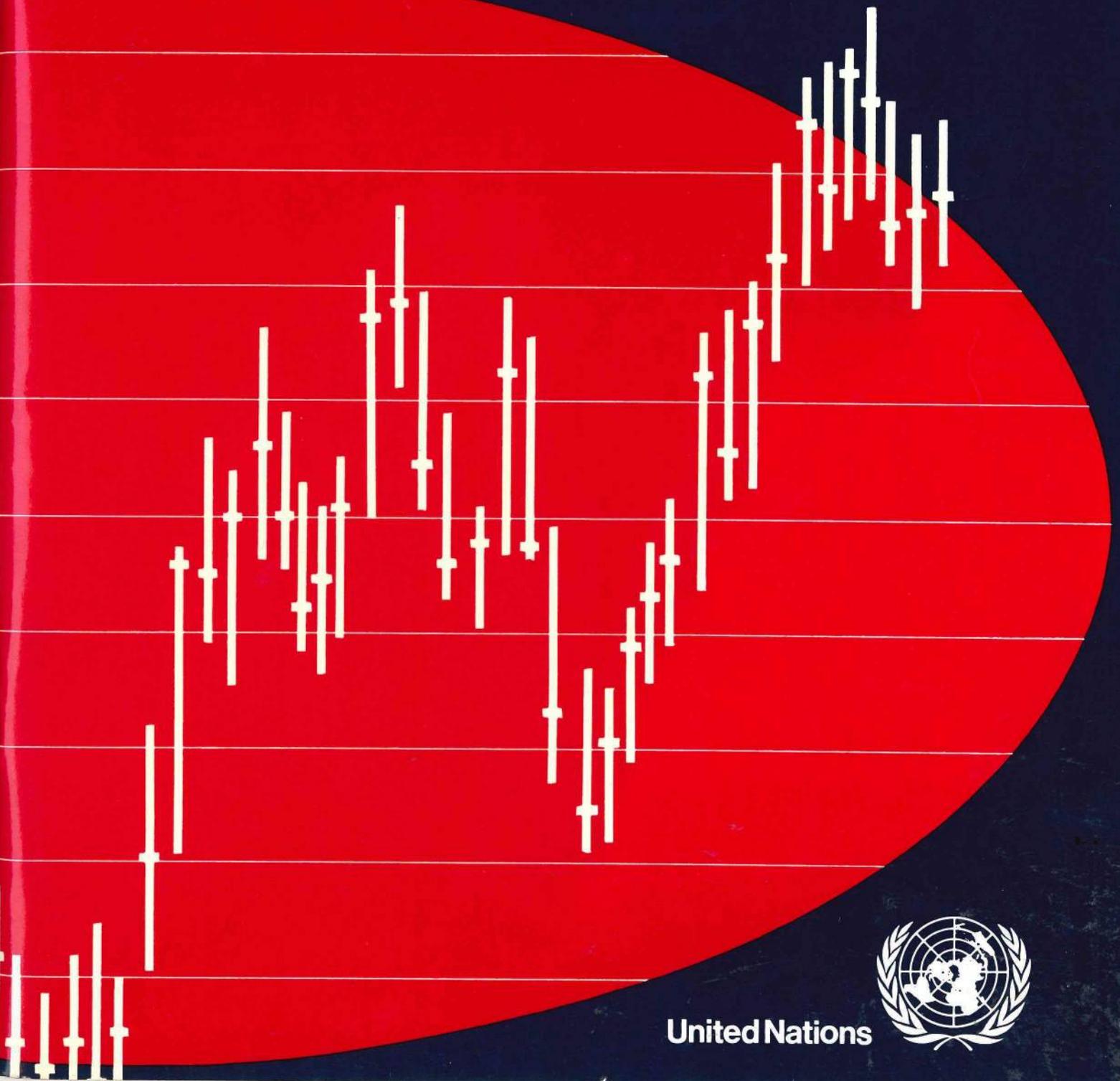


World Economic Survey

1981-1982 Current Trends
in the World Economy



United Nations



Department of International Economic and Social Affairs

WORLD ECONOMIC SURVEY, 1981-1982

Current Trends in the World Economy



UNITED NATIONS

New York, 1982

NOTE

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

E/1982/46
ST/ESA/124

UNITED NATIONS PUBLICATION

Sales No. E.82.II.C.1

00900

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 1981-1982 has been prepared to assist the Council in its deliberations at the second regular session of 1982. 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 at 1 April 1982.

CONTENTS

<u>Chapter</u>	<u>Page</u>
I. THE WORLD ECONOMY IN THE EARLY 1980s	1
The world economic situation, 1981-1983: salient features	1
Widespread slow-down of economic activity in 1981	1
1982: a critical year	3
World economic recovery fraught with uncertainties	4
The threat of protectionism	5
A slow recovery in developing countries	6
A longer-term perspective	8
The decline of growth rates in the last 15 years	8
Adaptability and domestic rigidities in developed market economies	10
Concluding remarks	14
II. GROWTH IN THE WORLD ECONOMY AND CURRENT POLICY STANCES	18
Marked deceleration of growth rates throughout the world economy	18
Virtual stagnation in developing countries	21
Developed market economies: deepening recession in 1981-1982	25
Further weakening of economic activity in the centrally planned economies	36
Agricultural production: improved over-all performance	42
Changing patterns of energy consumption and production	48
III. INTERNATIONAL TRADE AND PAYMENTS	54
An over-all view: the transmission of recession through international trade and financial markets	54
Stagnation in world trade	55
Weakening primary commodity prices	58
Further adverse terms of trade movements in energy-importing developing countries	61

CONTENTS (continued)

<u>Chapter</u>	<u>Page</u>
Lessened current account imbalances in the world economy	62
Worsening payments difficulties in deficit developing countries	64
Rapid changes in developing countries' interest payments flows	65
Financing the deficits of developing countries: serious liquidity problems in energy-importing countries	68
The developed market economies: large shifts in the aggregate deficit to the smaller countries	72
Adjustment efforts in centrally planned economies	75
Selected policy issues	77
Volatility in exchange rates for major currencies	77
The growing protectionist threat	80
IV. ADJUSTMENT AND INTERNATIONAL CAPITAL FLOWS TO DEVELOPING COUNTRIES	83
Short-term adjustment measures and their effects	83
Measures to bring about structural adjustment	86
Investment and adjustment of productive structures	87
External finance for structural adjustment	89
Current limitations to accelerated borrowing from private financial institutions	89
The uncertain contribution of other financial market flows	91
The path of direct investment	93
The inadequacy of official flows	93
Conclusions	96

CONTENTS (continued)

List of tables

<u>Table</u>	<u>Page</u>
I-1. World production: annual rate of growth in gross domestic product	2
I-2. Medium-term growth trends in the world economy	9
I-3. Developed market economies: long-term changes in selected parameters	13
II-1. World production: annual growth rates of output volume, by country groups and major sectors, 1971-1982	19
II-2. Developing countries: rates of growth of real gross domestic product, 1971-1983	22
II-3. Developed market economies: rates of growth of real gross national product/gross domestic product, 1976-1983	27
II-4. Developed market economies: central government budget surpluses or deficits as percentages of GNP	29
II-5. Major industrial countries and Switzerland: commercial bank lending rates to prime borrowers, end of period, 1978-1981	31
II-6. Developed market economies: rates of change in consumer prices, 1978-1981	33
II-7. Eastern Europe and the Union of Soviet Socialist Republics: basic economic growth indicators, 1976-1982	37
II-8. World food production, 1970-1981: indices and trends	43
II-9. World trade in food products, 1970-1980: volume indices and trends	45
II-10. World cereal production trends and trade volumes, 1970-1980	47
II-11. World oil production and consumption, 1979-1981	50
III-1. World trade: annual rates of change in volume and prices, 1976-1982	56
III-2. Changes in the prices of internationally traded commodities, 1980-1982	59
III-3. World: balance of payments on current account, by country groups, 1978-1982	63

CONTENTS (continued)

<u>Table</u>	<u>Page</u>
III-4. Net energy-importing developing countries: external interest payments and direct investment income as shares of total current foreign exchange earnings, 1976-1981	66
III-5. Net flow of IMF credit to energy-importing developing countries, 1978-1981	70
III-6. Developed market economies: balance of payments on current account, 1978-1982	73
III-7. Eastern Europe and the USSR: trade balances, 1979-1981	75
III-8. Nominal and effective exchange rates for selected convertible currencies, 1978-1981	78
IV-1. Net energy-importing developing countries: trade balance in real and nominal terms, 1977-1981	85

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.

The following abbreviations have been used:

ASEAN	Association of South East Asian Nations
CMEA	Council for Mutual Economic Assistance
DAC	Development Assistance Committee of the Organisation for Economic Co-operation and Development
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
LIBOR	London inter-bank offered rate
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:

<u>Centrally planned economies:</u>	China, Eastern Europe and Union of Soviet Socialist Republics
<u>Developed market economies:</u>	North America, southern and western Europe (excluding Cyprus, Malta and Yugoslavia), Australia, Japan, New Zealand and South Africa
<u>Developing countries:</u>	Latin America and the Caribbean area, Africa (other than South Africa), Asia (excluding Japan) and Cyprus, Malta and Yugoslavia

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

<u>Capital surplus countries:</u>	Brunei, Iran, Iraq, Kuwait, Libyan Arab Jamahiriya, Qatar, Saudi Arabia and United Arab Emirates
-----------------------------------	--

Deficit countries, subdivided into the following two subgroups:

<u>Other net energy exporters:</u>	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)
<u>Net energy importers:</u>	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 WORLD ECONOMY IN THE EARLY 1980s

The world economic situation, 1981-1983: salient features

Widespread slow-down of economic activity in 1981

Economic expansion decelerated markedly throughout the world in 1981. The slow-down affected all major regions and groups of countries, independently of their level of development or economic structure. The deceleration was particularly intense in the developing countries, most of which experienced a significant fall in per capita incomes.

World output in 1981 grew by a mere 1.2 per cent, which is about a third of the rate of growth experienced in the previous decade (see table I-1). International trade flows remained at 1980 levels (see table III-1). This was in marked contrast to an average annual rate above 5 per cent in the period 1971-1980. The major factor behind the poor performance of the world economy was the recession in the Western industrial countries. The developed market economies experienced an average growth rate of GNP slightly above 1 per cent for the second year in a row. Faltering economic activity led both to a significant increase in unemployment, which exerted a downward pressure on wages, and to weakening primary commodity prices. While the rate of inflation decelerated somewhat, it remained high by post-war standards. In the centrally planned economies, there was also a further slowing of economic growth from the unusually low levels observed in the previous two years.

Events in 1981 provided further evidence of the degree of interdependence of the global economy. During the year two distinctive features became manifest. First, in addition to linkages among economies through trade flows, financial links provided an important transmission mechanism of disturbances from abroad. As a result of a reduction of restrictions on capital flows, the internationalization of liquid asset holdings, and rapid progress in the communication of information, national capital markets have become more sensitive to external events and the degree of manoeuvre of national monetary authorities has decreased. Secondly, and partly as a consequence of the close financial links, a certain parallelism in policy emerged. This was due to a defensive reaction of several industrial countries provoked by persistent high interest rates in the United States of America and partly to convergence of views in most countries that the reduction of inflation had become a priority. This explains the increasing and unusually high levels reached by interest rates in a large number of countries at a time of high and growing unemployment.

The sharpest deceleration in economic growth in 1981 took place in the developing countries. The growth rate of GDP is estimated to have been of the order of 0.6 per cent. There was thus an actual fall in per capita GDP for the first time since the late 1950s. With the exception of agriculture, growth in other sectors of production sagged considerably.

Since 1978 growth rates in the developing countries have been progressively decelerating. The gravity of their economic problems is thrown into sharp relief by comparing their current economic performance with the average growth rate of

Table I-1. World production: annual rate of
growth in gross domestic product
(Percentage)

	1971-1980	1980	1981 <u>a/</u>	1982 <u>b/</u>	1983 <u>b/</u>
World	4.1	2.1	1.2	1.9	3.4-3.6
Developed market economies	3.4	1.5	1.2	1.3	3.3
Centrally planned economies <u>c/</u>	5.4	3.5	1.9	3.2	...
Developing countries	5.6	2.9	0.6	3	4-5
Capital surplus countries	4.8	-7.4	-10.1	...	...
Deficit countries					
Other energy exporters	6.0	6.7	5.4	4	5-6
Energy importers	5.6	4.1	1.4	3	4-5

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

a/ Preliminary estimates.

b/ Forecasts: Project LINK results for developed market economies; estimates based on annual and medium-term plan figures for centrally planned economies; Secretariat estimates based on forecasts for individual developing countries.

c/ Net material product.

about 5.5 per cent achieved during the 1970s and the aspiration of reaching a rate of 7 per cent incorporated in the International Development Strategy for the Third United Nations Development Decade (General Assembly resolution 35/56, annex).

Over-all growth in Latin America, which had hitherto been an island of uninterrupted high growth among developing countries, virtually came to a halt: the average growth rate for the region is estimated to have been about two percentage points below the rate of growth of the population. In the Asian subcontinent and the newly industrializing countries of south-east Asia, a certain momentum of growth was maintained. In other developing regions the deceleration in growth rates was substantial. In many of the economies of west Asia and north Africa decreasing world demand for oil led to further reductions in production. In Africa south of the Sahara, chronic problems were accentuated by the adverse international trade climate. For many of the countries in this part of the world, food deficits and shortages remained large and nutrition levels may have deteriorated further.

In the vast majority of developing countries, export revenues lagged considerably as international commodity markets weakened further. As a consequence of adverse movements in the terms of trade, in many countries per capita incomes fell, reducing both consumption and investment. Demand conditions were also affected by cautious government policies in response to high inflation rates and the need to maintain credit-worthiness in international financial markets. Partly because of this and partly owing to import constraints stemming from increasing external payments difficulties, growth in the modern sector shrank abruptly, and unemployment reached unprecedented levels in the main urban centres.

Even before 1980 a tight reserve situation and, more generally, the external financing outlook had led a very large number of energy-importing countries to restrain imports. In 1981, these are estimated to have increased in volume by only 2 per cent. However, in spite of import restraint, there was no progress in the over-all payments situation as export prices declined and service outflows increased, partly on account of higher interest rates. The deficit on current account of this group of countries increased by about \$9 billion, approaching \$80 billion in 1981 (see table III-3). Tight international financial conditions forced countries to resort once again to the use of international reserves. In energy-importing countries international reserves fell by about \$10 billion. As a result the international liquidity position of most of these countries is very precarious.

1982: a critical year

1982 can be seen as a crucial year on three counts. First, the major actors in the world economy are attempting to solve their current problems in untested ways. In particular, the United States, whose economy is at this juncture decisive for a broad-based recovery, has embarked upon a course that relies heavily on monetary restraint as a way to cool off demand and reduce inflationary expectations and on lower taxes and fiscal incentives to encourage private saving and investment. The response to these policies, and whether they will remain unmodified, remains uncertain. Secondly, the international trading system is being subjected to considerable strains. A number of important trade disputes have emerged in recent years which will need to be faced, if not policed, in the course of 1982. Thirdly, a large number of developing countries are undergoing an intense adjustment process

which has led to a slow-down in the manufacturing sector and in industrial employment. As a result of slow growth and falling terms of trade, per capita real incomes are declining, with adverse effects on the standard of living of different social groups, especially the most vulnerable. Such a situation is not likely to change before recovery in the industrial countries is well under way and the export outlook for the developing countries begins to improve significantly. In the meantime, the social and institutional fabric of several developing countries will undergo severe strains. 1/

World economic recovery fraught with uncertainties

The evolution of economic activity in the developed market economies, particularly in the large industrial countries, will crucially affect the rest of the world economy. Under present policies, short-term trends indicate that over-all production in the United States and Western Europe is likely to stagnate in the first half of 1982. If recovery does take place in the second half of the year, the rate of growth of the developed market economies for the whole of 1982 may be between 1 and 1.5 per cent. If momentum is generated in the second part of 1982, it is likely to be maintained during 1983, leading to a rate of increase in GDP of between 3 and 3.5 per cent (see table I-1).

The recovery in the second half of 1982 hinges largely upon a significant reduction in interest rates 2/ and a strong pick-up in the economy of the United States. It is possible that the current recession and the deceleration of price increases in the United States could reduce inflationary expectations substantially and lower nominal interest rates. This would induce a considerable expansion of demand in those activities that are particularly sensitive to interest rates - housing, consumer durables, and inventory accumulation - and would lead to more buoyant economic activity in the United States. The drop of interest rates in the United States would cause interest rates to fall in international financial markets and would enable Governments in other developed market economies to institute more stimulative policies. This should lead to a substantial expansion of demand - and hence industrial growth - in Western Europe.

1/ There is certain parallel in this situation with that in the developed market economies. In the course of 1982, the rate of unemployment is likely to rise from its already high level, and many Governments will feel increasing pressures to institute fundamental changes in short-term policies. To some extent, 1982 is also a test period for the centrally planned economies. There is a clear need to redress the severe imbalances in certain consumer markets: food-stuffs in general and staples such as bread, flour and meat in particular. Moreover, this has to be accomplished in the aftermath of the poor 1981 harvests, at a time of limited import possibilities, and during a period of increasing investment requirements to adjust economic structures in order to return to a more dynamic growth path.

2/ Forecasts in table I-1 assume a drop in the average level of the prime rate of three percentage points in the United States between 1981 and 1982, and a very slight rise - half a percentage point - in 1983. The forecasts also assume a 5 per cent decline in oil prices in dollar terms in 1982.

However, in the context of current policies such an outcome is by no means a certainty. The prospective fiscal deficits in the United States ^{3/} for fiscal years 1983 and 1984 have recently been revised upwards, increasing fears that government borrowing in capital markets will prevent any significant fall in interest rates. There are no firm signs that the erosion of business confidence taking place over the recent past has yet been reversed. There is a clear danger that if interest rates remain high in the developed market economies generally and if expectations of a recovery later in 1982 are not realized, the loss in business confidence could become cumulative. If this were to happen and if resistance to extensive use of protectionist measures weakened, there is a distinct possibility that the world economy could be engulfed in a recession of proportions not seen since the 1930s.

The threat of protectionism

In the general context of economic stagnation in the Western industrial countries, trade is expected to expand at very subdued rates during 1982. The volume of exports and imports of the developed market economies is forecast to increase by about 2.5 and 1 per cent, respectively, in 1982 (see table III-1). Although these figures are somewhat above those of 1981, they are still well below past trends. Sluggish demand conditions, at least in the first part of 1982, and increasing unemployment could intensify protectionist pressures which, owing to sectoral maladjustments in certain branches of industry such as automobiles, electronics, steel and textiles, are already a cause for concern.

Recently there have been increasing frictions among large industrial countries. Most of these disputes have involved individual products or lines of production. However, general market access is a broader area of concern. Japan's increasing trade surpluses with both the United States and the European Economic Community have led both of its major trading partners to mount strong campaigns for easier access to the Japanese market.

Among developing countries, there is an increasing concern that their own export trade could become entangled in the altercations among industrial countries. If the general economic situation deteriorates further, developed countries would encounter increasing difficulties in resisting restrictive actions. The recent renewal of the Multifibre Arrangement does not augur well. The global growth rate of textile imports covered by the arrangement is unlikely to reach even 1 per cent per annum, and its implementation involves the completion of bilateral negotiations between each importing country and a large number of exporting countries. For the major exporters of textiles and clothing, matters are complicated by the need to make room for the entry of new suppliers. With internal demand growing at just above 1 per cent per annum, very considerable pressures are being exerted to restrict severely the growth in bilateral quotas. In view of these problems, EEC has recently reaffirmed its position that if "satisfactory results" are not obtained from the bilateral discussions, it will withdraw from the Multifibre Arrangement.

^{3/} Important factors determining the size of the 1982 deficit are legislated tax cuts, increases in defence expenditures and lower revenues on account of the recession.

There is every likelihood that the November Ministerial Meeting of the General Agreement on Tariffs and Trade will be held in the midst of accumulated tensions in the field of trade among developed countries and between developed and developing countries. The agenda is likely to attempt a further resolution of the safeguards issue left unsettled by the Tokyo Round of Multilateral Trade Negotiations. A number of industrial countries are increasingly seeking to take escape clause action on a selective basis. This is a violation of the most favoured nation principle and would warrant action for compensation on the part of the offended Contracting Party. In the meantime, this restriction on the use of the safeguards clause is giving rise to a proliferation of voluntary export restraints and orderly marketing arrangements.

However, in spite of mounting pressures, protectionist actions have been rather limited until now. Countries have begun to implement the tariff reductions agreed in the Tokyo Round. Furthermore, the November Ministerial Meeting of GATT is also contemplating discussion of issues that might lead to further trade liberalization. All this gives certain room for hope that the international trading system will survive the adverse current economic climate. It is also possible, however, that crucial decisions during 1982 may favour protectionist stances.

A slow recovery in developing countries

During much of 1982 the international economic climate is not likely to provide any significant impetus to growth in developing countries. The exports of developing countries, particularly raw materials, will remain depressed until recovery in the industrial countries is well under way. Nor can any dramatic increase in international financing be expected. On the contrary, the preferred policies of lenders - international commercial institutions as well as official agencies - emphasize early adjustment in energy-importing countries. ^{4/} On the domestic front, agricultural expansion may turn out to be as favourable as in 1981, ^{5/} but in a large number of developing countries high rates of inflation and the need to restrict imports will prevent the adoption of policies geared to stimulating demand. Investment levels, which have remained relatively low in most developing countries since adjustment policies were instituted in 1980, are unlikely to pick up.

^{4/} Since energy-importing countries account for about 15 per cent of the total imports of the market economies, this may be accentuating the general economic slow-down.

^{5/} The combined FAO index of agricultural production for developing regions (1969-1971 = 100) increased from 130 in 1980 to 135 in 1981. Given the recent emphasis put on the agricultural sector in many developing countries, a similar expansion in 1982 appears likely. However, the possibility of a bad agricultural year owing to adverse climatic conditions cannot be discounted. Under present over-all conditions, a bad agricultural year could well be an unmitigated disaster for many countries.

Assuming that the terms of trade will deteriorate substantially less in 1982 than in the period 1978-1981, 6/ growth in energy-importing countries should improve somewhat this year and accelerate further, to about 4 or 5 per cent in 1983. Deficit energy exporters are likely to attain growth rates in the 4 to 6 per cent range during this period 7/ (see table I-1).

A growth rate of 3 per cent in energy-importing countries in 1982 will not allow for any significant increase in per capita incomes. In spite of this, payments difficulties will not subside for most of these countries. Their international reserve position is, in general, very weak. Despite insufficient import growth, reduced export prices during much of 1982 are likely to widen the gap between the import bill and export revenues. Debt-service payments are still increasing rapidly, partly on account of new borrowing and partly because of high interest rates. All these factors point to an increasing need for international financing. However, prospects are also bleak on this count. Budget restrictions in developed countries are leading to cutbacks in official development assistance. The financing capabilities of many multilateral institutions have already been stretched. Prospects for private financing, the most dynamic component of international capital flows in recent years, are also clouded as the credit-worthiness of many countries has been affected by the grim export outlook and domestic difficulties.

In sum, 1982 can be seen as a year in which growth in developing countries will again be unusually slow and in which there will be little or no scope for increased investment. The latter is likely to remain at the relatively low levels of 1980-1981. 8/ This could impair growth prospects for the whole of the first half of the decade. Without a significantly improved international economic environment, retrogression cannot be discounted as a distinct possibility in many - particularly the more fragile - of the developing countries.

6/ The terms of trade of energy-importing countries have fallen persistently since 1977. The cumulative fall in the period 1978-1981 for this group of countries is about 20 per cent. Thus, while the average rate of growth in GDP was 3.6 per cent in 1978-1981, the corresponding average annual rate of growth in real GDP adjusted for changes in the terms of the trade was only 2.8 per cent.

7/ Actually, development plans for the early 1980s of the countries in this group contemplated rates of growth above 6 per cent. However, the export outlook, particularly for oil, has led recently to a downward revision of growth rates. (No forecast has been attempted for surplus countries since the final outcome - growth in gross domestic product - in this group hinges mainly on the solution of the Iraq-Iran conflict.)

8/ There are indications that fixed investment grew slightly more than GDP in this group of countries during the 1970s.

A longer-term perspective

The decline of growth rates in the last 15 years

Viewed in a longer-term perspective, the pervasive slow-down affecting the world economy since early 1980 does not mark a sudden break with past trends. The slow-down of growth in the world economy as a whole started in the late 1960s, and during the 1970s there was an almost uninterrupted decline (see table I-2). In the earlier part of the period, this reflected the progressive deceleration of growth in the Western industrial countries, but by the second half of the 1970s the decline gradually embraced all the major country groups: developing countries, developed market economies and centrally planned economies. The intensification of this phenomenon in 1978-1982 has led to a current medium-term growth rate in the world economy which is significantly below that of any previous five-year period within the last two decades. This is also true for each of the major country groups.

Placed in this longer-term perspective, the most recent deceleration might readily be construed as another phase in a secular decline of economic growth. Certainly, it raises the question whether the recent performance of the world economy signals a lasting downward shift in rates of economic growth or whether it is the outcome of cyclical or temporary forces. The question is important for all country groups; it has a special importance for the growing number of developing countries which, in recent years, have chosen to pursue export-oriented policies as the best hope for rapid and efficient industrialization.

A main reason for the progressive slow-down in the world economy is no doubt the loss of dynamism in Western industrial countries since the mid-1960s. Although there is no simple and conclusive explanation for this phenomenon, one set of factors appears to be the rather exceptional circumstances prevailing in much of the 1950s and 1960s. These gave rise to an acceleration in growth rates from the second half of the 1950s to the mid-1960s. Important among these circumstances were the speed of the integration process in Western Europe, the pace of discovery and development of new sources of raw materials, the availability of low-cost energy, increasing expenditures on research and development, the speed at which many countries were catching up with United States technology, and a gradual process of trade liberalization.

By the late 1960s, the growth impulses provided by these factors began to weaken, and some moderation in the pace of growth was only to be expected. This was true both of total output and of output per man or per unit of investment, since both trends in output and productivity respond to very much the same complex of circumstances. This is not to say, however, that all the factors ceased to be important stimuli. For example, the trend towards a more open trading system was maintained despite retrogressive steps affecting particular products; and the share of trade in world output continued to rise. This remained true even after the mid-1970s when non-oil commodity trade was increasing at a rate some 50 per cent higher than total output. 9/

9/ Since most countries tried to reduce oil imports starting in 1973, the relevant variable for consideration is non-oil trade.

Table I-2. Medium-term growth trends in the world economy
(Average annual rate of growth
over a five-year period)

Period	Gross domestic product				International trade	
	World economy <u>a/</u>	Developed market economies	Centrally planned economies <u>b/</u>	Developing countries	World exports <u>c/</u>	Non-oil exports <u>d/</u>
1960-1964	5.7	5.4	6.2	6.7	6.6	6.6
1962-1966	5.7	5.6	6.4	5.3	7.0	6.6
1964-1968	5.8	5.5	7.7	5.5	8.3	8.0
1966-1970	5.6	5.2	7.4	6.2	9.0	8.8
1968-1972	5.6	5.1	6.4	7.2	9.5	9.8
1970-1974	4.9	4.2	6.9	6.8	8.7	9.6
1972-1976	4.1	3.4	6.3	6.0	6.7	7.6
1974-1978	3.4	2.6	5.5	4.9	4.3	5.5
1976-1980	3.9	3.6	4.1	4.8	5.4	6.3
1977-1981 <u>e/</u>	3.0	2.8	3.3	3.8	3.2	4.4
1978-1982 <u>f/</u>	2.6	2.3	2.9	3.2	2.9	4.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat. Output growth rates are based on data collected by the Secretariat from official sources; growth rates of international trade are derived from the world tables in International Monetary Fund, International Financial Statistics.

a/ Excluding Albania, China, the Democratic People's Republic of Korea, Mongolia, and Viet Nam.

b/ Net material product of Eastern Europe and the USSR.

c/ Volume of exports (world exports divided by unit value of exports).

d/ Calculated by subtracting from the total volume of exports the export volume of oil-exporting developing countries (for definitions, see International Monetary Fund, International Financial Statistics).

e/ Preliminary estimates for 1981.

f/ Growth rates for 1981 are preliminary estimates and for 1982 forecasts.

However, the actual deceleration in growth that took place in the years after the late 1960s did not simply reflect the diminishing positive effect of some of these exceptional circumstances. Events and circumstances emerged which were less propitious to sustained, and rapid, growth. After accelerating in the late 1960s, inflation became more entrenched in national economies, and the efficacy of established stabilization policies tended to decline. Expectations that prices would continue to rise became increasingly embedded in wage settlements, reducing downward price flexibility. By the early 1970s, it also became clear that the United States' external deficit could not be allowed to increase indefinitely, and the international monetary system shifted to a system of flexible exchange rates. Concern for environmental standards intensified and costs of abating pollution increased somewhat. Further, the larger, and abrupt, increase in the price of oil set in train an extended process of adjustment to changed cost conditions.

There is also a view that there were other changes taking place in these economies which lessened their capacity for adaptation and growth. For a complex of reasons that embrace not only economic policies but also social legislation and institutional factors, it is feared that labour markets have become more rigid and that industrial structures have been slow to effect adjustments. The slackened rate of investment evident in most of these countries over the last 10 years or so is also seen as symptomatic of a weakening of incentives, or a multiplication of impediments, to change and innovation. While many instances of inflexibility can be adduced in support of this view, the important question is whether it stands as a valid generalization. It is therefore worth reviewing the main arguments briefly.

Adaptability and domestic rigidities in developed market economies

One form of evidence taken to imply growing rigidity in labour markets is the tendency in some countries for the number of job vacancies to increase in recent years concurrently with rising levels of unemployment. This is seen as indicative of a growing mismatch between the skill composition of the labour force and requirements or between the geographical distribution of labour demand and supply. The concern about rigidity in labour markets is also partially based on analyses of the effects of social legislation or measures introduced in the last decade or two on labour mobility. The higher cost of separation payments in some countries, for instance, may have discouraged employers from releasing underutilized labour; or again, income-related unemployment benefits may have discouraged unemployed workers from accepting lower-paid jobs.

While these observations have substance, the over-all impression is none the less that the inter-industry and occupational mobility of labour remains high. In the United States, the average "quit" rate in manufacturing industries in the 1950s, 1960s and 1970s was 2 per cent, 1.9 per cent and 2 per cent per month, respectively, of the employed labour force. (This implies that on average in the course of the year almost 25 per cent of the employed labour force in manufacturing changed jobs during the 1970s.) ^{10/} While comparable evidence of changes in the

^{10/} United States Bureau of Labor Statistics, Employment and Earnings, United States, 1909-75 (Washington, D.C., Bulletin 1312-10, 1976) and Monthly Labor Review, various issues. "Quits" are defined as a termination of employment initiated by employees, failure to report after being hired, and unauthorized absences, if on the last day of the month the person has been absent more than seven calendar days.

rate of mobility over the last three decades is not available for Western European countries, recent rates of mobility do not suggest a strong resistance to change among members of the labour force. In the mid-1970s, the proportion of the labour force which in the course of a year changed jobs through moving from one industry to another industry, or from one occupation to another, was 25 per cent in the Federal Republic of Germany, 21 per cent in France, and 15 per cent in the United Kingdom of Great Britain and Northern Ireland. 11/ It is also pertinent to bear in mind that the general level of educational attainment of the work force has continued to rise in all these countries; and this invariably works towards enhancement of the adaptability of workers.

Certainly, some rigidities in labour markets have been much in evidence during recent years. The dominant role of some declining industries in the local economies of particular regions has, for instance, underlined the limited degree of geographical mobility. Wage structures, too, have not become noticeably more flexible. On balance, however, when account is taken of all the evidence, it is difficult to conclude that labour markets are manifestly less adaptable than they were a decade ago.

There is more substance to the position that industrial structures or, at least, some sectors of industry have tended to adjust more slowly to changing economic conditions, mainly because of the influence of governmental policies. Ailing industries received a growing amount of financial assistance from the State in the 1970s. For the OECD countries as a group, direct financial assistance to industry and agriculture rose from 1.3 per cent of GDP in 1955-1957 to 2.1 per cent in 1974-1976; and it is believed that indirect financial assistance in the form of tax concessions was also large in some countries. 12/ It is true, of course, that part of the financial assistance was provided under adjustment assistance legislation, and was intended to assist in the retraining or relocation of workers or in the retooling of factories to shift to more competitive products.

However, it is also true that much of the financial assistance has been used in ways that have kept in operation increasingly uncompetitive industries or activities. This has been the source of a persistent contradiction between the avowed pursuit of open trading policies and the actual granting of protection through subsidies. Still, in industry, though not in agriculture, the general effect of the financial assistance in itself has been to postpone and not to stop the contraction of ailing industries. The steel industry in the EEC countries, for example, has seen its labour force contract by about one quarter over the last 10 years. In the United States, the reduction has been about one fifth. It is encouraging that, over the last few years, Governments in some countries have begun to take a more critical view of state assistance to industry and agriculture.

11/ European Communities-Commission, Labour Force Sample Survey, 1973-1975-1977 (Luxembourg, 1980), table VI/1.

12/ In 1975, revenue losses resulting from tax concessions to industry ranged from 1.1 per cent of GDP in the Netherlands and the United Kingdom to about 2 per cent in the Federal Republic of Germany. In the United States, tax concessions to industry were estimated at 1.2 per cent.

Other evidence cited in support of the view that the Western industrial countries have begun to suffer from a persistent loss of dynamism is the decline which has taken place in the rate of investment. After high rates of increase in the 1960s, a marked deceleration took place in the 1970s. Gross fixed capital formation in the developed market economies increased, for example, by barely 2 per cent between the cyclical peaks in 1973 and 1978.

Among the several reasons put forward in explanation of this decline, some are of a more social or institutional character. A less innovative attitude of the part of managements and a diminished willingness on the part of the factory work force to adapt to new processes and techniques are sometimes mentioned; these tend, among other things, to reduce the profitability of new investments. Regulations introduced or strengthened to safeguard the population against health, safety or environmental hazards have raised the cost of many investments. Expenditure on research and development by government and the private sector appears - at least in the United States - to have declined in relation to the domestic product of industry since the late 1960s. ^{13/} However, in view of the long time lags involved, this is more likely to affect investment in the 1980s.

There have, however, been other forces more directly linked to current economic policies and events which probably impinged quite strongly on the present and expected profitability of new investment. On the demand side, the levels of demand prevailing during the late 1970s and into the 1980s have tended to fall below full capacity utilization. On the cost side, the same period saw an abrupt and substantial increase in energy costs while real wages were resistant to any downward adjustment. Entrepreneurial and property income as a percentage of domestic factor incomes declined appreciably over the decade (see table I-3). In the last year or two, however, these trends in the cost structure may have begun to change; real wages have been weakening and the extensive adjustments taking place in energy use have doubtless reduced current costs.

Investment decisions are, of course, more influenced by views about future prospects than by actual experience in the recent past, though the former tend to draw heavily on the latter. The last decade or so has been characterized by a certain loss of confidence in the evolution of the economic future and in the system of international economic co-operation. What was previously regarded as stable and dependable appears to have become volatile and unpredictable. Among the forces at work were the inflationary surges of prices that began in the late 1960s, the onset of the floating exchange rate system, the rapid changes in international oil markets leading to much higher energy prices and uncertainties regarding oil availabilities, the intensification of the wage-price spiral, the erosion of confidence in the ability of Governments to contain inflation and doubts about their capacity to control government expenditures and fiscal deficits, and, lately, the circumvention of trade rules. It is this broad recession in confidence, rather than any deeper external circumstance, that appears to have dampened investment.

^{13/} In other developed market economies for which comparable data are available, trends were mixed. In France and the United Kingdom, expenditure on industrial research and development in relation to domestic industrial product was also appreciably lower after the mid-1970s than it had been in the late 1960s. But in the Federal Republic of Germany and Japan, the situation was just the reverse.

Table I-3. Developed market economies: long-term changes in selected parameters

	Gross fixed capital formation <u>a/</u> (1975=100)	Capacity utilization in manufacturing (percentage) <u>b/</u>	Unemployment (standardized rates as percentage of labour force) <u>c/</u>	Entrepreneurial and property income as percentage of domestic factor incomes <u>d/</u>
1960	54.1	...	...	34.6
1965	71.8	87.7	2.6	33.5
1970	92.7	83.1	3.0	30.3
1971	97.0	81.4	3.5	29.4
1972	103.7	84.0	3.6	29.7
1973	111.2	87.3	3.2	29.3
1974	106.0	83.7	3.5	26.4
1975	100.0	74.0	5.1	25.5
1976	103.9	79.8	5.2	25.4
1977	108.2	81.2	5.3	25.5
1978	113.2	83.0	5.1	25.9
1979	117.6	84.7	5.1	25.7
1980	116.9	80.3	5.8	24.9

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of the Organisation for Economic Co-operation and Development.

a/ OECD member countries, excluding New Zealand.

b/ Canada, France, Federal Republic of Germany, Italy, United States (figures for 1965 do not include Italy).

c/ Australia, Austria, Belgium, Canada, France, Finland, Federal Republic of Germany, Italy, Japan, Netherlands, Norway, Spain, Sweden, United Kingdom, United States.

d/ Australia, Austria, Canada, France, Japan, United Kingdom, United States.

In summary, there do not appear to be sufficient grounds to identify a lessening capacity for adaptation as a major reason for the progressive deceleration in economic growth that has taken place since the 1960s. For the most part, the deceleration reflected the phasing out of exceptionally favourable circumstances prevailing in the late 1950s and early 1960s, and the phasing in of a subsequent period of disturbances caused by general price inflation and abrupt shifts in relative prices, particularly of energy.

The last decade or so saw a diminution of confidence in economic prospects among businessmen and consumers, which had its main cause not in a greater inflexibility of market structures or institutions but in a succession of events and of policy responses to those events. If there is greater confidence that the future will not be marred by fresh bouts of inflation, by sharp distortions in relative prices, by sudden disruptions in the supply of key commodities, or by a recurrent need to rein in demand to levels below full capacity utilization, the pace of new investment and the rate of economic growth could well recover significantly. This is not to say that the solution to the restoration of a more satisfactory pace of expansion in output lies readily to hand. The heart of the matter is, after all, the familiar dilemma of reconciling price stability and growth. The broader statement of the problem does, however, serve to emphasize that the more general need is to restore, by various means, a greater measure of predictability to the future.

Concluding remarks

The preceding analysis indicates that the present malaise affecting the world economy has its origins both in short-term factors and in causes of a more persistent character. The intensity of the recession is explained mainly by the superimposition of a cyclical downswing, accompanied by restrictive anti-inflationary policies, on a world economy which had already weakened. Actions are needed which address themselves both to the current recessionary situation and to the creation of conditions which will favour a more lasting recovery of economic growth.

On most counts, 1982 will be a particularly difficult year for the world economy, but there appear to be two areas of special concern. The first is the balance-of-payments situation of most developing countries. Over the last several years, a large number of developing countries have made strenuous efforts to adjust their productive structures to the substantial changes in their current account positions brought about mainly by exogenous factors. As a consequence, in the last three to four years, the volume of exports from these countries has increased significantly while the pace of growth in the volume of imports has decelerated appreciably. However, the deepening of the recession in the Western industrialized countries in 1981 led to almost insurmountable difficulties in most developing countries. This superimposed upon the 1979 increase in the prices of oil a deterioration in the terms of trade between other primary commodities and manufactures which shifted part of the payments deficit of the industrial countries to the developing countries. High interest rates further aggravated the pressure on their external accounts. External deficits had to be contained largely by restricting imports and, as a consequence, investment and per capita consumption fell. For the developing countries, the deceleration in growth of total output in 1981 was, in fact, much steeper than in other parts of the world.

In these circumstances, further progress in the adjustment of productive structures in developing countries has been rendered much more difficult. There is a clear need for increased external financing on appropriate terms to allow for continuation of the process. There are two important additional reasons for such an increase. First, it would have a countercyclical effect as aggregate demand in developed market economies is still weak. Secondly, an important part of the present deficit of developing countries on current account is of a transitory nature, 14/ and increased financing in the short term is unlikely to lead to an unsustainable position in the medium or long term. The policy implications of this view of the current situation are evident. There is need for expanded bilateral assistance, including ODA, and for multilateral agencies to adopt a more flexible approach. Steps should be taken so that a significant part of IMF resources could be made available under less strict conditionality, along similar lines to that of the oil facility in the mid-1970s. 15/ Also, it is important that the World Bank and other multilateral agencies find ways to increase substantially the loans for structural adjustment.

The second area of immediate concern is the level of interest rates. This will remain a critical determinant of economic performance during the year. If a further deceleration of inflation is not accompanied by an appreciable fall in interest rates, the recession may deepen and the expected recovery may be postponed or perhaps even aborted. Measures that may affect the level of interest rates are therefore of crucial importance. In this regard, a policy mix in the United States that does not rely so heavily on monetary restriction and gives more weight to the control of the fiscal deficit could contribute to a significant drop in interest rates. 16/

No less important, however, are measures that could have a substantial impact on reinforcing the hoped-for recovery, particularly in increasing the rate of capital accumulation. One of the most critical issues is to ensure that, from the

14/ Even a mild recovery in industrial countries should lead to a significant increase in primary commodity prices from the unusual low levels of 1981.

15/ It must be noted that in the first half of 1981 the Executive Board of IMF adopted guidelines that allowed members to use absolute amounts of assistance 12.5 per cent larger than those available earlier, and also it established, in conjunction with the existing compensatory financing facility, a line of credit to assist members in the financing of temporary increases in the costs of cereal imports. The increased operations of IMF with developing countries led to a level of existing arrangements at the end of 1981 of about \$20 billion, as compared to \$11 billion at the end of 1980.

16/ It can be argued that a more balanced policy mix would lead not only to lower interest rates but also to less volatility in such rates and to a lower inflation rate. In effect, recent experience suggests that heavy reliance on money supply management has led to both higher and more volatile interest rates. Moreover, large - and perhaps increasing - fiscal deficits in the United States make it unlikely that inflationary expectations in financial markets will subside significantly, since persistent and substantial deficits are widely regarded as a factor likely to contribute to another upsurge of prices in the future.

present position of pervasive retrenchment in both developing and developed countries, the next phase of the cycle leads to a sustained and accelerated pace of economic growth rather than to a hesitant - and perhaps very weak - recovery. Because of its immediate effects on industrial demand and subsequent effects on productive capacity, the expansion of investment in developing and developed countries will be the decisive factor in bringing about rapid and sustained recovery.

This points to a need for actions leading to an improved investment climate. There is an important international dimension to such actions: the prevailing view of a drift in the international system of economic co-operation has to be replaced by sustained efforts and actions that leave no doubt as to the real commitment to the system.

A better trade outlook for developing countries accompanied by external financial support can be an important stimulus to public and private investment programmes, some of which may be languishing because of uncertainties regarding the recovery in industrial countries. In the developed countries, an improved investment climate depends to a large extent on a significant reduction in inflationary expectations and a lessened volatility of key parameters. Thus, actions to reduce the instability of commodity prices, to dispel uncertainties about the international trading system, and to improve consultations on and harmonization of macroeconomic policies among the larger industrial countries are international elements in bringing about the restoration of sustained and adequate world economic growth.

Primary commodity markets continue to be an important source of instability both for the foreign exchange earnings of developing countries and for international price levels; and recent changes in some of these markets may be making for greater price instability in the years immediately ahead. Growing international trade in cereals unaccompanied by action to build stocks and improve their geographical diversification, ^{17/} and enhanced dependence of international supply and demand on the domestic policy considerations of a major supplier or on the vagaries of weather in a major importer, are straining the system and aggravating the volatility of food prices. More recently, spot prices of crude oil have changed abruptly, leading to a quick reversal of expectations regarding prospects in world oil markets. There is evidence that, partly because of uncertainties regarding future prices, some important investment projects intended to increase the supply of raw materials and due to start in the course of 1982 have been postponed. If industrial recovery gathers momentum, specific shortages may be quickly encountered and prices of some raw materials may escalate sharply. There is a clear need for action that could have a positive influence in stabilizing prices. In this regard, an important step forward would be to speed up the ratification of the Common Fund.

^{17/} There has been no significant progress regarding the 1972 Wheat Trade Convention, which has been recently extended to June 1983.

Trade is another vital issue in which there is a crucial need to dispel uncertainties. The tendency towards bilateralism and sectoralism ^{18/} in trade policy is gradually eroding confidence in the system. For many investors, it is becoming much riskier to undertake long-term contracts and commitments in a climate where previously accepted rules have ceased to be reliable. Thus the reassertion of free trade principles and a more unconditional commitment to GATT rules are essential. At the GATT Ministerial Meeting in November 1982, a reaffirmation of those principles is of primary importance. However, declarations need to be borne out in action. The way Governments actually deal with currently growing protectionist pressures will be a conclusive test of their will to maintain an open world trading system.

International consultation and harmonization of macroeconomic policies can have significant benefit in reducing undesirable international repercussions of changes in domestic policies. Improved co-ordination of financial policies, particularly among the countries of North America and Western Europe, may have substantial effects in lessening the volatility of exchange rates and interest rates in international money markets. The summit meeting to take place at Versailles in June 1982 provides an important opportunity for progress in this critical area.

At this juncture, parallel action on several issues could have a very substantial cumulative impact on world investment and output. Under present conditions, the mutually reinforcing effects of actions in the area of trade, money, finance and primary commodities - including food and energy - lend greater significance to an international consideration of such actions. The scope and importance of these issues are such that consultations need to involve all the main groups of countries: North and South, East and West. The spirit of Cancún gave new hope that an enhanced process of consultation and negotiation would materialize. The opportunity is still there. What has changed since last year is the cost of inaction that must be paid by the groups that are least able to afford it: their burden has increased disproportionately.

^{18/} Sectoralism manifests itself in the fact that not only in agriculture but also in manufacturing, one production line after another - textiles, steel, shipbuilding, synthetic fibres, electronics, automobiles - has been affected by some form of intervention with protectionist effect.

Chapter II

GROWTH IN THE WORLD ECONOMY AND CURRENT POLICY STANCES

Marked deceleration of growth rates throughout the world economy

The over-all performance of the world economy in 1981 proved to be the worst since the 1974-1975 recession. Growth declined to about 1.2 per cent after having receded in 1979 and in 1980 (see table II-1). This contrasts markedly with the average 4 per cent rate of expansion attained during the 1970s. In energy-importing developing countries, the substantial output slow-down was accompanied for the second year in a row by a significant deterioration in the terms of trade. As a result, there was a fall in the per capita real income of this group of countries which in 1981 averaged between 1 and 2 per cent.

A major factor shaping developments in the world economy in 1981 was the commitment of the major developed market economies to reducing the rate of inflation through policies that in the short run have had a severe impact on aggregate output. In their plans for 1981 the centrally planned economies also embraced cautious output objectives in order to come to grips with internal and external constraints that were not fully eliminated during the preceding two to three years of moderate output growth. As a result, the prospects for world trade and, by implication, the pace of exports in the majority of developing countries, particularly those that rely heavily on primary commodity export earnings, were not encouraging. In that light, the actual downswing in global economic activity that emerged in the course of 1981 was perhaps less surprising than the depth and pervasiveness of the economic malaise, particularly the sharp deceleration of growth in the developing countries and centrally planned economies.

The present recession did not start with abruptly faltering growth as did that of the mid-1970s. Instead, the superimposition of strong anti-inflationary policies on the already declining growth pace of the major developed market economies in late 1979 and 1980 transformed the downturn into an unusually long recessionary trough that in the course of 1981 engulfed virtually all major country groups. At present there are few unambiguous signs of recovery and sustained medium-term growth, since the factors that have been inhibiting more buoyant economic activity in the developed countries are expected to last at least well into 1982. On the basis of current forecasts of economic activity for the developed market economies, over-all output growth rates for 1982 on the whole do not appear to deviate appreciably from those observed in 1981. The growth of global output is therefore not likely to surpass 2 per cent in 1982. However, the current outlook for developments in 1983 is more encouraging as global growth may accelerate to somewhat above 3 per cent.

Unlike the 1974-1975 recession, when the energy-importing developing countries were able to mitigate the impact of weak external demand on their domestic economies by running down reserves or borrowing abroad, the severe adjustment problems encountered during the current downswing made such de-linking of growth rates not feasible. Foreign exchange reserves as a percentage of imports were extremely low, and the external indebtedness of these countries had risen markedly in the past few years. Furthermore, because of weak external demand, real non-oil commodity prices fell sharply, and the terms of trade for the net energy-importing

Table II-1. World production: annual growth rates of output volume, by country groups and major sectors, 1971-1982

(Percentage)

Item and country group <u>a/</u>	1971- 1980	1976- 1979	1980	1981 <u>b/</u>	1982 <u>c/</u>	1983 <u>c/</u>
Gross domestic product <u>d/</u>						
World	4.1	4.3	2.1	1.2	1.9	3.4-3.6
Developed market economies	3.4	4.1	1.5	1.2	1.3	3.3
Developing countries	5.6	4.9	2.9	0.6	3.0	4-5
Centrally planned economies <u>e/</u>	5.4	4.7	3.5	1.9	3.2	...
Agricultural production <u>f/</u>						
World	2.3	2.3	0	3.2	...	...
Developed market economies	2.0	2.2	-0.8	2.5	...	...
Developing countries	2.9	2.5	2.4	3.8	...	...
Centrally planned economies <u>e/</u>	2.2	2.3	-0.8	1.6	...	...
Industrial production <u>g/</u>						
World	4.5	5.5	1.8	1.0	...	...
Developed market economies	2.9	5.4	0.2	0.3	...	...
Centrally planned economies <u>e/</u>	6.7	5.7	4.1	2.0	...	...

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 72 countries which jointly account for more than 90 per cent of the population and for 95 per cent of the aggregate gross domestic product of the group. Country data are aggregated with 1978 GDP weights.

c/ Forecasts based on Project LINK results for developed market economies, plan figures for centrally planned economies, and Secretariat estimates for developing countries.

d/ Net material product in the case of the centrally planned economies.

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. Data for 1981 are estimates as of December. The average annual growth rates measured over a period of 10 years 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 - (i.e. mining, manufacturing, and electricity, gas and water).

developing countries declined significantly. Finally, rising interest payments on their floating-interest external debt further exacerbated their external payments problem. In the event, these countries resorted to import-reducing policies as a means to control external imbalances. Mainly as a result of these policies, the group's over-all output growth declined markedly, and a significant number of countries sustained an unprecedented fall in industrial output.

While the average 1981 price of crude petroleum exceeded the previous year's by about 10 per cent, weakening global demand for oil contributed to a sharp decline in export volume and nominal export revenues for most of the energy-exporting developing countries. Although these countries' import volume on average continued to grow substantially, in the course of 1981 several members of the group decided to postpone a number of industrial investments in response to weakening export revenues. This policy shift started to affect import volume in the second half of the year and could have a major impact on the growth of output and imports in 1982, which in turn may affect their principal trade partners, including some net energy-importing developing countries.

Economic policies in many developed market economies in 1981 were to a large extent determined by the priority that Governments accorded to fighting inflation and to prompt further adjustment to the 1979-1980 crude oil price rises. In many countries, this effort was considerably complicated by the fiscal and monetary policies pursued in the United States of America, where extraordinarily high interest rates resulted from restriction of the growth of the money supply at a time when credit demand remained strong. This monetary stance, which aimed at reducing both expectations about inflation and aggregate demand, led to a substantial surge in the value of the dollar relative to that of most European currencies. As a result, many European market economies experienced sharp increases in the domestic prices of oil and other major imports denominated in dollars. In order to prevent further currency depreciation and another boost to the wage-price spiral, most Governments opted for prompt adjustment and chose to curb inflationary pressures even at the expense of a reduction in the pace of economic activity. In the process, unemployment in many developed market economies surged to levels unknown in the post-war period, and the socio-economic costs resulting from output foregone mounted very rapidly. Although the pace of inflation slowed down in a number of countries, particularly towards the end of 1981 and in early 1982, policy makers remain committed to combating inflation. However, there are indications that the Governments of some countries are increasingly turning their attention to designing a more varied mix of policy instruments than the measures resorted to thus far.

Policy stances in most centrally planned economies were determined mainly by external payments considerations and the need to continue adapting productive structures and consumption patterns to the shifts in the level and composition of energy costs and to reverse the persistent slow growth in total factor productivity.

In developing countries, in addition to policies geared to cope with the increasing external payments difficulties, the implementation of measures to reduce inflation also became a major concern. This led many countries to restrain credit and in certain cases to reduce fiscal expenditures.

The upturn in developing countries, at least in the short run, is linked to an improvement in the economic conditions of the developed market economies. By

contrast, in centrally planned economies much will depend on the success of policies geared to correct production imbalances. For developed market economies, the starting date and the strength of the recovery are still marked by uncertainties. Disinflation remains the central focus of policies; although price increases have eased somewhat, inflationary expectations in financial markets are still strong. Nevertheless, there is a certain consensus that the economy of the United States should begin to improve in the second half of 1982. The recovery could gather some momentum if a significant drop in interest rates were to materialize. Under such conditions, growth in 1983 for the group as a whole could be in the range of 3 to 4 per cent, which is still substantially below the rate recorded during the recovery from the recession of the mid-1970s.

Virtual stagnation in developing countries

Economic growth in the developing countries fell abruptly from about 3 per cent in 1980 to about 0.6 per cent (see table II-2), and for the first time since the late 1950s per capita output declined by more than 1 per cent. This marks the fourth consecutive year in which output growth has decelerated. The gravity of the economic situation of these countries as a group can perhaps be best underlined by comparing their current growth of about 0.6 per cent with the 5.6 per cent achieved during the 1970s and the aspiration of reaching 7 per cent in the 1980s as embodied in the International Development Strategy for the Third United Nations Development Decade.

The deceleration of economic activity was pervasive: it affected more industrialized as well as less diversified developing economies, both oil exporters and importers, small and large countries in all main economic regions. 1/ With the exception of agriculture, where strong expansion was recorded, most other productive sectors (industry and commerce in particular) performed weakly.

The gross domestic product of the net energy-exporting countries fell by 0.5 per cent in 1981. Again, the level of output was affected by the continuing military conflict between Iran and Iraq. However, even without the latter two, 2/ over-all output growth in the energy exporters declined to 3.4 per cent - about 2 points below the 1980 pace. For the capital-importing sub-group of the energy exporters, the combined rate of growth of GDP was 5.4 per cent in 1981 - somewhat below the 6 to 7 per cent achievement of previous years.

1/ Growth did not decline in each and every country, however. Thus, among the Asian countries, Hong Kong, Malaysia, Singapore and Thailand maintained high growth rates and the Republic of Korea returned to rapid growth after the sharp contraction of 1980, so that the combined product of the region as a whole may have increased somewhat more in 1981 than in 1980.

2/ It appears advisable to delete Iran and Iraq from the sample on which the estimates are based, because the abnormal state of those two economies is not representative of the course of events in the rest of the group and because of the considerable weight of the two countries in the aggregates for the group (about 80 per cent of the population and two thirds of the combined GDP of surplus countries in 1978).

Table II-2. Developing countries: rates of growth of real gross domestic product, 1971-1983 a/

(Percentage)

Country group <u>b/</u>	1971- 1980	1976- 1979	1979	1980	1981 <u>c/</u>	1982 <u>d/</u>	1983 <u>d/</u>
Developing countries	5.6	4.9	4.4	2.9	0.6	3	4-5
Net energy-exporting countries (excluding Iran and Iraq)	5.5 6.3	4.8 (6.5)	4.7 (6.8)	1.4 (5.5)	-0.5 (3.4)	...	...
Capital surplus (excluding Iran and Iraq)	4.8 7.2	2.2 (6.9)	1.9 (8.0)	-7.4 (1.7)	-10.1 (-2.7)	...	...
Other countries	6.0	6.4	6.4	6.7	5.4	4	5-6
Net energy-importing countries	5.6	5.0	4.2	4.1	1.4	3	4-5

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 II-1. Data are shown also for the whole sample excluding Iran and Iraq.

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

c/ Preliminary.

d/ Forecast.

The growth of output in net energy-importing developing countries 3/ in 1981 was reduced by about two thirds to 1.4 per cent. This is a very low rate by any standard, including performance in any of the last 25 years, and attests to the severity of the development problems encountered by these countries. Moreover, slow growth was accompanied by a very significant deterioration in their terms of trade - of the order of 4 to 5 per cent - and markedly swollen debt-service outflows, partly on account of high interest rates in financial markets. As a consequence, income per capita for the group as a whole and for the majority of its members fell significantly, in a number of cases for the second consecutive year. 4/

Apart from agriculture, where output growth exceeded trend levels, performance in the various sectors of this group of countries trailed behind expectations. For the majority of the energy importers, mining activity was depressed by weakening non-oil commodity markets. Manufacturing production also sagged markedly as domestic demand eased on account of falling per capita income levels and a sharp deceleration in government expenditures. In a number of cases, manufacturing activity also suffered from shortages of imported intermediate goods as a result of very limited growth in import volume.

A major factor behind the pervasive economic downturn in developing countries in 1981 was the current recession in the industrial countries. The recession severely curtailed world demand for commodities and other export products of the developing countries and contributed directly to the erosion of non-oil commodity prices relative to the prices of internationally traded manufactures. Furthermore, the net energy-importing developing countries had to come to grips with larger energy import bills and the sharply increased debt-servicing burden.

As a result of the tight external payments situation, the imports of most net energy-importing developing countries had to be considerably compressed. The very low growth of import volume in 1980 and 1981 (around 2 per cent on average) and the appreciable fall in per capita incomes in 1981 underline the intensive ongoing adjustment process underway in the net energy-importing developing countries. In comparison to other country groups, the net energy-importing developing countries appear to have undertaken particularly severe adjustments.

Domestic demand developments in many of these countries were to a large extent conditioned by cautious government policies, which were geared towards adjusting to inflation and external imbalances. Although some countries enacted explicit measures to combat inflation and to maintain a favourable credit standing in financial markets, the government policies of most countries were on the whole shaped by external events. 5/ Aside from the implications of stagnant or even declining export revenues, worsening terms of trade, and mounting debt-servicing requirements, the sharp rise in interest rates in financial markets constrained

3/ The population of the net energy importers was about 1.8 billion in 1981, slightly more than 75 per cent of the total population of developing countries.

4/ In 1981, per capita income appears to have fallen for 27 out of the 49 energy importers for which information is available.

5/ For a comprehensive analysis of the foreign sector, see chap. III.

trade choices and measurably complicated the management of domestic monetary policies. Many opted for credit-tightening measures and higher interest rates in order to avoid capital flight. In the majority of countries for which information is available, in 1981 credit expansion in real terms continued the decelerating trend that had been in evidence since late 1979. In some cases, credit curbs were very substantial in 1981. The real volume of credit outstanding actually contracted in about a third of the countries for which recent data are available. Although the upward drift in nominal interest rates in most countries did not always yield positive real interest rates, in several of them domestic investment activity was widely discouraged by quantitative credit restrictions and therefore could not help to offset, not even in part, the impact of stagnant or declining external demand.

The restraints on imports and the anti-inflation monetary policies had a dampening effect on the buoyancy of the modern branches of manufacturing. Especially in the emerging durable goods industry, growth faltered abruptly and pervasively. As a result of the depressed level of activity in manufacturing, open unemployment in many developing countries rose sharply in 1981 and reached unprecedented levels in several of the main urban centres. For the first time, the modern sector failed to absorb labour in productive employment. This further exacerbated the already complex structural unemployment problems endemic to most developing countries. 6/ In some countries, 7/ employment in the non-agricultural sector actually declined in absolute terms for the second consecutive year.

The most likely economic scenario for 1982 for the net energy-importing developing countries does not look promising. Both internal and external factors are working against an early resumption of more rapid growth. The current international economic environment is not likely to provide any pronounced stimulus to growth as demand for industrial raw materials and commodities is generally expected to remain weak. Further, the prospect for increased international development finance, including official development assistance, seems bleak, and this will inhibit most Governments of developing countries from adopting more expansive economic policies. Neither can encouraging recovery signs be discerned from domestic sources. In many of these countries, continuing high inflation rates, 8/ tight government budgets, and the generally low levels of foreign

6/ Increases in the rate of open unemployment in urban centres were reported for Argentina, Botswana, Brazil, Colombia, Cyprus, Hong Kong, Israel, the Ivory Coast, Malawi, Malta, Mauritania, Mauritius, the Republic of Korea, Tunisia, Yugoslavia, and most Caribbean and Central American countries. Although there are some indications that the phenomenon is more widespread, exact statistical information is lacking at this time.

7/ Including Argentina, Brazil, Colombia, Mauritius and the Republic of Korea.

8/ Despite the fact that over two thirds of 79 developing countries examined managed to reduce or at least keep constant the rate of increase in consumer prices, some 70 per cent of them still had two-digit inflation rates by the end of 1981. Moreover, for the group as a whole the GDP-weighted average rate of inflation still increased from 37.7 to 42.4 per cent, as some of the larger developing countries experienced further price acceleration.

exchange reserves are bound to retard the implementation of stimulative policies that could bolster manufacturing output. Particularly serious is the continuing depressed level of investment activity, which cannot but impair growth opportunities at least for the remainder of the first half of the 1980s.

Although the situation differs from country to country, performance in 1981 and short-term prospects are not better in energy-exporting developing countries. In spite of efforts to diversify away from oil, the net energy-exporting developing countries are still largely dependent on oil as a source of both government revenue and investment financing. The recession in industrial countries, world-wide conservation efforts, and progress in inter-fuel substitution severely compressed oil demand, and prices during the second half of 1981 declined slightly. Weak world oil markets affected especially the traditional energy-exporting countries. However, the impact on actual output levels among the latter countries was shouldered disproportionately by a few of them, partly because of their reluctance to adjust official selling prices in line with market trends.

The outlook for developing countries with a large share in world oil exports is, on the whole, worse than what it was a year ago. Since global oil consumption is likely to contract again in 1982 and the relatively new oil producers are bent on expanding production, there is likely to be a marked additional drop in demand for oil from traditional exporters. In capital surplus countries, over-all growth will remain depressed unless the protracted Iran-Iraq conflict is brought to an end.

In deficit net energy exporters, several factors may prevent a marked growth acceleration in 1982. In most of these countries, inflation rates were still rather high by the end of 1981, ^{9/} which is making Governments more cautious with regard to increased fiscal expenditures. Further, several of these deficit net energy exporters have relatively large non-oil export revenues, which, after lagging markedly in 1981, may not recover until late 1982. As some of them are already heavily indebted, their growing current account deficits are expected to result in little or no expansion of import volumes in 1982, which will in turn affect the supply of industrial inputs and over-all manufacturing activity. As a result, the substantial stimulus to international trade provided by these countries since the mid-1970s may weaken markedly, and this could dampen the pace of world-wide economic recovery.

Developed market economies: deepening recession in 1981-1982

The recession that began in the developed market economies in the second half of 1979 deepened during 1981. For the second year in a row, over-all economic

^{9/} In this group of 19 countries, most were still experiencing double-digit inflation rates by the end of 1981.

growth averaged only slightly above 1 per cent, with little prospect for better performance forecast for 1982 (see table II-3). 10/

In contrast to the near simultaneity of the slump of 1974-1975 and the ensuing recovery in the large developed market economies, the current recession was initially less synchronized. While Canada, the United Kingdom and the United States experienced declining or stagnant real output during 1980, the European market economies, Japan and Australia remained relatively buoyant, although they incurred a slow-down in growth. By contrast, in the first half of 1981, the economies of Canada, Japan and the United States showed considerable strength, while the European ones weakened markedly. In the second half of the year, however, a more synchronized downturn in economic activity appears to have taken place, and output in the developed market economies as a whole may have ceased to expand altogether.

This poor economic performance is the result mainly of the policies adopted by Governments to deal with the effects of the persistent inflation of 1975-1978 11/ and of the energy price increases of 1979-1980. In 1974-1975, the policy reaction to the first round of energy price increases was not uniform as some countries sought to compensate for the expenditure-reducing effects while others paid more attention to curbing the inflationary consequences. After the 1979-1980 increases in energy prices, however, the policy stance of Governments in most countries was generally against accommodating the inflationary effect of externally-induced price shocks, thus preventing them from being passed into the wage-price mechanism. In the process, little was done to counter the deflationary impact of the energy price increases. For most European market economies, the sharp pressure on their exchange rates during 1980-1981 resulting from higher interest rates in the United States amounted to an additional external shock. In an effort to avoid further currency depreciation and the acceleration of domestic inflation, a number of Governments resorted to restrictive monetary policies and allowed interest rates to rise steeply. While fiscal austerity and a restrictive monetary policy would in any case have been adopted in the fight against inflation, events in foreign exchange markets added considerably to the degree of restraint that was finally chosen, especially in the smaller members of the group.

In most countries targets for the expansion of monetary aggregates were adopted which were substantially below the growth of nominal income. Although the control of the monetary authorities over the total money supply is imperfect, in

10/ All forecasts for the developed market economies are derived from Project LINK on the basis of the following assumptions: (a) demand management policy will continue on the course announced up to late 1981, except that monetary policy will be eased moderately and the average nominal interest rate for the group will decline by 2 percentage points over the preceding year's level (implying a 3 per cent drop in the United States' prime rate); (b) oil prices will decline in 1982 by 5 per cent in nominal terms and remain constant in real terms in 1983; and (c) there will be further exchange rate fluctuations chiefly to compensate for differential inflation rates and shifts in current account balances.

11/ It is important to recall that inflation in the United States had started to accelerate already in mid-1978, or well before the second oil shock.

Table II-3. Developed market economies: rates of growth of real gross national product/gross domestic product, a/ 1976-1983

(Average annual and annual percentages)

	1976-1979	1980	1981 <u>b/</u>	1982 <u>c/</u>	1983 <u>c/</u>
Developed market economies	4.1	1.5	1.2	1.3	3.3
Major industrial countries	4.4	1.3	1.5	1.3	3.5
Canada	3.6	-	3.0	1.0	3.2
France	3.9	1.7	0.8	3.4	4.1
Germany, Federal Republic of	4.0	1.8	-0.4	1.7	3.4
Italy	3.8	4.0	-1.0	1.2	2.8
Japan	5.3	4.2	3.1	3.4	3.3
United Kingdom	2.4	-1.4	-2.7	1.2	2.6
United States	4.7	-0.2	2.0	-0.4	3.7
Other countries	2.7	2.4	0.5	1.4	2.7

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

a/ Gross national product for Belgium, Canada, the Federal Republic of Germany, Iceland, Japan, the Netherlands, Switzerland and the United States; 1978 GNP/GDP weights and exchange rates.

b/ Preliminary estimates.

c/ Project LINK forecasts.

most major countries the average increase in the money supply 12/ tended to fall beginning in 1979, at a time when a major acceleration in inflation was under way. In real terms, the money supply actually contracted throughout the period 1979-1981 in virtually all major countries.

Fiscal policies have also been generally tightened. Although the majority of Governments introduced programmes to reduce budget deficits and restrain the growth in the size of the public sector, 13/ the recession and downward rigidity in many types of expenditures impeded achievement of these goals. Weak economic activity caused the revenues of the public sector in most countries to expand at an appreciably slower pace than anticipated. At the same time, the rise in unemployment activated automatic stabilizers, such as transfer payments and unemployment benefits, which led to substantial increases in expenditures. Moreover, deficits were exacerbated by the impact of high interest rates on Government debt-service requirements.

Although public deficits in 1980 and 1981 were not compressed by as much as anticipated, fiscal policies can still be categorized as comparatively tight. In the period 1979-1981, government budget deficits in the major industrial countries 14/ expanded only slightly, and deficits as a percentage of GNP were considerably below the levels that emerged in the mid-1970s (see table II-4). After adjusting for the effect of cyclical built-in stabilizers, discretionary budgetary changes introduced in 1981 had a deflationary impact on aggregate demand in all major industrial countries, except France and Italy. The average deflationary effect was of the order of 1 per cent of GNP for the seven major countries. 15/ None the less, budgetary deficits were large and, in the context of a restrictive monetary environment, government borrowing tended to compete with the private sector for funds and contributed to a sharp upward movement in interest rates.

12/ The money supply on which the above observations are based is defined as money plus quasi-money (M2). These figures do not give a complete picture of monetary conditions in the major countries, since M2 does not include a number of liquid assets (e.g. money market funds) or some types of deposits (e.g. non-bank Euro-currency deposits, which account for about 6.5 per cent of the aggregate money supply in the developed market economies) which have grown very rapidly in recent years. Conclusions derived from these money supply data should therefore be treated with caution.

13/ France, New Zealand and Spain are important exceptions in this regard.

14/ As examined in more detail below, movements in government deficits of the major industrial countries differed considerably from what appears to have occurred in the smaller countries.

15/ Organisation for Economic Co-operation and Development, Economic Outlook, No. 30 (December 1981), p. 25.

Table II-4. Developed market economies: central government budget surpluses or deficits (-) as percentages of GNP

	1973	1974	1975	1978	1979	1980	1981 <u>a/</u>
Major developed market economies							
Canada	-1.4	-1.1	-3.8	-4.5	-4.0	-3.5	-2.0
France	0.7	0.3	-3.0	-0.8	-0.1	-0.0	-2.0
Germany, Federal Republic of	-0.3	-1.0	-3.3	-2.0	-1.9	-1.9	-2.6
Italy	-8.9	-8.1	-13.2	-15.4	-11.1	-11.0	-14.0
Japan	-1.6	-1.3	-4.8	-6.6	-5.4	-3.5 <u>a/</u>	-3.0
United Kingdom	-3.2	-4.1	-7.5	-5.1	-5.4	-4.9	-4.0
United States	-0.6	-0.8	-4.9	-2.0	-1.2	-2.6	-1.6
Smaller developed market economies							
Australia	-2.2	-1.1	-6.3	-3.6	-3.0	-1.9 <u>a/</u>	-1.0
Austria	-1.3	-1.9	-4.7	-4.2	-3.5	-3.3	-2.5
Belgium	-2.9	-2.8	-4.7	-6.0	-6.5	-8.7	-12.0
Finland	1.7	1.1	-2.3	-1.6	-3.0	-2.3	-1.5
Greece	-2.2	-3.1	-3.8	-3.6	-4.0	-3.4	-7.5
Ireland	-6.3	-11.7	-13.3	-13.4	-14.3	-15.0	-20.0
Netherlands	0.3	-0.6	-3.1	-3.3	-4.6	-4.8	-6.0
Spain	-0.7	-1.5	-1.9	-2.4	-3.0	-2.5	-2.7
Sweden	..	-3.1	-2.5	-5.0	-7.3	-8.4	..
Switzerland	-1.1	-0.6	-1.2	-0.0	-1.4	-0.0	-0.2

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

a/ Preliminary figures based on partial data.

The generalized rise in interest rates to record levels, in both nominal and real terms, was a peculiar feature of the current recession (see table II-5). The policies adopted to deal with accelerating inflation were largely responsible for the rise in interest rates. In addition, changes in the conduct of monetary policy in the United States in late 1979 and the responses to the effects of these policies by the Governments of other major countries resulted in substantially greater volatility of interest rates and probably accentuated their upward trend. As shown in table II-5, with the exception of Switzerland and the United Kingdom, real interest rates - nominal rates deflated by changes in consumer prices - peaked in 1981.

As part of a general anti-inflation policy of restraining the growth of money and credit, in October 1979 the Federal Reserve Board announced a new strategy for controlling the monetary aggregates by putting greater emphasis on managing the supply of non-borrowed bank reserves rather than trying to control short-term interest rates. Immediately thereafter, these rates started a sharp upward trend, albeit with significant fluctuations. 16/ During the fourth quarter of 1981 both short and long rates tended to retreat somewhat, mainly owing to a pronounced slackening of economic activity. However, in spite of over-all weak economic conditions, both real and nominal interest rates remained high. 17/

In order to limit the currency depreciation that materialized in response to upward interest rate movements in the United States, a number of European countries, particularly the Federal Republic of Germany, raised the interest rates under their policy control and generally tightened monetary policy so as to support higher borrowing costs than those considered adequate from the point of view of the state of their domestic economies. Japan is an exception to the general trend as the successful containment of inflationary pressures in 1979-1980 and the rapid turnaround in the current account balance permitted the authorities to ease monetary policy in order to support domestic demand. As a result, nominal rates started to decline in mid-1980; none the less, the fall in nominal interest rates has been less rapid than the decline in the rate of inflation.

The rise in interest rates, which coincided with a cyclical downswing in both the United States and Europe, was partly responsible for the depth of the recession on both sides of the Atlantic. The sharp rise in rates had particularly adverse

16/ In the United States, short-term interest rates were heavily influenced by expectations regarding the future course of monetary policy. When weekly money supply figures are above the Federal Reserve's targets, market participants anticipate a more restrictive monetary environment, and interest rates tend to rise.

17/ Strictly speaking, the nominal interest rate tends to equal the sum of the real interest rate and the expected rate of inflation. Actual inflation rates are therefore not fully accurate measures to use. There is some evidence that expected inflation rates have recently exceeded actual ones, which would imply that real interest rates are actually below their measured magnitudes as reported in table II-5.

Table II-5. Major industrial countries and Switzerland: commercial bank lending rates to prime borrowers, end of period, 1978-1981

(Percentage)

	Canada	France	Germany, Federal Republic of	Italy	Japan	United Kingdom	United States	Switzerland
<u>Nominal rates</u>								
1978 December	11.50	9.80	5.50	15.00	4.50	13.50	11.75	5.00
1979 September	13.00	12.50	8.25	15.00	5.68	15.00	13.50	5.00
December	15.00	12.50	9.75	19.50	6.51	18.00	15.25	5.00
1980 March	16.50	14.65	10.50	19.50	7.70	19.00	19.50	5.50
June	13.25	14.15	11.50	19.50	9.27	17.50	11.50	5.75
September	12.25	13.90	11.50	21.00	8.85	17.50	13.00	5.75
December	13.25	12.25	11.50	20.50	8.16	15.00	21.50	5.75
1981 March	17.75	13.75	13.75	22.50	7.74	13.00	17.00	6.50
June	20.00	15.90	14.25	21.50	7.10	13.00	20.00	7.00
September	21.25	15.30	14.25	21.50	7.20	14.00	19.50	8.00
December	16.50	14.00	13.00	22.50	7.00	14.50	15.75	8.00
<u>Nominal rates deflated by consumer prices a/</u>								
1978 December	2.8	0.1	3.0	3.1	0.9	4.7	2.4	4.3
1979 September	3.2	1.3	3.1	-0.7	2.5	-1.3	1.2	0.1
December	4.8	0.7	4.1	0.5	0.7	0.7	1.8	-0.2
1980 March	6.5	0.9	4.5	-1.0	-	-0.7	4.2	1.6
June	2.8	0.6	5.2	-1.2	0.6	-2.9	-2.4	2.4
September	-1.4	0.2	6.1	-0.3	-0.2	1.4	0.3	1.9
December	6.3	-1.3	5.8	-0.7	0.7	-0.1	8.1	1.3
1981 March	4.7	1.1	7.8	3.3	1.4	0.3	5.8	0.2
June	6.4	2.6	8.2	1.8	2.4	1.5	9.5	0.6
September	7.7	1.2	7.2	2.4	3.2	2.3	7.7	0.5
December	4.0	-	6.3	5.2	2.6	2.2	6.3	1.3

Source: For interest rates, Morgan Guaranty Trust Company, World Financial Markets (New York); for consumer prices, International Monetary Fund, International Financial Statistics.

a/ Nominal rates were deflated by the increase in consumer prices between the month in question and the same month of the preceding year.

effects on credit-sensitive activities such as consumer durables, housing and inventory accumulation. Continued high rates are now delaying the recovery. Given current policy stances, the outlook for an appreciable abatement in the cost of borrowing is not very reassuring.

For the seven major industrial countries, real private fixed investment and residential construction virtually stagnated between 1979 and 1981. Public expenditure also exhibited little growth in real terms during 1980-1981, mainly owing to the stance of fiscal policies. Whatever demand growth there was came from private consumption and exports. The increase in private consumption was none the less very modest, owing to stagnation in real personal incomes, high interest rates which discouraged spending on consumer durables, and consumer uncertainty stemming from expectations of persistently high rates of inflation. Exports to the energy-exporting developing countries were buoyant and helped to sustain the level of aggregate demand.

The impact of the global recession on employment in developed market economies was very drastic: the average unemployment rate reached 8 per cent by the end of 1981, as compared to slightly over 5 per cent in 1979. ^{18/} This upswing in the rate occurred in virtually all developed market economies, but tended to be most pronounced in the smaller European countries, where it soared to between 9 and 11 per cent - well above the levels experienced during the post-war period. In fact, unemployment has become so acute a phenomenon in many of these countries that Governments may soon feel impelled to shift policy priorities in favour of job-creating programmes. In some countries (including Belgium, France, the Federal Republic of Germany and Spain), the reliance of Governments on and their confidence in the effectiveness of anti-inflation policies that raise unemployment have recently been weakening. However, only France has most clearly put the promotion of employment, primarily in the public sector, in the forefront of its economic policies. The adoption by a major industrial country of a programme specifically designed to foster employment and the current debates concerning the inauguration of new job-promoting programmes in several other European countries indicate that policy makers are allocating increasing importance to the issue.

One of the results of rapidly rising levels of unemployment has been a slackening in the rates of wage increases. In a number of countries, particularly the United Kingdom and the United States, wage settlements have come down significantly. In addition, labour unions have agreed to re-open ongoing labour contracts, scale down already-negotiated future pay increases and even reduce some fringe benefits. This implies that inflation rates should be slackening over the short term. In late 1981 a marked tendency towards lower rates of consumer price increases appeared in most countries. As can be seen in table II-6, the upward trend in consumer price inflation of recent years was halted in the second half of 1981. Since the prices of imported raw materials are expected to continue to weaken in 1982 and interest rates may also decline from the levels reached in 1981, consumer price increases may well slacken further by a couple of percentage points. Nevertheless, in spite of severe and growing unemployment, on average inflation rates are unlikely to decline to levels much below those experienced in 1978.

^{18/} In the decade before 1973, the average unemployment rate fluctuated around 3 per cent. The 1974-1975 downturn lifted it to over 5 per cent, which was not significantly reduced during the subsequent recovery.

Table II-6. Developed market economies: rates of change
in consumer prices, 1978-1981
(Percentage)

	Developed market economies	Major industrial countries	Other countries
Change from preceding year:			
1978	7.1	6.7	8.9
1979	9.2	9.2	9.0
1980	12.1	12.2	11.3
1981	10.2	9.9	11.7
Change from preceding half year, at annual rate:			
1980: First half	13.4	13.7	11.9
Second half	10.1	9.9	10.7
1981: First half	10.5	10.1	12.6
Second half	9.7	9.4	11.2

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

The recent performance of the smaller developed market economies 19/ suggests that they were particularly affected by the global slow-down. Since most are very trade-dependent economies, 20/ their vulnerability to outside events appears to have rendered their current economic problems perhaps even less tractable than those facing the large developed economies.

With the exception of Norway, which is the only net oil exporter of the group, the smaller developed market economies experienced a substantial deterioration of their terms of trade in 1979-1981 ranging between 5 and 15 per cent, with the sharpest movements prevailing for those most dependent on imports of primary goods and on exports of manufactures. These changes were equivalent to between 2.2 and 9.2 per cent of income in 1981. For many smaller countries this adverse movement entailed a further rise in the share of imports in GNP. 21/ Their dependence on international specialization made them particularly vulnerable since their imports could not be compressed as quickly as the fall in their exports. As a result, the current account deficits of these countries soared during the most recent recession, and swings in the size of the external deficit relative to GNP substantially exceeded those of the major countries. 22/

The magnitude of government expenditures relative to aggregate claims on resources rose to generally much higher levels in the smaller countries than in other market economies. 23/ On the other hand, government receipts sagged. Accordingly, in many of the smaller countries, particularly those with comprehensive

19/ Both in terms of growth and unemployment rates, since 1976 the smaller countries have fared much worse than the larger industrial countries. Their annual average growth rate was more than 1 percentage point below that of the major countries and levels of unemployment in 1980-1981 exceeded those of the major industrial countries by several points.

20/ Whereas in the major industrial countries the ratio of exports to GNP is invariably below 30 per cent (in Japan and the United States it is actually less than 15 per cent), it is up to nearly twice that in the smaller countries. In fact, the ratio is below 30 per cent only for Australia, New Zealand and Spain. As an illustration, export values of the world's largest (the United States) and third largest (Japan) trading nations in 1980 were only 3.5 and 2 times, respectively, the value of Belgium's exports.

21/ Only Luxembourg and Norway recorded an unambiguous fall in the import ratio between 1973 and 1980.

22/ Whereas in the aggregate their current account was in surplus in 1973 by about 1 per cent of GNP, in 1981 it was in deficit to the tune of nearly 3 per cent - well above the size of the deficit during the recession of the mid-1970s. The seven major industrial countries, on the other hand, had a surplus of 0.2 per cent of GNP in both 1973 and 1981.

23/ Whereas in the larger countries, this share amounted to about 37 per cent in the late 1970s, for the small European countries it reached 44 per cent. Belgium, Ireland, the Netherlands, Norway and Sweden either approached or surpassed the 50 per cent mark.

social programmes (including Belgium, Ireland and Sweden), the share of public deficits in over-all demand during the two recent recessions generally surpassed those of most large countries. ^{24/} While the latter on the whole improved their budget positions between 1975 and 1978, public deficits in several smaller economies (including Belgium, Spain and Sweden) deteriorated as unemployment continued to rise after 1975. ^{25/} The recession of the early 1980s led to further outlays, which in turn increased the share of government spending in GNP. Many countries eschewed raising extra tax or social security revenues to close the budget gap for fear of giving further impetus to rising labour costs and of discouraging work incentives, investment and exports.

The increase in public deficits has raised questions whether government social and other programmes will have to be compressed and tax revenues raised in the near future. Unlike the policy choices made in the mid-1970s, under the prevailing circumstances Governments have sought to avoid any broad demand stimulus or large subsidy programmes to declining industries. Instead, they have focused on alleviating the effects of the recession, while allowing the restructuring of industry to proceed with little interruption. In the short run, therefore, a substantial revival in economic activity of the smaller developed economies can be expected only from the foreign sector, or in other words from an economic upswing in the major industrial economies.

Forecasts of the level of economic activity in 1982 show recession in the first half of the year, with negative growth in the United States and only a modest recovery in the European countries. ^{26/} Under the assumption that recessionary conditions will cause interest rates to decline somewhat and thereby re-activate private residential construction and the purchases of durable goods, output growth may accelerate in the United States in the second half of the year. In addition, a relatively expansionary fiscal policy may help to boost demand. In Europe, the recovery is expected to be led by inventory re-stocking and net exports. The sharp depreciation of European currencies experienced in 1981 should stimulate exports and discourage imports. Final demand is expected to strengthen gradually in the second half of 1982 and into 1983. In Japan, a moderate strengthening in domestic demand is anticipated to coincide with substantially lower export growth in both 1982 and 1983. As a result, the growth of aggregate output is expected to remain at around 3 per cent.

All in all, prospects for a full recovery appear to be weak at this point. The projected growth rates for the developed market economies for the second half of 1982 and for 1983 are considerably lower than the average rate recorded in 1976, the first full year of recovery from the recession of the mid-1970s. While

^{24/} Except Italy and the United Kingdom.

^{25/} The rate of unemployment in the smaller countries, which was 2.4 per cent in 1973, soared to 8.3 per cent in 1980 and 9.8 per cent in 1981. In the larger countries, where unemployment reached 3.3 per cent in 1973, the corresponding rates for 1980 and 1981 are 5.7 per cent and 6.5 per cent, respectively.

^{26/} Except France, where expansionary fiscal policies are expected to lead to above-average growth.

interest rates may decline from their 1980-1981 record levels, they will remain high in real terms, thus discouraging fixed investment and preventing a full rebuilding of inventories and a complete revival of the housing industry. Moreover, the prospects for strong export-led growth are considerably less reassuring than in 1975-1976, since the recovery expected in 1982-1983 will probably be weakly synchronized, with the large economies exhibiting only moderate over-all output gains. Exports to the energy-exporting developing countries are unlikely to be as strong as in the recent past, since many of those countries are now experiencing large current account deficits and their imports are not expected to show very significant gains.

These forecasts embody several risks and uncertainties. Perhaps the greatest uncertainty derives from the response of interest rates in the United States to the current mix of fiscal and monetary policies. If no further changes are made in fiscal policies, the government budget is likely to impart considerable stimulus to demand. Personal income tax rates were reduced by 5 per cent at the beginning of fiscal 1982 (1 October 1981-30 September 1982), with further reductions of 10 per cent each slated for 1 July 1982 and 1 July 1983. Increased depreciation write-offs for businesses have also been introduced. On the expenditure side, while many social programmes have been drastically pared and additional cuts are likely, large increases in military spending were approved by Congress. The combined impact of these policies will probably be a substantial increase in the government deficit. If monetary policy is not eased, interest rates could remain at high levels or even increase, and other countries may be compelled to maintain high interest rates also. This could postpone the recovery by another 6 to 12 months and, accordingly, growth rates in 1982 and 1983 may be lower than in the forecast presented above.

Another imponderable is the response of policy makers to the growing level of unemployment. The recovery is not likely to be strong enough to curb unemployment. In fact, the unemployment rate is expected to rise further in 1982 to 8 per cent for the developed market economies as a whole, and only a slight decline is likely in 1983. As the number of unemployed approaches 30 million, policy makers may come under pressure to follow less restrictive policies or to take protective measures to bolster industrial employment. In the first case, economic activity may experience a revival, the strength of which would depend on the degree of fiscal and monetary stimuli. As noted above, the baseline forecast assumes continued stringency in fiscal policy (except in the United States and France) and a moderate easing of monetary policy. However, if the protectionist option is taken and policies fail to bring down interest rates significantly, there is a danger that the recession could turn out to be the sharpest and most protracted downswing in economic activity since the 1930s.

Further weakening of economic activity in the centrally planned economies

Over-all economic growth in the European centrally planned economies 27/ in 1981 further receded to 1.7 per cent (see table II-7) - about one percentage point

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

below the already uncharacteristically sluggish average 2.5 per cent for the two preceding years. The planned mild recovery to 3.2 per cent from last year's modest performance could not be attained. The dispersion in country performances, which in 1980 extended well beyond the already broad band recorded in 1979, further widened; it ranged from a 13 per cent drop in over-all output in Poland to a 5 per cent growth in the German Democratic Republic - the only country that reached its over-all target. In the USSR, growth declined by half a point below the previous year's weak recovery. Another year of disappointing or poor harvests in most countries contributed to below-plan performance. However, industrial expansion in some countries was the slowest, for the entire post-war period and other countries reported only modest progress in industrial branches - including energy, heavy metallurgy, and construction materials - not directly affected by the course of events in agriculture.

Table II-7. Eastern Europe a/ and the Union of Soviet Socialist Republics: basic economic growth indicators, 1976-1982
(Average annual and annual percentages)

	1976- 1980	1981- 1985 <u>b/</u>	1979	1980	1981 <u>c/</u>	1982 <u>b/</u>
Net material product	4.1	3.5	2.3	2.7	1.7	2.8
Industrial gross output	4.8	4.5	3.7	3.4	2.1	4.2
Agricultural gross output	1.0	2.5 <u>d/</u>	-1.8	-2.9	-0.9	4.7
Gross fixed investment	3.3	1.2 <u>d/</u>	0.2	0.7	0	0.7
Export volume	5.9	...	5.6	2.2	-3.1	...
Import volume	4.4	...	2.1	2.8	1.3	...

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

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

b/ Plan targets.

c/ Preliminary estimates based on plan fulfilment reports.

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

As formulated in the 1981 national economic plans of the European planned economies, which were set within the context of current medium-term growth policies, 28/ Governments sought to maintain slow growth of aggregate domestic claims on resources and to bolster exports within the bounds set by stringent import constraints and without compromising the stated need to protect attained levels of consumption. The plans embodied a slight acceleration of industrial activity and assumed recovery in agriculture from the abnormal decline of some 3 per cent in 1980, but no return to the fast growth experienced in the 1970s could realistically be envisaged.

This restrained policy stance of consolidation and structural adjustment was adopted in part because the environment for sustained strong growth did not appear to be very promising. For most European planned economies, it has become necessary to come to grips with less favourable growth conditions brought about by among other factors, slowing labour force growth, major shifts in relative real costs, and intense competing claims on resources. Furthermore, these structural changes have to be accommodated at a time when the prospects for export promotion are not at all encouraging in the near to medium term on account of likely external demand developments and severe limitations on the expansion of fuel and raw material output in the area of the Council for Mutual Economic Assistance.

In view of the above circumstances, policy makers opted for a further deceleration of economic activity in the short run. This policy choice had its most severe impact on investment expenditures. The average annual growth rate in investment of roughly 1 per cent reported for 1979-1981 contrasts markedly with the 8.2 per cent rate attained in 1971-1975 and even the 3.3 per cent rate in 1976-1980. The prospects for a fast turnaround in investment activity, which could provide a stimulus to sustained growth, are not at all bright.

The faltering pace of investment activity during the past three years or so, while permitting a sharp curtailment of imports, further limited and, in some countries, delayed the implementation of structural adjustments and also inhibited the swift expansion of capacities in fuel and raw material production, transportation and power generation. 29/ The planned reduction in investments in 1981 was exceeded in several of the European economies when, in the course of plan implementation, it became desirable, mainly for social reasons, to cushion further the impact of slow growth on consumption. The 1981 achievements and the targets of the 1982 plans are therefore generally below the already modest growth rates envisaged in the current medium-term plans. It appears, therefore, that the process of consolidation and adjustment to foster productivity growth and to overcome the growth inhibitions stemming from the highly material- and energy-intensive production structure of most of these countries will be stretched out far longer than originally envisaged.

28/ The broad policy targets of the current medium-term plans (1981-1985) and their implications for developments within the group as well as for interaction with the rest of the world economy are discussed in greater detail in the supplement to the present Survey.

29/ These capacity limitations were powerful factors underlying the slow-down in economic activity during the past three years or so.

The broad policy objectives underlying the 1981 plans appear to have been adhered to rather closely. Nevertheless, performance for the group as a whole lagged behind plans partly because of two different sets of unforeseen conditions that manifested themselves in the course of plan implementation.

First, the results for the group as a whole were influenced by events in Poland, 30/ where both national income and industrial production plummeted by roughly 13 per cent - an unprecedented contraction. Furthermore, unlike the previous year when output shortfalls in Poland had only a marginal impact on the implementation of intra-CMEA trade contracts, in 1981 the spill-over effects on economic activity in several CMEA partner countries were considerable. Under the prevailing taut external situation and the adjustment procedures embedded in the CMEA co-operation mechanisms, Poland's largest trading partners found it impossible or very costly to replace shortfalls in committed deliveries of basic fuels (hard coal and coke in particular), 31/ industrial raw materials (including copper and sulphur), and foodstuffs with supplies from outside sources. For components, spare parts and other semi-manufactures contracted for in the context of intra-CMEA specialization arrangements, substitute procurements from other sources could not be found on short notice. Although the absolute volume of planned shipments that Poland could not honour was small in comparison to over-all demand in the affected partner countries, it nevertheless proved to be cumulatively disruptive and hence had adverse effects on output levels in other CMEA countries.

Secondly, the over-all production plans of several countries were pushed off course by acute shortages of primary and intermediate industrial inputs, owing to sluggish output growth in basic sectors, export priorities, and pronounced import restraints, and by further setbacks in agriculture, which in turn called for larger imports of foodstuffs and food grains than had been envisaged. The attainment of key industrial targets was hampered in particular by shortfalls in fuel production in a number of countries other than Poland 32/ and generally weak growth in the primary good sectors. 33/ To some degree, the above trends corroborate the policy target to reduce the energy- and material-intensity per unit of output. However, in the short run absolute consumption levels in most countries of the group could apparently be lowered only by holding down activity in the consuming sectors,

30/ Poland's share in Eastern Europe's aggregate output is over one-fifth; for Eastern Europe and the USSR combined, Poland accounts for about 7 per cent.

31/ For example, Poland's exports of coal to the CMEA countries declined from 20 million tons in 1979 to 12 million in 1980 and apparently barely reached 4 million tons in 1981, although the original trade agreements for 1980 and 1981 had forecast levels comparable to those of 1979. Over-all exports of coal dropped to 15.2 million tons in 1981 - less than one third of the 1979 export volume.

32/ The output of primary fuels (petroleum, natural gas and coal) further receded in Eastern Europe as a group by an estimated 8 per cent and increased by less than 2 per cent in the Soviet Union, thereby further lengthening the period of successive volume declines that started in 1977.

33/ For example, the output of basic construction materials and metals appears to have contracted in 1981 after stagnating in 1980 and declining in 1979.

although a few CMEA members reported satisfactory progress in the implementation of conservation measures. 34/ In other countries conservation efforts were less successful. Since import constraints also kept imports down, shortages of industrial inputs were a deterrent to growth in user sectors. 35/

The Asian centrally planned economies 36/ as a group also attained only moderate output growth, and no quick return to the rates prevailing during the 1970s appears to be in the offing. But results varied considerably between the doubling of the growth pace to over 7 per cent in Mongolia (owing to buoyant industrial activity and a mild recovery in agriculture) and Viet Nam's modest 2 per cent (resulting largely from stagnation in agriculture), which did not even suffice to keep pace with population growth. China's aggregate output expanded by about 3 per cent - 2 points behind the plan target and last year's performance. While the country enjoyed the benefits of near-record grain harvests and strong industrial crops (including cotton, oil seeds and sugar), poor livestock output levels compressed aggregate growth in agriculture to 2.5 per cent. Activity in other sectors dropped markedly, especially in industry, where growth in 1981 receded to only 1.2 per cent. The output of heavy industry was slated to decrease by 5 per cent, but achievement was about 7 to 8 per cent behind last year's level. The sharpest cutbacks were encountered in machine-building, metallurgy and primary fuels.

Economic performance in China was pervasively affected by the ongoing adjustment policies that continue to impinge upon both current plan formulation and implementation and longer term structural policies. 37/ Although the various adaptations contemplated or experimented with have not so far been fully integrated into a coherent strategy for economic recovery, the adjustment process that initially had been scheduled for completion by 1982 is expected to continue to shape developments throughout the first half of the 1980s. The austerity measures of 1981 resulted in a curtailment of the budget deficit to one fifth that of the preceding year, a reduction by one half in the increase in retail prices to about 3 per cent, and the elimination of the external deficit. While the European planned economies were concerned primarily with enhancing the movement of labour into the more dynamic economic sectors, China has recently been confronted with the prospect of being unable in the short run to absorb a significant share of the new

34/ For instance, the German Democratic Republic reduced the consumption of energy, raw materials, and intermediate inputs per unit of output by 5 per cent in 1981 (Neues Deutschland, 16-17 January 1982).

35/ Czechoslovakia, for example, could not reach its conservation targets and deliberately scaled down output in user sectors in preference to cutting exports or resorting to additional imports.

36/ China, Democratic People's Republic of Korea, Mongolia and Viet Nam.

37/ Current policies seek changes in at least four different areas: a shift in growth priorities from heavy industry to agriculture and consumer manufactures, the curtailment of investment activity in an effort to cushion the adverse effects of economic stabilization on consumption, intensification of international trade and attainment of a balanced central budget.

entrants into the labour force. 38/ To foster employment and to alleviate at the same time the burden of guaranteeing a job to every able-bodied adult in the public sector, in October 1981 the Government adopted bold and wide-ranging measures designed to enhance self-employment, especially in the private and co-operative sectors. It is expected that henceforth significant new outlets for entrants to the labour force may emerge.

Developments in and the growth policies of the planned economies are unlikely to change significantly in the next two years or so. Balance-of-payments difficulties are likely to continue to be major determinants of output and consumption growth, as well as of policy stances. These conditions preclude buoyant activity in both the Asian and the European centrally planned economies, although perhaps not to the same degree.

Forecasts for the Chinese economy are dominated by the restrictions on government expenditures and domestic credit underlying the country's decision to seek further adjustments and stabilization in 1982. Over-all output growth is targeted at 4 per cent - slightly above the 1981 achievement - on the basis of an anticipated moderate recovery in heavy industry, mildly expansionary investment policies, and 4 per cent growth in both industry and agriculture. A recovery in energy output would bolster China's prospects by providing industrial inputs as well as foreign exchange. The other members of the group are aiming at buoyant output growth on the strength of rapid expansion in agriculture and steady industrial progress.

Low to moderate growth rates are embedded in the economic plans of the European countries for 1982. Poland's uncertain socio-economic situation dictates at best austere economic policies in the near future. Retrenchment is a common theme in the plans of the other European countries also. Since the volume of investments is planned to expand by less than 1 per cent, the opportunities for undertaking the rejuvenation of the capital stock in the productive sectors will be limited. Economic conditions in the Eastern European countries in 1982 will also be complicated by the further deterioration in intra-CMEA terms of trade for energy importers. Moderate to poor crops in 1981 will strain import policies and therefore investments. A major concern in all countries is restoring balance in important consumer markets, foodstuffs in particular, which were under considerable pressure in 1981. 39/ The situation in several countries will be further constrained by more limited imports of crude oil from within the region than the

38/ The anticipated increase in the non-agricultural labour force in 1981 amounted to some 10 million, but the socialized sector could absorb less than three quarters of that number.

39/ Some Eastern European countries resorted to various measures to curtail consumption (including rationing of major staples, anti-hoarding laws, and prohibition of private food exports).

volumes originally anticipated on the basis of the current medium-term intra-CMEA trade agreements. 40/

Although the majority of the planned economies remain committed to trade intensifications, conditions in 1982 appear to be such that volume increases will be quite limited for foreign exchange reasons in the case of the net energy-importing planned economies and mainly because of severe short-term output constraints in the case of China and the USSR. These countries as a group are therefore unlikely to provide a stimulus to world demand.

Agricultural production: improved over-all performance

Global agricultural and food production in 1981 rose by 2.5 and 3 per cent, 41/ respectively, thus exceeding the average growth recorded in the last decade (see table II-8) and halting the decline in per capita output levels of the preceding three years that resulted from stagnant production volumes. However, per capita gains remained marginal at best and did not significantly deviate from trends, which averaged 0.5 per cent per year for agriculture and 0.6 per cent for food during 1970-1980. The significant above-trend gain in world crops of some 4 per cent, which was well exceeded by growth in cereals, signalled a welcome turnaround of the 1980 production decline, but was too small to return per capita output to the levels prevailing in 1979.

While the advance in agriculture and food production was widespread and encompassed all major country groupings of the world economy, it was most conspicuous in the developing countries. However, there was considerable variation in the performance of individual countries and the over-all gains for the developing countries centred largely in Latin America and the Far East, while per capita agricultural production in Africa in particular stagnated and total food production even declined marginally. Among the centrally planned economies, agricultural and food production rose above previous levels, in spite of the fact that output remained constant in the European countries, and therefore did not regain the levels attained in the late 1970s. On a per capita basis, a further decline was incurred especially by the Soviet Union, where for the third

40/ Some countries are curtailing external procurements in order to forestall aggravating their intra-CMEA trade deficits, but others are adjusting to regional output constraints. For example, Czechoslovakia will reduce imports of standard fuel in 1982 by 2.6 million tons below the 1980 level and by even more in subsequent years (Rudé Právo, 27 January 1982). This includes a minimum 10 per cent reduction in crude oil imports. Since Czechoslovakia obtains nearly 100 per cent of its petroleum imports from the USSR, the envisaged conservation will have a favourable effect on the country's regional balance of payments.

41/ These growth rates were computed from the whole integer indices prepared by FAO. They should therefore be treated only as approximations to the actual rates.

Table II-8. World food production, 1970-1981: indices and trends

(1969-1971 = 100)

Country group	Total food production <u>a/</u>			Per capita production				
	Growth trend <u>b/</u>	1979	1980	1981	Growth trend <u>b/</u>	1979	1980	1981
World	2.4	125	125	128	0.6	106	104	105
Developed market economies <u>c/</u>	2.1	121	121	123	1.3	113	112	113
North America	2.5	126	122	132	1.7	117	112	120
Developing <u>a/</u>	3.0	128	132	137	0.5	102	102	104
Africa	1.7	114	119	121	-1.2	88	89	88
Latin America	3.6	136	140	145	0.9	107	107	108
Near East	3.3	134	136	137	0.6	105	103	101
Far East	3.1	127	132	139	0.7	102	103	107
Centrally planned economies	2.3	126	124	126	0.9	111	108	109
Asia	3.1	136	136	140	1.5	118	116	119
Eastern Europe and USSR	1.7	118	116	116	0.9	110	107	106

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

a/ Food production covers all agricultural commodities that are considered edible and contain nutrients. In addition to non-food agricultural products, such edibles as coffee and tea are excluded because they have little nutritive value.

b/ Average annual growth rate for 1970-1980, obtained as the slope of a regression line fitted to the data.

c/ Including Israel.

d/ Excluding Israel. The FAO regional grouping used in the table is as follows: "Africa" excludes South Africa, Egypt, the Libyan Arab Jamahiriya and the 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, the 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.

consecutive year performance was below plan levels, and cereal production trailed at least 60 million tons behind plan targets. 42/

While food output gains in the developing countries approximated the 4 per cent level called for in the International Development Strategy for the Third United Nations Development Decade and increased per capita output levels above those at the beginning of the 1970s, this was only marginally so. In fact, in a number of developing countries per capita food production in the past four years continued to be below the level observed in the benchmark years. The situation in Africa in particular remains very serious as average per capita output levels there receded further, thus contributing little to changing the average annual drop of more than 1 per cent recorded since the 1969-1971 benchmark. 43/ The food situation in some African countries, especially in north-east Africa and the Sahel region, continues to be a cause for concern.

Although over-all agricultural and food output gains in 1981 were mildly encouraging, the composition of output by regions and subregions shows that food security in the world remains precarious. On the one hand, normal year-to-year production fluctuations have critical consequences for many countries that barely succeed in maintaining minimum per capita output levels. On the other hand, the most substantial output expansion occurs in the food-surplus developed market economies. 44/ As a result, the food exports of these countries continue to expand rapidly (see table II-9), and world food trade has come to depend more and more on their growing food surpluses. The food surplus in these market economies may, of course, offset crop failures in other parts of the world. However, because the role of North America in global food trade has increased substantially in recent years but its food output policies depend predominantly on domestic policy considerations, the trading world has become potentially more vulnerable than in a situation with several exporters. 45/

Cereal output, over-all and by regions, provides a vivid illustration of the global improvement in crops as record harvests were reaped in the large exporting countries at the same time as they sharply declined elsewhere, mostly in Africa and

42/ The USSR has not yet officially reported the size of the 1981 harvest. Early reports estimated about 175 million tons (or 61 million tons behind the target), but more recent appraisals suggest a still lower magnitude. For example, the most recent FAO estimate puts it at 168 million tons (Food Outlook, 1982, No. 1, p. 7).

43/ Out of 47 African countries for which data are available, 34, mostly States south of the Sahara, reported per capita food output levels in 1981 that were below those of 1969-1971, in some cases very substantially so. Although some improved per capita output over the preceding year's levels, 20 of those reporting a negative trend for the 1970s incurred a further decline in 1981.

44/ Especially Australia, Canada and the United States, the latter accounting for the bulk of the surplus and export volume.

45/ A bad crop year on account of adverse weather in North America is also a factor that cannot be discounted.

Table II-9. World trade in food products, a/ 1970-1980: volume indices and trends

(1969-1971 = 100)

Country group b/	Exports			Imports				
	Growth trend c/	1978	1979	1980	Growth trend c/	1978	1979	1980
World	4.7	148	156	167	4.6	146	157	167
Developed market economies	6.3	172	183	204	2.5	127	131	130
North America	7.6	205	212	239	0.8	113	115	109
Developing countries	2.6	125	128	127	8.6	192	205	245
Africa	-3.5	81	75	78	8.8	210	213	245
Latin America	3.7	140	142	134	9.1	202	208	268
Near East	3.0	143	119	132	13.4	273	300	368
Far East	5.6	146	166	169	4.7	135	151	166
Centrally planned economies	-0.3	90	97	96	7.5	185	227	249
Asia	-0.2	100	111	113	6.9	174	225	229
Eastern Europe and USSR	-0.5	87	93	91	7.7	188	228	256

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. 34 (1981).

a/ Food products excluding fish. The trade volume indices are of the Laspeyres type with 1969-1971 average unit value weights.

b/ Coverage of regional groupings as in table II-8.

c/ Average annual growth rate 1970-1980, obtained as the slope of a regression line fitted to the data.

the centrally planned economies. Following two successive years of low growth in the global output of all cereals, which led to declining stocks and the declaration of a global food alert, an estimated record crop exceeding 1.5 billion tons was harvested in 1981, and record or near-record output levels were obtained for all major groups of cereals (wheat, coarse grains and rice). As a result, the recent drawdown of world cereal reserves was halted and the upward pressure on international prices evident during the past two years or so was reversed.

In 1981, the output of cereals in the developing countries of South-East Asia and especially Latin America improved substantially over the poor 1980 harvests (see table II-10). While the global and regional imbalances between production and consumption levels could on the whole be eased, individual countries continue to encounter shortages, and regional supplies, 46/ particularly in Africa, are still uncomfortably short of nutritional requirements, since many of the countries are recovering from two or, in some cases, three years of poor harvests.

The 1981 harvests and the prospects for 1982 tend to indicate that stocks can be replenished and that the downward price movements initiated in 1981 may continue. The 1981/1982 end-of-season carry-over stocks are forecast at above 268 million tons or 17 to 18 per cent of consumption - slightly exceeding the 253 million tons obtained two years ago, an amount deemed at that time to be the absolute minimum to safeguard world food security. Stock accumulation will most likely be centred mainly in the major exporters. Certainly, the large importing countries, whose reserves were run down to uncomfortably low levels during the last two years, could usefully direct some efforts to replenishing reserves. However, acute foreign exchange constraints (for example, in the case of the Eastern European countries) or capacity limitations on harbour unloading and storage facilities (as in the case of the USSR) for the time being may prevent a sizable restocking in these countries.

In spite of better balance between current production and consumption levels and the promise of improved reserves, there remains ample cause for concern about the world food situation in the early 1980s. While production can be expected to meet demand, markets could become even more unstable than in the 1970s, giving rise to wide swings in prices and in planted acreage.

The basic cause of instability has been the unprecedented rate of growth of world cereal trade since the early 1970s, which is projected to reach about 14 per cent of global output in 1981/82. The year-to-year requirements of the large net importers are on the whole unpredictable. 47/ In response to this rising degree of uncertainty in international grain markets, major grain exporters have

46/ The food situation in Asia generally improved in 1981, but Bangladesh, Sri Lanka, and parts of South-East Asia encountered crop shortfalls and need substantial grain imports. The Latin American countries prolonged their strong growth in cereal production of recent years. Only El Salvador, Haiti and Honduras remain heavily dependent on food imports and aid.

47/ This is especially true for the USSR, which since the early 1970s has chosen to cushion the wide fluctuations in domestic output from marginal lands through imports rather than through consumption and inventory adjustments.

Table II-10. World cereal production trends and trade volumes, 1970-1980 a/

Country group <u>b/</u>	<u>Per capita production index</u> (1969-1971 = 100)				Cereals trade (millions of tons)					
	Growth trend <u>c/</u>				Exports			Imports		
		1979	1980	1981	1979	1980	1981	1979	1980	1981
World	0.7	105	104	106	197	206	216	198	206	216
Developed market economies	1.5	115	111	118	173	181	188	107	108	114
North America	2.8	131	120	144	131	139	147	1	2	1
Developing countries	0.1	95	99	101	24	26	28	91	98	103
Africa	-2.1	81	82	80	0	0	0	13	15	16
Latin America	0.0	96	100	107	12	15	18	24	26	21
Near East	0.5	101	99	96	1	1	0	22	23	25
Far East	0.4	97	102	105	9	8	9	23	21	25
Centrally planned economies	1.1	112	110	109	5	6	4	59	65	70

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. 1, and other FAO data.

a/ Production data refer to calendar years. 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. Figures for 1980 are estimates and those for 1981 forecasts. Cereals include wheat, coarse grains and rice on a milled basis. Trade data include the wheat equivalent of wheat flour. Components may not add to totals because of rounding.

b/ Coverage of regional groupings as in table II-8.

c/ Average annual growth rate for 1970-1980, obtained as the slope of a regression line fitted to the data.

recently been favouring the increased use of bilateral trade agreements. While such contractual arrangements may offer useful guidance to the policy decisions of partner countries, they may induce even greater instability in markets as the burden of adjusting to tight supplies will have to be borne increasingly by residual importers or by the major exporters themselves. As a rule, residual importers can least bear the brunt of adjustment since they are mostly developing countries with barely adequate domestic food output levels and chronic foreign exchange shortages. On the other hand, national policy considerations in the major exporters ^{48/} may induce producers to scale output to assured demand levels rather than to bear the cost of large stockpiling, in particular in an environment of high interest rates. There is therefore ample room for concerted international action in order to maintain orderly markets with stable prices.

Changing patterns of energy consumption and production

Energy markets in 1981 were characterized by weakening demand, ample global supply, and downward price pressures from the second quarter, in some contrast to the sharp price changes and supply difficulties of the preceding two years. World production of primary energy in 1981 declined by an estimated 3 to 4 per cent, or about double the 1980 pace. Consumption also contracted, though probably not by as much. While the outlook for 1982 is very uncertain, further conservation efforts should help to hold down consumption and hence production growth, even if economic recovery were to materialize.

The decline in global energy use and production in 1981 reflected a combination of supply and demand factors. Over-all weak global economic activity was largely responsible for the sharp reduction in 1981 energy demand. Furthermore, conservation and reduced energy use in response to higher energy prices and pronounced shifts in the price structure continued to depress over-all demand.

The chief factor behind the reduction in energy production levels in 1981 was the response to weak over-all demand emerging from the current growth slow-down in the world economy. Also the continued conflict between Iran and Iraq and the socio-economic upheaval in Poland kept energy output in these countries well below normal levels. Global performance was affected by the reduction in OPEC output in particular, and also by over-all depressed production in the centrally planned economies, where output growth targets could not be attained. ^{49/} It bears noting,

^{48/} In this connexion, it is significant that government policy as well as farmers' interests in the United States have recently called for a sizable reduction in wheat acreage during the next crop season.

^{49/} Maintaining energy production at a relatively high level has become the linchpin of development in the centrally planned economies in the early 1980s. Nevertheless, performance lagged substantially behind planned levels for coal and crude petroleum. Natural gas production increased somewhat, owing to sizable gains in the USSR, which were eroded only to some degree by a reported 9 per cent decline in China. Over all, the aggregate output of the three key primary fuel sources declined by about 2 per cent for the group as a whole.

however, that some small energy producers among the developing countries significantly increased their output, 50/ particularly of fossil fuels, which enabled them to reduce energy imports.

The 1981 drop in over-all primary energy production stemmed to a significant extent from pronounced weakness in coal and crude petroleum markets. Natural gas production, on the other hand, rose by more than 3 per cent, buoyed by marked output gains, particularly in the United Kingdom, the USSR and the Netherlands. Coal output declined sharply in all major producer countries, especially in China (3 per cent), Poland (16 per cent) and the United States (6 per cent).

Developments in oil markets continued to have a major bearing on energy supply and demand. Under the combined influence of slow growth and intensifying conservation measures, world oil consumption contracted to less than 60 million barrels per day (mbd), or more than 4 per cent below last year's level, which itself was over 3 per cent below the 1979 peak of 65 mbd (see table II-11). Although the developed market economies accounted for almost all of the lower demand volume, 51/ consumption in other parts of the world also tended to decline or at most to remain unchanged. While oil consumption edged up marginally in the Soviet Union, it declined substantially (by 5-6 per cent) in China and Eastern Europe.

World oil production tended to decline steadily throughout the year 52/ and probably averaged less than 58 mbd - a sharp decrease from levels of 1979 and 1980. As in the preceding year, OPEC members bore the brunt of adjusting to declining demand. Their combined production fell drastically to a 10-year low of some 22.5 mbd - a decline of more than 8 mbd from the 1979 level or roughly twice the corresponding reduction in global oil consumption. As a result, OPEC's share of total oil output contracted significantly from about 48 per cent in 1979 to 38 per cent in 1981, but this was unevenly distributed over the member countries. While Saudi Arabia maintained output at around 10 mbd from late September 1980, when the Iran-Iraq conflict began, to August 1981, before it was reduced by 1 mbd, 53/ the production levels of African Light producers (Algeria, Libyan Arab Jamahiriya and Nigeria) were particularly affected by the depressed state of

50/ Local coal production increased markedly in countries such as Argentina, Brazil, Chile, Morocco, Pakistan and the Philippines, and natural gas output in, among others, Bangladesh, Brazil, India and Pakistan.

51/ Among the developed market economies, Western Europe and Japan accounted for about 70 per cent of the consumption cut in 1981, in contrast to 1980 when their share was 43 per cent. Further gains in over-all energy efficiency undoubtedly played a major role in many European countries, where local oil prices rose markedly over average 1980 levels.

52/ By November it reached about 55.5 mbd, down from the corresponding month of the previous year by 4.6 per cent.

53/ Saudi Arabia's output level was further reduced during the fourth quarter, when it averaged about 8.5 mbd.

Table II-11. World oil production a/ and consumption, 1979-1981

(Millions of barrels per day)

	1979	1980	1981 <u>b/</u>
<u>Production</u>			
Developed market economies	14.3	14.4	14.0
North America	11.6	11.6	11.4
Western Europe	2.3	2.5	2.5
Developing market economies	36.0	32.5	29.0
OPEC member countries	30.9	27.0	22.5
Mexico	1.5	1.9	2.3
Centrally planned economies	14.4	14.6	14.6
USSR	11.8	12.1	12.2
Total	64.7	61.5	58.9
<u>Consumption</u>			
Developed market economies	40.6	37.6	34.7
United States	18.5	17.0	16.2
Western Europe	14.5	13.7	12.3
Japan	5.2	4.7	4.1
Developing market economies	10.6	11.1	11.1
Centrally planned economies	13.5	13.9	14.0
Total	64.7	62.6	59.8

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Oil and Gas Journal, Oil and Energy Trends, and United States Department of Energy, Monthly Energy Review.

a/ Crude production except for North America, which includes natural gas liquids in the case of the United States.

b/ Preliminary.

over-all demand and by these countries' reluctance to realign their prices with prevailing market conditions. 54/

With the exception of Mexico and the United Kingdom, whose output levels rose significantly, other major producers did not expand their output perceptibly. Production in North America declined slightly on account of a sharp fall in Canadian output (about 13 per cent). In the centrally planned economies, total oil output in 1981 also remained roughly at last year's level, the marginal output gain of the USSR being offset by a 5 per cent decline in China.

A notable feature of oil developments in 1981 was the pronounced output gain of small producers, in Africa and South America in particular. In South America, Argentina, Brazil and Chile expanded output by intensifying secondary recovery at older wells (Argentina in particular) or by bringing on stream off-shore fields (as in Chile). These countries are expected to expand production at least until the mid-1980s, when they may achieve self-sufficiency in oil consumption. In Africa, the Congo and the United Republic of Cameroon also registered sharp output gains.

Given the state of oil markets, crude prices tended to weaken in the course of 1981, but the average world price was still 10 per cent higher than in 1980. By early summer, most exporters were compelled to lower official selling prices in order to protect their share of a shrinking world oil export market. The average official OPEC price declined for the first time in recent years in May 1981 and eased further until September, when it rebounded slightly following the \$2 price increase levied by Saudi Arabia. The latter measure was taken in an effort to unify the world oil price structure, which had diverged to an unprecedented degree during the tight market of 1979-1980. 55/ Price differentials narrowed as a result of a further reduction in the official prices of several exporters, and the average price of internationally traded crude eased somewhat towards the end of the year. 56/

During 1981 Saudi Arabia played an instrumental role in attempting to stabilize world oil prices and narrow price differentials. In spite of declining world demand, it succeeded in these endeavours by sustaining high output levels. As a result, Saudi Arabia increased its share in world oil markets to a point where it can play a pivotal role in maintaining balanced markets. In September 1981, a price agreement was reached which aimed at holding the price of the marker crude at \$34 until the end of 1982. However, market developments since then have put downward pressures on prices.

54/ The combined output of these producers declined in 1981 by about 30 per cent. The output of other OPEC members also declined, though at a much slower pace.

55/ By the beginning of 1980, price differentials ranged from \$1.5 for Indonesian Minas to \$8.5 for Libyan Sider over the marker crude (Saudi Light) price.

56/ As of early January 1982 it stood at \$34.18 per barrel, down from the beginning of the preceding year by \$1.31 or by 3.6 per cent.

More indicative of the altered state of world oil markets in 1981 than the evolution of official selling prices was the behaviour of spot prices, which declined throughout the year and from the second quarter remained below official contract prices. 57/ In addition to the over-all excess supply of oil, movements in spot prices also reflected the easing of tension in world oil markets 58/ and changes in inventory policies of major consumers. 59/ Inventory demand weakened considerably in mid-year and stocks were run down at a rate of about 1.5 mbd during the third quarter of 1981. Factors underlying the recent inventory reduction include high interest rates, growing expectations of stable oil prices, and declining oil consumption, all of which are depressing demand and exerting downward pressure on crude prices.

The outlook for world energy in 1982 still depends heavily on the evolution of petroleum markets. The current oil glut and price erosion reflect chiefly the dramatic decline in the level of world oil consumption in 1980-1981, increased output in non-traditional producers and changes in inventory policies of oil importers. These factors are expected to determine the basic state of world oil markets at least until the second half of 1982. Downward price pressure is likely to intensify, and may lead either to a lower marker price or to increasing differentials between non-OPEC and the official OPEC selling prices. 60/ However, while such price differentials may be sustainable when supply is tight, as in 1979-1980, they cannot be effective for long when there is ample supply. 61/

The current weakness in inventory demand has contributed measurably to maintaining excess supply in world markets. Stock depletion at a rate of around 1.5 mbd can continue until the third quarter of 1982, when inventories may equal around 90 days of consumption. At that level, inventory demand will need to be strengthened in order to avoid a repetition of panic-buying in the spot market, as in early 1979. Thus, inventory rundowns could augment aggregate oil supply by

57/ The spot price of the marker crude (Saudi Light), for instance, fell from a peak of \$41 per barrel in early January to \$31.97 in July of 1981 and increased thereafter to about \$34 in line with the official selling price. Since the end of 1981, it has declined sharply to about \$28 in mid-March.

58/ In spite of the lingering conflict between Iran and Iraq, the market's fear of future tight conditions has now largely receded due to the existence of high oil inventories and large (perhaps 30 per cent) idle capacity in OPEC member countries.

59/ Reflecting speculative demand, oil stocks in market economies accumulated rapidly from an equivalent of 90 days' consumption in the first quarter of 1979 to about 110 days' in the first quarter of 1981.

60/ The national oil companies of Norway and the United Kingdom have recently revised oil prices. As a result, their oil price was \$3 to \$4 below the OPEC marker crude price at the end of the first quarter.

61/ In fact, at their March emergency meeting, OPEC members decided to reduce price differentials by lowering the price of high quality African crudes by \$1.50 to \$2.

about 1.5 mbd in the short term, which will need to be offset by increased consumption or production cutbacks in order to stabilize prices.

Under present circumstances, world oil consumption is not likely to increase. In fact, global demand is anticipated to decline further by about 1 to 2 per cent in 1982. Assuming a 2 per cent decline of oil consumption and a further rundown of stocks at a rate of about 1.5 mbd, world oil production in the first three quarters of 1982 needs to be reduced by about 2.7 mbd from its 1981 level in order to maintain price stability. Non-OPEC supply is unlikely to be compressed and any further OPEC production cuts will have to be weighed against the need of most OPEC members to sustain or even to increase production in order to avoid a serious deterioration in their current account balances. 62/

62/ However, OPEC production declined in the first quarter of 1982; in January it stood at 20.6 mbd, down from the previous month by about 0.7 mbd, and there are indications that it contracted further to 18 mbd by mid-March 1982. Furthermore, at its March emergency meeting, OPEC decided to cut its output to about 17.5 mbd for the remainder of 1982, with Saudi Arabia targeting current output at about 7 mbd. If maintained, OPEC's average production would be about 18 mbd for 1982 as a whole. This implies a reduction of about 4.5 mbd from 1981 levels, which may be sufficient to balance aggregate world oil supply and demand in 1982 and hence stabilize official prices for the rest of the year.

Chapter III

INTERNATIONAL TRADE AND PAYMENTS

An over-all view: the transmission of recession through international trade and financial markets

The experience of 1981 showed once more the high degree of interdependence of the global economy. The recession in the developed market economies, which in some countries had already begun in 1980, tended to radiate outwards through its effects on the volume of trade and on prices.

In general, neither the developing countries nor the centrally planned economies were in a position to provide much of a counter-weight to the dampening effect on world trade and output stemming from the developed market economies. In the net energy-importing developing countries, the serious payments constraints to growth that had emerged in the preceding three years worsened, and the pace of their import growth continued to be very restrained. While growth in the deficit energy-exporting developing countries was more buoyant, a trend towards significantly reduced rates of expansion in import volumes emerged in the course of the year as their current accounts tended to swing into substantial deficit. Among developing countries, import growth remained strong only in the capital surplus countries. Among the centrally planned economies, only the USSR increased its import volume in a significant way. Other centrally planned economies, notably the Eastern European countries and China, made successful efforts to limit the expansion of their imports and to reduce their deficits with convertible currency countries.

A distinctive feature of 1981 was the transmission of recessionary impulses through capital markets in the form of interest rate pressures. The reduction of controls on the export of capital and the internationalization in the ownership of liquid assets have left the world economy with very sensitive capital and foreign exchange markets. Among developed market economies, capital market links have become particularly strong, and these links have reduced the autonomy of national monetary authorities. Rising interest rates in a key currency nation bring about reactions in three important variables: the bilateral nominal exchange rate with other major currencies, capital inflows, and the interest rate policy of other major currency nations.

The substantial increase in interest rates in the United States, the resulting pressures in international capital markets, and a defensive reaction in Western Europe led to a generalized tightening of monetary policies and widespread rises in interest rates. During 1981, real interest rates remained unusually high in spite of increasing unemployment. The dampening demand effect of such policies, which for some countries accentuated an ongoing cyclical downswing, brought about a downturn in the volume of imports of the developed market economies. This curtailed the pace of expansion in the demand for the exports of other regions, which found it increasingly difficult to insulate themselves from the impact of adverse external conditions. As a consequence of these developments, the growth of world trade has practically come to a halt.

Exporters of primary commodities have been particularly affected. The synchronization of recession in the industrial countries has led to a substantial fall in the prices of a wide spectrum of primary commodities. Besides, high

interest rates have made the fall unusually steep, as stocks have been reduced at a relatively fast pace. For a number of primary commodities of particular significance to developing countries, prices in real terms towards the end of 1981 were well below prices in any year since the late 1950s.

The volatility of interest rates also had adverse effects on the stability of exchange rates and on the environment in which trade relations are conducted. The instability of exchange rates that has characterized the world economy for the past two years or so has resulted to a large extent from the volatility of interest rates. The large fluctuations in exchange rates have undoubtedly contributed to the climate of uncertainty prevailing in the Western industrialized countries. In addition, the experience of the last two years shows that sharp fluctuations in exchange rates may also lead to an intensification of protectionist pressures from sectors whose competitive position is suddenly eroded in an unpredictable way.

The short-term outlook for world trade is beset by uncertainties. A recovery in the pace of expansion of world trade depends largely on events in the developed market economies. If these economies are able to recover their momentum, world trade would most likely expand commensurately. However, as noted in chapter II, the outlook in the developed market economies is very uncertain and hinges largely on a recovery in the United States. In addition, other growth poles in the world economy - namely, the energy-exporting countries - are expected to weaken. Even in the best of circumstances, the recovery is expected to be very slow by past standards.

An issue of increasing importance for the short-term outlook is the continued high level of interest rates in the United States, which are inhibiting the return of the dollar to levels more commensurate to the evolution of relative costs and prices in recent years. An overvalued dollar is likely to contribute to enlarging the current account surpluses of Japan and the Federal Republic of Germany and to lead eventually to the re-emergence of current account deficits in the United States, which in turn could introduce another element of instability into the world economy.

Stagnation in world trade

After growing by about 1 per cent in 1980, world trade appears to have shown no increase of any significance in 1981 ^{1/} (see table III-1). These figures compare very unfavourably with the average rate of over 6.5 per cent recorded during 1976-1979.

During 1981 the imports and exports of developing countries as a whole appear to have continued on the trend established in 1980: the volume of exports declined while real imports rose briskly. The behaviour of energy exporters and importers, however, differed markedly.

The net energy-exporting countries experienced a drastic reduction in their export volumes, owing to a sharp decline in oil imports into the developed market

^{1/} However, non-fuel trade appears to have risen by 2 to 3 percentage points. (In addition, it is unclear to what extent the published data on world trade capture the trade in armaments. Fragmentary evidence from various sources indicates that trade in arms continues to grow at very high rates.)

Table III-1. World trade: annual rates of change in volume and prices, 1976-1982

(Percentage)

	1976-1979	1978	1979	1980	1981 <u>a/</u>	1982 <u>b/</u>
<u>Volume of exports</u>						
World	6.6	4.9	6.1	1.5	-	1.5
Developed market economies	7.1	6.5	6.2	3.8	2	2.5
Developing countries	5.0	0.1	6.2	-5.8	-4.5	-2.5
Capital surplus countries	2.4	-6.1	2.2	-18.4	-17	-20
Other net energy exporters	5.2	2.2	10.3	-9.5	-5	2
Net energy importers	7.6	5.6	7.8	7.6	4	5
Centrally planned economies <u>c/</u>	6.8	5.5	4.8	2.2	-3	0.5
<u>Volume of imports</u>						
World	6.7	5.5	5.2	1.0	-	1.5
Developed market economies	7.4	5.3	7.5	-1.4	-3	1
Developing countries	5.2	5.0	-0.5	8.5	8.5	2
Capital surplus countries	10.6	0.6	-4.4	18.4	20	5
Other net energy exporters	3.3	4.6	-10.8	16.5	15	-
Net energy importers	4.6	6.6	5.5	2.6	2	2
Centrally planned economies <u>c/</u>	5.1	8.3	1.7	2.7	-	1.5
<u>Unit value of exports</u>						
Developed market economies	9.1	12.8	15.8	13.8	-4.0	3
Developing countries						
Capital surplus countries	14.0	0.3	44.0	71.8	9.6	-5
Other net energy exporters	14.2	1.8	34.9	57.1	5.2	-5
Net energy importers	10.5	5.5	15.7	14.5	-6.0	-0.5
<u>Unit value of imports</u>						
Developed market economies	9.8	10.0	19.2	22.3	-2.5	0.5
Developing countries						
Capital surplus countries	9.4	11.4	16.3	15.7	-3.8	2
Other net energy exporters	9.5	11.2	17.1	17.3	-3.4	1.5
Net energy importers	10.4	9.1	21.0	25.0	-1.7	0.5
<u>Terms of trade</u>						
Developed market economies	-0.6	2.5	-2.8	-7.0	-1.5	2.5
Developing countries						
Capital surplus countries	4.2	-10.0	23.9	48.4	14.0	-7
Other net energy exporters	4.3	-8.5	15.2	33.9	8.9	-6.5
Net energy importers	0.1	3.2	-4.4	-8.5	-4.4	-1

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/ Preliminary estimates.

b/ Forecasts.

c/ Centrally planned economies of Europe only.

economies. Their import volumes, on the other hand, continued to expand vigorously, despite the contraction in their export volumes and the downward pressures on international oil prices during the course of the year. Thus these countries were the only growth pole in the world economy during 1981, and their imports provided an important support to activity in both the energy-importing developing countries and the developed market economies. However, as current account pressures in the deficit energy exporters began to mount in the course of the year, these countries tended increasingly to limit the expansion of their imports.

By contrast, imports into the net energy-importing developing countries do not appear to have grown by more than 2 per cent, reflecting slow economic growth and strenuous efforts to bring down current account deficits. Despite growing difficulties in exporting manufactures to the developed market economies and the depressed markets for primary commodities, their export volumes appear to have risen by about 4 per cent, a rate about half that achieved in 1976-1979. There are indications that trade among developing countries, particularly exports to the energy-exporting countries, continued to expand rapidly.

In the developed market economies, while exports appear to have risen by about 2 per cent, imports may have declined by about 3 per cent. As noted above, exports to the energy-exporting developing countries were very buoyant and may have risen by over 20 per cent in real terms. Imports, on the other hand, were severely affected by the recession and the continuing adjustment to higher energy prices. Between 1979 and 1981, the volume of fuel imports (Standard International Trade Classification category 3) is estimated to have fallen by over 20 per cent, and non-fuel imports appear to have remained largely unchanged.

Owing to sharp changes in exchange rates and international competitiveness, trade trends differed widely among individual countries. Exchange rate depreciation and improvements in international competitiveness led to above-average export growth and below-average import growth in Japan and the major continental European countries. In the United States, the appreciation of the dollar up to the third quarter of the year caused import volume to rise moderately in spite of the recession and was mainly responsible for a small drop in real exports. The United Kingdom experienced a sharp decline in real imports, largely as a result of the severity of the recession, while its export volume continued to be affected by the loss of competitiveness brought about by a relatively high inflation rate and the past appreciation of sterling. The smaller developed market economies were generally affected by large balance-of-payments disequilibria which forced them to reduce their import volumes. On the other hand, their exports rose by less than those of the major countries, owing to depressed market conditions in the latter group of countries and to the relatively small share of exports going to the energy-exporting developing countries.

At the start of the implementation of the new five-year plans (1981-1985), the centrally planned economies of Eastern Europe and the USSR envisaged for 1981 only moderate over-all output growth and nearly stagnant internal consumption in an effort to foster exports and curtail import growth as much as possible. Developments in the course of 1981 for the Eastern European countries differed markedly from those in the Soviet Union. The Eastern European countries by and large held to their external targets, while the trade performance of the USSR was affected by output constraints and unplanned food and feed-grain imports.

Most Eastern European countries continued to give precedence to improving their balance with convertible currency partners over intra-group trade. Leaving aside Poland, Eastern Europe's efforts of recent years to increase output and moderate imports were by and large successfully repeated in 1981. Export volume growth of about 2.5 per cent, combined with a contraction of import volume of perhaps 2.7 per cent, was notable in view of the substantial deterioration in global economic activity and the marginal growth in output in Eastern Europe.

The trade volume changes of the USSR differed appreciably from those of Eastern Europe. On the whole, the USSR maintained stable exports to the group, but reduced exports to other countries quite substantially (8-9 per cent). Import volume from third partners, on the other hand, increased by about 12 to 13 per cent largely owing to very substantial increases in agricultural and food imports.

Only very modest impetus to growth in the world economy can be expected from international trade flows in 1982. The growth of world trade is unlikely to exceed 1.5 per cent in real terms. Import volume into the developed market economies is expected to continue to be affected by slow economic expansion, further cutbacks in oil imports, and trade restrictions among major trading countries. Since the current accounts of the energy-exporting developing countries are forecast to worsen sharply, with the deficit energy exporters going into substantial deficit, the growth of their imports is likely to slacken very markedly. In fact, only the capital surplus countries are expected to exhibit positive real import growth. Imports are also likely to remain depressed in the energy-importing developing countries, owing largely to unsatisfactory economic growth and to further efforts to come to grips with their payments difficulties.

In both Eastern Europe and the USSR, the growth in trade volume in 1982 is expected to be very modest. Limits to output growth are likely to entail at best a moderate upswing in export volume, even if the Polish economy can be stabilized, and foreign exchange constraints are likely to hold import volume down. Similarly, severe short-term output constraints for the key exportables of the USSR may well dampen export growth. On the other hand, although import volume is not likely to rise as much as in 1981, it will probably continue to increase in order to compensate for the weak performance of agriculture in 1981.

Weakening primary commodity prices

Primary commodity prices, which had risen rather sharply during 1979 and the early part of 1980, came under increasing downward pressures in 1981. Under the combined influence of weakening world economic activity, high interest rates and a deteriorating short-term outlook, the prices for most non-oil commodities declined drastically - on the average by 16 per cent (see table III-2).

Besides primary commodity prices, the prices for internationally traded manufactures also declined in 1981. Mainly owing to the sharp appreciation of the dollar, the dollar-denominated index of prices for manufactures exported by the developed market economies reversed its course from an increase of 10.4 per cent in 1980 to a decline of about 5 per cent in 1981. As a result, non-energy primary commodity prices fell in terms of the prices for manufactures by about 11 per cent.

Among the main commodity groups, metal prices were very severely affected by the recession in the industrial countries. Weakened industrial demand, particularly originating from the steel, construction and transportation sectors,

Table III-2. Changes in the prices of internationally traded commodities, a/ 1980-1982

(Percentage)

	1979	1980	1981	1982 <u>b/</u>
Non-oil primary commodities	15.3	14.8	-15.6	-4
Food	15.2	63.2	-21.3	-10
Tropical beverages	3.5	-5.9	-18.9	2
Vegetable oils and oil-seeds	15.6	-14.8	-3.1	-11
Agricultural raw materials	22.7	11.2	-13.0	-7
Minerals, ores and metals	28.8	13.2	-12.3	2
Crude petroleum <u>c/</u>	46.0	66.0	9.8	-5
Manufactures exported by developed market economies	14.4	10.4	-5.0	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, and United Nations, Monthly Bulletin of Statistics.

a/ Average annual market prices in dollar terms.

b/ Forecast.

c/ International average annual f.o.b. official selling prices, weighted by export volume.

which account for a large portion of metal demand, combined with the destocking policies of consumers owing to high interest rates, led to downward pressures on prices. The prices for some basic metals, notably copper, fell well below their average cost of production in some major producing countries. However, production cuts, strikes and buffer stock purchases helped to lessen the downward pressure on prices and prevented the excessive inventory build-ups associated with recessionary periods. In two isolated cases - tin and zinc - these factors were responsible for an actual increase in prices up to the end of 1981, but since then the markets for these commodities have also weakened.

The slow-down in world economic activity also depressed the demand for agricultural raw materials. In the case of cotton, prices were also influenced by steep increases in production brought about by very favourable weather conditions.

Food prices fell sharply in 1981, mainly owing to excess supply conditions resulting from good crops. In spite of heavy purchases on world markets necessitated by the third consecutive below-plan harvest in the Soviet Union, bumper crops in the United States caused prices to fall substantially. The price of sugar, which had soared in 1980, fell by almost 70 per cent between October 1980 and December 1981. This sharp turnaround in the behaviour of sugar prices reflected mostly changes in underlying supply conditions: a large decline in the output of a number of sugar producers such as India, Indonesia, Thailand and the USSR in 1980 was followed by a record sugar beet harvest in the European Economic Community in 1981.

The markets for tropical beverages continued to be in over-supply in 1981. Despite news of a Brazilian frost and the negotiation of a new international coffee agreement, prices fell on average by over 20 per cent relative to those prevailing in 1980. A large surplus of cocoa resulting from several years of over-production continued to depress the price of that product in the first three quarters of 1981, prompting the buffer stock programme of the International Cocoa Organization to go into operation. None the less, the market remained depressed and prices fell sharply. Excess supply also affected tea prices during 1981.

Until the fourth quarter of 1981, the prices for vegetable oils and oil-seeds held up fairly well. However, during the fourth quarter they appear to have yielded under the pressure of high production and weak demand.

Developments in oil markets also reflected the influence of weakening consumption and inventory demand resulting from the slow-down in world economic activity and high interest rates. ^{2/} Unlike other primary commodity markets where adjustments to reductions in demand were reflected primarily in lower prices, in the oil markets supply bore the brunt of adjustment. However, despite a sharp reduction in oil production in some of the main exporting countries, crude prices tended to weaken in the course of the year. For 1981 as a whole, however, crude oil prices increased on average by almost 10 per cent, mainly owing to the sharp price increases posted during the second half of 1980 and early 1981.

^{2/} For a full discussion of oil markets, see chap. II.

The weakened supply situation for a number of important commodities has rendered their prices very vulnerable to any sustained increase in demand. ^{3/} However, the current forecasts for 1982 envisage a further deterioration in the prices of primary commodities vis-à-vis manufactures. The main variable affecting the forecast for raw material prices (ores and metals, and agricultural products) is the sluggishness of the recovery in the developed market economies. Only minor improvements in the markets for tropical beverages are expected in 1982, and prices should remain at their 1981 levels. Food prices are more difficult to predict since they depend largely on weather conditions. With the information available at present, it is likely that the markets will again be in excess supply and that prices will continue to fall.

The slack in oil markets that developed in 1981 is expected to continue into 1982. Therefore, average prices for 1982 are likely to fall somewhat below their 1981 levels in dollar terms.

During 1981 the dollar prices for internationally traded manufactures were strongly influenced by the sharp appreciation of the dollar. Since the dollar is expected to depreciate mildly in 1982, and inflation in the developed market economies is unlikely to decelerate dramatically, manufactures entering international trade may experience price increases from their current levels perhaps averaging around 5 per cent for the year as a whole compared to average prices in 1981. Greater competitive pressures in a slack world economy than within individual countries account for the relatively slower pace of increase forecast for the prices of internationally traded manufactures than for the average domestic price level of the developed market economies.

Further adverse terms of trade movements in energy-importing developing countries

During 1979-1980 the energy-importing regions of the world economy - the net energy-importing developing countries, the developed market economies and the Eastern European countries - experienced a significant deterioration in their terms of trade. ^{4/} On the other hand, the energy-exporting developing countries and the Soviet Union benefited from substantial terms of trade improvements.

In 1981, despite the progressive weakening of oil markets during the year, oil prices relative to manufactures over the year as a whole were higher than in 1980. This largely accounts for the further terms of trade gains recorded by the net energy-exporting developing countries and for the continuing losses of the developed market economies. However, terms of trade movements for these groups of

^{3/} Low prices during 1981 caused a number of metal producers to postpone investments and close some mines. In addition, high interest rates discouraged the normal accumulation of inventories at the user industry level.

^{4/} The deterioration in the terms of trade was not as pronounced in the case of the Eastern European countries as in the other country groups. While these countries do obtain a share of their energy imports from world markets, most of their energy needs are supplied from within CMEA at prices which catch up with world prices only over a five-year period. However, the impact of the recent energy price increases will continue to affect intra-CMEA prices for at least another three years.

countries appear to have been moderate compared to those that took place in 1979 and 1980. During 1982, since the prices for manufactures are expected to rise relative to those of oil and non-oil primary commodities, the developed market economies should experience an improvement in their terms of trade, and those of the energy-exporting developing countries should worsen.

The net energy-importing developing countries have been particularly affected by the changes in international prices during recent years. The sharp drop in primary commodity prices during 1981 had a very adverse impact on these countries. In the 1978-1981 period, the energy-importing developing countries are estimated to have experienced a terms-of-trade loss of almost 20 per cent. Since in 1982 primary commodity prices are forecast to drop relative to the prices of manufactures, some additional terms-of-trade losses appear to be in store for these countries.

In the centrally planned economies of Europe, price changes in trade with third countries were on balance rather modest in 1981. Most Eastern European countries in fact appear to have experienced a marginal improvement in their terms of trade. The Soviet Union once again experienced higher energy prices, and its terms of trade appear to have improved by 9 to 10 per cent. Price movements within the group were, however, more substantial as intra-CMEA prices - in particular for energy products, which increased by about 20 to 25 per cent - continued to move upwards according to the lagged feed-through price formula adopted in 1975 and confirmed for the current medium-term plan period. As a result, the countries of Eastern Europe as a group experienced a deterioration in their intra-group terms of trade of about 4 to 5 percentage points, while the Soviet Union gained by a corresponding amount.

Lessened current account imbalances in the world economy

During 1979-1980, mainly as a result of changes in international prices, most energy-importing regions - developing countries and developed market economies - experienced growing current account deficits. On the other hand, the surplus energy-exporting developing countries and the USSR saw their surpluses rise rapidly, and in the deficit energy exporters the current account deficit disappeared in 1980 (see table III-3). The Eastern European countries, which are net energy importers, were able to contain their trade deficits through strenuous efforts to reduce imports and increase exports. In China, where oil accounts for about 10 per cent of exports, ambitious development plans requiring large increases in import volume caused the trade balance to deteriorate in 1979, while import restraint helped reduce the deficit in 1980.

While these imbalances were by and large considerably reduced in 1981, a continuing and increasingly disturbing element in the over-all current account picture is the fact that a large share of the counterpart to the surpluses of a few countries has come to be concentrated in the net energy-importing developing countries and the small developed market economies. In 1981, the deficit of the energy-importing developing countries continued to rise under the impact of deteriorating terms of trade and sharply increased interest payments. In the current international economic environment, the small developed market economies are also encountering serious difficulties in reducing their deficits.

Despite terms-of-trade changes which continued to favour energy-exporting regions, movements in trade volumes in 1981 helped to reduce current account

Table III-3. World: balance of payments on current account, a/
by country groups, 1978-1982

(Billions of dollars)

	1978	1979	1980	1981 <u>b/</u>	1982 <u>c/</u>
Developed market economies	31.3	-5.7	-42.7	-3.3	35.5
Major industrial countries	35.5	5.8	-15.2	15.5	41
Other surplus countries <u>d/</u>	2.1	0.3	-0.9	6.1	8.5
Other small economies	-6.3	-11.7	-26.6	-24.9	-14
Developing countries <u>e/</u>	-34.0	10.6	35.9	-11.5	-62.5
Capital surplus countries	19.0	65.9	103.7	81.5	32.5
Other net energy exporters	-22.8	-7.1	0.9	-15.5	-20
Net energy importers	-30.2	-48.2	-68.7	-77.5	-75
Centrally planned economies <u>f/</u>	-6.2	-0.3	1.6	3.3	-0.5
China	-1.2	-2.1	-1.2	0.5	0.5
Eastern Europe	-6.7	-5.1	-5.1	-3.4	-2
USSR	1.6	6.9	8.0	6.2	1
Residual balance <u>g/</u>	8.9	-4.6	5.2	11.5	27.5

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

a/ Excluding government transfers.

b/ Preliminary.

c/ Forecasts based on Project LINK results for developed market economies, plan figures for centrally planned economies, and Secretariat estimates for developing countries.

d/ Netherlands, Norway and Switzerland.

e/ The data presented herein underestimate the deficit due to the exclusion of Cuba and the developing centrally planned economies of Asia, where very partial data were available.

f/ Trade balances only.

g/ Reflects errors, omissions and asymmetries in reported statistics, service balances for the centrally planned economies and the balance of the groups listed with other countries.

imbalances. In the major developed market economies, a reduction in import volumes and buoyant growth of exports to the energy-exporting countries were the major factors behind the sharp improvement in the current account. By contrast, the energy-exporting developing countries and the Soviet Union saw their surpluses fall considerably, mainly as a consequence of large real import increases and export declines, particularly in the case of the first group of countries. In Eastern Europe, continued efforts to compress imports and encourage exports prevented the trade balance from worsening further, in spite of adverse terms-of-trade developments. China was able to eliminate its deficit by instituting policies which gave priority to the attainment of external balance.

In the course of 1982, owing largely to a projected fall in energy prices and trade volumes, further significant current account changes are forecast. The developed market economies should swing back into considerable surplus, the surpluses of the capital surplus energy-exporting developing countries and the USSR are likely to dwindle rapidly, and the deficits of the capital-importing energy exporters should continue to grow. In the case of the USSR, further increases in agricultural imports may also contribute to a sharply lower trade surplus. The deficits of the Eastern European countries, however, are not expected to change measurably as further domestic adjustment efforts will in part be offset by continued deterioration in these countries' terms of trade.

Worsening payments difficulties in deficit developing countries

For most developing countries, 1981 was a year of declining current account surpluses or increasing deficits resulting primarily from the more difficult international economic environment. However, because 1981 had been preceded by other difficult years, numerous deficit countries had introduced adjustment policies before the year began and some intensified these policies during the year. As a result, preliminary indications suggest that when data become available they will show declines in current account deficits for a certain number of countries. ^{5/} Nevertheless, these payments improvements are more than offset by the continued deterioration in other countries' accounts. Thus, the sum of current account balances of the deficit countries appears to have increased in 1981, but not by as much as in the preceding years.

Mainly owing to worsening terms of trade and sharply increased interest payments, 1981 marked the fourth consecutive year of current account deterioration for the energy-importing developing countries. In 1976 net current inflows were sufficient to pay for all but 20 per cent of merchandise imports, ^{6/} the rest being covered by net capital inflows. The ratio improved to 17 per cent in 1977, but in each succeeding year, net current inflows became increasingly inadequate. In 1981 the percentage shortfall reached twice the level of 1977; in other words, the energy-importing countries were able to pay for only about two thirds of their imports in 1981 out of net current inflows.

^{5/} Including Argentina, Brazil, Costa Rica, Cyprus, the Dominican Republic, the Ivory Coast, the Niger, the Republic of Korea and Uruguay.

^{6/} Net current inflows are here defined as those resulting from exports and net flows of services and private transfers. Imports are measured f.o.b. on a payment basis.

These developments took place in spite of significant adjustment efforts in these countries. During 1976-1979, the real export growth rate averaged 3 percentage points more than the rate of growth of imports. In 1980 and 1981, exports rose at an average annual rate of almost 6 per cent, while the growth of imports appears to have fallen to only slightly above 2 per cent. Thus there is evidence that there was substantial adjustment in trade-related sectors. Expectations are that 1982 will not show any significant improvement in import performance; in spite of substantially faster growth in export than in import volume, owing to a small further worsening of the terms of trade, the decline in the current account deficit is expected to be relatively small.

For the capital-importing energy exporters, 1981 marked the sudden end to the recent years of rapidly improving current account positions. In sharp contrast to 1980, the group's aggregate trade surplus fell in 1981 by over a third and was no longer able to offset the deficit on services and private transfers which had itself grown by almost 15 per cent. Owing to adverse terms-of-trade movements, in 1982 the current account deficit is expected to increase substantially. Thus the respite from adjustment pressures which some of the deficit energy exporters had enjoyed in 1979 and 1980 appears to have ended.

The current accounts of the surplus energy exporters are now declining rapidly. Indeed, the aggregate surplus is estimated to have fallen by about a fifth in 1981, owing primarily to a substantial drop in petroleum export earnings and rapid import increases which were only partly offset by increased earnings on external financial assets. For 1982, further reductions in these countries' large trade surpluses are expected, mainly owing to sluggish international oil markets. 7/

Rapid changes in developing countries' interest payments flows

The high interest rate policy of the developed market economies has imposed a significant economic cost on the capital-importing developing countries. 8/ While some increase in interest payments could have been expected even in the absence of higher interest rates, owing to higher levels of indebtedness, the increases in interest rates that have taken place since 1979 have been the major determinant of the rise in interest payments. In all, the interest payments of these countries rose by a third or more in each year since 1978.

The effect was most marked for the energy-importing developing countries which have been relying increasingly in recent years on external finance from

7/ Short-term current account forecasts for the surplus energy exporters are, of necessity, the most uncertain of any country groupings since their international economic performance is uniquely dependent on a single commodity, petroleum, whose price and export volume have been recently subject to sharp fluctuations arising from unforeseeable supply changes and shifts in demand brought about by substitution and conservation efforts.

8/ Deficit energy exporters and energy-importing countries.

international capital markets to cover their current account deficits. ^{9/} An indication of how much the burden has increased is the proportion of total foreign exchange earnings which are absorbed by the current costs of foreign capital. As may be seen in table III-4, ^{10/} the available data show the burden thus defined to have doubled between 1976 and 1981; between those two years, the increase in total payments was entirely due to higher interest payments on debt capital. Moreover, most of the increase has taken place since 1979, during a period which has been characterized by rapidly rising interest rates.

Table III-4. Net energy-importing developing countries: a/ external interest payments and direct investment income as shares of total current foreign exchange earnings, b/ 1976-1981

(Percentage)

	1976	1977	1978	1979	1980	1981 <u>c/</u>
Direct investment income	3.4	4.1	4.2	3.5	3.0	3
Interest payments	11.1	10.8	13.1	16.4	19.9	27.5
Total payments to foreign capital	14.5	14.9	17.3	18.9	22.9	30.5

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

a/ Based on data for 49 countries reporting sufficiently detailed information (Argentina, Bangladesh, Barbados, Botswana, Brazil, Burma, Central African Republic, Chile, Colombia, Costa Rica, Cyprus, El Salvador, Ethiopia, Fiji, Gambia, Ghana, Guatemala, Guyana, Haiti, Honduras, Israel, Jamaica, Jordan, Kenya, Malta, Mauritania, Mauritius, Morocco, Nepal, Pakistan, Papua New Guinea, Paraguay, Philippines, Republic of Korea, Rwanda, Seychelles, Sri Lanka, Sudan, Suriname, Swaziland, Thailand, Turkey, Uganda, United Republic of Tanzania, Uruguay, Yemen, Yugoslavia, Zambia and Zimbabwe).

b/ Exports of goods, total services earnings, and private remittances.

c/ Preliminary.

^{9/} While non-debt creating flows (i.e. direct investment and official grants) financed almost 40 per cent of the energy-importing countries' current account deficit in 1976, by 1980 and 1981 that share has fallen to under one quarter.

^{10/} The table does not include deficit energy exporters since adequate 1981 estimates were unavailable. However, incomplete information for these countries shows a similar trend.

Not all countries, of course, have been subject to the same degree of accelerating interest payments. Countries without access to private financial markets 11/ or those few which have decided not to resort to those markets have experienced only a modest increase. Such countries have not only limited the increase in their debt to a greater extent than have others, but they have also depended more on official development assistance and other forms of fixed-interest debt whose interest rates have not increased to the same degree as rates on loans from the private international banks. Indeed, the average cost of ODA debt from member countries of the Development Assistance Committee of the Organisation for Economic Co-operation and Development fell from 2.4 per cent per annum in 1974 to an estimated 1.8 per cent in 1981. 12/ Over the same period the average annual cost of indebtedness to the international financial organizations, as well as of official and private export credits from DAC member countries, was estimated to be higher by about 25 per cent. In marked contrast, the average annual cost of floating-interest bank debt rose by well over 100 per cent.

Since 1980, high real interest rates have been reducing the willingness of developing countries to finance current account deficits and have been inducing them to opt for lower rates of economic growth. 13/ In this respect, the current situation is quite different from that prevailing in 1973-1975. During the earlier recession, real interest rates, defined as nominal rates deflated by the export prices of developing countries, remained low; and while they became positive in 1975, they fell quite sharply in the following three years. In addition, debt levels in 1973 - in relation to relevant variables such as exports or GDP - were substantially lower than they are now. During the current contraction, real interest rates have risen sharply and are now very high. While nominal rates are likely to ease somewhat from their current levels, they are still likely to remain above the rate of increase in the prices of developing country exports. As a result, it will be more difficult for these countries to choose the option of foreign financing in preference to continued pursuit of growth-restrictive domestic policies.

A small number of developing countries have benefited from high interest rates. For the surplus oil-exporting countries, which are net recipients of international interest income, these flows have become a highly significant source of earnings. 14/ On the one hand, this has been due to the build-up by these

11/ In most cases, least developed and other low income countries.

12/ Organisation for Economic Co-operation and Development, Development Co-operation: 1981 Review (Paris, November 1981), p. 70.

13/ Higher interest rates are affecting not only the cost of financing available from private markets but also the cost of funds obtained from multilateral institutions, which in the end have had to raise resources from the private markets for re-lending to developing countries.

14/ In Kuwait, for example, owing to declining oil earnings and rising investment income, earnings on investments are forecast to provide an equivalent of two thirds of government revenue derived from oil in the fiscal year ending 30 June 1982.

countries of external financial assets that has accompanied the steady pattern of current account surpluses. In fact, from the end of 1975 until the end of 1981 alone, over \$300 billion were added to their stock of external assets. ^{15/} These monies have been placed largely in low-risk financial assets such as foreign government securities and directly with Governments and international institutions (most notably the International Monetary Fund and the World Bank) as well as in bank deposits in developed market economies and in the Euro-currency market. ^{16/} And whereas in the late 1970s such placements yielded relatively low rates of return, especially measured with respect to inflation, from 1980 they have been yielding significantly positive real returns. The result has been a substantial rise in financial earnings, particularly in 1981.

Financing the deficits of developing countries: serious liquidity problems in energy-importing countries

The countries that needed to mobilize the largest volume of additional external resources for payments financing purposes in 1981 were the deficit energy exporters. The net energy-importing countries intensified their mobilization of external resources, making particularly heavy use of IMF facilities. Both groups of countries made extensive use of reserves, but whereas the energy exporters were able to draw on large reserves, the energy importers had to resort to reducing further their already low reserve stocks. By the beginning of 1982, both groups of countries were giving high priority to adjustment efforts aimed at reducing external deficits even at the cost of foregone growth and investment.

For the deficit energy exporters, the effect of the unexpectedly rapid current account deterioration in 1981 may be seen in the behaviour of reserves, which began a generalized fall in the second quarter of the year. At the end of 1981, reserves were more than \$5 billion below the levels of a year earlier. ^{17/} The worsening in these countries' current account situation was also visible in an uncharacteristic expansion of short-term bank borrowing.

During 1981 the deficit energy exporters tapped the international capital markets for a good portion of their financing needs. Nevertheless, a relatively small share of the additional financing seems to have been arranged through

^{15/} Derived by summing the current account surpluses from 1976 to 1981 and adjusting for official transfers and direct investment outflows.

^{16/} It should be noted that a growing share of total ODA received by developing countries is being contributed by some of these surplus countries. In 1980 ODA from the surplus countries amounted to \$6.7 billion or 2.7 per cent of their combined GNP (excluding Brunei and Iran).

^{17/} To be sure, the rise in the dollar vis-à-vis other reserve currencies during 1981, by reducing the dollar value of non-dollar reserves, accounts for a certain portion of the reserve decline expressed in dollars; however, as the overwhelming bulk of these countries' reserves is dollar-denominated, the effect of exchange rate changes was less important than the actual use of reserves.

syndicated Euro-currency bank credits 18/ or international bond issues. 19/ Rather it seems that the bulk of the net borrowing was in less publicized forms, including an unusual surge in short-term borrowing.

During 1981 the energy-importing countries were able to slow down the rise in their combined current account deficit. As the current account deficit did continue to increase, mobilization of additional external resources and further depletion of reserves were nevertheless required. By the end of 1981, the reserve situation could only be described as extremely unsatisfactory. For the energy-importing group as a whole, reserve levels would support only two and a half months' imports. By way of contrast, as recently as the end of 1979, reserve coverage had been 3.8 months. In fact, over half the energy-importing developing countries ended 1981 having reserve coverage under two months' imports, and over 30 per cent could not even cover one month's imports. All together, reserve levels at the end of 1981 were about \$8 billion below those at the end of 1980.

At the same time as the energy-importing countries were using their reserve assets, they were also increasing their use of the reserve-related credit provided by IMF. Heavy drawings were made from the recently enlarged credit tranche and Extended Financing Facility resources. 20/ As can be seen in table III-5, total net drawings rose sharply in 1980 and 1981, and most of the financing came from these two relatively high conditionality sources. It may also be noted that the low conditionality IMF facilities did not provide significant amounts of new net financing. One adverse development of special importance for lower-income countries in need of soft financing was the end of Trust Fund lending in March 1981. 21/

Not only were energy-importing countries using high conditionality funds more intensively, but they also positioned themselves to increase their use of such funds further. Thus of the 32 standby and extended facility borrowing arrangements between the Fund and energy-importing countries existing at the end of 1981, totalling \$19.5 billion in commitments, fully \$14.1 billion were undrawn.

18/ According to data compiled by the World Bank, less than \$1 billion of additional gross financing was arranged in this form by these countries in 1981 (International Monetary Fund, IMF Survey, 25 January 1982, p. 18).

19/ Morgan Guaranty Trust Company, World Financial Markets, December 1981, pp. 8-10.

20/ The funds for these drawings were provided through ordinary sources (expanded through the seventh quota increase in 1980) and borrowings via the Supplementary Financing Facility and the new Enlarged Access Policy (the latter providing less than \$300 million of credit tranche drawings and over \$500 million of Extended Financing Facility drawings in 1981, its first year of operation). For details on these various mechanisms, see International Monetary Fund, Annual Report 1981 (Washington, D.C.), pp. 85-88.

21/ The Trust Fund, which had been established in 1976 with some of the proceeds from the sale of IMF gold holdings, made loans at very low interest cost to eligible low-income member countries, repayable in instalments from 6 to 10 years after disbursements.

Table III-5. Net flow of IMF credit a/ to energy-importing developing countries, 1978-1981

(Billions of dollars)

	1978	1979	1980	1981
Low conditionality flows	-0.1	0.9	1.2	-0.7
Buffer stock financing facility	0.0	0.1	-0.1	0.0
Compensatory financing facility	0.2	0.4	0.5	0.2
Oil facility	-0.7	-0.6	-0.7	-0.7
Trust Fund	0.3	1.1	1.4	-0.2
Higher conditionality flows	0.2	0.9	2.1	5.3
Credit tranche drawings	0.1	0.6	1.3	3.1
Extended facility drawings	0.1	0.3	0.7	2.2
Total	0.1	1.8	3.3	4.6
<u>Memorandum items:</u>				
Agreed standby and extended arrangements at year end	0.9	2.1	10.0	19.5
Undrawn balance of above	0.7	1.2	7.3	14.1

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

a/ Change in outstanding IMF credit to the energy-importing countries measured in dollars from 31 December of previous year to 31 December of year given. Changes thus result from net drawings in SDRs and changes in the dollar value of SDR balances.

Preliminary information suggests that net ODA flows deflated by import prices are likely to have risen somewhat in 1981, but not enough to make up the fall of over 11 per cent in 1980. While net ODA flows in 1980 expanded by almost 11 per cent in dollar terms, import prices in the net energy-importing developing countries rose by 25 per cent. Between 1977 and 1980, the share of the current account deficit of the energy-importing countries financed by ODA fell from almost two thirds to about one third. Neither does direct foreign investment appear to have risen very significantly in 1981. Instead of these sources, it was primarily private debt capital, both short-term and long-term, that increased to meet the demand for net capital inflows.

Neither publicized bond issues nor Euro-currency bank credits appear to have made a substantial additional net contribution to financing the deficit of the energy-importing countries in the past two years. Concerning the former, foreign and international bonds continued their decline as a vehicle for mobilizing private sector funds. Fixed interest payment commitments at high real rates for the six to eight years' duration that such bonds have averaged over recent years have been an

effective discouragement to many potential issuers. ^{22/} In addition, floating interest rate Euro-currency credits have been available since 1978 for longer maturities than bonds. Nevertheless, the period of rapid expansion in the use of these credits by the energy-importing countries may have come to an end. The level of gross syndicated Euro-currency borrowing by these countries did increase in 1981, but not by enough to regain its 1979 level, while borrowing activity seems to have slowed appreciably in early 1982.

In all, the total level of energy-importing countries' indebtedness to foreign commercial banks continued to grow in 1981, albeit by a smaller amount than the \$30 billion in each of the last two years. ^{23/} However, it does appear that the increased concentration of that debt in short-term borrowing observed in 1980 was maintained, at least through the first half of 1981. Presumably borrowing countries are continuing a preference noted in 1980 to make more of their bank loans in less publicized forms than loan syndications.

In any event, against the high level of foreign bank lending to energy importers in 1981 must be set what seems to be a significant net outflow of short-term capital. To a certain degree this may represent a conversion of previously incurred short-term debt to longer-term loans. However, it may also represent substantial amounts of outright capital export, as the nationals of developing countries, their local banks, and local branches of transnational banks sought to place their funds in the high-yielding investments available in the major capital markets.

The continued high rates of bank lending to developing countries in 1981 seem to belie the anxiety expressed in certain quarters that funds for these countries from the international banking system might not be forthcoming in adequate amounts. To be sure, certain countries which were perceived by the banks to be in serious medium-term balance-of-payments difficulties were forced either to curtail their borrowings or to pay higher rates of interest, i.e., higher "spreads" over the changing base rate for floating-rate loans. However, at those higher rates, substantial flows seem to have been forthcoming, largely owing to the ample supply of funds available from the deposits of the foreign exchange surpluses accumulated by certain oil-exporting countries.

Since the late 1970s sharp increases in loan-equity ratios and alleged over-exposure to lending to developing countries by a number of important banks have been cited by some observers as reasons for predicting that lending to developing countries could not continue to expand as in the past. However, over

^{22/} Indeed, floating interest rate bonds, having many of the characteristics of Euro-currency bank credits, have emerged in the Euro-bond market.

^{23/} As of the time of writing, partial information suggests that in 1981 the increase in indebtedness was possibly one half that of 1980.

the years there have been various waves of new entrants to the international banking industry. ^{24/} The most recent has been the emergence of a group of Arab banks, some owned by Governments, some by the private sector, some in partnership with other international banks. Many of these banks have become heavily involved in Euro-currency lending and have recently arranged an important share of total syndicated loans. ^{25/}

The developed market economies: large shifts in the aggregate deficit to the smaller countries

As a result of the substantial energy price increases that occurred in 1979-1980, of differences in the timing and amplitude of the downswings in economic activity in the major industrial economies, and of considerable fluctuations in exchange rates, very large and sudden shifts in current account balances took place between 1978 and 1981. The combined current account balance (excluding official transfers) of the developed market economies shifted from a surplus of \$31 billion in 1978 to deficits of \$6 billion in 1979 and \$42 billion in 1980 (see table III-6). Mainly owing to high levels of exports to the energy-exporting developing countries and a recession-induced decline in imports, during 1981 the combined deficit practically disappeared. The current account is expected to swing back into substantial surplus in 1982, owing mainly to further reductions in the imports of oil and a fall in oil prices. In addition, sluggish economic activity during most of the year should keep imports from expanding strongly. There has been a substantial alteration in positions within the group, and some further shifts are expected to take place in 1982. The seven major countries, which generate more than two thirds of the group's trade, accounted for only a third of the total deficit in 1980. These economies actually moved into a combined surplus position in 1981, and the surplus is expected to rise sharply in 1982. On the other hand, the current account deficits have risen very rapidly in the smaller economies. In spite of favourable terms of trade developments, these deficits are forecast to remain substantial in 1982. Therefore, the adjustment pressures on these countries have become, and will most likely remain, particularly intense.

A number of factors have been responsible for the large imbalances in the current accounts of the smaller deficit economies over the past three years. First, these countries must import most of their energy needs, which makes them very vulnerable to energy price increases. Secondly, they have been less successful than the major economies in making significant gains in the growing markets of the energy-exporting countries. Thirdly, the smaller economies are very dependent upon trade with the large industrial countries, whose imports fell in real terms in 1980 and 1981. Fourthly, because of the trade-intensive nature of their economies, the smaller countries have had considerably greater difficulties in restraining the growth of their imports than the seven major economies.

^{24/} Policy developments in major capital market countries also affect the degree of competition in international banking; e.g. liberalization of banking regulations in Japan and the United Kingdom were stimulatory in 1981 (see Organisation for Economic Co-operation and Development, Financial Market Trends, 20 November 1981, p. 27).

^{25/} International Monetary Fund, IMF Survey, 8 February 1981, pp. 41-43.

Table III-6. Developed market economies: balance of payments
on current account, a/ 1978-1982
(Billions of dollars)

Country or country group	1978	1979	1980	1981 <u>b/</u>	1982 <u>c/</u>
<u>Total developed market economies</u>	31.3	-5.9	-42.3	-3.3	35.5
<u>Major industrial countries</u>	35.5	5.8	-15.2	15.5	41
Canada	-4.1	-4.4	-2.0	-6.0	-7
France	4.8	2.9	-6.2	-6.6	-7
Germany, Federal Republic of	13.4	-0.3	-9.5	-1.8	8
Italy	7.7	6.1	-9.4	-6.0	-0.5
Japan	18.0	-7.9	-9.5	7.9	28
United Kingdom	5.1	2.7	11.1	16.0	5.5
United States	-9.4	6.6	10.2	12.0	14
<u>Other industrial countries</u>	-4.2	-11.6	-27.0	-18.8	-5.5
Surplus countries <u>d/</u>	2.1	0.3	-0.9	6.1	8.5
Others	-6.3	-11.9	-26.2	-24.9	-14

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

a/ Excluding government unrequited transfers.

b/ Preliminary.

c/ Forecast.

d/ Netherlands, Norway and Switzerland.

The improvement in the current account position of the developed market economies in 1981 came about largely as a result of growing surpluses in the United States and the United Kingdom and a sharp turn-around in the deficits of Japan and the Federal Republic of Germany. The increase in the United Kingdom's surplus resulted largely from a sharp decline in the volume of imports induced by the recession. Despite a worsening in the trade deficit, the current account surplus of the United States continued to expand, mainly owing to further increases in net factor income from abroad.

In 1981 Japan's current account balance swung into a surplus of almost \$8 billion, compared to a deficit of nearly \$10 billion in 1980. The reason for the swing was a sharp upsurge in exports for the second year in a row and a decline in the volume of imports, which resulted in a dramatic increase in the trade surplus from \$2.1 billion in 1980 to an estimated \$22 billion in 1981. The major factors behind the surge in Japan's exports have been the marked improvement in its price and non-price competitiveness and concentration of the marketing activities of Japanese firms in the rapidly growing markets of the energy-exporting developing countries and the newly industrializing countries of East Asia.

The current account of the Federal Republic of Germany also showed considerable improvement in 1981. The sharp currency depreciation which began in mid-1980 and extended until the third quarter of 1981 stimulated exports and induced a fall in the volume of imports, which were also affected by the recession. Despite unfavourable price movements brought about by exchange rate depreciation, the trade balance improved substantially. A reduction in the deficit on services and private transfers also contributed to the significant fall in the current account deficit. Some of the same factors were also behind the more modest improvement in the Italian current account, which none the less remained in substantial deficit. In France, more stimulative economic policies than in other major countries prevented the current account from improving. The more favourable cyclical position of the Canadian economy relative to those of its major trading partners, particularly the United States, appears to account for most of the rise in the Canadian current account deficit.

During 1982, expected changes in current accounts are strongly influenced by developments in energy markets. Since all of the developed market economies with the exception of Canada, Norway and the United Kingdom are net energy importers, the substantial reductions in the value of oil trade expected in 1982 would tend to increase these countries' surpluses or reduce their deficits.

The largest improvements in current accounts are expected to take place in Japan and the Federal Republic of Germany. The impact of a lower oil import bill is expected to be particularly large on the Japanese current account. In addition, the price effects of currency appreciation would also tend to enlarge the Japanese surplus. However, real export gains are expected to be considerably more moderate than in recent years as a result of voluntary export restraint. The Federal Republic of Germany should also see its current account swing into substantial surplus, thanks to real export gains stimulated by currency depreciation during 1981, continued import moderation, and favourable movements in the terms of trade.

On the other hand, in other countries current account improvements may be more limited, and in the case of the United Kingdom, a substantial decrease in its surplus is expected. In the United Kingdom, a moderate improvement in the economic

climate may cause imports to rise, and declining oil export revenues may also contribute to a significant fall in the surplus. In the United States the recent deterioration in competitive positions resulting from the sharp appreciation of the dollar may discourage exports. However, the surplus could rise marginally on account of a substantial reduction in the oil import bill. As regards the smaller deficit countries, a reduction is expected in their current account deficit as a result of a significant decrease in the volume of imports and an improvement in their terms of trade. However, their exports are expected to continue to be adversely affected by the sluggishness of economic activity in the major countries.

These forecasts give some cause for concern. Continued balance-of-payments problems will put additional pressures on the small deficit countries to dampen economic activity. Perhaps of greater global significance, large emerging surpluses in Japan and the Federal Republic of Germany may lead to increased tensions among the major trading countries and to further turbulence in exchange rate markets.

Adjustment efforts in centrally planned economies

In contrast to earlier years, when very substantial increases in export revenues enabled the USSR to expand imports without adverse effects on the external balance, the sharp increase in import volume in 1981 led to a pronounced decline in the trade surplus of about \$2 billion (see table III-7). Although the over-all balance was still in marked surplus, the trade balance with non-socialist countries declined by over \$3 billion. This resulted in part from weak volume export growth in energy, owing to output constraints, soft world oil markets, and perhaps also the diversion of supplies to CMEA partners. However, the chief factor responsible for the substantial drop in the balance with non-socialist countries must be attributed to the poor crops of the past three years which led to a surge in the imports of agricultural products and food-stuffs.

Table III-7. Eastern Europe and the USSR: trade balances, 1979-1981
(Billions of dollars)

Country group	Eastern Europe			USSR		
	1979	1980	1981 <u>a/</u>	1979	1980	1981 <u>a/</u>
World	-5.1	-5.1	-3.4	6.9	8.0	6.2
Centrally planned economies	-0.4	-1.8	-2.4	2.7	4.1	5.5
Developed market economies	-5.2	-3.5	-2.8	-0.5	0.7	-1.7
Developing countries	0.5	0.2	2.0	4.7	3.2	2.3

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

a/ Preliminary estimates.

The over-all deficit of Eastern Europe as a group declined by nearly \$2 billion, largely as a result of a strong import cut-back (in Poland in particular) and export promotion, especially in the German Democratic Republic and Romania. The Eastern European countries devoted particular attention, once again, to relations with non-CMEA countries in an effort to hold down a further increase in their convertible currency debt. However, except for Poland and Romania, which were forced to curtail drastically imports from convertible currency partners in view of severe liquidity problems, convertible currency imbalances stayed approximately at the levels observed in 1980. 26/

In contrast to the preceding few years, when shifts in intragroup imbalances were kept within rather narrow bounds, major switches in both the size and the direction of intragroup imbalances occurred. The most important cause of the \$1.0 billion increase in Eastern Europe's intragroup deficit was the very weak economic performance of Poland, which reduced exports to the group in order to cut its deficit with convertible currency countries. Bulgaria's intragroup deficit also increased markedly, however, while the shifts for the other Eastern European countries remained comparatively minor. The counterpart of the intragroup imbalances of Bulgaria and Poland was the sharp increase in the Soviet Union's surplus with the group.

The comparatively small changes in intragroup trade imbalances of Eastern Europe, excluding Poland, could be flexibly accommodated within the institutional arrangements that govern trade and payments relations among CMEA members. Special measures were taken, largely by the Soviet Union, to assist Poland in both its intra- and extra-regional payments relations. As regards the current account gap with market economies, countries once again sought to finance it through new borrowings on world capital markets, Government-supported export credits of the supplier countries, direct supplier credits, and gold sales. The latter accelerated substantially over 1980 levels, probably in order to procure high levels of imports of agricultural products and food-stuffs.

The combined net convertible currency debt of Eastern Europe and the Soviet Union (including the two CMEA banks), which in 1980 had passed the \$69 billion mark, probably increased by another \$4 to \$6 billion in 1981, primarily owing to a reduction in the USSR's deposits with the international banks. Several Eastern European countries (including, Bulgaria, Poland and Romania) succeeded in reducing their net indebtedness in convertible currencies, 27/ while that of the remaining members of the group changed only marginally.

26/ Measured in constant 1980 dollars, the deficits of the centrally planned economies with the market economies in 1981 would have been substantially larger as all countries devalued their currency against the dollar. In the case of the USSR, for example, the devaluation amounted to about 11.5 per cent.

27/ This observation is derived from data reported to the Bank for International Settlements. Since there appears to have been a substantial substitution of supplier credits for bank loans in 1981, particularly in the case of Romania, but actual data are missing at this time, the above estimates should be treated as broad approximations of events in 1981 as a whole.

The financial relations of some centrally planned economies with world capital markets in 1981 were extraordinarily complex, and a number of scheduled syndicated loans had to be withdrawn, postponed or scaled down in view of the negative impact of the external payments difficulties of Poland and Romania on the credit standing of the group as a whole. By the end of the first quarter of 1981, it had become evident that Poland would be unable to meet its debt-servicing obligations, and the country therefore decided to seek accommodation through debt rescheduling. Negotiations were most protracted, however, in part because of the lack of experience of Governments of market economies or private bankers with devising a comprehensive package to cope with severe external economic disequilibria in centrally planned economies. 28/ Although by late 1981 the final round of rescheduling negotiations had been completed, the agreement could not be implemented because Poland had insufficient exchange reserves to meet 1981 interest payments - a pre-condition for the agreement's activation.

Unlike Poland's structural disequilibrium problems, Romania's foreign exchange situation became acute in mid-year as a result of an unfortunate coincidence. The greater over-all scepticism in financial markets vis-à-vis active lending to Eastern Europe complicated the unusual maturity structure of Romania's foreign debt, which was dominated short-term revolving financial facilities. 29/ When the latter could no longer be rolled over, Romania was confronted with substantial liquidity problems that could be overcome only by curtailing imports drastically and by rescheduling debt.

Selected policy issues

Volatility in exchange rates for major currencies

Beginning in the second half of 1980 and extending to the third quarter of 1981, the dollar appreciated strongly in foreign exchange markets and the currencies of the European Monetary System (EMS), sterling and the Swiss franc experienced a significant downward swing. The yen also came under pressure during 1981 but its decline was considerably more moderate than for other major currencies. Since then, the dollar has tended to weaken somewhat and some of the other major currencies have recovered some ground (see table III-8). 30/

28/ If a similar situation were to recur in 1982 or 1983, the international community could have a better set of instruments to cope with it if, as expected, Hungary and Poland are admitted to IMF and the World Bank by mid-1982.

29/ These facilities were established largely to finance on a short-term basis current imports of crude petroleum for re-export in the form of petroleum products to industrial markets in Western Europe. Therefore, soft oil markets may have further complicated an already tight situation.

30/ Owing to the devaluation of the French franc and the Italian lira within the EMS parity grid in October, these currencies continued to decline against the dollar in the fourth quarter.

Table III-8. Nominal and effective exchange rates for selected convertible currencies, 1978-1981
(1975 = 100)

		Deutsche mark	French franc	Japanese yen	Sterling	Swiss franc	United States dollar
<u>Exchange rates against the US dollar a/</u>							
1979	Third quarter	148.1	104.5	132.9	98.9	168.3	
	Fourth quarter	149.1	106.6	123.8	100.1	163.4	
1980	First quarter	126.7	104.5	118.9	97.5	140.9	
	Second quarter	139.9	104.9	136.4	106.3	159.2	
	Third quarter	135.8	102.1	139.9	107.5	156.6	
	Fourth quarter	125.6	94.9	146.2	107.4	146.6	
1981	First quarter	117.1	86.5	140.7	101.0	135.0	
	Second quarter	102.9	75.0	131.4	87.4	127.2	
	Third quarter	105.9	77.0	127.5	81.0	130.6	
	Fourth quarter	109.1	74.6	135.0	85.9	143.7	
<u>Effective exchange rates b/</u>							
1979	Third quarter	127.5	93.0	130.3	91.2	145.7	92.8
	Fourth quarter	131.8	95.4	119.0	88.5	147.6	94.3
1980	First quarter	131.8	95.6	116.5	92.4	145.1	94.5
	Second quarter	129.6	94.8	123.1	94.6	143.8	94.5
	Third quarter	129.4	95.1	128.5	96.6	145.5	92.0
	Fourth quarter	124.3	91.9	137.9	100.1	142.2	94.5
1981	First quarter	119.9	88.0	146.7	101.8	135.1	98.6
	Second quarter	118.2	84.5	143.1	97.8	134.0	105.5
	Third quarter	116.5	82.8	140.3	90.5	136.0	111.2
	Fourth quarter	122.5	82.1	141.7	89.7	151.5	107.4

Source: International Monetary Fund, International Financial Statistics.

a/ End of period.

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

The widening interest rate differential in favour of dollar-denominated assets that emerged after the monetary policy changes of October 1979 in the United States appear to have strongly influenced exchange rates. Other variables, particularly expectations regarding, and unexpected shifts in, current account positions and economic policies may also have played an important role in 1980 and 1981. The growing strength in the United States' current account in 1980 and 1981 and the advent of a new administration committed to strong anti-inflationary policies appear to have caused a change in market sentiment regarding the dollar. At the same time, European current accounts appeared to have been more adversely affected by external shocks than previously anticipated. The large interest rate

differential in favour of the dollar, together with expectation of dollar appreciation, attracted large capital flows into dollar-denominated assets, and expectations with regard to the dollar were realized.

The appreciation of the dollar could have been expected to go on until a point where anticipated future depreciation would have exactly compensated for the higher yield on dollar-denominated assets. The sharp dollar appreciation that did in fact occur - about 20 per cent in effective terms in the period from the middle of 1980 to the third quarter of 1981 - is indicative that considerable overshooting may have taken place. It is possible that, in the absence of sudden current account shifts or other surprises, the appreciation of the dollar may have fed upon itself in a cumulative fashion, taking exchange rates away from equilibrium rather than towards it.

The dollar stopped appreciating during the third quarter of 1981. Evidence of a turnaround in the current account position of the Federal Republic of Germany, a deterioration in the current account of the United States, a quick winding down of inflation in Japan, and the continuation of relatively high albeit lower rates of inflation in the United States may have led to a change in expectations. A rebound in interest rates in the United States since the end of 1981, together with evidence that inflation is steadily declining, caused the dollar to appreciate again vis-à-vis other major currencies in the early months of 1982.

Exchange rate instability since mid-1980 ^{31/} is undoubtedly an expression of the unsettled condition of the world economy, but it is also contributing to its current problems in both the short and medium term. In the European countries, particularly the more open small economies, the sharp exchange rate depreciation of 1980-1981 added to inflationary pressures. In spite of tight monetary policies and the softening of international primary commodity markets, inflation rates in the vast majority of these smaller countries accelerated or remained above 10 per cent in 1981.

In addition, exchange rate instability has had unintended effects on the international competitiveness of individual countries whose currencies have tended to change value in ways unrelated to underlying cost and price considerations. For example, in 1980-1981, although inflation in the United Kingdom and the United States was well above the average for the developed market economies, the dollar and sterling had periods of rather sharp appreciation, while the currencies of countries with below-average inflation (Japan, the Federal Republic of Germany and Switzerland) were weak. In the United Kingdom the problems caused by sterling appreciation during 1980 and until the first quarter of 1981 were particularly acute. Although appreciation helped to reduce the rate of inflation, it also was an important factor contributing to the most pronounced recession the country has experienced since the 1930s. In the United States appreciation eroded the margin of competitiveness in certain industries, such as steel, and led to serious difficulties in less efficient plants.

^{31/} Extremely wide fluctuations in exchange rates from month to month, and even on a weekly basis, have been recorded in the past two years, partly reflecting interest rate instability stemming from difficulties in managing money supply aggregates in the short term.

From a longer-term perspective, exchange rate instability between major currencies is contributing to the generalized climate of uncertainty and may have adverse effects on the pace of growth in the medium term. By increasing the uncertainty regarding export prices in domestic currency, these sharp exchange rate fluctuations may contribute to a dampening of real trade flows and of investment, especially in the smaller economies whose exports represent a large share of total output. Exchange rate volatility may well be one of the factors behind the slow-down in the growth of world trade registered in the post-1973 period.

The growing protectionist threat

While the world economy has avoided trade wars of the type experienced in the 1920s and 1930s and liberalization efforts have continued on some fronts, the slow-down in economic growth in the industrial countries since the mid-1970s has been accompanied by growing protectionist pressures and increasing resort to special trading arrangements as a way to ease domestic tensions. For a number of years now, the process of adjusting economic structures to changing comparative advantage has been slowed by inadequate economic growth. Given the unfavourable international economic environment, 1982 promises to be a year in which the resolve of the major trading countries to maintain an open world trading environment will be severely tested.

The outcome of the Tokyo Round of Multilateral Trade Negotiations (MTN) - of which the third tariff cut was implemented at the beginning of 1982 according to schedule - left a large number of observers and participants, especially those from developing countries, disappointed with the results. Of particular concern is the ambiguity surrounding the new codes of conduct negotiated during the Tokyo Round. The system of supervising committees to administer the codes is transforming a document which was difficult to amend into "a virtually continuous negotiating process". ^{32/} As has been pointed out, the difficulty in using the amendment procedures of GATT is the main reason why codes of conduct were developed to operate side by side with the Agreement. ^{33/} The manner in which these codes are to be interpreted will provide a crucial test of the continued ability of the GATT system to maintain an open trading system, and the growing use of administered rather than legislated protection is already attracting wide notice. ^{34/}

It should be noted that in regard to imports of developed from developing countries, some protectionist measures that were being applied on a temporary basis were allowed to lapse. In spite of efforts from domestic groups, Governments generally resisted the pressure for renewal. During the current recession, however, restrictive measures of various kinds against developing country exports have continued to be taken by a number of developed countries. The most important

^{32/} "Multilateral trade negotiations: report by the UNCTAD Secretariat" (TD/B/861 of 24 August 1981), p. 1.

^{33/} John H. Jackson, "Developing country relationship to GATT in the post-MTN era" (UNCTAD/MTN/205 of 13 April 1981), pp. 3-6.

^{34/} See, for example, Douglas R. Nelson, "The political structure of new protectionism" (World Bank Staff Working Paper No. 471, 1981).

recent case of developed country protection against developing countries is the renegotiated Protocol to extend the Multifibre Arrangement and the related spring 1982 bilateral negotiations between each importing signatory and each of the exporting signatories. The recently renegotiated Multifibre Arrangement is the most restrictive of the three which have been negotiated since its inception in 1973 as the replacement for the Long-term Arrangement regarding International Trade in Cotton Textiles negotiated in 1962.

Renewal of the Multifibre Arrangement in December 1981 was accomplished through agreement on a legal protocol. Although the text of the Arrangement remained unaltered, understandings reached among the participants in the negotiations form the framework within which bilateral negotiations are to be conducted in 1982.

The 1977 renewal of the Multifibre Arrangement had led to a sharp curtailment of the growth of developing country exports of textiles and clothing to the major developed economies. The curtailment in growth rates was accomplished outside the specific framework of the Arrangement through an extensive network of bilateral agreements. Although the Protocol to renew the Arrangement for a further four years and seven months was agreed upon in December 1981, the bilateral negotiations have yet to begin.

The 1981 Protocol was signed by 41 signatories (EEC was a single signatory) that account for over 80 per cent of world trade in clothing and textiles. The dominant suppliers have agreed to a cut in their quotas as a means of providing some slack for new exporting countries. While the individual growth rates remain to be negotiated bilaterally, they are likely to be negative (as in some dominant supplier product categories), "positive zero" (i.e. fractions of a percentage point for very sensitive categories), or low. The largest growth rates in quotas will go to the non-dominant or new exporters.

The European Economic Community has threatened to withdraw from the MFA before the end of 1982 should it be dissatisfied with the outcome of its bilateral negotiations. The negotiations of the EEC bilateral agreements due to begin in May 1982 will be complicated by at least two factors. First, Portugal and Spain, two prospective members of an enlarged EEC before expiration of the present terms of the MFA, are likely to receive further access to the EEC market as part of the ongoing negotiations on the terms of their membership. Both countries are scheduled to join the Communities in January 1984, and the terms of accession now being negotiated may reduce the share of EEC market growth available to developing countries. Further, protectionist pressures on a number of EEC Governments, intense while the Protocol was renegotiated last December, are already mounting as the Communities discuss global quotas.

Significant moves towards a more protectionist trading environment also occurred in trade among developed countries. Trade tensions among developed market economies have centred on the bilateral trade balances of Japan with the United States and EEC and on the pricing and domestic support programmes of a number of steel-exporting countries supplying the United States market.

The growing size of Japan's trade surpluses with both the United States and EEC was a subject of continuing discussion between the three parties throughout 1981. By the end of the year, Japanese forecasts of a relatively high export-led

growth path in 1982 and 1983 were being revised downward. The appointment of an ombudsman to mediate disputes involving Japan's internal policies and practices was followed by an announcement of the lifting of a large number of non-tariff barriers which had long figured in disputes over the openness of the Japanese market. Despite the range of announced changes in Japanese policies, very considerable pressure from the United States and EEC is evident. In the most formal instance of restriction on Japan's export capability, the United States and Japan entered into a three-year agreement to restrain Japanese car exports to the severely depressed United States market. European restrictions on Japanese car exports are also quite extensive albeit less formal.

Late in 1981 and early in 1982 a number of measures were adopted by the United States to restrict the flow of steel imports from a variety of sources. Although largely aimed at Western European steel firms, the measures were also directed at the steel exports of some developing countries and some Eastern European suppliers. In November 1981, in an unprecedented action, the United States Government initiated complaints against five steel-producing countries, using its own investigating machinery rather than waiting for a complaint to be filed by a producer. This was followed in early January 1982 by the filing of a large number of anti-dumping suits by seven producers. These actions were taken at a time when the United States industry was operating at 60 per cent of capacity with 76,000 workers idle. 35/ If protectionist actions in the United States were to prosper, they would undoubtedly worsen the problems being faced by the steel industry in the rest of the world, particularly in EEC, where a special Community-wide plan has been adopted to increase capacity utilization and raise prices to more remunerative levels.

In addition to the specific instances of trade tension discussed above, a number of other issues are still the subject of disagreement among countries and are likely to feature in the proposed GATT Ministerial Meeting in November 1982. These may include a further discussion of the issue of selective safeguards, the operation of the codes of conduct negotiated during the Tokyo Round, trade among developing countries, the trade effects of agricultural support programmes and the growing international trade in services. However, the agenda of the meeting is still under negotiation.

Up to the time of writing, protectionist threats have given rise to relatively few protectionist measures. However, the ability of Governments to continue to resist such pressures is likely to depend in no small measure on the strength of the recovery from the current recession. If the recovery does not gather momentum before the end of 1982, protectionist pressures may become increasingly strong. 36/

35/ This phenomenon is not unrelated to the sharp appreciation of the dollar.

36/ A particularly worrisome sign is the recent discussion in the United States Congress of a number of trade reciprocity bills, according to which the United States would impose import restrictions on countries whose markets for United States exports are less open than the United States market.

Chapter IV

ADJUSTMENT AND INTERNATIONAL CAPITAL FLOWS TO DEVELOPING COUNTRIES

Since the mid-1970s developing countries have been under pressure to adjust the structure of their economies to sharp and permanent changes in international prices. The structural adjustments required by substantially higher international energy prices include an increase in the domestic production of energy, changes in industrial technology to make it more energy efficient and, in the energy-importing countries, the allocation of additional resources to the production of tradable commodities to counteract the effects of the deterioration in the terms of trade on the current account of the balance of payments. These structural adjustments are of a medium-term or long-term nature, and they require substantial investment. International capital flows in general and long-term official flows in particular have an important role to play in facilitating this process of structural adjustment.

Since 1979, developing countries have also had to adjust to a very adverse external environment. The cyclical downswing in industrial countries, superimposed on an already weakened world economy, has caused particular hardships for developing countries. As indicated in chapter III, the energy-importing developing countries have experienced rapidly growing current account deficits owing to a very sharp deterioration in their terms of trade and rising interest rates. In the second half of 1981 the deficit energy exporters were also faced with rapidly mounting current account deficits resulting from falling oil prices and contracting oil export volumes.

Adverse exogenous factors led most developing countries to institute policies of retrenchment and short-term adjustment. As a result, aggregate demand has been slowed down, and in some countries it has experienced a fall in absolute terms. In most cases, short-term adjustment has implied a drastic reduction in the pace of growth and the postponement of investments which are deemed desirable from the point of view of longer-term adjustment. Therefore, there is a potential conflict between these two forms of adjustment, which can be eased by an increase in medium-term and long-term capital flows for the purpose of adapting economic structures. As discussed below, such an increase in medium-term and long-term flows has not been forthcoming, and many countries have been forced to rely more heavily on short-term financing and to institute very stringent adjustment measures to contain their current account deficits.

Short-term adjustment measures and their effects

Perhaps the most important set of measures introduced to deal with the crisis in the external accounts refers to direct action to stimulate exports or to compress imports. While export promotion measures have figured prominently in many countries' policies for a number of years, they have recently been intensified. Since 1979, the energy-importing countries have sought to alleviate the foreign exchange shortage by seeking new export markets, launching new lines of exports, and developing schemes to link imports to exports. In addition, they have adopted a host of specific measures designed to limit the demand for foreign exchange. Thus import duties and surcharges, prior import deposits, quotas and temporary

prohibitions, licensing arrangements, schedules for repayment of suppliers' credit, travel restrictions, and controls on remittances and capital flows have become an integral part of most adjustment programmes. Some countries, committed in principle to opening up the economy to external competition for the sake of efficiency, found themselves reluctantly reversing those trends in order to defend their balance-of-payments position. Others, concerned about introducing distortions in relative prices by the use of such controls, relied more heavily on currency devaluation to redress their payments imbalance. In addition, the aggregate demand restraint policy introduced in a number of countries had as one of its main goals to reduce the growth of import demand.

Restrictive domestic policies had already been adopted by most energy-importing countries in 1979. Since then, progressive credit tightening seems to have occurred: in two thirds of 78 countries examined, real credit expansion has slowed down; indeed, in one out of every three countries, real credit outstanding has actually declined. Another sign of tightening credit conditions is the level of interest rates: with very few exceptions, there has been a significant upward drift in nominal domestic interest rates since 1979, although in many countries real rates are probably still negative. A particularly worrisome consequence of this policy of credit restraint is that it has contributed to a decline in investment - especially in industry and construction - and that it has had a particularly harsh impact upon small- and medium-sized borrowers who lack access to alternative means of finance and who had long been accustomed to public sector low-cost credit.

Attempts at fiscal austerity also date back to 1979 in many cases, but the record is less clear on the degree of fiscal restraint actually attained. The complexity and diversity of institutional features evolved by the public sector in a number of countries make it difficult to establish whether funds have been spent, saved or merely reshuffled among government agencies; moreover, even the borderline between the public and private spheres is often hard to draw. Nevertheless, there is considerable evidence to the effect that practically everywhere discretionary government expenditures have been curbed: investment programmes have been scaled down, postponed or abandoned; subsidies (notably on energy and food, but also on public utilities and transportation) have been eliminated or are in the process of being phased out, public sector hiring has been reduced and vacancies have gone unfilled, social programmes have been cut back and extensive programmes for the privatization of publicly-owned enterprises are well under way in several countries.

On the other hand, non-discretionary expenditures - notably debt-servicing obligations, but also inflation-related surcharges such as cost overruns, cost-of-living adjustments for public sector employees and other indexed costs - have soared. At the same time, some erosion of tax revenues has occurred, mainly as a result of the repeated decline in the growth of economic activity over the last five years. Thus, even where fiscal restraint has been exercised, budget deficits have often continued to expand.

The above notwithstanding, the progressively more restrictive policy thrust since 1979 may be seen in annual government budgets, fewer and fewer of which are actively stimulatory, announcements of expenditure cutbacks, or officially announced IMF arrangements which make reference to budget policy. More recently, the number of countries subscribing to severe austerity programmes has risen to

include several energy exporters. Furthermore, budgets being announced for fiscal years beginning in 1982 do not indicate that any over-all planned relaxation may be expected soon.

The cumulative impact of these various policies on over-all growth has been very substantial. After a disappointing rate of growth in 1980, the deceleration of growth that took place in the energy-importing countries in 1981, of almost three percentage points, is without precedent. 1/

On the external front, the combination of efforts to increase exports and restrain imports has also had quite a dramatic effect on real trade balances. As may be seen in table IV-1, the trade balance in constant 1977 dollars was reduced by almost one half between 1978 and 1981. The table shows that there has been a fairly substantial growth in real exports, 2/ especially when the depressed condition of the world economy is taken into account. The conservation of imports,

Table IV-1. Net energy-importing developing countries: trade balance in real and nominal terms, 1977-1981
(Billions of 1977 dollars)

	1977	1978	1979	1980	1981 <u>a/</u>
Exports	105.4	111.3	120.0	129.1	134.5
Imports, f.o.b.	-123.7	-131.9	-139.1	-142.7	-145.5
Real trade balance	-18.3	-20.6	-19.1	-13.6	-11.
Trade balance in current dollars (billions)	-18.3	-27.3	-41.3	-54.9	-59.5

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

a/ Preliminary.

1/ It should be noted that weakening demand conditions stemming from domestic policies and the slow-down of export growth were not the only factors responsible for the deceleration in output growth rates. On the supply side, energy constraints and reduced availabilities of certain imported inputs also had a negative effect on manufacturing and transport activities.

2/ This was due partly to a shift in the direction of exports towards the more rapidly expanding developing country markets.

particularly since 1979, appears to have been widespread across both countries and economic sectors; in addition to the efforts to restrain energy and food imports, the imports of manufactures, including machinery and equipment, appear to have been held down. In spite of these efforts, the trade balance in nominal terms worsened sharply, owing to adverse terms of trade movements. Thus the major impact of the short-term adjustment measures has fallen on the pace of growth, and there has been no improvement in the current account.

An additional concern of most developing countries during this period has been to slow down inflation. Restrictive economic policies appear to have had only limited success, however, in reducing the rate of inflation.

The external shocks to which countries were subjected and the policy response to these shocks contributed to the acceleration of inflation in 1979 and 1980. First, the rise in the dollar prices of imports, which was so marked in 1979 and 1980, imparted inflationary shocks to domestic prices. Secondly, devaluation directly affected the domestic prices of all tradable goods in many countries. Thirdly, in those countries forced to constrain the growth of imports, the limited availability of imports placed upward price pressures on domestically produced substitutes also. Partly because of these factors, in 1980 the median rate of inflation in the energy-importing countries, as measured by consumer prices, was 15.8 per cent, compared to 10.3 per cent in 1975-1978. In 1981, however, in numerous energy importers there was a mild easing of inflation, and the median rate declined to 14.3 per cent. Undoubtedly, progress on the inflation front was partly the result of the easing of dollar import prices in 1981, but it was also due in large part to the slow-down in economic growth and to restrictive monetary and fiscal policies.

Measures to bring about structural adjustment

The need to cope with immediate and pressing balance-of-payments crises has figured most prominently in the policy packages adopted since 1979 by a large number of developing countries, but some important measures aimed at inducing longer-term structural adjustment have also been taken or reinforced.

The boundaries between measures to deal with short-term problems and those designed to bring about longer-term adjustments of productive structures are somewhat blurred. For example, some measures taken to compress imports and stimulate exports - for example, currency devaluation - may induce a reallocation of resources towards the tradables sector in the longer run. Other measures with a longer-term impact were also taken or reinforced by most countries. The specific contents of the programmes varied from place to place, but a number of elements were common to most of them. Virtually everywhere the domestic price of energy was raised to reflect its international cost. In part, this measure was dictated by fiscal necessity: energy subsidies were adding to soaring budget deficits. Higher energy prices served to bring about a degree of energy conservation and to foster substitution of domestic for imported energy sources. For example, the volume of petroleum imports, which accounted for over 90 per cent of the total fuel imports of the energy-importing countries, declined from 1979 to 1981 by roughly 30 per cent, while some important gains were registered in domestic energy production, particularly among small producers.

In most countries, the adjustment programme also contained features designed to further emphasize the agricultural sector, so as to substitute imports or to generate a larger exportable surplus. Typical measures in this area included the reduction or elimination of food subsidies (also undertaken to reduce budgetary pressures), the allocation of credit to farmers on a preferential basis (in terms of both cost and availability), renewed efforts at technical and marketing assistance, and the further development of irrigation schemes in conjunction with hydroelectric projects, some of which had been started in the second half of the 1970s and were now coming on stream. Indications are that there has been progress in expanding the agricultural base. Partly as a result of these measures, the over-all annual rate of increase in cereal production in the energy-importing countries rose from 2.1 per cent per annum during 1976-1978 to 3.8 per cent per annum during 1979-1981. ^{3/}

Investment and adjustment of productive structures

As explained above, increased investment is an important component of most programmes leading to structural adjustment, either in agriculture or other key sectors. However, short-term adjustment to the balance-of-payments difficulties of recent years has implied severe downward pressures on consumption and investment expenditures. The reaction of policy makers to the current situation has been quite different from that in the mid-1970s. ^{4/} Aided by a surge of private capital inflows and ODA, the share of GDP devoted to gross capital formation jumped markedly in developing countries during the period 1974-1978. Moreover, during the recession of the mid-1970s the increase in investment expenditures helped to counteract the impact on aggregate demand of the contraction in export earnings.

During the current recession the situation is turning out very differently. Both ODA and medium-term international bank lending have failed to expand as vigorously as in the mid-1970s. The considerably more moderate growth of ODA has affected the capacity of the least developed and other low-income countries to carry out investments needed for structural adjustment, while the slowdown in international bank lending has had an adverse impact on the investment programmes of the middle-income developing countries. Partly as a result of these trends in long-term and medium-term capital flows, many countries have chosen to dampen the growth of domestic expenditures, and the trend in investment shares observed during 1974-1978 has been reversed. Thus, of 69 energy-importing developing countries for which 1979 estimates were available, 29 per cent had falling investment shares.

^{3/} Excluding India, which had an exceptionally low harvest in 1979. Since then, Indian cereal production has increased at a rate similar to that of other developing energy importers (based on cereal production data presented in Food and Agriculture Organization of the United Nations, Food Outlook, 1982, No. 1, and 1981 Statistical Supplement).

^{4/} For a discussion of developing country responses to the crisis of the mid-1970s, see World Economic Survey 1979-1980 (United Nations publication, Sales No. E.80.II.C.2), annex I.

In 1980, of 54 countries, estimates showed the proportion experiencing a decline to have risen to 46 per cent, and preliminary results for 1981 suggest, if anything, a further decline in investment shares. Some countries have even suffered actual declines in real gross capital formation. Of the aforementioned samples, 23 per cent had falling real investment in 1979 and 41 per cent did so in 1980. Figures show that African countries have been disproportionately represented in these categories in both years.

In addition, the contribution to growth that may be expected from new investments is likely to be smaller than in the past. The sharp changes in energy prices of recent years have made a portion of the capital stock obsolete, and a share of the new investments will have to be devoted to making possible the use of alternate fuels in industry and transportation or to diminishing the use of energy per unit of output. Moreover, certain projects may have to be abandoned in favour of other investments; and new projects, such as more intensive exploration and development of potential domestic energy sources, may themselves be relatively capital-intensive.

As indicated in the World Economic Survey 1980-1981, 5/ domestic energy development was one of two areas singled out for particular attention in the process of structural adjustment, the other being agriculture. In both areas, large-scale capital projects as well as incremental investments are being undertaken. In energy, several countries now have plans significantly to increase petroleum production levels in the near future.

Thus far, however, no over-all breakthrough in energy production is expected in the near term in the energy-importing developing countries. In 1981, these countries increased domestic oil production by about 7 per cent. In addition, in the four energy importers which were utilizing nuclear power to generate electricity, output has essentially been at a plateau since 1979, 6/ although additional countries have nuclear plants in varying stages of construction. Furthermore, doubts have arisen of late about the long-term opportunity cost of alcohol-based motor fuel, for which significant investment programmes have been planned in several tropical countries.

Indeed, it seems that there continues to be an inadequate degree of energy investment, including petroleum, which is the primary commercial energy source for these countries. One major indicator is the number of oil-drilling rigs active: it is estimated that there were 373 drilling rigs active in the energy-importing developing countries at the end of 1981, and this was three fewer than the year before. In fact, over the past four years, the energy-importing developing countries were clearly not experiencing as much expansion in oil exploration activity as the rest of the world, and the energy-importing countries of Africa

5/ World Economic Survey 1980-1981 (United Nations publication, Sales No. E.81.II.C.2), pp. 75-76.

6/ Based on data through 11 months of 1981 for Argentina, India, Pakistan and the Republic of Korea, as published in United States Department of Energy, Monthly Energy Review, February 1982, pp. 96-97.

appear to remain particularly under-drilled. Over all, from 1977 to 1981, the average annual growth rate of rigs active in the energy-importing developing countries was 9 per cent. In contrast, taking the developed market economies and the energy-exporting developing countries together, the average annual growth rate over this period was 17 per cent.

It would thus seem that, in the crucial area of oil, investment has fallen well below what would be needed to bring about a significant adjustment in the relative prices that now prevail in the international economy. The failure of energy investment to expand adequately cannot be ascribed to a lack of fossil fuel reserves in the energy-importing developing countries. While estimates vary as to their probable reserves of oil, recent analyses indicate that 1990 oil production could be from 2.2 to 3.3 times the 1980 production levels of those countries. 7/

External finance for structural adjustment

From the preceding analysis it can be inferred that developing countries had to emphasize short-term adjustment in payments imbalances in preference to structural adjustment, which would have required a significant reallocation of investment and larger infusions of foreign capital. 8/ Perhaps the main reason for this choice has been the unavailability of adequate medium-term and long-term foreign capital flows at a time of limited growth in incomes and a severe tightening in export revenues. As stated above, medium-term international bank credits, which played such an important role in helping to increase investment in the mid-1970s, have failed to expand at a similar rate since 1979. In addition, the slow advance registered by ODA has adversely affected the investment possibilities and foreign exchange availability of the least developed and other low-income countries. In response to the onset of the current crisis, a number of developing countries had attempted to attract larger inflows of direct investment. Despite the new incentives that many countries instituted, substantially larger inflows have failed to materialize.

Current limitations to accelerated borrowing from private financial institutions

During the 1970s many developing countries greatly increased their external private borrowing, altering the maturity structure of their debt in the process. In more recent years, facing a less attractive borrowing environment, these countries have had to reassess the desirability of further rapid increases in

7/ See "Energy investment requirements of the developing countries - problems of estimation and financing": report of the Technical Energy Group of the Task Force on Long-term Development Objectives of the Administrative Committee on Co-ordination at its second session (New York, 12-14 October 1981).

8/ Reallocation of investment is much easier in an expanding economy with an increasing rate of saving and investment. Under conditions in which the rate of investment is stagnant or decreasing on account of falling incomes, such reallocation becomes extremely difficult unless additional foreign capital is available.

capital market debt. At the same time, some other countries have begun to tap these markets for annual rates of borrowing which are for them of unprecedented size.

For the capital-importing developing countries as a whole, the level of total external debt reached the order of \$475 billion in 1981, roughly twice the level of debt outstanding as recently as the end of 1977. The fastest growing component, and the private sector component to which more countries have access, has been international commercial bank debt. Thus, whereas bank debt is estimated to have been around 40 per cent of the total external debt of the deficit developing countries in 1973, by the beginning of 1981 it was at least 60 per cent. ^{9/}

While such bank debt has played an important role in being readily available at a time of greatly increased need, it has had a number of limitations as a form of investment finance for adjustment. First, a significant part of bank finance is short-term, usually for financing trade. More recently, however, countries have apparently also increased short-term borrowing for balance-of-payments purposes in lieu of longer-term loans. Moreover, the longer-term bank finance that is available is rather of a medium-term nature, with maturities which are seldom longer than 10 years. Applying such finance to infrastructure investment, for example, would require more frequent refinancing than has been necessary in the past,

A second drawback to current international bank finance is the method usually applied in determining interest costs, i.e., adding a fixed percentage spread to a fluctuating base interest rate. ^{10/} As discussed in chapter III, there have been very considerable changes in the base rate in recent years and, given the new factors determining interest rates in the major capital markets, future interest rate developments are extremely uncertain even over the short term. Greater volatility in interest rates has increased the degree of uncertainty regarding investments with funds borrowed from international capital markets. Moreover, whereas interest rates during the 1970s were largely negative in real terms, since 1980 they have been strongly positive when deflated by the prices of goods exported by the capital-importing developing countries.

As a consequence of severe balance-of-payments problems, the number of developing countries facing difficulties in servicing their bank debt has recently risen sharply. During 1981 nine member countries of IMF sought to renegotiate external debt through formal "creditor clubs", the largest number since the inception of multilateral debt relief exercises in 1956. Even among the countries not having actual debt crises in 1981, there were very considerable debt-related

^{9/} Off-shore banking centres in developing countries are excluded. It should also be noted that, since many developing countries place a portion of their foreign exchange reserves in Euro-currency deposits, and since most low-income countries have very inadequate access to bank credit, not all developing countries are net borrowers. At the end of 1980, out of 91 capital-importing developing countries for which there was adequate information, 41 generally lower-income countries were net creditors of the international banks.

^{10/} Most commonly, the 180-day London interbank offered rate (LIBOR) or the United States banks' "prime rate" on loans to preferred corporate customers.

pressures which, as has been indicated previously, contributed to economic policy turning sharply towards constriction. The source of the difficulty appears to reside in the substantially higher interest rates that countries had to pay on their floating-rate debt at a time of weakening export revenues and reduced international reserve levels. In addition, the tight balance-of-payments situation of the immediately preceding two years had forced many countries significantly to increase their borrowings, much of which was in the form of short-term debt.

Developments in 1981 suggest that in spite of the increased financial difficulties of many countries and the perceived higher riskiness of lending to certain high-debt countries, the international banks as a group have remained generally willing to continue lending to developing countries. However, the expansion of medium-term bank lending has slowed down significantly from the growth rates registered in the 1970s. While this may partially reflect a growing reluctance of the borrowing countries to increase their medium-term and long-term indebtedness at variable rates, there are indications that the international banks are becoming more cautious in their lending policies to those countries which are already heavily indebted to the private banks. Spreads have also increased considerably for many countries. Therefore, bank lending to developing countries may be expected to slow down further.

The uncertain contribution of other financial market flows

Foreign and international bonds have recently been playing a less and less significant role as a financial vehicle for developing countries. Indeed, the over-all activity on the major national bond markets has recently been rather unsettled, with sharp fluctuations in the volume of new issues in response to unusual swings in the terms available. For example, Kuwait's dinar bond market, an emergent source of international capital, was closed by the Government from October 1980 to August 1981. Also, from late 1979 to early 1981, Japan closed its private placement market to foreign borrowers, a vehicle extensively used by developing countries. Similarly, the Federal Republic of Germany halted non-resident deutsche mark bond issues on the domestic and Euro-markets for the first quarter of 1981. The bond markets, of course, were being buffeted by the effects of short-term interest rate swings, payments imbalances, and exchange rate movements.

The future level of bond market activity, as well as the developing countries' participation in that activity, remains highly uncertain. Currently, there is also exceptional uncertainty concerning the level of future United States Government borrowings, which could affect the total supply of bonds and thus market yields. Although developing country borrowers are not likely to be discriminated against in any formal manner, neither are they likely to greatly increase their access in the near term, given international conditions and market perceptions of risk.

There are, nevertheless, other vehicles for transferring long-term capital to the developing countries. Although they have not played a predominant role in the total transfer of resources, they have made a significant contribution. One of these vehicles is the International Finance Corporation (IFC), an affiliate of the World Bank, which was established to promote the growth of private investment and business in developing countries. With funds derived from official capital

subscriptions, loans and reinvested earnings, in 1981 IFC made loans in developing countries of \$800 million towards projects costing \$3.3 billion. 11/

There are also certain international private financial institutions, owned by many of the major transnational corporations and banks, which invest in the equity of and make loans to developing country enterprises. 12/ A further development in 1981 was the formation of the ASEAN Finance Corporation (AFC), whose equity is to be held by private and public entities of the ASEAN countries. The Corporation will itself provide equity, start-up loans and technical assistance to smaller enterprises in ASEAN member countries as well as guarantee outside loans and underwrite debt and equity issues. Partly to mobilize external funds, AFC has been in the process of forming the ASEAN-Japan Development Corporation as a joint venture with private Japanese investors. In the future, this form of private international financial co-operation could become an important source of funds for developing countries. At the present time, however, the amounts involved are small.

A final source of private finance of importance to some of the developing countries has been the earnings of nationals overseas. 13/ Such expatriates generally use the financial institutions of the host countries to hold their savings, as well as to transfer home remittances. However, overseas workers have to a certain degree also preferred to accumulate their savings in the institutions of the host country rather than in home country banks or other forms of domestic savings. With this in view, in 1981 countries including Egypt, Jordan and the Sudan took steps to attract home more overseas earnings of their nationals. These steps included offering higher interest rates in home banks on deposits of overseas nationals and making exchange rate adjustments. However, there is evidence that incentive schemes of this kind do not significantly increase total remittances, at least in the short run.

All in all, portfolio flows other than bank lending have not provided substantial amounts of financing to the deficit developing countries during the current recession. While some mechanisms appear to be promising, in the short-term future they are unlikely to make a significant contribution to the large balance-of-payments needs of developing countries.

11/ Fiscal year ending 30 June 1981 (International Finance Corporation, Annual Report, 1981, Washington D.C.).

12/ The oldest, ADELA (Atlantic Community Development Group for Latin America) began business in 1965, while two others, PICA (Private Investment Company for Asia) and SIFIDA (Société internationale financière pour les investissements et le développement en Afrique) were established in 1969. ADELA has recently undergone a financial restructuring.

13/ In 1980, for example, private transfers represented more than 20 per cent of the foreign exchange earned from merchandise exports in Bangladesh, Jordan, Morocco, Nepal, Pakistan, Somalia, the Sudan, Turkey, Yemen and Yugoslavia.

The path of direct investment

As discussed in the World Economic Survey 1980-1981, many countries have sought recently to take policy measures to encourage more direct private investment inflows. ^{14/} Scattered evidence from a number of developing countries does not as yet show any indications of a surge in foreign investment in 1981. In fact, partial 1981 data for a certain number of countries indicate a slowdown or actual decrease in foreign investment registrations or approvals by host country Governments. Inferences from the source country side also do not indicate a marked response as yet to such incentives.

In spite of the incentives which developing countries have offered to direct investment, and the further incentives which may be under consideration, there is reason to expect their near-term over-all effectiveness in increasing net flows to be marginal. First, enterprises considering direct investment to produce manufactures or primary products for export are highly influenced by the world market outlook for the medium and long run. Because of the deteriorating situation during 1981 and 1982, the start of some large projects involving foreign investment has been postponed indefinitely.

A second factor tending to retard increased direct investment is the level of interest rates. In 1981, the alternative to a relatively risky investment in a productive enterprise was a relatively riskless return from financial assets paying unusually high rates of interest. It is, of course, still true that traditional direct investors - for example, the transnational corporations - investing for reasons of longer-run competitive strategy or global production needs, do commit themselves to projects even when short-term factors, such as the cost of capital, are adverse. Nevertheless, there are also other direct investors, including those from capital surplus developing countries, who are seeking, in essence, to diversify their investment portfolios by purchasing assets such as real estate or existing enterprises as well as helping to establish new firms. Scattered evidence suggests that the high interest rates of 1981 were a fairly strong disincentive to direct investment.

In sum, what many countries viewed as a promising form of foreign capital at the beginning of the current crisis has failed to become a reality.

The inadequacy of official flows

Official flows can play a very important role in facilitating the process of structural adjustment in developing countries. First, official loans, be they official development assistance, flows from multilateral institutions, or export credits, are made available to a broader range of countries than are private flows. Secondly, official flows are generally available at lower interest rates and longer maturities than private flows. Since some investments related to structural adjustment (for example, in infrastructure or retraining facilities) are slow in maturing and have higher social than private rates of return, the terms and conditions of official flows are in such cases more appropriate than those of

^{14/} See World Economic Survey 1980-1981 (United Nations publication, Sales No. E.81.II.C.2), pp. 83-85.

private flows. Thirdly, during a period of falling rates of economic growth and foreign exchange stringency, the availability of long-term foreign capital inflows on appropriate conditions may be crucial for carrying out the investments required by structural adjustment.

The least developed and other low-income countries are especially in need of official flows. These countries have economies which are usually specialized in a few primary commodities and therefore do not have the flexibility of more mature economies to shift production and exports from one product line to another. Moreover, these countries have very inadequate access to the international banks and to other forms of private flows. In fact, the least developed countries as a group rely virtually completely on official flows for medium-term and long-term external capital. The group of lower-income oil-importing countries as a whole obtain over 90 per cent of their medium-term and long-term flows from official sources, while the middle-income oil-importing countries rely on official flows for less than a third of their inflows. 15/

Since the mid-1970s, the growth of official financing has been far from adequate. On the one hand, nominal ODA flows to the energy-importing developing countries, which had not yet grown at all in 1977, rose by 25 per cent to \$17.1 billion in 1978, to \$21.4 billion in 1979 and \$23.7 billion in 1980. On the other hand, in terms of the ability of those countries to purchase imports in general, ODA grew by 15 per cent in 1978, slowed to 3 per cent in 1979 and fell by 11 per cent in 1980. 16/ For 1981, preliminary indications are that ODA flows were probably able to finance a somewhat higher level of imports than in 1980.

The ODA outlook for 1982 and beyond is uncertain. Although donor countries were under considerable budgetary pressure, there were certain encouraging developments in 1981. One was that the United States passed a foreign aid bill for fiscal 1982 rather than a continuing resolution for the first time in three years; it allowed for a 14 per cent increase in economic assistance over the reduced levels reached in fiscal 1981. 17/ New ODA commitments were made by other developed countries in 1981, including that by France to achieve the ODA target of 0.7 per cent of GNP by 1988 at the latest, 18/ and that of Japan to extend during 1981-1985 more than twice the dollar value of ODA disbursed during the previous five years. Also encouraging were the increases announced over the past 18 months in the capital of certain of the oil-exporting countries' funds for economic

15/ Data are estimates for 1980 of World Bank country groupings. Lower-income countries are defined by the Bank as those having per capita GDPs below \$400 in 1979; accordingly, middle-income countries are those with per capita GDPs above \$400. See World Bank, Annual Report, 1981 (Washington D.C.), p. 23.

16/ ODA to all developing countries and multilateral agencies rose from 0.35 per cent of GNP in 1978 and 1979 to 0.37 per cent in 1980 for DAC member countries. See Organisation for Economic Co-operation and Development, Development Co-operation: 1981 Review (Paris), p. 174.

17/ This excludes food aid under PL-480, where budget authority was reduced; including food aid, the increase in assistance was 8 per cent.

18/ The French commitment refers to aid to independent countries.

co-operation with other developing countries and the recent agreement to replenish the International Fund for Agricultural Development, albeit at a level below the target set by its Governing Council. Most recently, a record amount of pledges was made at the March 1982 Pledging Conference on the World Food Programme, even though some of the principal donors had not then made their pledges. 19/ Also, by the end of 1981, the International Emergency Food Reserve exceeded 500,000 tonnes for the first time in its history.

Nevertheless, even with these developments and the efforts of those DAC member countries which at least seek to sustain their ODA flows in relation to GNP, the over-all ODA outlook is not encouraging. The date for achieving the United Nations' target of 0.7 per cent of GNP as ODA for all donor countries recedes further and further into the future. Moreover, in 1982 it has already become necessary for the World Bank to make considerable revisions in planned lending owing to the reduction in contributions to the International Development Association (IDA) below the agreed sixth replenishment levels. The Bank estimated that IDA lending in fiscal 1982 would probably not exceed \$3 billion, instead of the planned \$4.1 billion. Although the Bank was seeking to provide loans to make up the IDA cuts, the two are not close substitutes.

Finally, the outlook for non-concessional official flows is highly uncertain. On the one hand, the general capital increase of the World Bank has gone into effect. When member countries' subscriptions are completed, the World Bank's capital and lending authority will be substantially enhanced. 20/ On the other hand, given the poor outlook for imports of capital goods by most developing countries, official export credits are unlikely to expand as in the past. Furthermore, in the United States there has been recently a certain degree of domestic controversy over the appropriate level of budget support to finance exports. The outlook for non-concessional multilateral credit is further complicated by the fact that the ultimate source of funds for a large share of the loans that are made by the multilateral institutions is the international capital market. If high interest rates continue to prevail, as is likely, this would be an effective deterrent to borrowing by developing countries, particularly the least developed and other low-income countries.

While interest rates on official flows are considerably more attractive than interest rates on private credits, they have nevertheless risen over the last two years. Higher interest rates have raised the cost of funds to the official financial intermediaries, although less dramatically than for developing country borrowers owing to their continued access to the fixed-term bond market and their ability to make private fixed-interest placements with the Governments of developed

19/ Pledges of \$680 million were made toward the \$1.2 billion target for the biennium 1983-1984 (A/CONF.111/SR.2, paras. 63-65).

20/ Nevertheless, World Bank resources are still inadequate for the demands placed upon them. In response to the growing constraints on its resources, the Bank has recently indicated that it would apply its "graduation" guidelines with greater firmness in the future (International Monetary Fund, IMF Survey, 5 April 1982, p. 105).

and surplus energy-exporting countries. The result is that, for example, the World Bank was forced in January 1982 to raise its charges on new loans by adding a 1.5 per cent "front end" commitment fee. ^{21/} The annual interest rate on new loans continued to be 11.6 per cent, although it had been 9.6 per cent 12 months earlier. Similarly, interest rates under the OECD Arrangement on Officially Supported Export Credits were raised in November 1981; for low-income countries, they were increased from 7.75 per cent to 10 per cent.

Conclusions

Under current conditions, and in the absence of more decisive international financial support, the measures adopted by developing countries in the second half of the 1970s to effect structural adjustment are being increasingly jeopardized. These measures have been instrumental in increasing the volume of exports at a significantly faster pace than the volume of imports. However, adverse movements in the terms of trade, particularly in 1980 and 1981, and increases in interest rates have changed considerably the financial position of most of these countries, imposing upon them an adjustment of a different nature. Imports have been restricted through a variety of measures which, in the end, have led to a substantial deceleration in over-all growth.

Access to foreign resources to finance the growing deficits of developing countries has not been sufficient to prevent a certain fall in investment rates and a deterioration in their reserve position. On the one hand, official flows have expanded only modestly in recent years, affecting particularly the investment capabilities of the least developed and other low-income countries. On the other hand, the expansion of medium-term bank credits has decelerated markedly, partly owing to a growing reluctance on the part of developing countries to continue to build up their bank debt at much higher and more volatile interest rates, partly to growing cautiousness on the part of the banks themselves.

Therefore, the energy-importing countries have been forced to institute restrictive domestic policies in an attempt to repress their current account deficits by compressing import growth. In the course of 1981, they were joined in this policy stance by a number of energy exporters whose deficits had begun to grow as a result of developments in oil markets.

These policies of short-term adjustment are in conflict with efforts under way for a number of years to bring about the adjustment of productive structures to the new set of relative prices prevailing in the international economy. While short-term adjustment to reduce current account deficits requires a dampening of domestic expenditures, including investment, long-term structural adjustment necessitates an increase in the rate of investment. Thus the policies of short-term adjustment followed by many developing countries have implied the postponement or abandonment of projects aimed at structural adjustment.

^{21/} In order to ease the burden of the new charge, borrowers could capitalize it; i.e., borrow the fee and add it to the amount of the original loan.

Larger volumes of capital flows can ease this conflict between short-term and longer-term goals. A significant increase in ODA flows would be of particular importance to the least developed and other low-income countries, which depend heavily on such flows and which have been disproportionately affected by the current crisis. More generally, greater access to balance-of-payments financing on terms which recognize the longer-run nature of the problem would also help to resolve the conflict between reducing balance-of-payments deficits and the need for structural adjustment. Of course, a part of the increases in current account deficits in developing countries is of a transitory nature and is due to the recession in the developed market economies. Therefore, recovery in these latter countries should be accompanied by declining current account deficits in developing countries, and their need for continued balance-of-payments support would correspondingly lessen.