing in the post-war period. Towards the end of 1982, the prices of beverages and metals rose somewhat, which might signal a firming of commodity prices. However, market prospects for 1983 do not indicate that prices are likely to stage a significant recovery.

Undoubtedly the major factor behind the decline in commodity prices, particularly for industrial raw materials, has been the recession in the industrial countries. This has coincided with conditions of unusual excess supply in the markets for commodities whose prices are more affected by supply than by demand developments (e.g., food and tropical beverages). The supply of tropical beverages responded to the sharp price increases of 1976-1977 with its customary lag of several years, and the increase in production and stocks helped to bring down prices beginning in late 1979. Cereal prices were depressed by excellent crops in 1981/82 almost worldwide (except for those of the Soviet Union and some developing countries).

Table II-3. Rates of change in the prices of internationally traded commodities, 1980-1984 a/

(Percentage)

	1980	1981	1982	1983 b/	1984 b/
Non-fuel primary commodities	14.7	-15.7	-15.3	1	7
Food	63.2	-21.4	-30.2	-6	9
Tropical beverages	-5.9	-18.9	-4.4	5	4
Vegetable oils and oilseeds	14.9	-3.1	-23.0	-9	7
Agricultural raw materials	11.2	-13.0	-12.9	3	8
Minerals, ores and metals	13.3	-13.4	-12.7	5	10
Crude petroleum	65.8	11.5	-5.6	-15	5
Manufactures					
Exported by developed market economies	10.5	-5.1	-2.0	3	5
Exported by developing countries	6.4	5.4	3.0 c/	3	5

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on United Nations Conference on Trade and Development, Monthly Commodity Price Bulletin; United Nations, Monthly Bulletin of Statistics; and information provided by the National Institute of Economic and Social Research (London).

a/ Expressed in dollars.

b/ Forecasts.

c/ Preliminary estimate.

The ongoing cyclical downswing has had some peculiarities which have put additional downward pressures on prices. High interest rates have forced consumer industries to reduce their inventories and may have dampened speculative activity as well. The sharp appreciation of the dollar since late 1980 has made commodities whose prices are strongly influenced by United States markets more expensive in terms of other currencies, reducing demand for them in non-dollar markets and perhaps their dollar prices. The downswing in prices, together with other factors analysed in detail below, have resulted in unusually severe balance-of-payments problems in a large number of developing countries. Some countries which are heavily dependent on the exports of a particular commodity have been reluctant to curtail their exports, and in some cases they have sought to increase them. Conversely, demand for imported commodities in developing countries and also in Eastern Europe has been adversely affected by the same factors.

The weak recovery expected in the main industrial countries implies that, in the foreseeable future, commodity prices are unlikely to return to the levels prevailing before the most recent price slide. Good crops in recent years and the consequent accumulation of large stocks will serve to keep the prices of a number of agricultural commodities (e.g., cereals, oilseeds and cotton) depressed. Among

food commodities, only sugar can be expected to experience some recovery from its current low levels, as many producers abandon unprofitable sugar production. Beverage prices will also continue to be adversely affected by the stock overhang that has resulted from several years of excess supply. Demand for some raw materials will depend on the behaviour of specific sectors. For example, the strength of the recovery in the construction sector will be a determinant factor in the case of tropical timber; and the fortunes of the automobile industry, a particularly depressed sector, should influence the prices for natural rubber. As regards metals, excess capacity will probably moderate price pressures stemming from actions by consumers to replenish their inventories. In sum, although primary commodity prices may bottom out in the first half of 1983, they are not likely to show a strong rebound in the following 18 months. As demand in the world economy strengthens in the second half of 1983 and into 1984, the prices of some commodities, particularly among the metals, may begin to rise somewhat faster than the prices of manufactures exported by developed countries.

In recent years, price swings have increased in intensity and have become more pro-cyclical: after a sharp run-up beginning in 1972, they plunged in 1974-1975; the upswing in economic activity of 1976-1979 was accompanied by a considerably stronger rise in commodity prices; and during the current recession prices have been unusually depressed. Taking a longer view of the behaviour of commodity prices, it becomes apparent that price variability has been increasing over time, especially if one compares trends since 1970 to the experience of prices during the 1960s. 6/ Moreover, price movements have become more synchronized across commodities. 7/ The increase in the amplitude and synchronization of business cycles in the developed market economies since 1970 as compared to the earlier post-war period appears to be the most significant factor explaining these trends in the behaviour of commodity price changes. In addition, the generalized increase in the degree of uncertainty - as reflected in large and rapid changes in exchange rates, inflation, and interest rates - prevailing in the world economy has undoubtedly spilled over into the area of commodity price formation. The result of these price trends has been to render the export earnings of developing countries increasingly more unpredictable.

During 1982, oil markets were also severely affected by the deepening and synchronization of the cyclical economic downturn in the major industrial countries. In the first quarter, spot crude prices fell sharply. After recovering in April, they remained remarkably stable until late 1982, although continuing to stay somewhat below official prices. Reflecting the heightened uncertainty over the future course of oil prices caused by the failure of the January 1983 OPEC consultative Ministerial meeting to reach accord on production cut-backs, spot prices weakened considerably. Official prices, which had remained relatively stable in 1982, also came under increasing downward pressure. Since mid-February, when the North Sea producers lowered their contract prices by about 10 per cent and Nigeria soon followed suit with a price cut of almost 15 per cent, an uneasy and speculative atmosphere has characterized conditions in world oil markets.

The fact that during the current recession oil prices have fallen only moderately in the face of a continuing weakening in demand reflects the important role of supply restraint in bearing the brunt of adjustment. Since producers which are not members of OPEC have increased their exports, prices have been maintained by agreement among OPEC member countries to curtail production sharply. While most countries were affected, a large share of the cut in output was borne by the surplus countries. In view of the difficult balance-of-payments situation of the

deficit OPEC members, these countries are likely to resist further production cut-backs. Although the situation is extremely fluid, the most likely outcome for 1983 is an average decline in prices of about 15 per cent on a year-on-year basis, which would imply some additions to inventories in the developed market economies, a moderate increase in exports by the deficit OPEC member countries, but perhaps stationary export volumes in the capital-surplus countries. As demand gradually recovers, prices should firm in the second half of 1983. In the absence of supply shocks, oil prices in 1984 are likely to move in line with international inflation.

International prices and the terms of trade

In 1982 the terms of trade of the net energy-importing developing countries worsened for the fifth consecutive year. Whereas in the 1978-1980 period the major factor had been an increase in import prices - for manufactures and oil - in 1981-1982 the deterioration in the terms of trade of this group of countries was caused mainly by falling primary commodity prices. Without a doubt, the world economic instability of recent years has had its most serious consequences on the energy-importing developing countries. The adverse economic environment for these countries is clearly reflected in the evolution of their terms of trade, which deteriorated by about 25 per cent between 1978 and 1982. This factor alone goes a long way to explain the unsatisfactory economic performance of these countries during the past three years, their severe current balance-of-payments difficulties, and their growing levels of external indebtedness. The external environment is unlikely to provide much relief in 1983 and 1984, as these countries' terms of trade are expected to improve only marginally.

As a result of falling oil prices, the energy-exporting developing countries also experienced worsening terms of trade during 1982, thus reversing a three-year trend of very sharp improvements in their relative foreign trade prices. The drop in oil prices may well become somewhat more accentuated in 1983. Since import prices are likely to rise, the terms of trade of the energy-exporting countries will probably deteriorate further in 1983 before stabilizing in 1984.

The main beneficiaries of price movements during 1982 were the developed market economies. Although their export prices (measured in dollars) fell, the drop in their import prices was considerably larger, owing to the sharp fall in the prices of imported primary commodities. A recovery in export prices and continued weakness in the prices for their imports should bring further terms-of-trade gains in 1983.

As regards the centrally planned economies, mainly because of the special pricing arrangements that prevail within the CMEA, the price movements in intra-group trade differed measurably from those in trade with the market economies. In the latter, unit values (in terms of dollars) declined for both exports and imports by 6-7 per cent, with the result that the terms of trade changed only marginally. In intra-group trade, however, the annual revision of the CMEA price formula entailed another deterioration in Eastern Europe's terms of trade of 3 to 5 per cent on balance, while the Soviet Union registered a corresponding gain. In 1982, fuel prices increased by roughly 25 per cent in terms of transferable roubles to reflect further the changes that occurred in world oil prices in the late 1970s. The repositioning of intra-CMEA energy prices to world price averages of 1977-1981, from the 1976-1980 base in the preceding year, did not, however, suffice to establish parity with current world prices, although the latter were declining in the second half of 1982. As a result, another round of adjustments, amounting perhaps to 17 to 20 per cent, can be anticipated for 1983.

International payments

Large shifts in current account balances

In the period 1979-1981, current account developments in the major regions of the world economy were shaped to a large extent by terms-of-trade movements, particularly the increase in the price of oil and the drop in primary commodity prices. Thus most net energy-exporting countries (mainly a few developing countries and the Soviet Union) experienced sharp increases in their trade and current account surpluses, while net energy-importing countries (most developing countries, most developed market economies, and Eastern Europe) had to cope with substantial and, in many cases, increasing deficits (see table II-4). Until 1981, while certain sources of private financing were already tightening, countries were by and large able to finance the larger current account imbalances resulting from adverse international price movements. As regards the Eastern European countries, deliberate policies to minimize the increase in convertible currency debt helped to reduce their trade deficit in spite of worsening terms of trade.

During 1982, the forces at work were more complex. Terms-of-trade movements affected current accounts as before, although the country groupings which experienced falling terms of trade changed, as has been described above. A second important factor that was very widespread in 1982 was a limitation on external resources available to finance current account deficits. If external financing to maintain normal rates of economic growth had been forthcoming, most deficit countries would have registered considerably larger trade and current account deficits in both 1981 and 1982. However, international financial markets became increasingly less accessible to developing countries, and lending to the centrally planned economies practically ceased altogether. In spite of growing interest payments and adverse terms-of-trade movements, the combined current account deficit of the energy-importing developing countries fell markedly, reflecting a considerable adjustment in the trade accounts. The extent of these countries' adjustment efforts can be gauged from the fact that in 1982, at the trough of the recession, their collective deficit was equivalent to only 35 per cent of their export earnings on goods, as compared to 45-50 per cent in 1974-1975. Likewise, the Eastern European countries were forced to take unexpectedly severe adjustment measures and actually recorded a sizeable aggregate trade surplus.

The fall in oil prices and the sharp contraction in the volume of oil trade had a major impact on the current accounts of the energy-exporting developing countries. The large surpluses recorded by these countries in 1979-1980 had already begun to dwindle in 1981 under the impact of rapid rates of expansion of import volumes and declining oil exports. During 1982, despite falling imports in real terms, these countries registered a collective deficit. As regards the capital-surplus countries, their surplus declined by almost $80 billion between 1980 and 1982. During this period, there was also a large negative swing in the current account of the deficit energy exporters, although it was not as pronounced as that of the capital-surplus countries. In the second half of 1982, some of the deficit energy exporters encountered sudden and significant financing problems in international capital markets, and this may have worked to restrict their deficits. In addition, the decline in their export earnings was not as sharp as that of the capital-surplus countries.

Table II-4. World balance of payments on current accounts, a/ by country groups, 1978-1983

(Billions of dollars)

Country group	1978	1979	1980	1981	1982 b/	1983 c/
Developed market economies	31.0	-6.5	-42.1	-12.2	-2	10.5
Major industrial countries	35.1	5.0	-15.9	14.8	18.5	21.5
Other surplus countries d/	2.1	0.2	-0.9	10.8	11.5	13
Other small economies	-6.3	-11.7	-25.3	-37.8	-32	-24
Developing countries	-32.2	10.8	36.8	-32.9	-69.5	-89
Capital-surplus countries	19.9	61.3	101.0	65.9	23	-5.5
Other net energy exporters	-22.3	-3.4	3.4	-26.3	-28.5	-33.5
Net energy importers e/	-29.8	-47.1	-67.6	-72.5	-64	-50
Centrally planned economies f/	-6.2	-0.3	0.9	4.8	16	10
China	-1.2	-2.1	-1.3	1.6	4.5	1
Eastern Europe	-6.7	-5.1	-5.8	-2.7	4	4.5
USSR	1.6	6.9	8.0	6.2	7.5	5
Residual balance g/	7.4	-4.0	4.4	40.3	55.5	68.5

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International and Financial Statistics; other official national and international sources; and forecasts of the United Nations Secretariat.

a/ Excluding government transfers.

b/ Preliminary estimates rounded to the nearest half billion dollars.

c/ Forecast.

d/ Netherlands, Norway and Switzerland.

e/ The data presented herein underestimate the deficit of these countries owing to the exclusion of some countries, accounting for about 5 per cent of the group's exports, for which insufficient data were available.

f/ Trade balances only.

g/ The world current account discrepancy reflects timing asymmetries, omissions and errors in trade balances and under-recording in the receipts of services, in particular investment income that is channelled through off-shore financial centres. An important additional source of discrepancy in world trade in 1981-1982 that has produced biases in favour of imports has been large reductions in oil stocks in shipments still at sea.

In the developed market economies, a significant improvement in the terms of trade was the main factor behind the $10 billion reduction in their current account deficit. While their trade deficit declined by $9 billion, their surplus on services and invisibles rose by about $1 billion. 8/

The forecasts shown on table II-1 for trade volumes and prices during 1983 and the expectation that, year-on-year, average interest rates during 1983 will be lower than in 1982 have important implications for current account developments. Among developing countries, the continuation of stringent adjustment in energy-importing countries, some improvement in their terms of trade (mainly on account of lower oil prices), and lower interest rates should translate into further substantial reductions in their current account deficits. The energy exporters are expected to experience large terms-of-trade losses owing to a drop in the price of oil relative to their import prices. As a result, the surpluses of the capital-surplus countries should continue to shrink. The deficit energy exporters, however, are likely to continue to adjust their real import levels downward, and their export volumes could experience some recovery as a result of modest increases in their oil exports and some pick-up in other export categories as well. Therefore, their collective current account deficit should not rise substantially.

The expected decline in relative primary commodity prices, particularly oil, would benefit mainly the developed market economies, which should experience a swing into current account surplus. The Eastern European countries are expected to suffer further terms-of-trade losses in their intra-CMEA trade; however, current plans call for further efforts towards import substitution and raising the volume of exports which, if realized, would lead to a slightly higher overall trade surplus. The Soviet Union's trade surplus is expected to decline, owing directly to the fall expected in fuel prices on world markets, further large imports of food, and a possible increase in machinery imports from the major industrial countries. These factors making for a lower surplus could be partly offset by terms-of-trade gains in intra-CMEA trade. As regards China, the trade surplus may decline sharply as a result of ambitious import plans.

Increasing difficulties for debtor developing countries

In 1982 the liquidity difficulties of developing countries, which had been building over recent years, reached critical levels for a number of the countries which have been significant international borrowers. By the end of 1982, several countries with different economic and social systems and at different stages of development in Africa, Asia, Europe and Latin America had been affected. In all such cases the debtor countries found themselves unable to make timely contractual payments of principal, and sometimes also of interest, on their foreign debts, particularly on loans from international commercial banks.

Debt-servicing difficulties erupted when a number of private banks, especially but not exclusively smaller banks which were relatively new to international lending, became unwilling to renew or roll over maturing credits to certain borrowing countries. Net new lending to a number of other countries also became difficult to arrange. While net flows from the banking system to the energy-importing countries had been on a downward trend since their peak in 1979, the contraction in 1982 was dramatic (see table II-5). As regards the deficit energy exporters, the decline in net lending began in 1982, when it became increasingly apparent that their export earnings would be severely affected by the

recession. Having already been drawn down extensively, foreign exchange reserves did not provide adequate liquidity, and the result for a number of countries was an accumulation of debt-servicing arrears.

Table II-5. Capital-importing developing countries: net new borrowing from major financial centres, a/ 1979-1982

(Billions of dollars)

	1979	1980	1981	1982 b/
Net change in liabilities of developing countries to banks				
Deficit net energy exporters c/	17.3	16.6	19.1	12
Net energy importers	27.8	23.5	19.6	11
Net change in liabilities minus assets held by banks				
Deficit net energy exporters c/	-5.0	1.4	23.2	21
Net energy importers	19.3	26.2	17.7	13

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on quarterly data of the Bank for International Settlements.

a/ Includes short-term debt.

b/ Preliminary estimates.

c/ Excluding Bahrain and Oman.

For some countries, ad hoc emergency funding measures of a short-term nature were arranged by the Governments of the major industrial countries, in certain cases with the financial co-operation of the Bank for International Settlements. Medium-term lines of credit and adjustment programmes were also negotiated with the IMF, and the international banks were persuaded over time to extend further credits. Finally, an extremely large number of debt reschedulings were arranged during the year. Thus 21 multilateral debt reschedulings were agreed in 1982 or were still under negotiation at the end of the year, of which 16 entailed rescheduling of debt to foreign commercial banks ("London Club" meetings) and five involved rescheduling of debt to official sources ("Paris Club" meetings). By comparison, there was a total of 12 such reschedulings of developing country debt in 1981, itself about twice the number of reschedulings in each of the preceding three years.

A large number of developing countries, nevertheless, did not experience debt-servicing difficulties. Indeed, in mid-1982 almost half the developing countries were net creditors to the international banks. 9/ Several of the net creditors were oil-exporting countries which had placed substantial portions of the surpluses earned over the past decade in accounts with the banks. But most of the countries were small or low-income countries - including the large majority of the least developed countries - which have not had significant access to international bank loans and which tend to maintain their foreign exchange reserves primarily in the form of bank deposits.

As the international recession lengthened, export revenues fell and the export outlook worsened. Many countries which had access to the international capital markets nevertheless experienced increasingly more acute liquidity problems. The progressive drawing down of their deposit balances with the banks and declining ratios of undisbursed credits to debts falling due caused rising concern in the international banking community. Thus developing countries found their access to medium-term financing sharply curtailed and had to resort to short-term credits.

As a result of high interest payments, growing recourse to short-term borrowing and the fall in export earnings, the demands which debt-servicing payments made on foreign exchange earnings reached an unusual intensity in 1982, especially when repayment of short-term credits is included. 10/ If all debt-servicing requirements had been met out of current foreign exchange earnings, the capital-importing developing countries would have had to devote over 60 per cent of those earnings to service their external debt in 1982, up from about 37 per cent during 1978-1980 (see table II-6). Since external debt is very unevenly distributed among developing countries, in 1982 the total debt-servicing burden of the 20 largest debtor countries would have absorbed almost 70 per cent of their foreign exchange earnings, more than twice the debt-servicing burden of the remaining capital-importing countries.

It is of particular concern that the ratio of interest payments to export earnings had also become quite substantial by 1982, absorbing over 15 per cent of total foreign exchange earnings, or twice the ratio prevailing as recently as 1978. Interest payments rose owing to increasing debt levels and average interest rates (see table II-7). The rise in interest rates paid by developing countries reflected mainly the upward trend in all market-related rates and increasing reliance on the international banks. Whereas the capital-importing developing countries as a whole held 48 per cent of their total debt with the commercial banks at the end of 1977, that share had surpassed 60 per cent by the end of 1981. Most of that debt was either of a short-term nature or at floating interest rates, in either case subject to annual interest and related charges which exceeded 17 per cent on average in 1981 and 1982. 11/ The fall in base interest rates on international bank loans which began in mid-1982 will help contain the debt-servicing burden in 1983.

A continuing problem, however, is the high level of debt amortization. Indeed, whereas average interest rates began to fall in 1982, average amortization rates - i.e., the share of total debt repayable during the year - continued to rise, particularly for the energy-exporting debtor countries (see table II-7). The rise in the short-term component of debt was particularly steep for the energy-exporting countries in 1982.

Table II-6. Capital-importing developing countries: ratios of debt service to export earnings, a/ 1978-1982

(Percentage)

	1978	1979	1980	1981	1982 b/
Interest payments	7.6	9.1	10.5	13.3	15.5
Total debt service	37.0	36.4	38.1	48.2	61
Net energy exporters	41.1	34.6	34.1	45.9	63
Net energy importers	34.5	38.1	41.4	50.0	59.5
Twenty largest debtors	41.7	41.1	42.8	54.4	69.5
Others	23.4	22.6	22.6	26.6	33
Memorandum items:					
Debt service on public and publicly guaranteed debt	15.4	15.8	13.8	15.1	20
Total interest payments plus amortization on public and publicly guaranteed debt c/	17.7	19.2	18.0	21.1	26

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on World Bank, Debtor Reporting System; Bank for International Settlements, Maturity Distribution of International Bank Lending; International Monetary Fund, International Financial Statistics; and Secretariat estimates.

a/ Debt-service payments (excluding servicing of IMF credits) as a share of exports of goods and services and net private transfers. Figures are based on a sample of 86 developing countries for which adequate data were available.

b/ Estimates rounded to the nearest half percentage point (no account is taken of any delays in scheduled payments).

c/ Entails a lower-bound estimate of amortization of all medium- and long-term debt since private, non-guaranteed medium- and long-term debt is excluded.

Table II-7. Capital-importing developing countries: average rates of interest and amortization of external debt, a/ 1978-1982

(Annual payments as percentage of outstanding debt at beginning of year)

	1978	1979	1980	1981	1982 b/
Average interest rates					
Capital-importing developing countries	6.6	8.1	9.9	11.0	10.9
Net energy exporters	7.2	9.0	10.8	12.3	11.9
Net energy importers	6.3	7.6	9.3	10.3	10.3
Average amortization rates					
Capital-importing developing countries	25.8	24.3	26.0	29.0	30.9
Net energy exporters	29.9	25.9	28.9	32.9	36.5
Net energy importers	23.4	23.4	24.3	26.8	27.6

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on World Bank, Debtor Reporting System; Bank for International Settlements, The Maturity Distribution of International Bank Lending; and other international sources.

a/ Includes all external debt to commercial banks (including short-term debt) as reported by the Bank for International Settlements plus all government and government-guaranteed external debt as reported by the World Bank (excluding double counting). Debt to the International Monetary Fund is excluded. Based on a sample of 86 countries for which adequate data were available.

b/ Estimates (no account is taken of any delays in scheduled payments).

The unusual debt-servicing difficulties of a number of developing countries in 1982 has undoubtedly changed the perceptions of borrowers and lenders regarding the desirability of relying excessively on short-term credits to finance balance-of-payments gaps which may turn out to be more durable than previously expected. The remaining question is whether sufficient volumes of medium- and long-term credit from the private sector, as well as from various channels of official international co-operation, will be forthcoming to permit an orderly lengthening of the maturity structure of developing country debt. Concerning the private sector's contribution, the answer is tied to the outlook for sufficient growth in export earnings in order to service such debt appropriately.

Declines in longer-term flows to developing countries

As detailed elsewhere in this Survey, developing countries have been taking stringent policy measures to decrease their balance-of-payments deficits on current account to levels which can be supported by normal long-term capital inflows. Based on recent trends and policy stances, the levels at which current account deficits may be sustained - and thus the level of real transfers of resources - themselves appear to have fallen compared to what might have been expected a few years ago when the International Development Strategy for the Third United Nations Development Decade was negotiated.

Certain of the adverse trends in capital flows in 1982 were related to the debt-servicing crisis discussed previously. Thus there was a 16 per cent drop in the gross value of agreed Euro-currency bank credits arranged for the capital-importing developing countries. For the energy-importing countries, the fall was a much sharper 31 per cent. 12/ As noted above, net flows from the banking system contracted sharply. The value of bond placements, which in any case are only a small fraction of borrowings from the international banks, fell marginally.

The decline in Euro-currency credits points to an uncertain future for what had become a major vehicle for medium- and long-term capital transfers. There is now enhanced sensitivity on the part of the management of international banks, their national regulatory authorities and the capital markets in general to further lending to developing countries. To a certain degree, such sensitivity could be mitigated by recent joint efforts of the major banks to improve the quality and timeliness of information on borrowing countries. Nevertheless, no strong upsurge in international bank lending to developing countries is anticipated for the time being.

After a promising rise of about 24 per cent in 1981, direct investment flows to capital-importing developing countries appear to have fallen in 1982 and, based on surveys of investor intentions and other sources, a further decline in such flows in 1983 is quite possible. Most direct investment is either in resource-based sectors or in manufacturing. Trends in commodity prices and the stagnation of incomes associated with the current recession may have discouraged potential investors, despite the policy measures developing countries have taken to increase these flows. 13/ Any significant pick-up in direct investment flows is contingent on an acceleration in the pace of economic recovery.

Most disturbing, however, have been the trends in ODA, since these flows finance activities and projects for which private financing is not a practical substitute. In 1981 nominal ODA receipts expressed in dollars fell by 11 per cent. The 1980 level of ODA receipts was probably not regained in 1982. In the light of the difficulties being experienced by both developed and developing country donors, the outlook for ODA is not promising. 14/ Moreover, the particular financial difficulties and uncertainties of the multilateral development assistance institutions disbursing highly concessional resources remained unresolved. During 1982 much concern had centred not only on the agreed level of contributions to a number of multilateral institutions - including the International Development Association, the United Nations Development Programme and the International Fund for Agricultural Development - but also on the timely payment of these contributions. Since the least developed and other low-income countries have no effective alternative to finance the imported component of development programmes,

the development consequences of a continuation of current trends in overall ODA flows should not be underestimated.

In the coming few years, developing countries will not be in a position to apply all of their capital inflows to finance current account deficits. Significant improvement of reserve positions will also be necessary, both in rebuilding depleted reserve levels and in repaying the recent spate of official balance-of-payments loans, principally to the IMF.

Given the inadequacies in the levels of capital inflows and the high cost of non-concessional flows, since 1980 the deficit countries have made heavy drawings on their international reserves. More particularly, the reserves of the energy-importing countries fell by almost $16 billion between their most recent peak at the end of 1979 and the end of 1982 (a decline of over $7 billion in 1982 alone). As a result, about half of the capital-importing countries had under two months' import coverage, and a quarter had import coverage of less than one month. 15/

As the experience of recent years has demonstrated, the international economy is subject to great instability. In the absence of adequate access to counter-cyclical balance-of-payments financing, in rebuilding their international reserves developing countries will be under some incentive to increase their import coverage above levels formerly considered desirable.

Balance-of-payments difficulties drove a growing number of developing countries to seek financing from the Fund. As may be seen in table II-8, beginning in 1979 net borrowings from the IMF rose steadily, reaching almost $5 billion in 1982. In early 1983 there were heavy drawings as countries began to use facilities arranged since late 1982. It may nevertheless be observed that the value of IMF agreements in effect and their undrawn balances at the end of 1982 were well below those of end-1981, despite continuing and even intensifying balance-of-payments difficulties. This resulted from the unprecedented cancellation of about $4.5 billion in undrawn balances, only some of which were eventually re-negotiated. The reason for these cancellations was the inability of a number of countries, under the circumstances prevailing in 1982, to meet all the conditions attached to their IMF lending programmes.

Overall, financing by the IMF in 1981 and 1982 was arranged in support of very difficult adjustment programmes. Despite the fact that developing country deficits could be attributed to a large extent to the depressed cyclical conditions prevailing in the world economy, drawings from low-conditionality facilities played a relatively modest role, as can be seen in table II-8. Moreover, the average length of agreements decreased sharply (from 22 months in 1980 to 14 months in 1982). In other words, in the midst of an extremely intense international recession from which only a slow, uncertain and drawn-out recovery was anticipated, the IMF was concentrating its financial resources on programmes requiring rapid adjustment. This notwithstanding, the IMF programmes did help finance import levels which otherwise might have been foregone. Nevertheless, rapid adjustment in many countries implied stringent demand management policies which had drastic deflationary effects.

Table II-8. Effective net flow of IMF credit a/ to the capital-importing developing countries, 1978-1982

(Billions of dollars)

	1978	1979	1980	1981	1982
Low conditionality flows	0.2	0.8	1.0	-0.6	1.1
Buffer stock financing facility	-	-	-	-	0.1
Compensatory financing facility	0.4	0.2	0.2	0.4	1.5
Oil facility	-0.7	-0.6	-0.7	-0.8	-0.4
Trust Fund	0.4	1.2	1.5	-0.2	-0.2
Higher conditionality flows	0.1	1.0	2.1	5.3	3.7
Credit tranche drawings	-	0.7	1.4	3.0	1.6
Extended facility drawings	0.1	0.3	0.7	2.2	2.1
Total flows	0.3	1.8	3.1	4.6	4.8
Memo:					
Agreed stand-by and extended arrangements at year-end	3.2	3.8	10.9	19.5	13.4
Undrawn balance of above	2.4	2.6	8.0	14.1	7.2

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International Financial Statistics.

a/ Measured as difference between indebtedness to IMF at beginning and end of year, thus including valuation change as well as actual flows.

Some effects of exchange rate instability in the developed market economies

External financial developments in the industrialized market economies during 1982 were influenced by the high real interest rates prevailing in the United States, the continuation of substantial capital flows into this country, and the sharp appreciation of the dollar. In addition, there were significant changes in the pattern of current accounts as between countries.

Perhaps the single most important variable explaining differences in current account movements was the very substantial appreciation of the dollar against all major currencies between the fourth quarter of 1980 and the third quarter of 1982. During this period, the dollar appreciated by almost 30 per cent in effective terms. This development reduced the competitiveness of United States industries and increased the competitiveness of the manufacturing sectors of the Federal Republic of Germany and Japan, countries which had lower rates of inflation than the United States. It is estimated that, in 1982, while the markets where the United States sells its manufactures contracted by about 1.5 per cent, that

country's exports of manufactures declined by more than 15 per cent. 16/ Partly as a consequence of exchange rate developments, the current account surplus of the United States was eroded, and the current account surpluses of the Federal Republic of Germany and Japan rose (see table II-9). During 1983, the effects of past exchange rate movements and a stronger cyclical position in the United States than in its major trading partners are expected to give further impetus to the swings in current account balances observed in 1982: while the United States current account is likely to go into considerable deficit, as a consequence of a record trade deficit of about $50 billion, the surpluses of the other two major economies could increase substantially even in the event of continued trade restrictions on Japanese exports.

Other variables also had an influence on current account developments. Overall demand conditions which were stronger than in their main trading partners helped to reduce the United Kingdom's surplus and to increase France's deficit. On the other hand, the disappearance of Canada's traditional current account deficit was due to the unusually strong recession affecting the Canadian economy. The rebuilding of inventories, which have a high import content, and falling oil export revenues were also factors explaining the decline in the United Kingdom's surplus.

The smaller developed market economies have had growing balance-of-payments problems in recent years, owing mainly to worsening terms of trade. High interest rates have also had an adverse impact on their current accounts, since most of them are capital importers. Improving terms of trade appear to have helped reduce their combined current account deficit in 1982. Further terms-of-trade gains, relatively depressed domestic demand conditions, and lower interest rates are all factors making for a rather substantial decline in these countries' deficit during 1983.

The sharp exchange rate fluctuations that have characterized the period since the demise of the Bretton Woods system of fixed parities continued during 1982 and in the early months of 1983. As shown in table II-10, since the end of 1980 until the third quarter of 1982, the dollar appreciated steadily against all other major currencies, notwithstanding the fact that domestic price levels and unit labour costs in manufacturing rose faster in the United States than in the Federal Republic of Germany or Japan.

Up to the middle of 1982, perhaps the main explanatory variable was the large and widening spread between interest rates in the United States vis-à-vis those in other major money market centres. Since mid-1982, however, interest rate differentials have tended to narrow, as nominal interest rates in the United States have come down considerably faster than elsewhere. Nonetheless, until the closing months of 1982, the dollar continued to appreciate; and after a hiatus of about two months, the upward trend in the dollar resumed in the early months of 1983.

Several factors appear to explain these developments. In the first place, in the United States real and nominal interest rates have remained higher than in other major industrial countries. Secondly, political instability and the perception of better prospects for the United States economy than for the major European countries may have contributed to capital flows into dollar-denominated assets. Thirdly, there appear to have been substantial flows of direct investment into the United States from other major industrial countries and particularly from Japan, motivated to some extent by mounting trade tensions.

Table II-9. Developed market economies: balance of payments on current account a/ 1980-1983

(Billions of dollars)

Country or country group	1980	1981	1982 b/	1983 c/
Developed market economies	-42.1	-12.2	-2	10.5
Major industrial countries	-15.9	14.8	18.5	21.5
Canada	-1.3	-4.9	2	2.5
France	-6.1	-5.3	-8.5	-4
Germany, Federal Republic of	-8.5	-0.1	10	15
Italy	-9.6	-8.0	-5.5	3.5
Japan	-9.5	6.1	8.5	16.5
United Kingdom	11.1	16.0	10	1
United States	8.0	11.0	2	-13
Other countries	-26.2	-27.0	-20.5	-11
Surplus countries d/	-0.9	10.8	11.5	13
Others	-25.3	-37.8	-32	-24

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International Financial Statistics, and forecasts of the United Nations Secretariat.

a/ Excluding government unrequited transfers.

b/ Preliminary estimates rounded to the nearest half billion dollars.

c/ Forecast.

d/ Netherlands, Norway and Switzerland.

Note: Because of the large residual balances for the world current account since 1980 as shown in table II-4, the figures reported in this table should be taken more as a reflection of the direction of change in the balances of individual countries than as precise magnitudes.

Table II-10. Nominal and effective exchange rates for selected convertible currencies, 1981-1982

(Fourth quarter of 1980 = 100)

	Deutsche mark	French franc	Japanese yen	Sterling	Swiss franc	United States dollar
	Exchange rates against the United States dollar a/					
1981 First quarter	93.1	91.1	96.2	94.1	92.1	
Second quarter	81.8	79.0	89.9	81.5	86.8	
Third quarter	84.2	81.1	87.2	75.5	89.5	
Fourth quarter	86.8	78.6	92.3	80.0	98.1	
1982 First quarter	81.0	72.4	82.4	74.7	91.2	
Second quarter	79.5	66.1	79.9	72.9	83.8	
Third quarter	77.4	63.3	75.3	71.0	81.4	
Fourth quarter	82.4	67.2	86.4	67.7	88.4	
	Effective exchange rates b/					
1981 First quarter	96.5	95.8	106.4	101.7	95.0	104.3
Second quarter	95.1	92.0	103.8	97.7	94.2	111.6
Third quarter	93.7	90.1	101.7	90.4	95.6	117.7
Fourth quarter	98.6	89.3	102.8	89.6	106.5	113.7
1982 First quarter	97.9	87.3	101.1	91.0	107.5	118.2
Second quarter	99.8	85.8	98.3	90.2	103.7	122.5
Third quarter	100.3	80.4	95.1	91.3	102.1	128.5
Fourth quarter	101.9	80.3	96.5	89.0	102.6	130.6

Source: International Monetary Fund, International Financial Statistics.

a/ End of period.

b/ Period average; as defined and calculated by IMF, International Financial Statistics.

Although it is extremely difficult to forecast their direction and magnitude, it is likely that exchange rates will continue to fluctuate widely. The configuration of current account balances forecast for 1983, with growing surpluses in the Federal Republic of Germany and Japan and a substantial deficit in the United States, suggests that the dollar may come under some pressure. Moreover, there are indications that the improving prospects of the Japanese economy have already brought about a reversal of the long-term capital outflows of the past two years. An additional imponderable is the possible impact of the disappearance of the OPEC current account surplus. Both public and private asset holders in OPEC member countries have exhibited a marked preference for holding their assets in dollars. As the surplus of these countries continues to shift towards industrial countries other than the United States, it is possible that there will be substantial swings in the demand for various currencies, perhaps against the dollar and in favour of other major currencies. Thus the balance of forces in the near term appears to be in favour of a depreciation of the dollar. 17/

Improvement in the external payments situation of the centrally planned economies

Since the spring of 1981, the rapid changes in the international financial environment have posed perhaps the most binding constraint on the economic growth of the Eastern European economies. The severe credit squeeze inhibited the implementation of their already modest growth targets. Poland was the first one to feel the full impact of the credit squeeze in view of its inability to meet external obligations on schedule and agree to the debt rescheduling terms offered by the commercial banks. This situation was compounded by the refusal of Governments in some major industrial countries to renegotiate that part of Poland's debt due in 1982, which also prolonged the rescheduling exercise by commercial banks. More recently, Hungary and Romania had to face up to a liquidity crisis as private banks withdrew their deposits and called in otherwise predictable roll-overs of short-term credit facilities. Romania was forced to reschedule but, after some difficulties, Hungary obtained fresh funds. 18/ The other Eastern European countries also experienced far tighter credit conditions than in recent years. The payments difficulties of Poland and Romania at a time of hardening lending terms contributed to financial markets losing confidence in the ability of the Eastern European economies to manage their debt. The global economic recession and the sharp deterioration in the political climate only exacerbated the liquidity crisis.

As a result, syndicated bank lending to Eastern Europe and the USSR, which had practically ceased by the second half of 1981, did not recover, and little new financing from other sources became available. The strictures on obtaining fresh funds at a time of record debt-servicing obligations left the most exposed Eastern European countries little choice but to enact a combination of externally-induced adjustment measures, involving abrupt and incisive import curtailment and accelerated export promotion, if necessary by postponing and possibly aggravating internal imbalances and, by implication, short- and medium-term growth prospects.

The adjustment measures enacted in 1982 also underline the degree to which policy-makers of planned economies can drastically compress their import needs and boost exports. Seen from another angle, the experiences of 1982 demonstrate that the external debt of these economies is manageable. A proper restructuring of their exposure in combination with more buoyant global economic activity and maintenance of relatively unhindered access to foreign markets would go a long way towards solving the liquidity crunch that stifled economic activity in a number of Eastern European countries.

While adverse developments in non-socialist markets had been eased in earlier years in part by the traditional institutional and policy-making arrangements typical of the CMEA, in 1982 forces from within the group did not compensate for the impact of the global recession and the loss of confidence by the international financial community. In addition to the further deterioration in Eastern Europe's terms of trade, new loans that had come forth in preceding years to spread out over time the impact of price increases not only failed to emerge in 1982, but they were in fact reversed in a number of instances. Perhaps more important was the reduction in deliveries of basic fuels and raw materials from within the region. Finally, the implementation of regional integration plans under the CMEA long-term target programmes of co-operation remained limited in scope.

The adjustment measures adopted were successful in attaining their objective. The trade balance of the USSR, Eastern Europe and China combined improved by $11 billion - a truly remarkable achievement under the circumstances. The swing of over $6.6 billion in Eastern Europe's trade balance was particularly impressive (see table II-11). China held to its chosen course of further adjustment and cautious import policies, which enabled it to record a $4.6 billion trade surplus. In spite of weak prices for its convertible currency exports and continuing difficulties in the production of exportable primary commodities, the Soviet Union also registered an increase in its trade surplus of about $1.4 billion.

Table II-11. Centrally planned economies: trade balances, 1980-1982

(Billions of dollars)

	Eastern Europe			USSR			China		
	1980	1981	1982 a/	1980	1981	1982 a/	1980	1981	1982 a/
World	-5.8	-2.7	4.0	8.0	6.2	7.6	-1.3	1.6	4.6
Centrally planned economies	-1.9	-3.2	-1.6	4.1	6.0	4.1	-0.1	-0.1	-0.4
Developed market economies	-3.8	-2.9	1.1	0.2	-1.2	-	-6.3	-5.9	-2.6
Developing countries	-0.1	3.5	4.5	3.7	1.5	3.6	5.1	7.6	7.6

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on official national and international data sources as well as independent estimates.

a/ Preliminary estimates.

The improvement in the USSR's external position emerged largely from accelerated export promotion in spite of weak domestic activity and sluggish world demand. This situation contrasts with the sizeable increases in export revenues obtained in the past few years chiefly resulting from higher oil prices. 19/ Last year's $1.2 billion deficit with the developed market economies was fully wiped out, the surplus with the planned economies declined by about $1.9 billion, but that with developing countries expanded by an almost equal amount. 20/

While China's overall export value in dollar terms rose by 4 per cent, import value contracted very sharply - by about 12 per cent. Trade with the planned economies rose very markedly in both directions. Aided by the good grain harvests of 1981-1982 and the substantial increase in domestic production of light manufactures, exports to the market economies increased by about 7 per cent in value; while import substitution, especially of durable consumer goods, and the abandonment or postponement of contemplated import-intensive investment projects resulted in a decline in dollar import value of 17 per cent. 21/

The most dramatic changes in the foreign sector were, however, experienced by Eastern Europe. As noted above, through a combination of strict import controls and stepped up export promotion, these countries were able to bring about a significant improvement in their combined trade balance. Though precise numbers for trade quantum changes are not available at this stage, preliminary calculations suggest a significant divergence in trade behaviour as regards convertible currency countries and the transferable rouble area.

Available information suggests that exports to the market economies may have risen by 5 to 6 per cent in real terms and that import volume from these economies probably declined by as much as 13 per cent. Together with nearly unchanged terms of trade, this trade profile resulted in a dramatic improvement of $5 billion in the external balance with the market economies - four fifths with the developed countries. The easing in Eastern Europe's imbalance with convertible currency partners was not an isolated phenomenon, as had been the case in preceding years: the German Democratic Republic, Poland and Romania improved their trade position with non-socialist countries by about $1.5 billion each, and Hungary gained $0.5 billion.

In trade with socialist countries, Eastern Europe boosted exports and pruned imports by 2 to 3 per cent in quantum terms, mainly in an effort to contain the effects on the trade balance of the 4 to 5 per cent deterioration in its terms of trade as a result of the continued adaptation of intra-CMEA fuel prices to world levels. The external deficit with socialist countries, the Soviet Union in particular, decreased by about $1.6 billion, nearly exclusively on account of Poland.

The sharp curtailment of Poland's deficit and the nearly unchanged net position of the other Eastern European countries facilitated the accommodation of transferable rouble imbalances within the traditional intra-CMEA clearing system. As regards convertible currency transactions, the difficulties encountered by nearly all centrally planned economies in financial markets led to a reduction in their outstanding debt levels. In spite of record debt-servicing outflows, partly stemming from high interest rates, the combined net convertible currency debt of the European planned economies (including the two CMEA banks) probably decreased from $67 billion in 1981 to around $62 to $63 billion in 1982, mostly on account of reductions in the debt of the Eastern European countries. 22/ This contrasts markedly with the progressive increases in debt levels of recent years.

Notes

1/ For instance, of some 114 safeguard actions in effect since 1978, only 30 have been taken within GATT's article XIX (Escape Clause); the rest, including 37 voluntary export restraint or orderly market agreements, have ignored GATT procedures.

2/ See World Economic Survey 1981-1982 (United Nations publication, Sales No. E.82.II.C.1), p. 81.

3/ For full texts of these decisions, see IMF Survey, 18 January 1983 and 21 February 1983.

4/ The shortfall equals actual export earnings minus trend earnings. The trend is estimated using a five-year geometric average of export earnings centered in the shortfall year (in this case, 1982). It thus requires forecasting export earnings two years ahead (1983 and 1984). For this purpose, the forecasts of trade volumes and prices shown in table II-1 were used. Since shortfalls calculated with aggregated data are likely to underestimate the sum of the shortfalls for individual countries, a formula proposed by Goreux to correct for this bias has been used to estimate the aggregate shortfalls in export earnings for the two groups of deficit developing countries. See L. M. Goreux, "Compensatory financing: the cyclical pattern of export shortfalls," IMF Staff Papers, November 1977, pp. 632-637.

5/ A relevant illustration is given by the range of experiences in 1975, a year of plunging commodity prices and burgeoning current account deficits. Based on actual trade data, 45 developing country members of the IMF had shortfalls in that year. As a percentage of quotas, the shortfalls ranged from a low of 4 per cent for Yugoslavia to a high of 804 per cent for Singapore. While half the countries had shortfalls of 70 per cent of quota or more, the dispersion of country shortfalls was quite marked; e.g., the standard deviation was 1.3 times the mean shortfall.

6/ Two measures - the standard error of the regression of the natural logarithm of price on time and the coefficient of variation - show a significant increase in price instability for almost all commodities since 1970 as compared with the period 1961-1970.

7/ The coefficient of variation of price changes across individual commodities exhibits a statistically significant decline in the 1961-1981 period.

8/ There is evidence that the net investment income of these countries is under-reported. This could be due to the growing importance of off-shore international banks not subject to full control by national authorities, whose revenues have risen rapidly in recent years as a consequence of higher interest rates and growing levels of lending to deficit countries. This factor alone can explain a significant share of the large world current account discrepancy shown in table II-4.

9/ Data of the Bank for International Settlements (excluding developing countries or territories which are off-shore financial centres).

10/ Short-term bank credits, most commonly used to finance international trade, have frequently been excluded from discussions of external debt on the grounds that such credits are usually self-liquidating; e.g., they are repaid with receipts from export sales. However, in a situation such as existed in 1982 in which short-term credit was also used for overall balance-of-payments financing and in which further extension of any credit was not always assured, it is appropriate to consider the problems arising from the servicing of all debt. For comparison, indicators of debt-servicing burden, excluding amortization and all servicing of short-term debt are given in table II-6.

11/ Organisation for Economic Co-operation and Development, External Debt of Developing Countries, 1982 Survey, p.31.

12/ Based on data compiled by the Organisation for Economic Co-operation and Development, Financial Statistics Monthly, January 1983.

13/ See World Economic Survey, 1980-1981 (United Nations publication, Sales No. E.81.II.C.2), pp. 83-85.

14/ For an assessment of the prospects for aid from DAC member countries, see Organisation for Economic Co-operation and Development, Development Co-operation, 1982 Review.

15/ Based on a sample of 59 countries.

16/ Organisation for Economic Co-operation and Development, OECD Economic Outlook, No. 32 (December 1982), p. 125.

17/ Given the difficulties in predicting exchange rates, the forecasts included in this Survey are made on the basis of the technical assumption that exchange rates will remain unchanged from their levels of end-1982.

18/ The latter's accession to the IMF in early 1982 undoubtedly eased the credit crunch.

19/ Petroleum exports to developed market economies account at present for more than three fourths of Soviet exports.

20/ The source of the larger surplus with developing countries is unclear at this stage. The most pronounced increase was reported in trade with Iraq and the Syrian Arab Republic. However, the bulk of the increase occurred in the unspecified residual - that is, the difference between the reported sub-total and the sum of the identified partners - which contains, among others, defence-related transactions.

21/ Trade data reported for China by various national and international sources are not yet fully consistent. In what follows, the official Chinese statistical handbook for 1981 and communications from the newly created Ministry of Foreign Trade are utilized. In some instance, however, these sources had to be supplemented with estimates derived from other sources.

22/ In the first three quarters of 1982, reductions in outstanding debt levels amounted to $1.9 for Poland and to about $0.6 billion each for the German Democratic Republic, Hungary and Romania.

Chapter III

GROWTH IN THE WORLD ECONOMY AND CURRENT POLICY STANCES

Virtual stagnation in global economic activity - an overview

In 1982, the economic recovery in the developed market economies, forecast for the second half of the year, failed to materialize, and the current world-wide economic recession intensified; global output growth decelerated for the third consecutive year to reach a low 0.2 per cent - the worst performance since the recession of the mid-1970s (see table III-1). The present slow-down stands in marked contrast to the roughly 4 per cent annual rate of expansion registered in the 1970s.

The stagnation of global economic activity in 1982 was the result of weak growth throughout the major country groupings. Retrenchment was widespread in the developing economies and disinflationary policies continued to be pursued in most developed market economies. Although the centrally planned economies as a group, and especially the European countries, reported one of their weakest economic performances of the post-war period, their growth none the less was positive in contrast to that of the other groups of countries.

Several factors determined the course of world economic activity in 1982. One of the most important ones was the pursuit by the United States for most of 1982 of a highly restrictive monetary policy which conflicted with a large fiscal deficit. Another was the commitment of other major industrial economies to curb domestic inflation, if necessary by further tightening monetary restraints, in order to prevent a substantial deterioration of their exchange rates relative to the United States dollar. This policy mix could not but further curtail effective demand and hence reduce their output and employment well below the already depressed levels of 1981. Another factor was the adoption by the European planned economies of modest objectives for output and internal demand in their 1982 plans in an effort to ease a variety of constraints that had hindered their growth since the late 1970s. These cautious output policies in developed countries severely blighted the prospects for an upswing in trade and, by implication, in the exports of developing countries. The external environment was particularly bleak for the countries that rely heavily on primary commodities for their export earnings. In addition, the sharp reversal in world financial markets in 1982 severely constricted the flow of funds, especially to the fast industrializing developing countries which recently had financed part of their industrial expansion from foreign sources.

In spite of the fact that the current recession is already in its third year and has affected without exception all major groups of market and planned economies, the prospects for swift recovery in 1983 and beyond are not very encouraging. On the basis of current forecasts, the growth of aggregate output in the developed market economies could reach perhaps 2 per cent in 1983. In view of the modest targets for expansion in the 1983 plans of the planned economies and the prospect for 2 per cent growth in developing countries, this means that global output in 1983 is unlikely to grow by more than 2.5 per cent. Although the current outlook for 1984 is not as bleak, with growth possibly accelerating to about 3.5 per cent, the likelihood of sustaining even this modest pace beyond 1984 is not at all assured.

Table III-1. World: annual growth rates of output volume, by country groups and major sectors, 1976-1984

(Percentage)

Item and country group a/	1976-1980	1981	1982 b/	1983 c/	1984 c/
Gross domestic product d/					
World	3.9	1.4	0.2	2	3.5
Developed market economies	3.5	1.3	-0.3	2	3.0
Developing countries	5.2	0.7	-0.7	2	3
Centrally planned economies e/	4.3	2.2	2.6	3.5	4
Agricultural production f/					
World	2.0	3.0	1.9	...	...
Developed market economies	1.9	3.7	1.0	...	...
Developing countries	2.6	4.2	1.2	...	...
Centrally planned economies e/	1.6	1.5	3.5	6.5	...
Industrial production g/					
World	4.7	0.7	-1.0	...	...
Developed market economies	4.4	0.4	-2.3	...	...
Developing countries	4.8	-1.4	-2.0	...	...
Centrally planned economies e/	5.3	2.5	3.1	3.5	...

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on international and national sources.

a/ For a specification of the country groupings, see the explanatory notes at the beginning of the present document.

b/ Preliminary estimates, derived in some cases from data for a period of less than 12 months. Estimates for the developing countries are based on a sample of 81 countries which jointly account for more than 90 per cent of the population and for 95 per cent of the aggregate GDP of the group.

c/ For the developed market economies, Secretariat forecasts based on Project LINK country models and other institutional forecasts; plan figures for centrally planned economies; and Secretariat forecasts for developing countries.

d/ Net material product in the case of the centrally planned economies. 1980 prices and exchange rates were used to obtain regional and global averages.

e/ China, Eastern Europe and the USSR only.

f/ Based on gross output indices prepared by the Food and Agriculture Organization of the United Nations, except for the centrally planned economies in 1981-1983, for which national statistical sources were used. Data for 1982 are estimates as of December. The average annual growth rates measured over a multi-year period reflect exponential trends obtained by fitting regression lines to the data points.

g/ Based on indices of value added in developed market economies, indices of gross output at constant prices in the centrally planned economies, and Secretariat estimates of gross output for the developing countries. The coverage is International Standard Industrial Classification categories 2-4 (that is, mining, manufacturing, and electricity, gas and water).

An unprecedented recession in developing countries

Since 1979, the developing countries, which account for more than half of the world's population, have seen their growth rates decline. However, in 1982, for the first time in more than forty years, their aggregate output actually fell (see table III-2). Out of 82 countries for which preliminary data are available, 29 registered negative growth, and for some the recession acquired the traits of a depression.

Table III-2. Developing countries: annual rates of growth of real gross domestic product, 1976-1984 a/

(Percentage)

Country group b/	1976-1980	1981	1982 c/	1983 d/	1984 d/
Developing countries	5.2	0.6	-0.7	2	3
Net energy-exporting countries	5.3	-0.2	-2.7	1	1.5
Capital surplus	3.9	-8.3	-7.4	...	...
Other countries	6.2	4.5	-	...	...
Net energy-importing countries	5.1	1.3	0.9	2.5	4

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on national and international sources.

a/ See footnote b/ to table III-1.

b/ For specification of the country groupings used, see the explanatory notes at the beginning of the present document.

c/ Preliminary.

d/ Forecast.

During this global recession, unlike that of the mid-1970s when their own foreign reserves were larger and massive foreign loans were available, the developing countries could not avoid being particularly badly affected, and indeed their growth decelerated by substantially more than did that of the developed countries. In view of their weak economic performance over the past years, the group's growth target of 7 per cent, set forth in the International Development Strategy for the 1980s, has become increasingly remote. Only a resumption of vigorous economic expansion can prevent a decline in per capita output during the first half of the 1980s.

The fall in output in 1982 caused per capita output to fall for the second consecutive year. Countries that had maintained relatively strong growth in 1981 registered either a marked deceleration or stagnation; the energy exporters of the Western Hemisphere even experienced a retrogression. Only the countries of South and East Asia (particularly the more industrialized exporters of manufactures) attained gains in per capita output levels, although their aggregate rate of growth slackened from over 6 to under 4 per cent.

The regions with the poorest economic performance in 1982 were Africa, Western Asia and the countries of the Western Hemisphere. Under the impact of falling petroleum production and exports, the aggregate output of the countries of Western Asia contracted by over 18 per cent in 1979-1982. After experiencing practically stagnant aggregate output in 1981, the developing countries of the Western Hemisphere registered a decline of between 1 and 1.5 per cent. For their part, the African countries experienced the fifth year of shrinking per capita output.

Among the energy-exporting countries, the major factor behind the contraction in output was the sharp fall in the external demand for oil. In the capital surplus countries, a steep decline in aggregate activity occurred despite vigorous expansion in the non-oil sectors, especially manufacturing, public investment and services. Since the oil sector accounts for between 65 and 90 per cent of aggregate output, except in Iran, the imposition of comparatively low production ceilings by OPEC members to prevent a major slide in oil prices resulted in very substantial reductions in overall output. The performance of the deficit energy exporters was also affected by the decision to set low quotas, although to a lesser degree since oil exports constitute a smaller proportion of their aggregate output. In addition, other energy-exporting developing countries were not bound by the OPEC agreement to curtail production and some (including Egypt, Malaysia and Mexico) succeeded in raising their exports.

Aside from those capital surplus countries that remained in current account surplus despite the steep decline in export earnings, the energy-exporting countries generally had to face tightening foreign exchange constraints. In most of these countries, ad hoc import and exchange controls were imposed in an effort to cope with a steadily worsening external payments situation. Although some had recourse to international capital markets to finance essential imports, the combination of declining exports and the need to curb domestic absorption for balance-of-payments reasons reduced growth rates substantially. It is estimated that on average their GDP stagnated in 1982, implying a reduction in per capita output of 2.5 to 3 per cent.

The net energy-importing developing countries also experienced severe balance-of-payments problems because of the international recession. The scarcity of foreign exchange in a number of countries could be overcome in the short run only by compressing imports, sometimes through emergency controls, and hence the pace of feasible growth. While foreign exchange shortages reduced the availability of primary and intermediate inputs, their effects were most pronounced for capital equipment, which may impair growth in the medium term.

The international recession also had a severe impact on aggregate demand. Plummeting commodity prices led to cuts in the domestic demand for manufactures by those sectors of the population whose incomes depend crucially on agricultural commodity exports. While revenues in terms of local currency were in some cases supported by devaluations, in many African and Asian economies farm revenues fell,

leading to curtailments in the demand for manufactures. Also the developing country exporters of manufactures were faced with depressed markets for their products in both the industrial and other developing countries.

The intensity and length of the global recession, coupled with the international credit squeeze and the inadequate expansion of ODA, made it impossible for most developing countries to undertake counter-cyclical policies of the kind they had pursued in the mid-1970s. The vast majority of both energy exporters and energy importers therefore either enacted severely restrictive policies or tightened those policies that were already in place. Particularly in Latin America, the exacerbation of inflation resulting from the sharp devaluations that became inevitable in the face of serious payments deficits made it imperative to apply restrictive policies. Furthermore, in the absence of adequate counter-cyclical financing, a growing number of countries had recourse to the IMF and introduced comprehensive adjustment programmes that were a condition for drawing from the Fund.

The main objective of policy in most developing countries was a reduction in their recession-induced external payments imbalances. To this end, a variety of instruments were applied either to reduce imports or to stimulate exports. In order to constrain imports, countries resorted to or intensified strict import controls, imposed prior import deposits, increased tariffs and, in some cases, undertook sharp devaluations. As devaluations improve international competitiveness, they also tended to stimulate exports. Other policies that were adopted to stimulate exports included fiscal incentives to export activities over and above those which were already in place, preferential access to bank credit, frequently at subsidized interest rates, and inducements to foreign investment aimed at producing for foreign markets. Efforts were also made to attract tourism and induce capital inflows by offering attractive returns on foreign currency deposits.

Because of its effect on government revenues and outlays, the global recession made the adoption or intensification of restrictive policies all the more necessary. The recession reduced domestically generated fiscal receipts, and declining trade values had an adverse impact on revenues from foreign trade taxes, on which most countries depend heavily. On the outlay side, the export-promotion measures in particular tended to widen the budget gap. In some countries where Governments attempt to stabilize the incomes of primary commodity exporters, the maintenance of prices paid to producers at a time of steep declines in international prices, also exacerbated budgetary difficulties.

On balance, though, discretionary fiscal policies turned increasingly restrictive in the course of 1982. On the revenue side, most countries raised both direct and indirect tax rates and attempted to broaden their tax base. Efforts were also made to curtail current expenditures: real wage rates in the public sector were allowed to decline, public sector employment was reduced through attrition, and subsidies on goods and services provided by public enterprises were either eliminated or cut back.

Certain expenditures, including defence, were difficult to trim and others, such as foreign debt service, inevitably rose. In the face of these inflexibilities and the difficulties in reducing current expenditures at a time of growing unemployment, the brunt of the effort to curtail overall budget deficits fell on public investment, as in the preceding two years; new investment projects

were either postponed or abandoned altogether. Expenditure was slashed to drastically below the planned levels in 1982, particularly in the larger deficit energy exporters, and the 1983 budgets that have been published indicate that most Governments intend to continue with their policies of restraint. Even the capital surplus countries reduced the growth of their public expenditures to well below the rates of recent years.

Monetary policy was also progressively tightened in most developing countries through the adoption of increasingly stringent ceilings on the expansion of credit to the private sector and through increases in those interest rates that were under policy control. In a number of Latin American countries where interest rates are determined by market forces, real rates reached record levels. The policy-induced domestic liquidity squeeze in these countries was accentuated by the collapse of a large number of financial institutions and by sharp falls in international reserves, as fears of devaluation led to capital flight and to attempts by private debtors to repay their external debts as soon as possible, in advance of further currency erosion. In these circumstances, it became necessary to ease the credit squeeze.

The industrial sector was the one most seriously affected by the recession. The cutbacks in oil production by the major energy exporters translated directly into a marked contraction of their industrial output. Producers of other minerals and metals fared somewhat better as their tight foreign exchange situation forced them to maintain, and in some cases to increase, production and exports, even when unit values were falling. The brunt of the recession was borne by manufacturing. This was for a variety of reasons. As this sector depends most heavily on imports for primary and intermediate inputs and capital goods, import controls set a limit to the levels of feasible activity. Furthermore, since the demand for manufactures is particularly income-elastic, the falls or stagnation in aggregate absorption adversely affected domestic demand for them. Finally, the exporters of manufactures saw their markets shrink appreciably, and in some cases the volume of their exports contracted.

In many developing countries, particularly the lower-income countries, growth depends heavily on agricultural production because it is the main contributor to aggregate output. Moreover, agricultural incomes provide a major source of demand for domestic manufactures. Although agriculture fared somewhat better than industry in 1982, increases in production did not keep pace with population growth. In Africa, the trend of declining per capita agricultural and food production observed since the early 1970s was arrested but not reversed. Although satisfactory crops were harvested in many countries, severe droughts throughout southern Africa reduced grain output and contributed to a poor overall economic performance. In Asia and the Pacific, agricultural production generally stagnated on account of adverse weather conditions; in several countries, including India, output declined.

The improvements in the employment situation that some developing countries registered in the 1970s came to an abrupt halt during the current recession. Although the information available is at best sketchy, the labour market situation appears to have deteriorated very sharply in the past two to three years. In Latin America, urban unemployment reached proportions without recorded precedent, and real wages in manufacturing declined significantly. Some countries experienced rapid growth in disguised unemployment, generally in the form of services with very low marginal productivity. Although unemployment in Asia did not rise to the same

extent, there were also signs of softer labour market conditions, such as stagnant or declining real wages. In some countries, including India and Malaysia, the number of new jobs created fell substantially short of the expansion of the urban labour force.

Although developing countries as a group experienced an increase in recorded rates of inflation, this stemmed from events in the Western Hemisphere, where several countries recorded annual rates of inflation approaching or exceeding 100 per cent; with the exception of a few countries in Africa and of Israel, inflationary pressures tended to ease elsewhere (see table III-3). In the Western Hemisphere, balance-of-payments pressures and falling international reserves led to sharp devaluations which immediately affected local prices. In addition, most of these countries used a variety of import controls that had a direct impact on domestic prices. On the demand side, the global recession and its domestic repercussions worked to diminish their fiscal revenues. Since these countries do not have well-developed domestic capital markets, the resulting budget deficits were mostly monetized, and money supplies rose rapidly, albeit by less than domestic prices.

While the above factors were also present to varying degrees in other regions, restrictive domestic policies and declines in the foreign prices of imported goods helped to ease inflation in the countries that did not have to resort to large currency devaluations. In general, those countries that were able to avoid a steep decline in the value of their currency were relatively successful either in reducing their inflation rates or in maintaining rates which were well below the average for developing countries. Finally, some countries in Africa enacted price controls to repress inflation.

The near-term growth prospects for the developing countries are not very encouraging. While foreign exchange constraints should ease somewhat in the coming 18 months, the external difficulties faced by most developing countries will not be quickly eliminated. The forecast of weak growth in the developed market economies in 1983-1984 should lead to only a modest improvement in the export earnings of the developing countries. Moreover, there might be only a gradual easing in the severe liquidity squeeze of 1982. For deficit countries, these factors set against the persistence of payments difficulties, suggest that, in the absence of significant policy changes, output growth, although likely to improve, will continue to be sluggish.

The outlook for the energy exporters as a group depends heavily on demand for oil, which is expected to remain flat in 1983, and on the evolution of oil prices. After weakening in early 1983, these are expected to remain stable for the rest of the year. While some of the deficit energy exporters, particularly those that do not belong to OPEC, may increase their oil exports, this is likely to be accomplished at the expense of falling exports in other countries. Thus the capital surplus countries may register further declines in their aggregate output. The magnitude of the drop, though, is likely to be considerably smaller than that experienced in the past three years.

Table III-3. Developing countries: annual rates of change in the consumer price index, 1976-1982 a/

(Percentage)

Country group	1976-1980	1981	1982 b/
Developing countries	33.5 (11.7)	38.1 (13.8)	45.8 (10.8)
Africa	17.1	22.2	15.4
South and East Asia	9.1	13.6	7.0
Western Asia	15.4	20.2	18.0
Western Hemisphere	62.0	65.0	87.4
Others	32.0	37.5	31.0
Memorandum items:			
Net energy-exporting countries	15.4 (11.7)	18.8 (16.2)	28.7 (11.9)
Net energy-importing countries	46.8 (11.6)	51.5 (13.2)	55.8 (9.8)

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International Financial Statistics; and United Nations, Monthly Bulletin of Statistics.

a/ The group for which data are available includes 19 net energy-exporting and 59 net energy-importing developing countries. Figures in parenthesis indicate median values.

b/ Preliminary.

Even this gloomy forecast for the developing countries is subject to considerable downward risk since it assumes that export earnings will improve somewhat, that financing for the persistently large current account deficits will be forthcoming, and that countries experiencing cash-flow problems will be able to roll over or re-finance maturing credits. These are rather optimistic assumptions given the current world economic situation and the stance of the major actors in the world economy. If economic conditions in the industrial centres do not show a marked improvement, protectionist sentiment could endanger even the modest recovery forecast for developing countries. A prolongation of the 1982 credit crunch would also adversely affect the developing world, chiefly as a result of inevitable import restraints. This in turn would dampen growth in the industrial centres.

Deepening of the recession in developed market economies

The economic recession that began in the developed market economies in the latter part of 1979 deepened in 1982. Whereas official and other forecasts made at the end of 1981 had predicted a gradual fall in the rate of inflation and a slow recovery of output in the course of 1982, this did not happen, largely because of the macroeconomic policies pursued with great determination in the United States. These policies were aimed at reducing the domestic rate of inflation but they also reduced the amount of freedom other countries had to pursue more expansionary economic policies, and thus quickly choked off the inventory-led upturn that was hesitantly beginning in some of the developed market economies at the start of 1982. The final result was that, in 1982, nearly all of the developed market economies experienced falling or stagnant levels of real output (see table III-4), sharply rising unemployment, very high real interest rates, record numbers of business insolvencies, continuing weak demand for private investment, large fiscal deficits, and a general weakening of currencies vis-à-vis the United States dollar. The one positive development was the rapid slow-down in the pace of inflation in several countries.

The outlook for 1983 points in the direction of a mild upswing with the growth of aggregate real output ranging from 1 to 2 per cent - a very anaemic rate after such an extended and deep recession. Although by the second half of the year, the rate of growth in the United States should accelerate to between 4 and 5 per cent, only 2 1/2 per cent is projected for the year as a whole. In addition, a few other major developed countries, including Canada, the Federal Republic of Germany and the United Kingdom, are expected to regain some semblance of economic expansion in 1983. Most European countries will share in the recovery only by year-end or the beginning of 1984. By then the pace of economic activity in the developed market economies as a group could accelerate to an annual rate of 3 per cent.

As a result of the present recession, the longest and, for most developed market economies, also the deepest since the Great Depression of the 1930s, the group's aggregate output grew from 1980 to 1982 by an annual rate of 0.5 per cent in comparison to 5 per cent from 1961 to 1973 and 4 per cent from 1976 to 1979. By 1982, the downturn affected nearly all countries: the level of economic activity contracted in 11 countries 1/ and an additional five 2/ showed little or no growth. Only Japan reported anything like a satisfactory rate of growth, of 3 per cent, which was, though, unusually low when compared with that country's past achievements.

1982 was, then, the third year running of the recession that had gathered momentum in the wake of the contractionary adjustment measures undertaken first in 1979. Any successful and prompt adjustment in economic structures to contain the immediate effects of this doubling of the oil price on inflation and on its underlying expectations would have involved the adoption of some combination of disinflationary policies. However, since the deflationary impact of the second oil shock on aggregate domestic demand in the developed market countries had lost considerable strength by 1981 at the latest, the explanation for the lack-lustre performance of 1982 and the less than comforting outlook for an early and sustainable recovery in 1983 lies elsewhere.

Table III-4. Developed market economies: annual rates of growth of real gross national product, a/ 1976-1984

(Percentage)

Country or country group	1976-1980	1980	1981	1982 b/	1983 c/	1984 c/
All developed market economies	3.5	1.2	1.2	-0.3	2.0	3.0
Major industrial countries	3.6	1.0	1.2	-0.4	2.0	3.5
Canada	2.9	0.5	3.1	-4.5	2.0	3.5
France	3.3	1.1	0.3	1.5	1.0	2.0
Germany, Federal Republic of	3.6	1.8	-0.2	-1.1	1.0	3.0
Italy	3.8	3.9	-0.2	-0.3	-1.0	2.5
Japan	5.0	4.8	3.8	3.0	3.0	3.5
United Kingdom	1.5	-1.8	-2.2	0.5	2.0	2.0
United States	3.7	-0.4	1.9	-1.7	2.5	4.0
Other industrial countries	2.8	2.5	0.8	0.2	0.5	2.5

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on various official national and international sources.

a/ Constant 1980 prices and exchange rates in United States dollars. For France, Italy, the United Kingdom and all of the "Other industrial countries", the measure used is gross domestic product.

b/ Preliminary estimates.

c/ Secretariat forecasts (based on Project LINK country models and other institutional forecasts).

This explanation is to be found primarily in the demand-depressing policy stances adopted by Governments in most of the developed market economies and, in particular, in the conflicting but, on balance, deflationary mix of fiscal and monetary policies pursued by key developed market economies. These policies lengthened and intensified the present slump, and adversely affected trade policy stances. The basic aim of almost all of the deflationary policies adopted has been to erode inflationary expectations and to cut inflation by setting targets for money supply growth that were below the expected increase in nominal GNP, and that

allowed little room for increases in the Government's borrowing requirements. However, these policies led to historically high interest rates, which depressed aggregate demand in nearly all developed market economies. The resulting underutilization of factor inputs, and particularly labour, lowered the rate of inflation and moderated wage demands.

In the United States, the retightening of monetary policy from the latter half of 1981 until well into the third quarter of 1982 not only deepened the recession there and in Canada, 3/ but through its effect on interest and exchange rates, also removed the possibility of the long-expected recovery in Europe and Japan from taking firm root. Furthermore, the spreading economic slow-down and high interest rates acted as a barrier against the few countries 4/ that were initially following expansionary policies. In nearly all cases, the results of these policies were increases in inflation and in external imbalances and only marginal gains in employment and output.

High nominal and real interest rates in the United States exerted a major pull on capital movements and led to a significant appreciation of the United States dollar against most other convertible currencies. This association of high real interest rates with an appreciating currency - incidentally, a major departure from post-war experience - was strengthened by large flows of direct and portfolio investments into the United States. These were spurred not so much by bolstered confidence in that country's economic fortunes, as by the fact that real long-term interest rates there were very high and the prospects for profitable investment in many other market economies were perceived to be even less reassuring.

As well as depressing domestic private investment, persistently high real interest rates in the United States militated against a relaxation of monetary policy in other industrial countries. 5/ Many of them set restrictive targets for some variant of monetary aggregates and indeed real money supply growth decelerated or remained small in nearly all major economies (see table III-5). Because of the openness of the smaller developed market economies and their continuing high pace of inflation, a relaxation of monetary policy would only have been construed as inflationary and would have added to the external pressures on their currencies. Some of these countries (including Belgium and the Netherlands, which were subject to the disciplines of the European Monetary System) therefore focused their efforts primarily on maintaining their exchange rates and kept the growth of their money supply in line with that of their main trade partners.

As a result of the tight monetary policies being pursued, interest rates remained high, although some easing in nominal terms occurred in response to the contraction in private demand for credit. However, since inflation declined more than nominal interest rates, real long-term interest rates, as conventionally measured, increased in early 1982 and remained high during the year, presumably owing to the fact that inflationary expectations were still high (see table III-6). 6/ In some key developed market economies, real interest rates were quite high by post-war standards, 7/ and this was especially the case for long-term rates, whose trends were perverse in several countries, in sharp contrast to the experience of the previous recession. 8/ This unusual coincidence of high real interest rates with the trough of the cycle discouraged consumer borrowing and deterred investment.

Table III-5. Major developed market economies: real rate of change in broad money supply (M2), a/ 1979-1982

(Percentage change from previous period-end)

Country	1979	1980	1981	1982 b/	1982 c/ 1st half	1982 c/ 2nd half
Canada	6.8	4.9	6.7	-3.9	-2.6	-2.9
France	3.9	-1.7	0.9	2.1	-3.4	0.7
Germany, Federal Republic of d/	2.1	1.3	0.3	0.0	-3.0	4.8
Italy	4.0	-6.3	-5.0	-3.1	-8.8	-6.2
Japan e/	6.4	4.1	7.7	5.4	2.1	5.9
United Kingdom f/	-2.7	1.7	1.2	1.5	3.8	3.4
United States	0.3	0.6	0.3	3.6	3.9	4.8
Memorandum item narrow money (M1) g/						
United States	-0.9	-1.6	-3.8	2.5	-0.6	8.6
Canada	-6.4	-0.4	-9.2	-6.0	-8.9	4.7

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, World Economic Outlook, 1982; OECD, Main Economic Indicators, February 1983; Commission of the European Communities, Annual Economic Report, 1982-83.

a/ IMF definition of money (M1) plus quasi-money. The rate of change in real money supply is measured by calculating the end of period to end of period change in the stock of M2 and deflating it by the GNP deflator.

b/ Preliminary, money stock up to the end of December 1982 for Canada, the Federal Republic of Germany, the United Kingdom and the United States; money stock up to the end of November 1982 for Japan; money stock up to the end of September 1982 for France and Italy.

c/ Annualized half-yearly growth rates deflated by GNP deflator of the same period.

d/ M1 plus domestic saving deposits.

e/ M2 plus certificates of deposits.

f/ Sterling M3.

g/ M1 is narrowly defined money supply, that is, currency plus domestic demand deposits.

Table III-6. Major developed market economies: real interest rates, a/ 1975-1982

(Percentage)

Country	1975	1976	1979	1980	1981	1982 b/
Canada						
Short-term	-1.6	-0.9	3.2	6.0	4.2	3.1
Long-term	-1.7	-0.3	-0.1	1.7	4.7	3.1
France						
Short-term	-4.5	-1.3	-1.3	-6.5	2.9	2.4
Long-term	-3.4	-0.7	-0.1	1.0	3.3	3.3
Germany, Federal Republic of						
Short-term	-2.1	0.5	2.1	4.1	6.8	3.3
Long-term	1.7	4.3	3.6	3.5	5.9	3.5
Italy						
Short-term	-5.8	-1.9	-3.5	-3.0	1.7	1.8
Long-term	-5.0	-4.2	-1.6	-3.8	2.5	2.6
Japan						
Short-term	3.0	0.3	3.1	7.7	4.5	4.4
Long-term	1.6	2.0	5.0	6.0	5.7	5.5
United Kingdom						
Short-term	-12.3	-0.3	1.6	-4.1	-1.0	0.2
Long-term	-9.8	-0.2	-1.8	-4.2	2.3	3.4
United States						
Short-term	-3.2	-0.1	2.5	4.0	6.4	5.6
Long-term	-0.1	2.5	0.8	2.2	3.9	6.3

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International Financial Statistics; and Morgan Guaranty Trust Company, World Financial Markets.

a/ Both short- and long-term rates are period averages net of the change in the GNP deflator. The short-term rate is the bank rate in Canada and the United Kingdom, call money rate in France, Germany, Italy and Japan, and the Federal Funds rate in the United States. The long-term rate for Germany is the yield on Public Authorities Bonds and for others the yield on long-term government bonds.

b/ Preliminary. Data up to November 1982 for Italy; for all other countries, data up to December 1981.

During 1982, then, the brunt of the battle against inflation was generally borne by restrictive monetary policies. Fiscal policies were generally supportive and in only a few cases were they expansionary. However, through its effect on automatic stabilizers, the recession triggered unprecedented increases in nominal government deficits in most countries. Tight monetary policy in the majority of market economies therefore had to be pursued simultaneously with substantial public sector borrowing requirements that in many cases were even rising as percentages of GNP (see table III-7). 9/

Table III-7. Selected developed market economies: general government budget surplus or deficit (-) as percentages of nominal GNP or GDP, a/ 1978-1982

Country	1978-1980	1980	1981	1982 b/
Major developed market economies				
Canada	-2.4	-2.1	-1.0	-4.0
France	0.1	0.3	-1.6	-3.5
Germany, Federal Republic of	-2.8	-3.1	-4.5	-4.2
Italy	-9.1	-8.3	-11.9	-13.0
Japan	-4.8	-4.2	-4.0	-3.4
United Kingdom	-3.5	-3.2	-2.3	-1.5
United States	-0.2	-1.3	-1.0	-3.6
Other economies				
Belgium	-7.3	-9.3	-13.4	-13.0
Denmark	-1.7	-3.2	-7.0	-9.0
Netherlands	-3.5	-4.1	-4.8	-6.0
Sweden	-2.5	-4.0	-5.3	-6.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on OECD, OECD Economic Outlook and other official national and international sources.

a/ Budget deficit or surplus of central, state and local governments.

b/ Preliminary figures based on partial data.

Cyclical factors were largely responsible for the growth in budget deficits. Transfer payments to the growing numbers of the unemployed rose and record debt-servicing payments, induced by higher interest rates, had to be met. In the smaller developed market economies, in particular, expenditure on social benefits, and on supporting basic industries, many of which had been losing their competitiveness, increased rapidly. Several of these countries (including Belgium, Denmark and Ireland) 10/ borrowed heavily in international money markets to finance, in effect, public and private sectors' consumption. Finally, at the same

time as the recession caused government expenditures to rise, it caused tax revenues to fall short of budgeted levels.

In a number of countries serious efforts were made to compress the non-cyclical, discretionary part of public expenditures. However, for some of the major countries the current record budget deficits also stem from changes in the discretionary components. This was especially the case in the United States, where two reductions in income tax rates, a variety of tax concessions and incentives enacted in 1981 and 1982, and the acceleration in real defence outlays would have yielded a deficit even if there had been full employment. The third reduction in income tax rates in mid-1983 will exacerbate this structural disequilibrium unless comprehensive balancing controls are put in place.

Although the present fiscal deficits are large, recent estimates of the cyclically adjusted budgetary imbalances for 1982 suggest that the overall effect of the fiscal policy stances of the seven major industrial countries was neutral. 11/ In the smaller developed market economies, the recession and high interest rates tended to reduce fiscal inflows and increase outflows, but these effects were mostly counterbalanced by changes in the discretionary component. Whereas in 1981 changes in the discretionary component had generally provided a stimulus, in 1982 they tended to depress economic activity. In a few cases (including Belgium, Greece and Ireland), the net result was an actual reduction in the budget deficit. The austerity programmes promulgated in some of these countries also sought to compress what had hitherto been treated as the public sector's non-discretionary component; social security contributions were raised and current spending, particularly on civil service pay and some social benefits, was held down.

Even in the few countries which pursued expansionary fiscal policies and, as in the United States, 12/ granted a variety of direct income tax cuts and incentives, the outcome in terms of real growth of output and employment was on balance disappointing. In the United States, private demand failed to respond to personal income tax cuts and to increased social security benefits, and corporate demand to fiscal incentives. This largely explains why the expected consumer-led recovery did not materialize in 1982. 13/ Uncertainty about the employment situation, high interest rates and faltering business confidence in the wake of disappointing sales all led to a sharp contraction in total consumer spending on durable goods and on residential construction, a decrease in private capital formation and a precipitous reduction in inventories. 14/

While the pace of economic activity slowed down in the majority of countries in 1982, the degree of divergence in the growth rates of the major industrial economies, as indicated by the standard deviation, was appreciably higher than in 1981. 15/ This was chiefly caused by differences in the relative restrictiveness of monetary and fiscal policies, and in the magnitude and impact of shifts in the various components of final demand, including trade. 16/ In some of the major countries, stocks were built up slightly, but in others the sharp fall in the level of real private consumption was followed by precipitous declines in inventories.

In the the case of the smaller developed market economies, not only was activity depressed by restrictive monetary policies, and in some cases too by

fiscal restraint; it was also strongly affected by exchange rate pressures and the depressed demand for their goods from their main trading partners. As prices of nearly all internationally traded commodities are denominated in US dollars because of the preponderant weight of the United States in world commodity markets, the dollar's sharp appreciation led to price pressures from within the group of developed market economies as a whole that adversely affected domestic inflation, especially in these smaller countries. Monetary policy, particularly in most European members of the group, could therefore not be relaxed, and in some it was in fact tightened to stem the erosion in the value of their currencies. Further fiscal austerity and monetary restraint increased considerably the degree of disinflation and helped produce levels of unemployment even higher than those which policy-makers had already found difficult to tolerate. Nevertheless, policies of disinflation did not always suffice to offset external pressures (especially those caused by weak demand in the European Economic Community, the unexpected strength of the US dollar, capital outflows and high debt-service requirements), and five of the smaller European countries (Belgium, Denmark, Finland, Spain and Sweden), in addition to France, devalued their currencies; Greece resorted to the same measure in early 1983. The primary commodity producers - Australia, New Zealand and South Africa - were also buffeted by weak prices for their export commodity and a contraction in the inflow of foreign investment.

By year-end the absolute number of the unemployed in the developed market economies soared to 32 million - a record average of 8.5 per cent of the civilian labour force; only Japan maintained a low rate, of 2.3 per cent. Youth, who normally experience frequent but short-term spells of unemployment, and the "continuously unemployed", who are more likely to be older workers, were particularly strongly affected. In the United States, the rise in the level of employment came to a halt as the procyclical fall in productivity and the continuing recession induced businesses to shed labour to protect their financial positions. Record bankruptcies and faltering business confidence made for gloomy re-employment prospects. Whereas in the seven major economies, unemployment surged from 6.5 to 8 per cent (see table III-8), the impact of the recession was much more pronounced in the smaller countries, where unemployment moved up from 8.8 per cent in 1981 to an unprecedented 10.5 per cent in 1982.

The severe reduction in economic activity was felt most by industry. As a result of surging pessimism as to the strength of an eventual recovery, labour unions in a number of countries gradually accommodated to employer and government demands that they moderate nominal wage raises and, in some cases, even pared down existing benefits 17/ in return for greater job security. Nevertheless, average annual unit labour costs in manufacturing, which roughly equal nominal wage increases net of changes in average labour productivity, inched up in all of the major countries. A rather modest decline, of 3 to 4 percentage points, in the actual rate of increase, occurred only in the Federal Republic of Germany, Italy and the United Kingdom (see table III-9). The data for the smaller countries are less comprehensive, but also point in the direction of increasing unit labour costs. Downward wage rigidities, in particular, have made it exceedingly difficult to align the changes in nominal wages only to those in labour productivity.

Table III-8. Selected developed market economies: unemployment rates, a/ 1976-1983

(Percentage)

Country or country group	1976-1980	1980	1981	1982 b/	1983 c/
Major developed market economies	5.3	5.6	6.5	8.0	9.0
Canada	7.7	7.5	7.6	11.0	13.0
France	5.3	6.3	7.3	8.3	9.5
Germany, Federal Republic of	3.4	3.1	4.8	7.6	9.0
Italy	7.1	7.4	8.5	9.0	9.5
Japan	2.1	2.0	2.2	2.2	2.5
United Kingdom	6.4	7.3	10.6	12.0	12.5
United States	5.2	7.0	7.5	9.7	10.5
Other economies					
Belgium	8.2	9.4	11.7	13.9	14.5
Denmark	5.7	6.1	8.1	9.1	9.0
Ireland	8.5	8.3	10.3	12.1	14.0
Netherlands	4.3	4.7	7.5	10.4	13.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based in the case of the major countries on OECD, OECD Economic Outlook and in the case of other economies on Commission of the European Communities, Annual Economic Report 1982-83.

a/ Number of unemployed persons as a percentage of the civilian labour force.

b/ Preliminary estimates.

c/ Forecasts.

Table III-9. Major developed market economies: annual rates of growth in unit labour costs a/ in manufacturing, 1976-1982

(Percentage)

Country	1976-1980	1980	1981	1982 b/
Canada	7.7	10.9	10.3	15.0
France	9.4	12.3	11.2	14.0
Germany, Federal Republic of	5.0	8.7	4.1	1.5
Italy	12.9	13.7	20.8	17.0
Japan	0.7	2.7	3.2	3.5
United Kingdom	15.7	22.7	8.6	5.0
United States	8.1	11.0	7.1	7.2

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Comparison of Manufacturing Productivity and Labor Costs, United States Department of Labor; and OECD, OECD Economic Outlook, December 1982.

a/ All figures are expressed in local currency; unit labour cost (ULC) may be equated with the nominal wage bill per unit of real output. The percentage change in ULC is therefore roughly equal to the percentage change in average nominal wage rate less the percentage change in average labour productivity.

b/ Preliminary estimates.

This rigidity of wage costs, together with downward pressures on producer prices and the high cost of financing inventories, reduced corporate profit margins in some developed market economies, and particularly the United States. This further compressed corporate demand for factor and intermediate inputs. As a result, factory closings and business bankruptcies mounted not only in depressed sectors, such as steel and ship-building, but also in growth industries, including, in some countries, electronics and communications. 18/ These and other factors contributed to a substantial idling of plant and equipment. While levels of capacity utilization in manufacturing fell rapidly in the second half of 1982, they still were not as low as those observed in the trough of the mid-1970s, except in the United States, where they dipped to 68 per cent. But differences in the measurement base stemming from the very weak rates of investment since the late 1970s, in contrast to the rapid capital accumulation that preceded the previous recession, should not be ignored.

The contractionary policy mix in the major industrial countries resulted, on average, in a deceleration of inflation - measured in terms of consumer prices - of 2 to 3 percentage points. In the smaller countries, however, the decline was only marginal, from an average 11.8 per cent in 1981 to 11.2 per cent in 1982 (see table III-10). This difference can be attributed largely to the varying impact of changes in trade prices. In the United States, for example, the near halving of the annual rate of increase in consumer prices to about 6 per cent in 1982 was only in part directly induced by policy; the drop in commodity prices and the dollar's appreciation accounted for a significant portion. On the other hand, the smaller gain in the battle against inflation in Europe stemmed in part from external factors. Movements in the GNP deflator, which is an aggregate indicator of internal price movements from which the impact of import prices is netted out, help clarify these points. It declined by 3.4 percentage points in the United States and 4 percentage points in the United Kingdom, stayed virtually unchanged in Japan, and increased in all other major and most of the smaller economies.

The reduction in inflation, achieved primarily through monetary restrictions, has, then, so far been modest. 19/ It has, however, been achieved at a considerably greater cost in loss of output than in the preceding period. The particular policy mix adopted - to which there were alternatives, as argued in the World Economic Survey 1981-1982 20/ - can explain much of this difference. Furthermore, it has yet to be learned how far weak investment activity and the loss of labour skills caused by cutbacks in training and lay-offs may entail bottlenecks early on in the recovery.

Apart from the contribution of weak commodity markets, the major reason for the slow-down in inflation in some countries in 1982 was the moderation in the increases in labour costs. 21/ For example, hourly earnings in manufacturing decelerated markedly in all major developed countries, except France. However, these improvements were in some cases counterbalanced by a procyclical decline in average labour productivity; only in the Federal Republic of Germany and the United Kingdom was the downward trend in wage increases reinforced by productivity gains, which came about through substantial labour shedding.

Table III-10. Developed market economies: rates of change of GNP deflator and consumer prices, 1976-1983 a/

(Average annual and annual percentages)

Country or country group	1976-1980	1980	1981	1982 b/	1983 c/
GNP deflators					
All developed market economies	7.9	9.0	8.3	7.2	6.0
Major industrial countries	7.7	8.9	8.2	6.7	5.5
Canada	8.7	11.0	10.1	10.7	6.5
France	10.2	11.9	11.0	12.0	10.0
Germany, Federal Republic of	4.1	4.4	4.2	5.0	4.0
Italy	17.5	20.6	18.4	17.7	14.0
Japan	3.9	2.8	2.6	2.4	3.0
United Kingdom	14.4	18.5	12.7	8.8	5.0
United States	7.8	9.3	9.4	6.0	4.5
Other industrial countries	8.7	9.0	9.1	9.8	8.5
Consumer prices					
All developed market economies	8.9	12.1	10.2	7.8	...
Major industrial countries	8.7	12.2	9.9	7.1	...
Canada	8.7	10.1	12.5	10.8	...
France	10.4	13.6	13.4	11.9	...
Germany, Federal Republic of	4.1	5.5	5.9	5.3	...
Italy	16.3	21.2	19.5	16.4	...
Japan	6.5	8.0	4.9	2.6	...
United Kingdom	14.4	18.0	11.9	8.6	...
United States	8.9	13.5	10.4	6.2	...
Other industrial countries	10.1	11.3	11.8	11.2	...

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International Financial Statistics; OECD, OECD Economic Outlook; and other official national and international sources.

a/ Base year is 1978.

b/ Preliminary estimates.

c/ Forecast.

The outlook for the modest successes in the battle against inflation of 1982 continuing into 1983 and 1984 is clouded by uncertainties. Most commodity prices are showing signs of strengthening and those currencies that appreciated in 1982, thus helping reduce domestic inflation, could reverse their movements in 1983. Confidence that inflation will be held down to the rates of the latter half of 1982 must, then, be based largely upon weak labour markets or substantial improvements in productivity holding down unit labour costs, and, perhaps even more questionably, upon a further and significant decline in the prices of energy.

The prospects for growth in the developed market economies are decidedly mixed: only a modest recovery to about 2 per cent is forecast for 1983 - making it the fourth successive year of sluggish performance. In addition, the further decline in business investment projected for all the major economies, except Japan and the United Kingdom, unfavourably affects the outlook for sustained growth beyond 1983. Since export demand is projected to be weak, the key to recovery in the developed market economies must be the revival of domestic demand. This however depends almost totally on further declines in interest rates and on a continuation of the relatively expansionary monetary policy in the United States that started in August 1982.

Under these conditions, a mild recovery is expected to start in North America and to gather some momentum by mid-year; the Federal Republic of Germany may grow by perhaps 1 percentage point and Japan may repeat its modest performance of 1982. However, many of the European economies, major as well as smaller, are not expected to share in this recovery until the latter part of 1983 or early 1984.

The main impetus for the cyclical upswing in the United States is expected to come from a moderate expansion in personal demand for durables, which will be helped by the tax cut scheduled for July, a sharp rebound in private residential investment and a moderate restocking of inventories. On the other hand, the momentum of the recovery should be slowed by an anticipated contraction, for the second consecutive year, in non-residential investment and by weak demand for exports together with a surge in imports, both caused by the effect of the strong dollar in 1982 being felt in 1983. In Europe, policies should continue to remain cautionary mainly to forestall currency depreciations and balance-of-payments difficulties. In many of the smaller countries, but also in France and Italy, the same constraints on economic policy as applied in 1982 - large fiscal deficits, high rates of inflation, weak external positions and the resulting pressures on exchange rates - will continue to apply in 1983 and are bound to inhibit the emergence of a bold stimulus to growth. In Japan, however, relatively strong consumer demand and a moderate increase in exports together with low growth in the volume of imports are projected to keep growth at about 3 per cent in 1983.

The growth rates projected for 1983 remain well below those traditionally associated with a recovery period, especially after such a protracted and deep recession. For example, while the cyclical rebound rate in the United States, measured over four quarters from the trough of the recession, has traditionally exceeded 6 to 7 per cent, current forecasts average out to a markedly slower pace.

Even these modest forecasts embody several risks and uncertainties. This is particularly so for the reaction of interest rates to the currently projected budgetary deficits in the United States. While the latter's fiscal policy stance is somewhat expansionary, as it should be at the bottom of a recession, without a pronounced monetary accommodation the public sector's expected borrowing

requirements may, by 1984, crowd out the credit markets. This would be happening at a time when the demand for credit by the business sector should be high since the increases in consumer expenditure and inventory re-stocking projected for 1983 should by then have led to substantial increases in the rates of capacity utilization. In these circumstances, a credit squeeze could prove decisive in preventing any appreciable increase in business fixed investment, and could choke off the incipient upswing in 1984. For these reasons, a further decline in interest rates is still essential for bringing about an improvement in consumer and business confidence. While inflation is expected to remain low in the near future, it is as yet uncertain whether this will be sufficient to bring down nominal long-term interest rates quickly.

Given the declared commitment of United States policy-makers to keep inflation in check as against the fact that several factors that have kept inflationary expectations high have not changed, it is not possible to rule out at this stage a rekindling of inflation and a resumption of the conflict between fiscal and monetary targets. This might lead to an increase in interest rates and to a weakening of the recovery in the United States and, consequently, through the direct influence on the monetary policies of other countries and through the indirect influences, via the exchange rate, on global financial markets, to a further deflationary push to the rest of the world economy.

The experience of 1982 demonstrates the limitations of unco-ordinated policy actions. It also indicates that while individual countries can accelerate their pace of economic expansion through stimulatory policies, a co-ordination of the macroeconomic policies of the key developed countries is necessary to mitigate the risks of rekindling inflation and to ensure a sustained recovery beyond 1983. An agreement on co-ordination could be guided by the recognition that in a globally interdependent economy, although an individual country's restrictive monetary policy might be successful in obtaining the often very necessary result of reducing domestic inflation, its effect on economic activity at home and, through these direct and indirect effects on activity in other countries, are often very important. For the monetary and also fiscal policies of individual countries to be truly successful in restoring non-inflationary growth to them and to the world economy would, then, require that they support and be supported by policies being pursued elsewhere. This could be achieved by the design and implementation of an internationally dovetailed mix of macroeconomic policies.

A joint recovery programme for the developed market economies would in general entail the implementation of expansionary monetary and/or fiscal policies. For each country, the form and size of the stimulus would depend on its particular situation and economic structure. Such a co-ordinated policy mix could usefully be supplemented by the adoption of incomes policies by countries which, in view of their already high fiscal deficits and inflation rates or balance-of-payments problems, have little freedom of manoeuvre to relax their monetary or fiscal policies without adding to their present difficulties. However, it should be added that if existing trade barriers remain intact, a co-ordinated recovery programme by the major industrial economies may fail to produce the results that it would have a few years ago. That is, in the present protectionist environment, it can only be expected that the positive stimulus of the domestic growth of one country to that of other trading countries will be considerably lessened.

Continued weak growth in the centrally planned economies

Since the late 1970s, the centrally planned economies as a group, and particularly the Eastern European countries, 22/ have had to face a variety of obstacles to their growth. The protracted slow-down in global economic activity and changes in world markets forced adjustment upon these economies and partly explain their weak economic performance. At the same time, though, adjustment has had to be made to account for the slowing growth of factor availability and for supply bottlenecks within the CMEA, as well as for the only limited successes with measures to save material inputs and foster factor productivity. Proper adjustment to these factors has proved to be a major challenge for the planning and management systems of these countries, as evidenced by the ongoing reappraisals of medium-term development policies in a number of them.

The growth in the aggregate output of the group of centrally planned economies in 1982 virtually equalled that of 1981 - namely, 2.5 per cent. 23/ In spite of this being the fourth consecutive year of below-plan output levels and slow growth, economic activity in these countries was none the less more buoyant than in any other major group of developed or developing market economies.

The mild recovery from a decline in activity of 1.2 per cent in 1981 to the increase of 2.8 per cent anticipated in the Eastern European plans for 1982 was not achieved; aggregate economic activity declined marginally (see table III-11) owing to the fourth consecutive year of negative growth in Poland. The Soviet Union's target of 3 per cent, slightly below the 1981 achievement, was not attained; aggregate growth decelerated to 2.6 per cent. Over the past four years, the pace of expansion of the European centrally planned economies combined averaged an uncharacteristically low 2.3 per cent per year (with 0.5 per cent for Eastern Europe but 3 per cent for the Soviet Union). The achievements of 1981-1982 and the forecasts for 1983 suggest that most members of the group are not likely to fulfil their current five-year plan (1981-1985) targets. 24/ In fact, some have already reassessed their medium-term development prospects, 25/ but no comprehensive revisions to their plans have as yet been published.

In 1982, the Asian planned economies regained substantial growth in both industry and agriculture in spite of shortages reported in the availability of skilled workers and materials. The latter shortages were partly caused by import constraints. China over-fulfilled its plans with a 5 per cent rate of growth because of good grain and cash crops that came in response to agricultural reforms, an acceleration in coal output and a successful adjustment to external constraints.

The Soviet Union had envisaged a repetition of the previous year's performance by setting a 3 per cent target for growth in 1982. The expansion was expected to come from a sharp recovery in agriculture, good growth in industry as bottlenecks in infrastructure and material supplies were anticipated to ease, and a faster coming on stream of projects already in progress. On the other hand, only marginal increases were planned in overall investment activity. Furthermore, the foreign trade sector was expected to contribute little to growth, owing to the virtually unchanged level of oil output, in particular, and to the need for sizeable imports of foodstuffs and fodder grain to offset the low 1981 harvest. With the exceptions of the commissioning of investment projects and the successful export drive, the assumptions behind the plan as to the feasible rate of domestic economic activity proved in retrospect to have been too optimistic.

Table III-11. Centrally planned economies: basic economic growth indicators, 1976-1983

(Average annual and annual percentages)

Country or country group	1976-1980	1981-1985 a/	1980	1981	1982 b/	1983 a/
Eastern Europe c/						
Net material product	3.9	3.2-3.4	0.7	-1.1	-0.1	3.3
Industrial gross output	5.5	3.7-4.0	3.0	-0.5	0.6	4.1
Agricultural gross output	0.8	2.2-2.9 d/	-3.8	2.1	0.6	2.5
Gross fixed investment	2.7	-0.4 d/	-2.2	-7.6	-5.8	-2.8 e/
Export volume e/	6.4	...	2.3	1.7	4.5	...
Import volume e/	4.0	...	1.1	-4.8	-6.7	...
Soviet Union						
Net material product	4.3	3.4 f/	3.9	3.3	2.6 f/	3.3 f/
Industrial gross output	4.5	4.7	3.6	3.4	2.8	3.2
Agricultural gross output	1.6	2.5 d/	-1.9	-1.0	4	10.5
Gross fixed investment	3.4	2.1 d/	2.4	3.8	2	3.2
Export volume e/	4.8	...	1.6	0.4	5.4	...
Import volume e/	5.8	...	7.3	8.2	7.5	...
China						
Net material product	4.9	4.0	5.2	3.0	5.0 g/	4.0
Industrial gross output	7.4	4.0	8.7	4.1	7.0	4.0
Agricultural gross output	3.8	4.0	2.7	5.7	5.0	4.0
Gross fixed investment	8.5	1.7 d/	7.9	-20.6	5.6	19.5
Export value (in dollars)	20.3	8.1 h/	28.7	14.4	3.8	0.5
Import value (in dollars)	21.2	9.2 h/	19.9	-1.2	-11.5	21.8

Source: Department of International and Economic and Social Affairs of the United Nations Secretariat, based on national statistical publications, plans and plan fulfilment reports.

a/ Plan targets.

b/ Preliminary estimates based on plan fulfilment reports and other partial information.

c/ Bulgaria, Czechoslovakia, German Democratic Republic, Hungary, Poland and Romania.

d/ Change in the five-year average output from the average of the preceding five years expressed as an annual compound rate.

e/ Estimates based on scattered information in plans and related policy discussions.

f/ Net material product utilized.

g/ Estimates based on GDP indicators.

h/ Based on plan data expressed in local currency.

Perhaps the central explanation for the below-plan performance in the USSR was the lack of success in boosting productivity growth - a feature that extends to nearly all European planned economies. The environment allows for only minimal increments in capital and labour inputs, with both being increasingly appropriated for sectors, such as services and environmental protection, that do not quickly result in material output increments. Economic activity in consequence has become vulnerable to rigidities in economic management, to shortcomings in material supplies, to capacity constrains in some sectors, and to structural imbalances in the composition of demand and supply. 26/

It is being increasingly recognized in many planned economies that a sustained improvement in productivity requires a combination of technological change, more flexible management techniques, and significant improvements in the working and social environment. These improvements include the mechanization of repetitive or hazardous tasks, a more objective evaluation of jobs and responsive approaches to promotion, as well as increases in residential construction, in social infrastructure, and in public transportation and a reduction in waiting lines. 27/

However, in the absence of large increases in investment outlays, the shift in outlays away from traditional priority sectors since 1979 in the USSR in combination with below-target growth in average labour productivity may have reduced the feasible levels of output of basic industrial goods. This in turn would consequently have affected the levels of feasible activity elsewhere in industry. A moderate pace of investment, with expenditure being geared towards non-conventional projects, such as consumer services and transportation, may then have favourable implications for medium- and long-term growth, mainly through increased labour productivity, but will continue to constrain traditional sectors in the immediate future.

The above constraints to growth in the USSR have become particularly important in an environment such as that of the early 1980s. Moreover, 1982 was another year of adverse weather conditions - inadequate winter cover and excessive summer drought - which were exacerbated by shortfalls in the availability of fertilizer, by the idling of farm equipment, and by the inadequacy of storage and transportation facilities. Furthermore, energy and material conservation was below that planned, the expansion of oil and coal output was insufficient, and the export-promotion drive helped create supply bottlenecks.

The conditions for short-term growth in Eastern Europe were markedly different from those elsewhere. In 1981, the growth of aggregate output, and of industrial and agricultural production, was below plan, and the outlook for external trade and financial flows appeared unfavourable so planners adopted modest goals for 1982. These were set at about 2.8 per cent growth for total income, 2.2 per cent for industry and 4 per cent for agriculture (as against -1.2 per cent for income, -0.5 per cent for industry and 1.9 per cent for agriculture realized in 1981). There was also an explicit commitment to moderate investment activity and accelerate exports. These targets for investment levels and for export growth, as well as other targets, especially in the construction, services and transportation sectors, were not met. Import constraints, above-plan cutbacks in investment, constraints in intra-CMEA deliveries of basic industrial inputs and an all out export drive for balance-of-payments reasons are the chief causes responsible for idling a significant part of the production infrastructure in these countries. But employment levels were maintained, albeit at the cost of slow or even negative growth in labour productivity.

In some contrast to the USSR, in Eastern Europe it was mainly adverse external factors that determined growth in the short term. Two deserve special emphasis. One was the intensification of the global economic recession and rising protectionist trends in the European market economies which placed bounds on the planned export drive. Indeed, the substantial gains in export volumes actually achieved under these difficult circumstances were remarkable. The other was the high interest rates in financial markets which substantially increased the debt-service burden for countries with a large external exposure - all these countries but Bulgaria and Czechoslovakia. In the first half of 1982, these pressures were considerably exacerbated by shifts in the confidence of financial markets in the overall payments position of Eastern Europe, and particularly in the solvency of Poland and Romania, both of which resorted to debt rescheduling. The effects of these shifts in confidence were aggravated by the abrupt deterioration in the international political climate that sets the framework for economic co-operation between market and planned economies. Under these circumstances, countries that otherwise would not have encountered debt-servicing problems were drawn into a liquidity squeeze as commercial banks suddenly withdrew their short-term deposits and called in otherwise predictable roll-overs. This abrupt action particularly affected the German Democratic Republic, Hungary and Romania. The dramatic curtailment of capital inflows at a time of record interest rates, the protracted debt-rescheduling negotiations with Poland and Romania, and the delays in securing new short-term credit facilities only complicated matters. In addition to these pressures emanating from the market economies, the large energy importers in particular incurred another substantial upward adjustment in the price of energy traded within the CMEA, although regional prices there continued to remain markedly below current world levels. As a result, most Eastern European countries were faced with further adverse shifts in their intra-CMEA terms of trade, and with below-plan deliveries of regional supplies of crucial primary inputs, particularly oil.

The Eastern European countries were in consequence left with little room for manoeuvre: external factors necessitated economic adjustments and so imports were sharply curtailed and exports promoted, especially in relations with convertible currency partners. In some cases, the curbs in imports and the skimming of domestic markets for exports worsened the bottlenecks in domestic supplies of industrial inputs and foodstuffs. Although the external account showed a dramatic turnaround, this gain was obtained at a considerable price in terms of output foregone, of reduced per capita real income levels in some countries and of widespread cuts in investment, even beyond those set in the plans. The cumulative effect of these cuts cannot but affect the potential for medium-term growth.

The net result of these various factors was that, in 1982, economic activity in Eastern Europe as a whole did not recover from the weak level of 1981. The relative magnitude of the shortfalls below planned performance differed markedly from country to country, but all countries except Czechoslovakia and Romania performed less well in 1982 than in the preceding year. Poland saw further sharp contraction in economic activity, though of a lesser magnitude than in 1981.

Industrial production of the group improved slightly from a drop of 0.5 per cent in 1981 to an increase of 0.6 per cent in 1982. This was mostly because of a much smaller contraction in output in Poland than in 1981. While the evidence for the different sectors is at this stage still sketchy, there are some signs that the slow-down may have affected heavy industry more than consumer-oriented industrial branches. The main reasons for this are probably the extreme

tightness of energy supplies, the continued sluggishness in construction, the generally modest successes with conservation 28/ and input-substitution policies, and the concerns about balance in consumer markets for certain products.

Economic activity, particularly in energy-intensive branches of industry, continued to be held back by the below-plan production levels and tight supplies of essential fuels and raw materials. The overall production of energy products increased by over 3 per cent, owing to the recovery of coal output in Poland and to substantial gains in the USSR's natural gas output levels. Oil production on balance remained unchanged, the small increase in the USSR being offset by the contraction for Romania. The pattern of energy consumption, though, was affected by reductions in Soviet deliveries which complicated the material supply situation in a number of Eastern European countries. Also, the output of other basic raw materials (including cement, steel and primary chemicals) was not very buoyant. Certainly, some countries succeeded in compressing the material-intensity of production, but there are evidently limits to what can be achieved without major changes in technology, in the structures of production and consumption, and in managerial styles. The situation was worsened by short-term investment and trade exigencies, which inhibited structural change. Most countries did not attain their planned targets for conservation, and the reduction in the volume of consumption of materials resulted on the whole from weak activity in user industries.

The year 1982 was characterized by generally good cereal and on the whole satisfactory root crops in Eastern Europe. However, the group's agricultural performance has continued to be a source of considerable internal and external bottlenecks. In addition to their lingering effects on user sectors in industry, the successive poor to moderate crops and the very tight constraints on importing feedstock inhibited activity in the livestock sector. Planners strove to minimize herd losses, and mainly because of import constraints, enacted a significant shift in the composition of herds and hence in the structure of livestock products. As a result, food markets in most planned economies remained very tight; in some countries they worsened. However, the better crops of 1982 may reduce the need for foodstuff and feed imports for some Eastern European countries in 1983 and boost export revenues for others. The same appears to be the case for the Asian planned economies, chiefly on account of above-plan grain crops. The USSR's 1982 harvest, though substantially above the preceding year's, was weak for the fourth consecutive year. Consumer markets in livestock products in particular continue to be very tight.

Since the late 1970s, investment activity has borne the brunt of shifts in the external environment and of internal bottlenecks. However, with the exception of the construction sector, the slow growth in the capital stock has not so far curbed aggregate output to any significant extent. Yet this situation cannot but cumulatively lower medium-term growth, particularly if, as appears likely, planners fail to carry out those investment projects that, in their current medium-term plans, they had apparently counted on to buttress shifts in production and consumption structures.

Most countries were able to cushion the adverse effects of slow growth on consumers. However, some strains in consumer and labour markets were increasingly evident as weak economic performance restricted nominal gains in labour and other incomes. Indeed significant increases in consumer prices eroded these gains in several Eastern European countries.

The Governments of the centrally planned economies have so far without exception held on to their commitments to full employment and to the protection of attained levels of living whenever feasible. However, under conditions of downward rigidity in the levels of real incomes and of insufficient incentives for job mobility, there is little room left for macroeconomic adjustment beyond reducing inventories and whittling down investment programmes. As these "reserves" are gradually exhausted, incremental adjustments will by necessity impinge upon consumption, as became very clear in 1982.

Growth in a number of indicators of real levels of living have so far lagged well behind the medium-term plan targets. Furthermore, real per capita income levels contracted in several countries as a result of increases in retail prices which were not offset by special allowances, as had generally been the norm with price revisions since the mid-1960s. 29/ The rationalization of the retail price system may facilitate the implementation of conservation measures, particularly for fuels and foodstuffs on which planners have put the highest priority. In the medium to long run, a price system that better reflects true relative economic scarcities may have a salutary effect directly on production and distribution, and indirectly on consumer market balance and motivation in labour markets. In the short run, however, such drastic adjustments in the price system without substantial improvements in the availability of goods and services as occurred in 1982 in several countries, 30/ may discourage workers and hence complicate the long-sought boost in factor productivity.

On the basis of the 1983 plans and related policy discussions, economic development priorities in the group are unlikely to change drastically from those discussed above. External payments considerations continue to be the central focus of output and distribution plans, and therefore the pivotal constraint on policy flexibility with respect to output, trade and income distribution. However, the outlook is favourable for more substantial growth than in recent years. The Eastern European plans for 1983 stipulate positive, albeit low to moderate growth; the USSR is hoping to increase output by over 3 per cent; and China and the other Asian planned economies anticipate on the whole a repetition of their 1982 growth performance.

In the post-war growth context, the USSR's overall output target for 1983 appears quite modest, yet its attainment depends on a number of conditions: on a substantially larger increase in factor productivity than that achieved in recent years, on the success of energy and material conservation measures, on the attainment of the levels of energy output specified in the current five-year plan, and on better and more intensive utilization of existing plant and equipment. In this respect, the modest expansion of investment activity by 3.2 per cent will serve primarily to foster modernization and speed up the completion of unfinished investments. The targets for growth in industrial output (3.2 per cent) and in labour productivity (3 per cent) are moderate, although quite superior to recent achievements. Those for agricultural output (10.5 per cent) 31/ and its components, are perhaps too ambitious, even when the rather low base is taken into account, and especially if weather conditions were to remain adverse. Moreover, the targets for key livestock products appear to be on the high side in view of the poor 1982 harvest, the inauspicious outlook for world trade and capacity bottlenecks in harbour unloading and storage facilities.

In Eastern Europe, a recovery to 3 per cent growth could be facilitated by an orderly debt-rescheduling for Poland and Romania, a recovery, even though weak, in

Poland, relatively normal conditions in international financial markets and a more buoyant external demand, especially from the market economies. Reductions in debt levels and in payments imbalances continue to be accorded the highest priority in the majority of countries and so policy discussions centre on further retrenchment in domestic absorption in order to ease these external pressures. For the first time in the post-war planning experience, certain members of the group are now targeting for negative real income growth 32/ and for another round of significant cutbacks in investment outlays. These may delay further the upgrading of the capital stock employed in material production and hence the acceleration of the growth in factor productivity that the medium-term plans had envisaged.

In 1983, economic conditions in Eastern Europe will also be affected by the further adjustments expected in the energy importers' intra-CMEA terms of trade. 33/ The necessity of improving the balance of payments forces these economies to adopt even more stringent energy-conservation and import-substitution measures. Although global economic conditions in 1983 do not appear to favour gains in the volumes of trade, some of the planned economies have made the fulfilment of their plans conditional on a sharp improvement in exports. This may well be contingent on shifts in the commodity structure of exports. Under prevailing conditions, import activity is planned to remain sluggish and most countries are not anticipating sizeable quantum changes, a goal that may be facilitated by the good 1982 harvests.

China's 1983 plan is based upon further restrictions on government expenditures and domestic credit fostering structural adjustment and stabilization. The growth rates of aggregate output, of industry and of agriculture are each expected to be 4 per cent. Oil output might continue to stagnate and production of basic industrial products, including steel, will contract more as the reorientation of China's economic structure away from heavy towards light industry proceeds. Management and incentive reforms, which have already contributed to lowering urban unemployment and to raising rural purchasing power levels, are to be continued. Investment priorities include energy, especially off-shore oil projects, and transportation, in both of which there have been rather important bottlenecks in recent years, and the upgrading of existing manufacturing facilities.

Modest progress in food production and agriculture

While agriculture is the sector normally least disturbed by the vicissitudes of the world economy, the present recession has appreciably affected it through the trade sector. The fall in the demand for non-agricultural primary commodities aggravated the balance-of-payments problems of the developing economies in particular, and many countries were forced to restrain imports of food and related products. Furthermore, high interest rates and large inventories of foodstuffs in the exporting countries did not provide much of an economic incentive to build up inventories elsewhere. This was especially the case in countries where infrastructural investments would have been required. Stocks of foodstuff in many large importing countries therefore continued to be low. Finally, trade in agricultural products has suffered from the protectionist pressures resulting from the recession, and traditional exporters have threatened to retaliate if agricultural subsidies in many industrial countries are not corrected soon. The consequences for stability in world markets are potentially very serious.

Agriculture performed reasonably well in 1982 and global output of food and agricultural produce reached record levels. While the growth of food production slowed down in 1982 and remained below the average rate of the previous 11 years (see table III-12), per capita output levels showed modest advances in most areas of the world. On balance, the possibility of serious global food shortages emerging in the short run receded. Indeed, surpluses overhung the markets of all major foodstuffs and strengthened the price slide that had started in early 1981. Non-food agricultural production declined in 1982 in all country groups, except Asia and Oceania, mainly because demand for industrial crops (such as cotton, jute, rubber, sisal and timber) was lower in the user sectors of the industrial countries. 34/ Beverages experienced production declines.

The varied food and agricultural performances of the different country groups suggest that many serious problems are far from resolution. This is especially true for the developing countries, whose per capita food production declined fractionally. This decline was caused by some significant shortfalls, especially in India, Sri Lanka and Thailand, and only a modest growth in output elsewhere. Total and also per capita food and agricultural production increased in the centrally planned economies, but output levels in several countries lagged behind forecasts. With the important exceptions of Australia and South Africa, developed market economies either increased their food and agricultural production in 1982, as in Canada and Western Europe, or matched recent record food production levels, as in the United States.

In Africa, per capita output of food and agriculture stabilized after the previous year's decline, but the overall situation remained critical with a total of 21 Sub-Saharan countries facing abnormal shortages at the beginning of 1983. This was even before the problems caused by the exodus of aliens from Nigeria to Chad, Ghana and Togo - three countries already classified as having abnormal food shortages - had been taken into account. Droughts affected the Sahel, parts of East Africa and, most severely, Southern Africa. Overall food production in South Africa and Zimbabwe, the two largest net food exporters of the region, fell by 20 per cent in 1982. This is particularly serious because of the generally parlous state of agriculture in the African developing countries. Their per capita and sometimes even total production is below the levels of a decade ago, a situation which is all the more grave in that, unlike the food-deficit countries of the Near East, few of them command sufficient export revenues to make up easily for any drastic shortfalls in production through imports. As a result, their nutritional levels are generally below acceptable minimum levels. This critical situation highlights the continuing need, even in a time of overall global balance, for an emergency food reserve and substantial food aid.

The International Emergency Food Reserve (IEFR) was set up to alleviate the plight of the victims of drought or man-made disasters. Their numbers in 1982 were estimated at about 8 million. The bulk of emergency food assistance has recently benefited the victims of man-made disasters particularly those in Afghanistan, East Africa and Kampuchea. However, the medium- to long-term viability of IEFR is not at all assured. While the IEFR's annual replenishment target of 0.5 million tons of grain was surpassed by about 20 per cent in 1981, in 1982, funding fell short by about 10 per cent, and pledges for 1983 and 1984 amounted, as of early 1983, to only one half and one third of their respective replenishment targets.

Table III-12. Indicators of net world food production, a/ 1971-1982

(1969-1971 = 100)

Country group	Total food production				Per capita net production			
	Growth trend b/	1980	1981	1982	Growth trend b/	1980	1981	1982
World	2.4	125	129	131	0.6	104	105	106
Developed market economies c/	2.0	121	125	126	1.2	111	113	114
North America	2.6	123	134	134	1.5	111	120	119
Western Europe	1.8	123	121	125	1.3	117	115	119
Oceania	2.7	123	132	120	1.4	107	114	102
Developing countries d/	3.3	133	139	141	0.8	104	106	105
Africa	1.9	119	122	126	-1.0	90	89	89
Latin America	3.7	138	144	149	1.2	108	110	111
Near East	3.2	138	140	144	0.4	104	103	103
Far East	3.5	134	142	142	1.3	107	111	109
Centrally-planned economies	2.0	124	124	129	0.5	107	106	109
Asia	3.1	136	141	147	1.5	115	117	120
Europe	1.1	115	113	117	0.3	106	104	106

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on FAO data.

a/ All edible commodities that contain nutrients net of intermediate use, such as seed and animal feed.

b/ Average annual growth rate for 1971-1981, obtained as the slope of a regression line fitted to the data.

c/ Including Israel, Malta and Yugoslavia.

d/ Excluding Israel, Malta and Yugoslavia. The FAO regional grouping used in the table is as follows: "Africa" excludes South Africa, Egypt, the Libyan Arab Jamahiriya and Sudan; "Latin America" includes the Caribbean; "Near East" includes Afghanistan, Bahrain, Cyprus, Democratic Yemen, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, the Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, Sudan, the Syrian Arab Republic, Turkey, the United Arab Emirates and Yemen; "Far East" includes Bangladesh, Bhutan, Brunei, Burma, Democratic Kampuchea, East Timor, India, Indonesia, the Lao People's Democratic Republic, Malaysia, Maldives, Nepal, Pakistan, the Philippines, the Republic of Korea, Singapore, Sri Lanka and Thailand, and also includes the territory of Hong Kong and the Chinese territory of Macao.

Apart from the need for food aid to meet present and future emergencies, there continues to be a need for the kind of agricultural assistance that will raise nutritional levels in many developing countries to acceptable levels. After the substantial increases over a number of years in the international resource commitments to food and agriculture, there has recently been a slow-down in the growth of food assistance. For example, shipments of food aid in cereals increased from 8.9 million tons in 1980/81 to only 9.0 million tons in 1981/82, and allocation, for 1982/83 are for 9.4 million tons. While the bulk of this aid is flowing to the food-aid priority countries, because of their growing population the share of their cereal imports covered by aid has been slipping to 18 per cent in 1981/82 from an average of 24 per cent in the three preceding crop years.

In view of the above developments, many countries, especially the low-income food-deficit countries in Africa, were forced to divert scarce foreign exchange to importing cereals, often at the expense of their development programmes. Foreign exchange shortages were aggravated by the very weak prices these countries received for their commodity exports. Since these prices are not expected to stage a strong recovery in 1983, foreign exchange constraints will continue to limit severely the ability of these countries to relieve food shortages. The need for substantial food aid from the international community will therefore become more urgent.

The overall favourable performance of world agriculture in 1982 resulted in substantial net additions to stocks, especially for cereals which increased from 231 to 275 million tons (see table III-13). The distribution of these stocks reflected the varied situation of individual countries. In fact, the total increase in global stocks was accounted for by North America and fully 39 million tons of the increment was in coarse grains, which are not for direct human consumption. On the other hand, carry-over stocks in the developing countries increased by only 4 1/2 million tons and remained unchanged in China and the USSR. The latter's stocks of cereals were estimated to be less than half their 1979 level.

Forecasts for 1982/83 prepared by FAO show a further increase of 51 million tons in the carry-over stocks of cereals in the United States and a total increase in global stocks of 55 million tons - about 70 per cent in coarse grains. 35/ This would raise total cereal stocks to be 21 per cent of consumption - above the average of the previous decade, but not that of the 1960s. Whereas throughout most of the post-war period stocks were held primarily by the major exporters to smooth fluctuations in world markets and thereby assure price stability, the present high United States inventories reflect the difficult conditions of the farming industry in that country.

In 1982, prices received by farmers in the United States were only 3 per cent higher than in 1979, whilst the cost of their primary and intermediate inputs, including financing and fiscal charges, had risen by over one fourth. Although government loans against crop collateral initially alleviated the farmers' situation, the prolonged slide in real prices forced many farmers into default, which accelerated the build-up of government-held surpluses and added to government expenditures. Policy-makers are therefore now seeking to reduce surpluses by a scheme under which farmers would be paid cash subsidies for agreeing to take 20 per cent of their acreage out of production and would receive commodities from the government reserve if they agreed to take out another 30 per cent. The scheme is proving effective in reducing the acreage planted and might have an appreciable impact on stocks and marketed supplies in 1984. On the other hand, there are long-term risks in the present policy, especially if the prolonged setting aside of acreage were to be compounded by any adverse climatic factors.

Table III-13. World stocks and trade in cereals, 1979-1983

(Million tons)

Country group a/	Stocks b/ 1979	1980	1981	1982 c/	1983 d/
World	273	256	231	275	330
Developed market economies	147	141	120	163	217
North America	95	92	75	120	174
Western Europe	28	26	26	24	...
Australia	6	5	3	3	1
Other	18	18	16	16	...
Developing countries	50	46	51	55	55
Africa	5	4	5	7	6
Latin America	7	6	10	10	11
Near East	6	8	9	9	9
Far East	33	28	28	31	32
Centrally planned economies e/	76	69	61	57	58

	Exports f/			Imports f/		
	1980	1981	1982 c/	1980	1981	1982 c/
World	208	215	203	207	215	203
Developed market economies	178	180	167	57	59	56
North America	139	139	130	2	1	1
Western Europe g/	21	21	22	29	30	28
Australia	13	15	10	-	-	-
Japan	1	1	-	25	24	24
Other	4	4	5	1	4	3
Developing countries	25	30	32	85	84	89
Africa	1	1	1	24	24	24
Latin America	14	19	21	27	19	22
Near East	1	-	1	24	28	30
Far East	9	11	10	10	13	13
Centrally planned economies	6	5	4	65	73	58
USSR	1	1	1	35	45	34
China	1	1	1	14	14	16
Other	4	3	2	16	14	8

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Food and Agriculture Organization of the United Nations, Food Outlook, 1982, No. 11/12 and 1983, Nos. 1 and 2; and FAO Monthly Bulletin of Statistics, 1982, No. 10.

a/ Coverage of regional groupings as in table III-12.

b/ Carry-over stocks for crop years ending in the year given.

c/ Preliminary.

d/ Forecast.

e/ USSR and China only.

f/ Export and import data refer to crop years starting in the year shown in column heading, except for rice on a milled basis, for which data refer to the calendar year of the year shown. Cereals include wheat, coarse grains and rice on a milled basis. The data include the wheat equivalent of wheat flour. Components may not add to totals because of rounding.

g/ Excludes intra-EEC trade.

Another factor behind the increase in global stocks of cereals was the fact that consumption grew by less than population. This largely stemmed from a weakening in the demand for feed grains caused by a shift towards less expensive substitutes, the effect on demand of the world recession, balance-of-payments difficulties in many food importers and the well below-plan grain harvest in the Soviet Union. The shortfall there was not fully compensated through imports. A change in these factors might lead to a sharp increase in cereal consumption, which could reverse the apparently favourable stock position in due course.

In view of these considerations, a situation in which the security of international grain supplies depends upon the major exporter holding stocks at a higher level than it perceives to be prudent continues to be inherently unstable. It would, then, be expedient for major importing countries, both market and centrally planned, to build up their inventories, especially at this time of low prices. However, foreign exchange constraints or inadequate storage and transport facilities have prevented many countries from pursuing this objective. Nevertheless, a solution to the present instability in cereal markets would require individual countries to pursue such a policy. Moreover, internationally co-ordinated efforts are needed to reduce the instability in world markets that results from large swings in the levels of stocks held by individual countries.

The figures for trade in food products given in table III-14 illustrate several unsatisfactory features of the recent agricultural situation. With greater international specialization, the volume of trade in food products could be expected to expand. However, many of these countries that have become dependent or increased their dependence on net imports of food were in a weak position to finance these imports by increases in their export earnings from other commodities. In the 1970s, the developing countries, except those in the Far East, and the centrally-planned economies saw their food imports grow more rapidly than their exports. The situation in Africa was especially grave as the volume of its food exports in 1981 was 25 per cent below the average for 1969-1971, whilst that of its imports was 169 per cent higher. Foreign exchange constraints make it doubtful whether past import levels can be maintained in Africa - and many other developing countries - and in several planned economies. On the other hand, the developed market economies have seen their food exports grow more rapidly than their food imports. Moreover, a sustained expansion of demand from the world's largest food-importing region, Western Europe, is also uncertain.

Because of these considerations, the possibility of disposing of the future surpluses of the major net exporting areas, primarily Australia and North America, cannot be thought of as encouraging. Indeed, the main focus of attention in current discussions on agricultural trade is the reconciliation of the agricultural policies of the European Economic Community and Japan with the export needs of the United States. This has become an increasingly contentious issue for some developing countries too.

Table III-14. Trade volume in food products, a/ 1971-1981 indices and trends

(1969-1971 = 100)

Country group b/	Exports				Imports			
	Growth trend c/	1979	1980	1981	Growth trend c/	1979	1980	1981
Developed market economies	6.3	183	204	211	2.3	134	132	133
North America	7.5	210	240	247	0.6	114	107	114
Western Europe	6.2	178	193	205	2.3	134	135	132
Oceania	3.6	142	161	143	2.0	129	128	130
Developing countries	2.5	128	125	138	9.3	210	252	263
Africa	-3.9	77	77	75	9.6	216	248	269
Latin America	3.3	132	121	141	10.6	227	291	289
Near East	3.5	132	124	154	13.3	301	360	401
Far East	6.5	183	196	207	5.9	151	178	178
Centrally-planned economies	-1.1	95	94	90	7.0	205	224	249
Asia	-1.1	106	110	97	7.3	209	208	211
Europe	-1.0	92	88	88	6.9	204	229	260

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Food and Agriculture Organization of the United Nations, FAO Trade Yearbook, vol. 35 (1982).

a/ Food products excluding fish. The trade volume indices are of the Laspeyres type with 1969-71 average unit value weights.

b/ Coverage of regional groupings as in table III-12.

c/ Average annual growth rate for 1971-1981, obtained as the slope of a regression line fitted to the data.

Weakening energy demand in world markets

The intensification of the global economic recession in 1982 reduced total energy demand, which affected prices and led to some cutbacks in production levels for the third consecutive year. These cutbacks were, though, not deep enough to maintain energy price stability. Total primary energy production declined by about 2.6 per cent - slightly less than the contraction in 1981. While the levels of output of oil and natural gas contracted by about 6 and 3.3 per cent respectively, that of coal rose by 3.4 per cent. These magnitudes suggest that further shifts in the world energy balance occurred in 1982; because of the sluggishness of the projected recovery in consuming countries, they are expected to continue in the near future.

Demand was perhaps the crucial determinant of the state of world energy markets in 1982. Further conservation measures as well as the substitution of coal for other primary fuels, implemented in response to the 1979-80 oil price rise, intensified the reduction in demand brought about by sluggish economic activity in energy-using sectors, particularly cement and electricity generation. As a result, the energy intensity of GDP declined further: in the industrial countries, energy use relative to GDP has fallen by as much as 16 per cent from 1973 to 1981.

Total world production of coal inched up in 1982, primarily because in Poland output recovered from its abnormally low level of 1981 and in the United States it increased slightly. Since world coal trade dropped sharply, a substantial accumulation of inventories took place. After having risen by 9 per cent in 1981, exports of steam coal decreased in 1982, as weak European consumption was not offset by the strength of Far Eastern demand. The drop in exports was very sharp for the United States, 36/ owing to Poland's re-entering the Western European market and the dollar's appreciation, which gave a pronounced competitive edge to other exporters, and South Africa in particular.

World output of natural gas contracted by 3.3 per cent in 1982 owing to a variety of factors, including government pricing policies, downward revisions of investment programmes, receding oil output and the overall decline in energy demand. With the exceptions of Mexico and the Soviet Union, output declined throughout the world, particularly in Western Europe.

The weakness in the overall market for energy had its greatest effect on petroleum. The drastic reduction in the level of world oil consumption since 1980 reflects both the vigour of conservation and substitution efforts undertaken in reaction to past oil price hikes and the slow-down in the pace of world economic activity. In spite of sizeable production cutbacks by OPEC member countries, the world oil industry experienced a substantial underutilization of refining and production capacity, 37/ falling prices, shrinking revenues and increasing uncertainty over future demand and price.

In the past three years, world oil consumption has dropped steadily: in 1982, it declined by 3.3 per cent to 58.4 mbd bringing the contraction from the 1979 peak of 65 mbd to 10 per cent (see table III-15). As in the previous year, the developed market economies accounted for the bulk of the contraction (about 80 per cent in 1982). However, the reduction in the level of oil consumption of the developing economies of between 3 per cent and 4 per cent in 1982 is particularly noteworthy since it may signal a break in their long-term pattern of oil use. 38/

Table III-15. World oil production a/ and consumption, 1979-1982

(Million barrels per day)

	1979	1980	1981	1982 b/
Production				
Developed market economies	14.3	14.4	14.4	14.6
North America	11.6	11.6	11.5	11.4
Western Europe	2.3	2.5	2.6	2.8
Developing market economies	36.5	34.0	30.4	27.4
OPEC member countries	31.8	28.0	23.6	19.5
of which: crude oil	30.9	27.0	22.5	18.6
Mexico	1.5	1.9	2.4	2.7
Centrally-planned economies	14.4	14.6	14.6	14.7
USSR	11.8	12.1	12.1	12.3
World total	65.2	63.0	60.2	56.7
of which: crude oil	62.8	60.0	55.9	53.2
Consumption				
Developed market economies	40.6	38.7	36.0	34.4
United States	18.5	17.0	16.0	15.4
Western Europe	14.5	13.8	12.8	12.3
Japan	5.2	4.7	4.4	4.2
Developing market economies	10.6	11.6	11.5	11.1
Centrally-planned economies	13.5	13.3	12.9	12.9
Total	64.7	63.6	60.4	58.4

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Oil and Gas Journal; United States Department of Energy, Monthly Energy Review; and OECD, International Energy Agency, World Energy Outlook, 1982.

a/ Including natural gas liquids.

b/ Preliminary.

In the 1970s, oil consumption in the energy-importing developing countries rose steadily: at an average annual rate of 5.1 per cent during 1974-1981, in contrast to only 0.4 per cent in the industrial countries. Based on the long-held view that growth in oil consumption in the developing countries will not fall below a minimum of 4-5 per cent a year, global oil demand was expected to keep expanding even if demand in the developed countries were to contract steadily. The 1982 experience conflicts with this view and does not appear to be a temporary phenomenon especially as several large developing country importers of petroleum have made substantial progress in their conservation efforts. Most forecasts of world oil demand will accordingly need to be revised downward.

In addition to the sharp reduction in global oil consumption, a marked rundown in the stocks of the industrial countries in 1982 also played an important, although less decisive, role in curbing demand and thus in intensifying pressure on prices. Inventories were liquidated very rapidly in the first half of the year because of high interest rates; large world surpluses of crude oil, tankers and refining capacity; and the growing expectation that oil prices would fall even further. For the year as a whole, the inventories were run down by roughly the volume that in 1981 was held in excess of normal requirements. 39/

Since the end of the year, inventories have remained at normal levels and so current spot market prices can be considered as reflecting the underlying demand/supply balance, and therefore as being good indicators of official oil prices in the near future. The substantial drop in spot prices in the first quarter of 1982 was directly related to de-stocking and the sharp upswing in the amount of Soviet oil exported to the market economies. 40/ After recovering in April, spot oil prices stabilized until year-end at an average of around $32 a barrel for Arabian Light and $33.60 a barrel for higher quality African/North Sea oil. In early 1983, downward price pressures gathered some momentum. The price stability of 1982 was achieved because the burden of the adjustment to weak demand was borne by supply, in some contrast to developments in other primary commodity markets where prices have fallen sharply.

World output of petroleum declined by 6 per cent in 1982 to an average of 56.7 mbd or 13 per cent below the 1979 peak of 65 mbd. As in recent years, OPEC members bore the brunt of this adjustment: their combined output of crude and liquids fell by 17.3 per cent to 19.5 mbd, a decline of about 40 per cent from the 1979 peak of 31 mbd. Output on balance stagnated in North America and the centrally-planned economies, but in other major producers, particularly Mexico and Western Europe, it increased significantly.

At the present time, it is rather difficult to assess future oil price developments. The dominant view is that nominal oil prices will at most remain unchanged for the foreseeable future but that in the short run they are more likely to fall. However, if such views caused a slackening of the drive towards energy conservation and substitution, they could prepare the ground for further unexpected oil price increases, especially if the levels of inventories remain relatively low.

The near-term outlook for stable oil prices hinges largely on the pricing and production policy of OPEC members, although their share in world supply has contracted markedly. In view of sluggish demand and tightening financial constraints, these countries have to choose between lowering prices to elicit demand and curbing production levels. While the options are rather clear, the alternative outcomes are not since there is considerable uncertainty about the

output and pricing policies of other producers and, most importantly, about how erratic will be fluctuations in world demand for oil.

Recent experience indicates that world oil demand can oscillate quite widely in the short run. In the post-war period, consumption rose steadily until 1975, when it fell by about 2 per cent; it then rebounded sharply in 1976 and grew gradually until 1979; in 1980, it once again reversed course and began to fall rapidly. In other words, fluctuations in aggregate oil consumption went through two different cycles in the last ten years generally parallelling those in the level of economic activity in the industrial economies. In the last three years, however, this relationship appears to have been invalidated as the positive, albeit modest growth in the industrial countries was achieved without increasing oil consumption. For example, while the absolute level of economic activity increased by about 2.6 per cent between 1979 and 1981, oil consumption actually dropped by 14.4 per cent. This recent experience raises questions about the nature and stability of the link between oil demand and aggregate economic growth.

Another important factor determining the demand for oil is the cumulative influence of conservation and substitution measures taken in response to price shifts. To forecast the future levels of demand for oil is, then, a very uncertain undertaking, requiring an assessment of the results of past and future investment in conservation and in the research and development of new energy-saving technologies. These investment efforts were intensified in the first half of the 1970s and then at the end of the decade because of the shifts in oil prices. The results of the research and development efforts are still being assessed and applied and steps to conserve energy are continually being taken. Moreover, the evidence is that although the present level of energy prices has deterred investment in several new capital-intensive projects to produce synthetic energy, there is still a considerable incentive to invest in energy-saving technologies. Little, though, is known about the future direction and results of this research, and, in particular, about how it will be affected by future price trends. In view of these considerations, a tentative overall conclusion would be that, although part of the drop in demand for energy was caused by the present recession, a considerable part was also produced by past investments in conservation and research and development and that, although these efforts might slacken somewhat in the medium term because of expectations of weak prices, the lagged effect of past efforts will continue to restrain energy consumption during that period.

Early results of a study of the oil market suggest that in industrial countries as much as 40 per cent of the drop in oil consumption was of a structural or permanent nature - that is, predominantly caused by energy conservation and substitution and the adoption of energy-saving technologies. 41/ This would lend support to the view that the modest recovery in economic activity forecast for 1983 for the industrial countries is unlikely to reverse the present excess supply of oil especially if, as expected, recovery in energy-intensive sectors (such as automobiles, steel and chemicals) takes place with some lag.

Under these conditions of weak demand and stable inventories, aggregate oil production would have to be kept at its 1982 level of 53.2 mbd in order to match total demand. Any increase in the output of non-OPEC producers, which could be expected to be 1 mbd, would have to be offset by lower OPEC production levels if the group were not to see a fall in prices.

Notes

1/ Belgium, Canada, the Federal Republic of Germany, Italy, Iceland, Luxembourg, the Netherlands, New Zealand, Sweden, Switzerland and the United States.

2/ Austria, Greece, Norway, South Africa and the United Kingdom.

3/ The present recession in North America was far more severe than that of 1975, when output slackened by less than half the 1982 rate.

4/ France, Greece, New Zealand and Spain.

5/ Despite the expansionary monetary policy in the United States towards the latter half of 1982, the after-effects of the earlier constriction remained severe for many countries. In spite of small inflationary pressures in Japan, monetary policy was relatively tight to protect the yen and therefore entailed high real rates of interest. For much the same reason, the Federal Republic of Germany and the United Kingdom followed cautiously accommodating policies as money supply growth remained at or slightly below the upper targets. In France and Italy, on the other hand, in view of relatively high inflation rates, monetary policy moderately tightened towards the end of 1982 to relieve exchange rate pressures within the European Monetary System (EMS). The monetary policy of the smaller European countries belonging to the EMS more or less followed the Federal Republic's.

6/ The real interest rate equals the nominal interest rates net of inflationary expectations, which, however, cannot be observed. The deflation of nominal interest rates with the change in the GNP deflator therefore yields only an approximation of real interest rates as perceived in financial markets.

7/ But in some of the smaller countries, including Greece and Ireland, negative real interest rates prevailed for most of 1982.

8/ With a given increase in money supply during a recession, idle money balances tend to flow into financial markets, where yields and hence interest rates come under pressure. This is normally reinforced by the flow of private funds withheld from new capital assets. Since in a recessionary environment the fall in nominal interest rates usually exceeds the reduction in inflation, real interest rates then tend to be very small or even negative.

9/ Belgium, the Federal Republic of Germany, Japan and the United Kingdom were important exceptions.

10/ Debt-service ratios for Denmark and Ireland are the highest among the developed market economies.

11/ Canada, France and the United States had on balance an expansionary fiscal policy, while in the other major countries it was contractionary (see OECD, Economic Outlook, December 1982, pp. 22-25).

12/ Other countries (including Australia, the Netherlands, New Zealand and Norway) also reduced personal income taxes and granted various fiscal incentives to business investment and construction.

13/ Rather than benefiting current consumptions, the personal income increments may have been used to rebuild cash positions in response to the decline of real household wealth during the preceding two years.

14/ Residential investment in real terms decreased by an annual rate of 10.9 per cent and production of vehicles and parts by 10.2 per cent during 1982. However, the decline in nominal interest rates and the very favourable financing rates set for new car purchases led to an appreciable increase in housing starts and automobile sales towards year-end.

15/ The standard deviation of these countries' growth rates increased in 1982 to 2.2 from 1.7 in 1981.

16/ Among the major seven industrial economies, trade's contribution to growth was negative in France, the United Kingdom and the United States; its positive contribution in the case of Canada resulted mainly from a sharp reduction in import volume, but in the case of other countries from export quantum gains.

17/ In the United States' manufacturing sector, for example, the rate of increase in gross hourly earnings fell from nearly 10 per cent in 1981 to an estimated 6.4 per cent in 1982. The drop, although less pronounced, also occurred in other sectors, including construction, mining and services.

18/ In the Federal Republic of Germany, for example, insolvencies in the first half of 1982 were 40 per cent higher than a year earlier. In the United Kingdom, the corresponding rate was 35 per cent or 63 per cent over 1980 levels (Financial Times, 6 January 1983). In the United States, business failure in 1982 exceeded 25,000 which was roughly 50 per cent higher than in the preceding year (Dun and Bradstreet, Weekly Business Failures (New York), various issues).

19/ Also exceedingly modest in comparison with the mid-1970s. The 2.8 per cent average drop, with a standard deviation of 4.3, in the rate of change in consumer prices in 1982 for the major economies contrasts with a 1.9 per cent drop, although with a standard deviation of 5.7 in 1975, when these countries followed accommodating fiscal and monetary policies; excluding the United Kingdom, where inflation actually increased in 1975, the average drop was 3.5 percentage points with a standard deviation of 4.2.

20/ World Economic Survey 1981-1982 (United Nations publication, Sales No. E.82.II.C.1), pp. 15-17.

21/ Tax-induced non-wage labour costs did, though, increase in a number of countries. (See E. van Lennep, "Getting the balance right", OECD Observer, 1982, No. 11, pp. 4-5.)

22/ Albania, Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Poland and Romania.

23/ The aggregate growth of the European centrally-planned economies and China of 2.5 per cent in 1982 appears to have been surpassed somewhat by the other planned economies. However, the result for the group as a whole is not likely to exceed the cited magnitude.

24/ For a more comprehensive analysis of these plans in the context of the current world economic situation and long-term growth prospects of the European planned economies, see "Medium-term growth and trade in the light of the socio-economic development plans of Eastern Europe and the Union of the Soviet Socialist Republics for 1981-1985", Supplement to World Economic Survey 1981-1982 (United Nations publication, Sales No. E.82.II.C.2), pp. 20-27.

25/ See, for instance, the recent statement by N. Ceausescu, Secretary-General of the Romanian Communist Party, in Scînteia (Bucharest), 17 December 1982.

26/ As the USSR's plan fulfilment report notes, "shortcomings of labour, material and technical supplies, fluctuations in transport services and interruptions of energy supplies in various regions of the country" constrained growth (Pravda (Moscow), 23 January 1983).

27/ These problems are being increasingly recognized. As an illustration, Mr. Y. V. Andropov, the new Secretary-General of the Communist Party of the USSR, recently emphasized the central importance of solving economic and organizational problems that are depressing productivity (see Kommunist (Moscow), 1982, No. 17, pp. 15-16).

28/ However, the German Democratic Republic again succeeded with very ambitious conservation measures. In industry, for example, the specific consumption of important energy and other primary materials decreased by over 6 per cent and, in consequence, the material cost of production per unit of output value declined by 2.6 per cent (Neues Deutschland (Berlin), 15-16 January 1983).

29/ The case of Poland, of course, is exceptional as the sharp contraction in output levels of the last two years was passed through also to consumption. Fixed income earners were particularly strongly affected. For a recent commentary on the dilemma this poses for socialist policy makers, see the interviews with Cz. Bobrowski in Zycie Warszawy (Warsaw), 1-2 January 1983 and J. Kordos in Zycie Gospodarcze (Warsaw), 1983, No. 1, pp. 1, 4.

30/ In fact, in several countries rationing of a number of foodstuffs and other consumer goods remained in effect or was reinforced in the course of the year.

31/ If realized, this would yield the level envisaged in the current five-year plan.

32/ The Hungarian 1983 plan slates a 3 to 4 per cent decrease in aggregate domestic uses comprising a 10 per cent cut in investments and 0.5 to 1 per cent decrease in private consumption relative to anticipated 1982 levels. Average real incomes in 1983 will surpass, but real wages will drop below the corresponding 1980 levels (Népszabadság (Budapest), 3 December 1982).

33/ Because of the delayed passing through of world market prices in the intra-CMEA trade price formula, energy prices in the group will rise by another 17 to 20 per cent to reflect 1978-1982 average world prices. Since the world energy prices of 1981-1982 considerably surpass those of 1977-1978, intra-CMEA oil prices will remain below current world levels in 1983.

34/ The high 1982 global food output stemmed in part from the fact that the acreage withdrawn from the production of non-food agricultural commodities because of depressed prices had largely been devoted to foodstuff production.

35/ Rice stocks are expected to decrease by about 3 million tons primarily because of the setback in Indonesia's harvest.

36/ United States coal exports totalled 96.4 million tons, 5.6 per cent less than in 1981.

37/ Current surplus refining capacity in Europe is about 40 per cent (Petroleum Intelligence Weekly, 22 November 1982); in OPEC alone, it amounts to about 5 mbd (see Petroleum Intelligence Weekly, 8 November 1982).

38/ In the first half of 1982, for example, consumption fell by 4.5 per cent in Brazil, 7 per cent in the Republic of Korea, 10 per cent in Thailand and 6 per cent in the Philippines (Petroleum Intelligence Weekly, 15 November 1982). In contrast, the oil exporters increased consumption in 1982, albeit at a slower pace than in the past.

39/ Oil stocks peaked at 127 days of consumption in mid-1981. At the end of 1982, total crude and product stocks amounted to 113 days of consumption, which compared with just 97 days in early 1979, seems to be quite adequate in view of probable oil price developments. See Petroleum Intelligence Weekly, 18 October 1982.

40/ Net exports of crude and products increased by 0.4 mbd or 26 per cent in the first half of 1982 compared with the corresponding period a year earlier (see Petroleum Intelligence Weekly, 6 December 1982).

41/ These results are based on an aggregate econometric model of oil consumption behaviour in the OECD countries. The model was constructed in the Department of International Economic and Social Affairs of the United Nations Secretariat and was estimated, using quarterly data, over the 1971-1981 period.

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