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WORLD ECONOMIC SURVEY, 1990

Corrigendum

1. Page 65, left-hand column, second paragraph, lines 7 and 8

Delete of Multilateral Trade Negotiations

2. Page 74, left-hand column

Delete the third, fourth and fifth paragraphs.

3. Page 98, left-hand column, first paragraph, lines 9-12

The third sentence should read

At first, the deficit countries would be accorded loans on commercial terms to clear most of the balance, the rest paid in hard currency, and the surplus countries would receive hard currency and, in smaller proportion, assets in the form of claims on the CEPU.

4. Page 98, left-hand column, second paragraph, lines 5 and 6

The third sentence should read

Second, loans by and claims against the CEPU would substitute for actual foreign exchange lending.

5. Page 103, right-hand column, line 2

After rate insert (see figure IV.11 for monthly United States sales of dollars for foreign exchange).

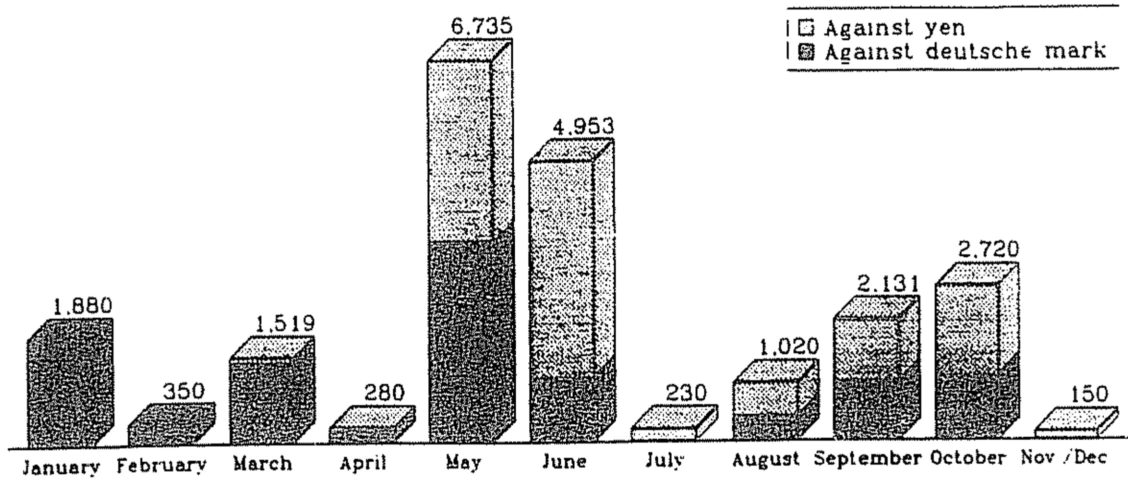
6. Page 104

Insert the following figure:

90-16359 1792j (E)

Figure IV.11. United States foreign exchange market intervention, 1989

(Millions of U S dollars sold)



7. Page 162, right-hand column, line 4

Footnote 14 should read 11

8. Page 170, right-hand column

The table should read

Total factor productivity of seven major market economies, 1961-1988[a]

(Average annual rate of growth)

	1961-1973	1974-1979	1980-1988
Canada	2.0	0.7	0.3
France	3.9	1.7	1.5
Germany, Federal Republic of	2.7	2.0	0.7
Italy	4.6	2.2	1.0
Japan	6.4	1.8	1.8
United Kingdom	2.2	0.5	1.9
United States	1.6	-0.4	0.4
Group of Seven	3.2	0.8	1.0

Source: OECD, *Economic Outlook*, No. 46 (December 1989), table 39.

[a] Defined as a weighted average of the growth of productivity of labour and capital in the business sector (weights in each period are shares in output of labour and capital). Total for group is the average of individual country data, weighted by 1987 GDP at 1987 exchange rates.

9. Page 180, right-hand column (table VIII.8)

Table VIII.8 should read

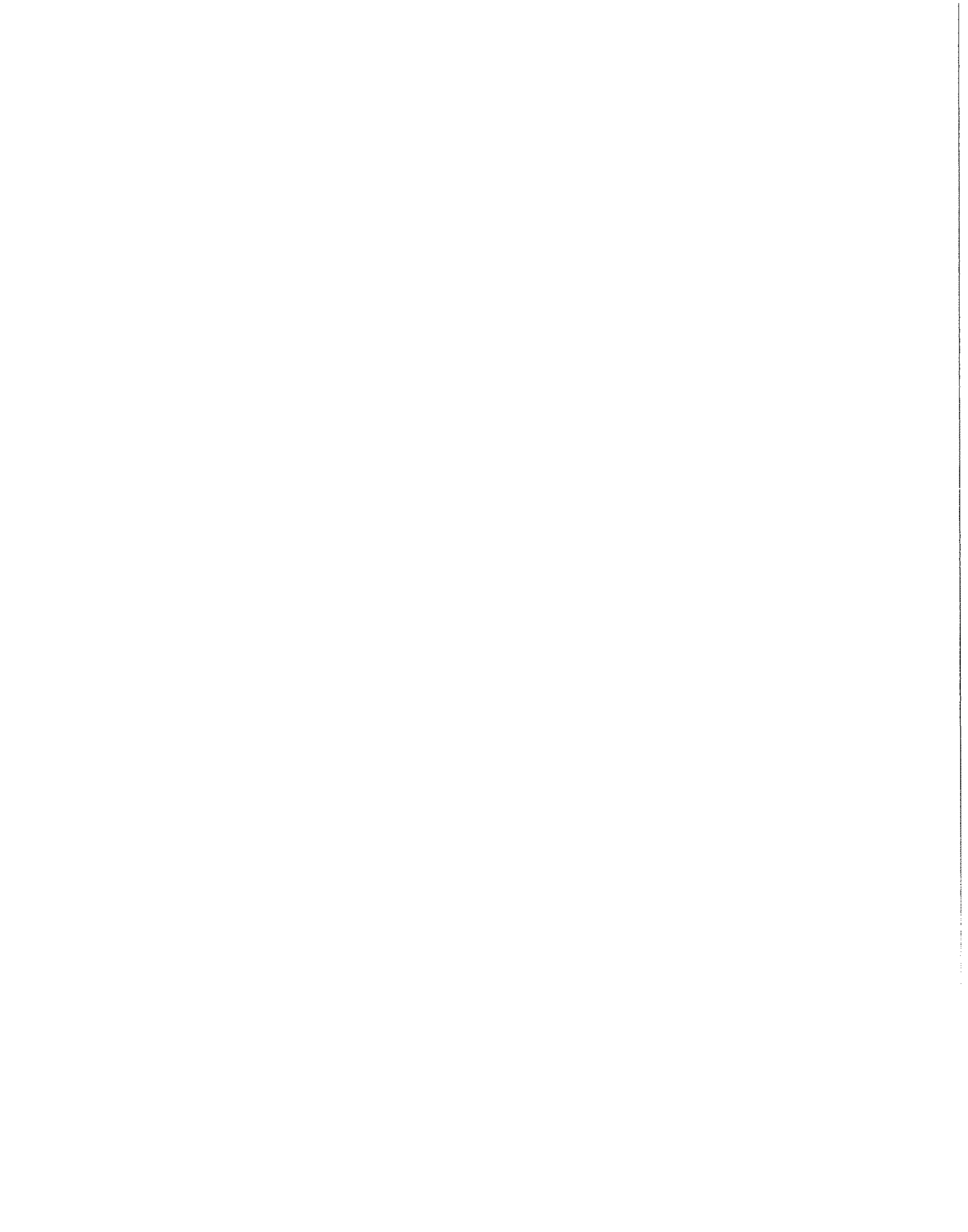
Table VIII.8. Growth of manufactured exports and of export markets of seven major market economies, 1983-1989[a]

(Average annual percentage change in volume)

	1983-1985		1986-1989	
	Market growth	Export growth	Market growth	Export growth
Canada	15.7	14.0	7.5	4.5
France	5.4	2.9	7.5	4.2
Germany, Federal Republic of	5.9	6.2	8.0	5.6
Italy	4.3	6.1	7.2	6.4
Japan	7.3	9.6	6.8	2.2
United Kingdom	5.3	5.3	6.9	5.8
United States	6.0	1.1	8.2	14.7
Group of Seven	6.6	5.9	7.5	6.4

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of OECD, *Economic Outlook*, various issues.

[a] Market growth is defined as a weighted average of the growth of manufactured imports in each exporting country's national or regional markets, the weights being the share of manufacturing trade flow in 1981 for years up to 1986 and 1985 for years thereafter.



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Department of International Economic and Social Affairs

WORLD ECONOMIC SURVEY 1990

CURRENT TRENDS AND POLICIES IN THE WORLD ECONOMY

UNITED NATIONS
New York, 1990

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.

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PREFACE

The year 1989 witnessed changes of historic proportions. The upheavals in Eastern Europe were mainly political in nature but have great economic significance for the countries of the region, as well as for the world at large. The easing of tension between the super-Powers has improved the prospect for reductions of defence expenditures and genuine co-operation on issues of global concern. Together, these largely unexpected changes hold out great promise for economic and social development throughout the world.

While the year was one of great political change, the challenges of international development and world poverty remained the same. In many countries, trends of stagnation and decline continue despite a vigorous expansion of world output and trade, usually because these countries remain handicapped by the external debt crisis. The pattern of resource flows between countries remains unchanged. Risks and uncertainties in the international economy continue to be high.

The *World Economic Survey, 1990* analyses these and other issues. It first provides an overview of the major issues, a review of the changes that have taken place in the international economy in the 1980s and an agenda for national and international action. It then examines regional and national developments with particular attention to policy changes, especially in Africa, Latin America and Eastern Europe. In accordance with Economic and Social Council resolution 1989/103, an assessment is made of the causes and consequences of desertification in developing countries.

The important developments in international trade and trade policy are given careful attention. The Economic and Social Council, in resolution 1989/112, requested the inclusion in the *Survey* of an analysis of trends in the net transfer of resources to the developing countries and their impact on the economic growth and development of those countries. A detailed analysis of such issues is included in the overall study of international financial flows.

Topics that have been singled out for special attention are recent developments in the international oil markets; the problem of inflation in Eastern Europe, the Union of Soviet Socialist Republics, China and Viet Nam; and the reasons for the long duration of the expansion of industrial economies.

In accordance with Economic and Social Council resolution 1989/113, the *Survey* contains a separate chapter on the impact of the world economic situation on the social situation of the developing countries, which is examined in some detail. As requested in resolution 1989/106, the socio-economic attainment of women in recent years is assessed in a special section.

As in the past, the *Survey* was prepared by the Department of International Economic and Social Affairs, with the co-operation of other offices and agencies of the United Nations system. This year, we had special contributions from the United Nations Office at Vienna, the Economic Commission for Latin America and the Caribbean, the United Nations Conference on Trade and Development and the International Monetary Fund, as well as important exchanges with all the United Nations regional commissions and the Organisation for Economic Co-operation and Development. We also drew on data and detailed analyses prepared by the General Agreement on Tariffs and Trade, the International Monetary Fund, the World Bank, the regional commissions, the United Nations Conference on Trade and Development and other international institutions. To all of them, we express our great appreciation.

It is our hope that the *World Economic Survey, 1990* will be of use to Governments, policy makers, the public and academic institutions and, most of all, that it will assist the Economic and Social Council in its examination of current developments and issues in the world economy.

Rafeeuddin Ahmed
Under-Secretary-General for
International Economic and Social Affairs

CONTENTS

	Page
Preface	iii
Explanatory notes	x
I. THE WORLD ECONOMY AT THE BEGINNING OF THE 1990s	1
The year 1989	1
The 1980s in perspective	2
Current world economic trends and short-term outlook	6
The national and international policy agenda	7
II. TRENDS IN GLOBAL OUTPUT AND POLICIES	13
The developed market economies: preparing for landing	14
Eastern Europe and the Soviet Union: at the cross-roads	18
Developing countries: the quest for resumed growth	21
Short-term outlook for the world economy	48
III. INTERNATIONAL TRADE	51
Overview	51
Trade flows and trade balances among country groups	53
Commodities	60
The uncertain future of multilateralism	63
Conclusions	74
IV. INTERNATIONAL FINANCE AND THE NET TRANSFER OF RESOURCES	75
The net financial transfer of the developing countries	75
Limitations of international policy toward developing country debt	88
The reform effort in Eastern Europe and the Soviet Union	94
Net financial transfers and exchange rate management in developed market economies	100
V. THE INTERNATIONAL OIL MARKET	105
Oil price recovery	105
Further increase in oil consumption	107
Pronounced production shift to OPEC member countries	108
New oil supply concerns	111
New directions in structural change of the petroleum industry	112
New directions in structural changes	115
VI. INFLATION, STABILIZATION AND ECONOMIC REFORM IN CHINA, EASTERN EUROPE, THE UNION OF SOVIET SOCIALIST REPUBLICS AND VIET NAM: ASPECTS OF THE POLITICAL ECONOMY OF TRANSITION	119
Inflation and the dilemma for reformers	119
Forms of inflation	120
Central planning and imbalances	123
Balancing the economy under central planning	125
Central planning and imbalances in the reform process	126
Starting conditions for market-oriented reform	127
Inflation, stabilization and economic reform in selected countries	128
Conclusions	155

CONTENTS *(continued)*

Page

VII. EXTERNAL ECONOMIC FACTORS AND SOCIAL CONDITIONS IN DEVELOPING COUNTRIES . . . 157

Declining per capita incomes during the 1980s . . . 157
Transmission channels and impact of external factors on the social situation . . . 159
The fall in urban wages and shifts in rural poverty . . . 162
Conclusions . . . 165

VIII. SOME FACTORS UNDERLYING THE PROLONGED EXPANSION OF THE MAJOR DEVELOPED MARKET ECONOMIES . . . 167

The abatement of inflation . . . 167
The buoyancy of household spending . . . 173
The rebound of fixed, non-residential investment . . . 177
The international transmission mechanism . . . 179
The role of policy . . . 185

IX. SPECIAL ISSUES . . . 189

A. Socio-economic attainment of women . . . 189
B. Selected socio-economic indicators . . . 205

Annex STATISTICAL TABLES . . . 225

BOXES

I.1. Declaration adopted by the United Nations General Assembly at its special session on international economic co-operation and development . . . 7
II.1. The challenge of adjustment: Nigeria . . . 30
II.2 Desertification and agricultural development in Africa . . . 34
III.1. An option for reforming the CMEA trade régime . . . 59
III.2. Motives for regional integration . . . 69
III.3. Farm trade . . . 73
IV.1. Measuring the net transfer of financial resources of developing countries . . . 79
IV.2. Implementation of the "Wass Report" recommendations on financial flows to Africa . . . 86
IV.3. A proposal for a Central European Payments Union . . . 98
VIII.1. Revival in productivity growth? . . . 170
VIII.2. The rising level of corporate indebtedness in the United States . . . 184

TABLES

I.1. Growth of world output, trade and population, 1981-1991 . . . 1
I.2 Growth of world output, 1971-1990, per capita GDP and share of world population by country group(s) . . . 3
II.1. Growth of population and output, by region, 1981-1991 . . . 13
II.2 Eastern Europe and the Soviet Union: selected macro-economic indicators, 1980-1989 . . . 19
II.3. Selected Latin American countries: interest payments by the non-financial public sector, 1980, 1983 and 1987 . . . 26
II.4. Africa: government views and policies regarding population growth and fertility, 1980 and 1989 . . . 36

CONTENTS *(continued)*

TABLES *(continued)* — *Page*

II.5. China: selected measures of economic performance, 1988-1990 46
III.1. World trade, 1980 and 1985-1990 52
III.2. Intra-bloc trade of some major trading blocs 54
III.3. Inter-bloc trade 54
III.4. Developed market economies: trade balance, 1980-1989 55
III.5. Developing countries: trade balance, 1980-1989 57
III.6. Eastern Europe and the Soviet Union: trade balance, 1980 and 1987-1989 58
III.7. Import coverage ratios of all selected non-tariff measures applied by selected developed market economy countries on all products, excluding fuels, 1981-1989 67
IV.1. Net transfer of financial resources of groups of developing countries, 1980-1989 77
IV.2. Net transfer of financial resources of the capital-importing developing countries, 1980-1989 82
IV.3. Foreign debt of the capital-importing developing countries, 1980-1989 83
IV.4. Net financial transfer arising from trade among European CMEA countries, 1980-1989 97
IV.5. Net financial transfer of European CMEA countries in convertible currencies, 1980-1989 97
IV.6. Net transfer of financial resources of developed market economies, 1980-1989 101
IV.7. Net resource transfers to the United States, by regions, 1980-1989 102
V.1. World oil demand, 1980-1990 107
V.2. Changes in the composition of oil demand in developed market economies 108
V.3. Changes in the composition of oil demand in developing countries 108
V.4. OPEC oil production quotas 109
V.5. World crude oil production 110
V.6. United States petroleum industry indicators, 1980-1989 111
V.7. World proved oil reserves, end 1979-end 1989 113
V.8. Integration of oil companies, 1988 114
V.9. Changes in oil company indicators 115
V.10. Crude oil production capacities of OPEC member countries 115
V.11. Investment requirements for additional production capacities by the year 2000 116
VI.1. Consumer price developments in Eastern Europe and the Soviet Union, 1970-1989 120
VI.2. Annual growth rate of NMP produced, monthly nominal wages and labour productivity in Eastern Europe and the Soviet Union, 1970-1989 124
VII.1. Real per capita income, 1980-1989 158
VII.2. Growth of output and per capita income, 1981-1989 159
VII.3. Government public expenditure in primary education and health care, 1980 and 1985 160
VII.4. Trends in social indicators, 1970-1987 161
VII.5. Real growth in factor payments 161
VII.6. Employment and labour earnings by segment, for Latin America and Africa 163
VII.7. Domestic terms of trade between agriculture and industry, 1980-1987 165

CONTENTS *(continued)*

TABLES *(continued)*

Page

VIII.1. Growth of real GDP of seven major market economies, 1961-1989 168

VIII.2. Real labour cost and productivity in the business sector of seven major market economies, 1974-1988 172

VIII.3. Net household saving of seven major market economies, 1974-1989 174

VIII.4. Population dependency ratios of seven major market economies, 1965-1995 175

VIII.5. Growth of financial wealth of households in the United States, 1974-1987 176

VIII.6. Growth of real private gross non-residential fixed investment of seven major market economies, 1974-1989 178

VIII.7. Rates of return in the business sector of seven major market economies, 1974-1989 179

VIII.8. Growth of manufactured exports and of export markets of seven major market economies, 1983-1989 180

IX.1. Females in the different employment categories, latest available year 191

IX.2. Rates of economic activity among urban and rural women in selected countries: 1980 census round .. 191

IX.3. Wage differentials in non-agricultural activities 193

IX.4. Indices for pupils enrolled at different education levels, percentage of females in total enrolment, and gross enrolment 193

IX.5. Comparison of rates of illiteracy among those aged 15-24, by gender and by urban and rural areas: 1980 census round 194

IX.6. Young people, aged 20-24, who had entered the second level of education or post-secondary studies, 1970 and 1980 196

IX.7. Life expectancy at birth, by region 196

IX.8. Maternal mortality 197

IX.9. Total fertility rate 198

IX.10. Differences between urban and rural dwellings in developing countries; units without piped water, toilets or electricity: 1980 census round 201

IX.11. Birth and survival of children in rural and urban areas 201

IX.12. Women in the four highest levels of government, by region 202

IX.13. Women in legislatures, 1975 and latest year 202

IX.14. Urban and rural population growth, 1985-2000, medium variant 206

IX.15. Urban agglomerations with projected populations of 10 million or more in the year 2000 209

IX.16. Average annual rate of growth of total and per capita agricultural production, 1976-1989 212

IX.17. Average annual rate of growth of total and per capita food production, 1976-1989 215

IX.18. Production of electricity, 1970-1988 217

IX.19. Consumption of motor gasoline, 1970-1988 220

FIGURES

II.1. Growth of output in Western Europe, Japan and the United States, 1980-1989 15

II.2. Short-term interest rates in the Federal Republic of Germany, Japan and the United States, 1986-1989 16

II.3. Exchange rates of the dollar against the deutsche mark and the yen, 1986-1989 17

II.4. Latin America: growth of output and population in heavily indebted and other countries, 1980-1989 . 23

II.5. Latin America: volume of imports and exports and merchandise trade balance, 1980-1989 24

CONTENTS *(continued)*

FIGURES *(continued)*

Page

II.6. Africa: growth of output and population by subregion, 1980-1989 27

II.7. West Asia: growth of output and population of energy-importing and energy-exporting countries, 1980-1989 37

II.8. West Asia: budget balances in selected countries, 1981-1988 40

II.9. South and East Asia: growth of output and population by subregion, 1980-1989 42

III.1. Trade and output, 1980-1989 52

III.2. Composition of world and developing country exports, 1980 and 1988 56

III.3. Non-fuel commodity price indices, 1980-1989 61

III.4. Exports of mineral-exporting developing countries: volume versus value, 1981-1990 63

III.5. Terms of trade for selected country groups, 1980-1989 64

IV.1. Net international transfer of financial resources in 1989 76

IV.2. Investment and net financial transfer of 15 highly indebted developing countries, 1980-1989 78

IV.3. Investment and net financial transfer of sub-Saharan Africa, 1980-1989 78

IV.4. Additions to GDP of developing countries under two scenarios, 1991-1994 79

IV.5. Gross borrowing on international capital markets by capital-importing developing countries, 1981-1989 83

IV.6. Multilateral resource commitments for development, 1980-1989 85

IV.7. Secondary market bids on bank debt of developing countries, 1986-1990 89

IV.8. Secondary market bids on bank debt of Brady-Plan countries, 1986-1990 90

IV.9. Net transfer of financial resources of four planned economies, 1970-1989 96

IV.10. Real effective exchange rates of Federal Republic of Germany, Japan and the United States, 1980-1989 103

V.1. Crude oil prices 106

V.2. OPEC oil production and f.o.b. oil prices 109

VI.1. Eastern Europe: consumer price indices, 1970-1989 121

VI.2. China, Eastern Europe and the Soviet Union: indicators of growth, productivity and wages, 1981-1989 121

VI.3. Viet Nam: price indices, 1981-1989 129

VI.4. Viet Nam: indices of relative prices, 1981-1989 133

VI.5. Poland: indicators of inflation, 1971-1989 135

VI.6. Poland: indicators of inflation, 1971-1981 137

VI.7. Poland: divergent retail price movements, 1971-1988 137

VI.8. Poland: growth in real income and its sources, 1970-1988 139

VI.9. Hungary: indicators of wholesale price inflation, 1970-1989 141

VI.10. Hungary: indicators of consumer price inflation, 1970-1989 141

VI.11. Hungary: growth in real per capita income and its components, 1971-1987 143

VI.12. China: measures of inflation, 1976-1989 146

VI.13. China: wage, productivity and price changes, 1979-1989 147

VI.14. China: indices of relative prices, 1980-1988 148

CONTENTS *(continued)*

FIGURES *(continued)*

Page

VI.15. China: money supply and credit growth, 1978-1989 ... 149

VI.16. China: composition of government expenditure, 1978-1988 ... 150

VI.17. USSR: implicit wholesale price index, 1960-1988 ... 153

VIII.1. Commodity import prices of developed market economies, 1970-1989 ... 168

VIII.2. Growth of real private consumption expenditure of seven major market economies as a group, 1974-1989 ... 173

VIII.3. Growth of real private gross non-residential fixed investment of seven major market economies, 1974-1989 ... 178

VIII.4. Growth of aggregate demand and output of seven major market economies, 1983-1989 ... 181

IX.1. Prevalence of anaemia in pregnant women ... 204

IX.2. Consumption of motor gasoline, 1970-1988 ... 212

EXPLANATORY NOTES

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

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

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

A hyphen (-) 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 (/) between years indicates a crop year or financial year, for example, 1988/89.

Use of a hyphen (-) between years, for example, 1986-1989, 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. In most cases, the growth rate forecasts for 1990 and 1991 are rounded to the nearest half of a percentage point.

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

The following abbreviations have been used:

ACP	African, Caribbean and Pacific Group of States
APEC	Asian Pacific Economic Co-operation Forum
ASEAN	Association of South-East Asian Nations
ATPC	Association of Tin Producing Countries
CAP	Common Agricultural Policy
CBI	Caribbean Basin Initiative
CEPU	Central European Payments Union
CMEA	Council for Mutual Economic Assistance
EC	European Community
ECA	Economic Commission for Africa
ECE	Economic Commission for Europe
ECLAC	Economic Commission for Latin America and the Caribbean
EES	European Economic Space
EFTA	European Free Trade Association
EPU	European Payments Union
ESCAP	Economic and Social Commission for Asia and the Pacific
ESCWA	Economic and Social Commission for Western Asia
f.o.b.	Free on board
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Co-operation Council
GDP	Gross domestic product
GNP	Gross national product
IBEC	International Bank for Economic Co-operation (Moscow)
IFAD	International Fund for Agricultural Development
ILO	International Labour Organisation
IMF	International Monetary Fund
LIBOR	London interbank offered rate
LNG	Liquefied natural gas
LPG	Liquefied petroleum gas
mbd	Million barrels per day
NATO	North Atlantic Treaty Organization
NMP	Net material product
NTM	Non-tariff measure
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development

OPEC	Organization of the Petroleum Exporting Countries
SDR	Special drawing rights
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
VER	Voluntary export restraint

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 United Nations Secretariat 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:

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

Developing countries: Latin America and the Caribbean, Africa (other than South Africa), Asia (excluding Japan), Cyprus, Malta, Yugoslavia; for some analyses, China has been shown separately.

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

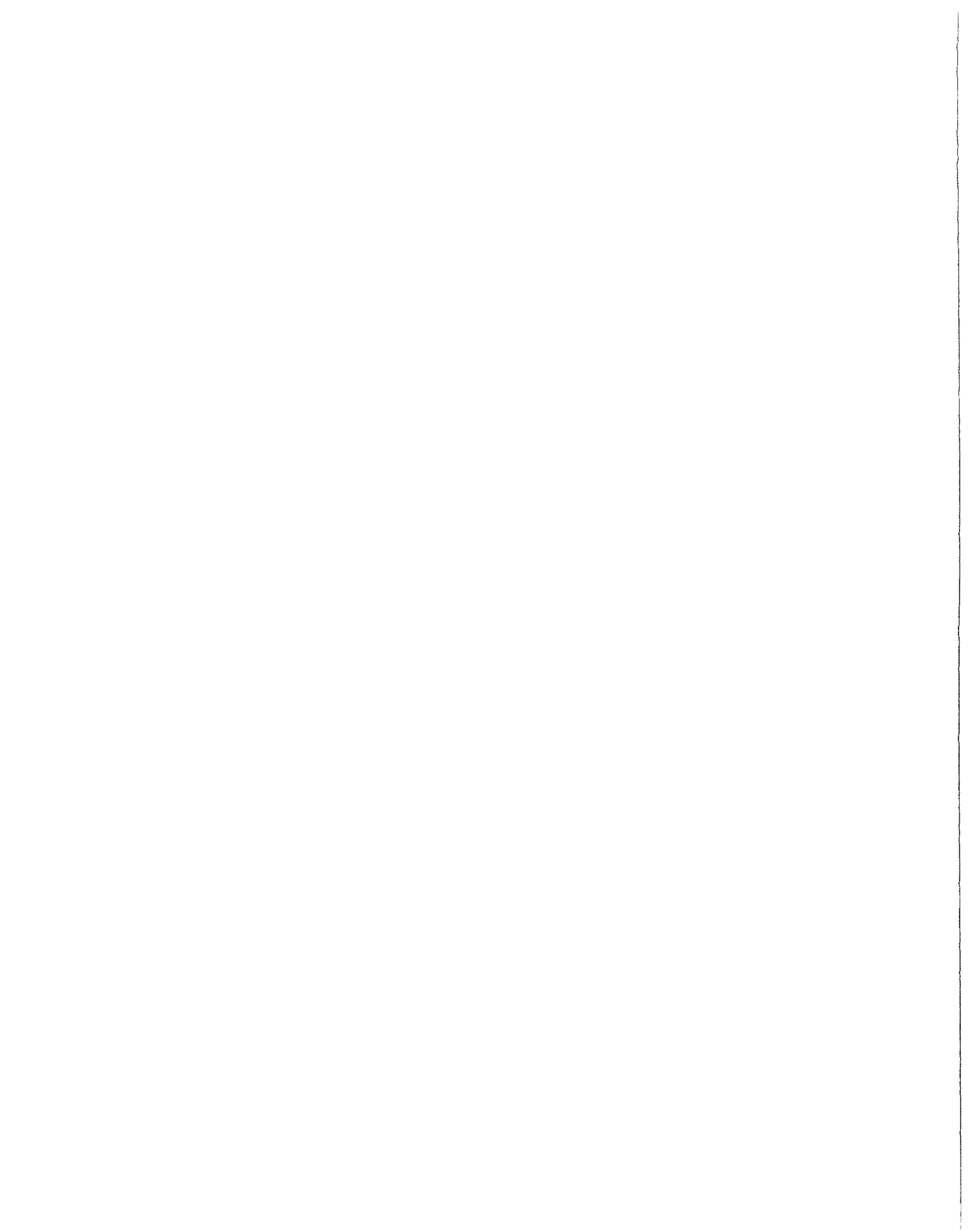
Capital-surplus countries: Brunei Darussalam, Iran (Islamic Republic of), Iraq, Kuwait, Libyan Arab Jamahiriya, Qatar, Saudi Arabia, United Arab Emirates

Deficit countries (or capital-importing countries), subdivided into the following two subgroups:

Other net energy exporters (or deficit energy (exporters): Algeria, Angola, Bahrain, Bolivia, Cameroon, Congo, Ecuador, Egypt, Gabon, Indonesia, Malaysia, Mexico, Nigeria, Oman, Peru, Syrian Arab Republic, Trinidad and Tobago, Tunisia, Venezuela.

Net energy importers: All other developing countries.

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



Chapter I

THE WORLD ECONOMY AT THE BEGINNING OF THE 1990s

The year 1989

The dramatic political upheavals that occurred in 1989 marked the end of a long period of intense international dispute over the appropriate organization of modern industrial societies. The relaxation of tensions between the super-Powers seemed to reduce the risk of nuclear annihilation. In the longer term it should open up new opportunities for peaceful co-operation throughout the world. However, the transition that has been set in motion has so far generated much political turmoil and economic crisis, and there is inevitably great uncertainty and apprehension about the way it will unfold.

Although the events in Eastern Europe tended to overshadow other developments in 1989 and early 1990, remarkable changes occurred elsewhere too. The European Community agreed to crown its plans for a single market in 1992 by the institution of a common currency, which will be a step of immense historical significance and wide political implications. Throughout the world there was an important awakening to both local and global environmental threats to future development and the need for joint action. There was also a readiness, which had been growing throughout the 1980s, to re-examine fundamental assumptions about the nature and the objective of economic and social progress, and a reaction against the neglect of the human condition.

If 1989 was rich enough in unexpected and significant events to stand out as a turning-point in many respects, it is also important to note what did not happen. The stagnation and decline in much of the developing world were not reversed, after seven years of sustained growth in the industrialized countries, after solid growth of international trade for three consecutive years, and after major adjustment efforts in Africa and Latin America. It is true that in Latin America, democratic Governments waged new attacks on the deep economic crisis and financial disorder of the continent. In Africa, important signs of change in South Africa and many other countries held out some promise of an eventual way out of the crippling stagnation of the continent. But the persistence of the development crisis is taking its toll, and impatience is giving way to resignation and exodus.

World output grew by 3.1 per cent, compared with 4.4 per cent in 1988 (see table I.1). The developed market economies continued their long post-war expansion and grew by 3.5 per cent, more vigorously than expected. The developing countries of South and East Asia, which account for a large proportion of world population, grew by 6 per cent despite a sharp slow-down in China. But most countries in Africa and Latin America continued to stagnate or decline. In the economies of Eastern Europe and the Soviet Union, output increased by about 1 per cent.

World trade remained dynamic despite the slow-down in world output. The volume of trade increased by about 6.7 per cent in 1989, after an increase of 9 per cent in 1988.

Outside Eastern Europe, the performance of the world economy in 1989 seemed in many important respects an extension of its recent past. This was particularly true of the pattern of regional diversity and of the persistent imbalances and the pattern of resource flows among countries. The large current account imbalances among the major economies abated only slightly. The problems arising from the external debts of the developing countries persisted.

Table I.1 Growth of world output, trade and population, 1981-1991[a]

	Annual percentage rate of change of gross domestic product and trade						Rate of growth of population 1985-1990 (annual percentage)
	1981-1986	1987	1988	1989	1990	1991	
Output							
World	2.8	3.5	4.4	3.1	2.2	3.0	1.7
Developed market economies	2.3	3.2	4.3	3.5	2.7	3.1	0.5
Eastern Europe and the Soviet Union	3.2	2.6	4.1	1.2	-1.2	0.2	0.9
Developing countries	2.7	4.1	4.5	3.4	3.1	4.5	2.1
World trade volume	2.3	5.3	9.0	6.7	5.9	6.0	

Source: Department of International Economic and Social Affairs of the United Nations Secretariat.
[a] Preliminary estimates for 1989; projections for 1990 and 1991; net material product for Eastern Europe and the Soviet Union.

Some of the key international prices remained practically unchanged or retained their recent trends, while others changed significantly. On average, non-fuel commodity prices were stable. Fuel prices, on the other hand, rose substantially during the year. International interest rates rose, primarily in response to inflationary tendencies in developed market economies. Exchange rates of major currencies were volatile and the dollar appreciated significantly, tending to erode United States competitiveness built up over the past years and hence the prospects of reduction of the country's large trade deficit.

After the overview in the present chapter, chapter II examines global and regional trends in output, focusing on the large diversity of conditions and experience, and on the short-term prospects for the world economy. Chapter III presents an analysis of recent trends in international trade and developments in the trading system. Chapter IV examines the pattern of resource flows among countries with special emphasis on the problem of net outflow of resources from the developing countries associated with the international debt crisis. Recent developments in the international oil markets are surveyed in chapter V. Chapter VI examines the problem of inflation in Eastern Europe and in China and Viet Nam in the context of their internal and external imbalances and attempts at economic reform. The impact of external economic changes on the social situation of the developing countries is examined in chapter VII. Chapter VIII analyses factors explaining the duration of the recent expansion of the developed market economies, the longest in postwar history. An analysis of the socio-economic attainment of women in recent years is presented in Section A of Chapter IX and some selected socio-economic indicators are reviewed in Section B.

The 1980s in perspective

Between 1980 and 1990, important changes in the functioning of the world economy took place. The relative position of countries in the world economy also changed and new growth poles appeared. There were large shifts of income between countries. Markets became further globalized and interdependence among countries increased. The structure of production and trade shifted further from primary production towards manufactures, and even more markedly towards services. New opportunities of development arose and new challenges emerged, accompanied by major shifts in emphasis in economic policy preoccupations. Perceptions of causes and conditions of development were greatly modified.

Growth of world output: a diversity of experience

World output grew by just over 30 per cent in the 1980s, more slowly than in the 1970s, when it increased by over 45 per cent (see table I.2). World population increased by 20 per cent to 5.2 billion; over 90 per cent of the increase took place in developing countries. World per capita output grew by about 1 per cent a year compared with 2 per cent in the previous decade.

While the global economy expanded more slowly, there was a great diversity of growth experience. Growth in developed market economies slowed from 3.1 per cent in the 1970s to 2.6 per cent in the 1980s. Per capita income still increased by about 2 per cent a year over the decade. The rates of growth of the individual economies also became more similar than before, which reflected a greater degree of integration. The process of integration was most apparent in Western Europe but other industrial countries also came to be more closely linked to one another. The Soviet Union and Eastern Europe also grew more slowly in the 1980s than in the 1970s.

Among developing countries there was great divergence. In Latin America the annual rate of growth of GDP plummeted from 5.5 per cent in the 1970s to just over 1 per cent in the 1980s. Per capita GDP declined and in 1990 was almost 10 per cent lower than in 1980. In Africa the rate of growth declined from about 5 per cent in the 1970s to less than 1 per cent in the 1980s; per capita output fell by 20 per cent over the period. There was also a large decline in per capita output in West Asia. By contrast, South and East Asia, including China, grew by over 7 per cent a year in the 1980s. The high rate of growth was not confined to the relatively small newly industrializing countries. Some of the most populous countries of the region grew faster than before.

This altered the relative position of countries on the income scale. Per capita income of a number of low-income Asian countries approached or exceeded the average income level of sub-Saharan Africa, and those of middle-income Asian countries approached or exceeded Latin American or even developed country levels.

In the 1980s, growth of the developing countries was practically unrelated to the level of development. Countries of the same level of per capita income grew at different rates: some middle-income countries grew fast while others declined, and many low-income countries stagnated while others grew vigorously. However, the least developed countries, in which the handicaps were particularly severe, showed the least progress and in many cases declines.

There has been much debate about why growth rates differed so much between countries in the 1980s. This disagreement has often centred on the relative roles of external and domestic factors. The role of domestic policies and factors tended to be heavily emphasized by Governments of rich countries which remained unaffected by adverse external developments or had themselves benefited from the changes in world markets. External factors were emphasized by countries that had been heavily buffeted by world market trends beyond their control.

As analysed in past *World Economic Surveys*, both domestic and external factors have to be recalled in order to explain the differences in growth performances in the 1980s. The number of success stories actually declined sharply in the 1980s, and the number of setbacks and failures increased. There must have been some common factors at work behind

the simultaneous reversal of the economic fortunes of so many countries, and they are not hard to find.

The dramatic fall in commodity prices and terms of trade was one such factor. Between 1980 and 1988, the real prices of non-fuel commodity exports from developing countries declined by some 40 per cent. Fuel prices declined by 50 per cent. Latin America's terms of trade fell by about 25 per cent; for West Asia and Africa, the terms of trade fell by 40 per cent. The loss for South and East Asia was relatively small. The transfer of real income from Latin America, Africa and Western Asia towards their trading partners in the developed countries was large. The impact of this loss was compounded by the debt crisis, itself partly the result of the collapse of commodity prices, and by the sharp rise in interest rates in the 1980s. The combination of these external shocks reduced real disposable income and investment. Many developing countries were forced to adopt stringent measures of stabilization and adjustment, which have not so far resulted in sustained economic growth.

The magnitude and impact of these external shocks go a long way towards explaining why some developing countries were doing so much worse than others in the 1980s, and there has been little sign of the cyclical reversal, at least in commodity prices, that past experience at first led many to expect. As a result, domestic reform and adjustment to a new international economic environment has come to dominate policy discussions towards the end of the decade. The number of countries experimenting with domestic economic reforms has never been larger. Many dogmas have been shed. There has been a perceptible shift towards recognition of the need for structural reform and institutional change, often including an attempt to reduce the overload on the public sector and regulations that had become irrelevant.

Table I.2 Growth of world output, 1971-1990, per capita GDP and share of world population by country groups

	Growth of GDP (annual rate)		GDP per capita (US dollars)[a]		Share of world population 1990 (per cent)
	1971-1980	1981-1990	1980	1990	
Developed market economies	3.1	2.6	10 200	12 500	15.6
Eastern Europe and the Soviet Union[b]	5.2	2.5	3 200	3 820	7.8
Developing countries	5.6	3.2	760	850	76.7
Africa	4.9	0.5	750	580	11.7
Western hemisphere	5.5	1.0	2 320	2 090	8.5
South and East Asia	5.8	7.0	380	570	52.4
China	5.9	9.0	290	610	21.7
West Asia	6.5	-0.2	4 180	3 000	2.5
Mediterranean	5.3	3.2	1 940	2 210	1.5
World	3.9	2.9			100.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat

[a] In 1980 prices

[b] Net material product.

Globalization of markets and increased interdependence

Markets for both goods and financial assets became further globalized in the 1980s as new technologies reduced the economic distance between countries in quantum jumps. The integration of the financial market was particularly dramatic.

After a period of trade pessimism in the early 1980s, world trade grew vigorously in the latter years of the decade. The value of world exports increased from under two trillion dollars in 1980 to over three trillion in 1989. The volume of trade increased by 4 per cent a year. Most of the growth came from trade in manufactures which grew much faster than world output of manufactures. Increased product differentiation, greater intra-industry trade and great advances in communications and transport technologies linked national markets more tightly.

Financial deregulation, abolition of exchange control and new information and communication technologies brought about, in only a few years, a close linking of national financial markets, with great implications for the functioning of the world economy. These links affected not only the markets of the major industrial countries which account for the bulk of the world financial flows; markets of some developing countries as well were integrated with the main world financial centres. The integration of world financial markets and the great reduction of transaction costs have produced gross financial flows of enormous magnitudes. Exchange rates have come to be set on the basis of expectations in financial markets rather than by the needs of trade adjustment. Loosely co-ordinated monetary policy, occasional intervention in exchange markets and, above all, a quest for credibility in control of inflation are the elements of the international monetary "non-system" which is likely to last until the major actors can agree on a better way. Its weakness has been its instability.

Volatility and misalignment of exchange rates

The system of floating exchange rates, which succeeded the Bretton Woods system of fixed rates in the early 1970s, showed greater volatility and a greater tendency to get out of line with economic fundamentals than its proponents had anticipated. The dollar started to appreciate from around 1980 and by 1985 was grossly overvalued. It depreciated sharply over the next three years and by 1988 seemed to be near an equilibrium rate, but in 1989 it was appreciating, raising once again concerns about misalignment.

The integration of the financial markets may have made the international allocation of world savings more efficient in that they flow more freely where they have the highest rate of return. It has, however, contributed to the gyration of exchange rates in the 1980s by making it easier to shift resources across national borders in response to signals that may be quite unrelated to long-term trends. The tendency to medium-term misalignment led to large and unwarranted shifts of resources and changes in balance of trade. The excessive short-term volatility also eroded the efficiency of exchange rates as a price signal because producers and exporters are less likely to be guided by current exchange rates if the perception is that they are not going to last.

The volatility and misalignment of key currencies in the early 1980s led to a shift in policy makers' attitudes. The decision by the Group of Five in September 1985 to push the dollar down was the first step away from a benign neglect of the exchange rate to a policy of keeping key currency rates within reasonable, though undefined, limits. Indeed, policy co-ordination among major economies amounted in practice to little else. Yet, there was no consensus to develop a fully fledged alternative to the system of freely floating exchange rates, and the key rates fluctuated wildly despite occasional massive central bank interventions and attempts to enhance the credibility of desired ranges of exchange rates in spite of visible discrepancies between macro-economic policies of key actors.

Trade imbalances among the major economies and United States fiscal deficits

The appreciation of the dollar in the first half of the decade was part of a process that produced record trade imbalances among the major economies which the subsequent depreciation was able to chip away only slowly. The United States trade deficit increased from about $25 billion in 1980 to $160 billion in 1987, declined to $127 billion in 1988 and to about $113 billion in 1989. United States imports exceeded exports by only 11 per cent in 1980; the figure rose to 64 per cent in 1987 before declining to a still large 31 per cent in 1989. The trade surpluses of the Federal Republic of Germany and Japan rose correspondingly over the decade, as did the surpluses of a few developing countries.

The United States external deficit is widely attributed to the United States fiscal deficit. The United States federal deficit rose from 2.4 per cent of GDP in 1981 to over 5 per cent in 1985 and in 1989 was still higher than at the beginning of the decade. The United States became the world's largest borrower and largest debtor country. Great investor confidence in the United States economy produced adequate capital inflows, and some economists argued that it was the strength rather than the weakness of the United States economy that was the cause of the imbalance. Whatever the reason, one of the major themes of the international economic policy debate in the 1980s was whether this was a sustainable situation, and there were frequent warnings that at some point it would no longer be possible to finance the deficit: there would be a sharp fall of the dollar—a "crash landing", a steep rise in interest rates and a subsequent recession. As the decade proceeded, these concerns came to seem unwarranted. The perception at the end of the decade was that the component of stable long-term capital imports was substantial and that, in the new global financial market, the deficit could be sustained for a long period of time.

This apparent confidence in the sustainability of the situation was partly due to the sea change in the approach to economic policy that took place early in the 1980s. In particular, the shift towards controlling inflation as the most important policy objective and the success of developed market economies in this effort restored investor confidence in the economic expansion that began in 1982 (see chap. VIII) and hence in the continued pattern of capital flow among these economies.

The relative neglect of the exchange rate was itself largely the result of the preoccupation of the major developed market economies with domestic price stability. A single instrument of policy, monetary policy, could not be used for two objectives, that is, domestic price stability and exchange rate stability, simultaneously, and the latter objective was usually sacrificed to achieve the former.

High interest rate and declining savings

The rise in real interest rates was a distinctive feature of the world economy in the 1980s. Interest rates rose in the early 1980s, from the low and often negative real rates of the 1970s, to historically high levels and remained fairly high throughout the decade. For many developing countries real rates of interest rose to extraordinary levels as their export prices declined which greatly worsened their external debt problem.

The restrictive monetary policy pursued by the industrial countries at the beginning of the decade led to a hike in interest rates to start with, but the reasons for continuing high interest rates over the 1980s are not entirely clear. There is little doubt, however, that the large United States fiscal deficit had a role. The deficit of the federal Government in 1982 was about $125 billion, which was equal to 70 per cent of the combined fiscal deficits of the six other large industrial countries, and rose to over $200 billion in 1986, much of which was financed by savings from the rest of the world. Such a strong stimulus to expenditure uncompensated by any increase in private saving contributed to the high rates of interest in the United States and the world at large.

The high level of real interest rates was not accompanied by an increase in savings rates. The household savings rate in the United States fell from 8 per cent in the late 1970s to just over 3 per cent in 1987 and only slightly more in 1988. But

savings rates declined in other industrial countries as well, including Japan, France and the United Kingdom, where the decline was more modest, and the Federal Republic of Germany, where it was only marginal. Increased availability of credit facilities stimulated consumption. Perhaps more important was the rising wealth of households. Their assets consisted mainly of houses and stocks, both of which appreciated sharply in the 1980s, creating a "wealth effect" on consumption. Demographic changes in the industrial countries also served to lower savings rates.

Yet, by the late 1980s, a recovery in savings rates seemed to be taking place in developed market economies, partly as a consequence of declining fiscal deficits. The increase in gross fixed investment has persistently exceeded the growth in gross domestic product since 1987.

Major reforms in Eastern Europe and the Soviet Union

If for many developing countries and some developed market economies the 1980s ended in a state of lingering inertia, for countries of Eastern Europe the last year of the decade was a year of unprecedented and largely unpredicted eruption. The changes that occurred in quick succession were largely political in nature but their economic implications are potentially very great. The future shape of their economic system is far from clear. There is no doubt, however, that almost all of these economies are moving towards a market-based system that differs greatly from earlier attempts at reform which aimed to keep the basic characteristics of a centrally planned economy intact (see chap. VI).

While these changes were precipitated by political developments, not the least of which was the change in political leadership in the Soviet Union, they were the combined result of internal economic factors and world-wide economic changes. As their economies grew more complex, institutions that were put in place more than 70 years ago in the Soviet Union and 40 years ago in the other countries were increasingly incapable of facing the new complexities. In most of the countries the system even failed to resolve some of its age-old problems such as agriculture. Technical progress and growth of productivity ground to a halt in critical areas. Economic growth slowed sharply in contrast to the robustness of the developed market economies towards the end of the decade. Shortages developed in key sectors and external constraints, including those resulting from CMEA relationships, were becoming more severe.

The reforms being pursued at the turn of the decade are vast. Profound institutional changes are envisaged. The nature of micro-economic policies and macro-economic management are bound to change dramatically. One of the key objectives is a further integration into the world economy.

The trading system

The stagnation in international trade in the early 1980s raised serious concern about the international trade system. The weakness of the system was directly observable. Protectionism increased in the late 1970s and early 1980s as a response to rising unemployment in the industrial countries. In later years, when unemployment was declining, protectionism continued to be fueled by rising bilateral trade imbalances. Trade tension remained high throughout the 1980s, in particular between major industrial countries. Trade barriers continued to proliferate. Many took the form of "voluntary" export restraints and other bilateral arrangements. Almost all of them were discriminatory. The multilateral trading system, conceived as an arrangement based on the principles of transparency and non-discrimination, was being eroded.

The system needed strengthening, but the problem to be addressed was highly complex, involving old questions such as the bringing under the purview of GATT rules major sectors such as agriculture and textiles, the inadequacy of the GATT dispute settlement and enforcement machinery, the treatment of grey area measures, the role and the needs of the developing countries, safeguard measures and, indeed the fundamental issues of balance of rights and obligations under GATT. The evolution of the world financial and trading system had, moreover, brought into prominence the new and complex issues of services, intellectual property and trade-related investment.

An initial attempt to strengthen the system was made at a GATT ministerial meeting in 1982, when an elaborate programme of work to strengthen the system was approved. This was followed by a special session of GATT in 1986 at which the decision to start a full-scale multilateral trade negotiation was taken. In its scope and complexity, the Uruguay Round of negotiations launched at that session was the most ambitious round of trade talks so far. The progress of negotiations has been difficult and slow and, as of mid-1990, is being viewed with cautious optimism (see chap. III).

Meanwhile, GATT membership has steadily increased despite occasional shows of suspicion of the system. The Union of Soviet Socialist Republics, has achieved observer status. There has been a greater willingness to use the GATT dispute settlement machinery and, as one of the early results of the current negotiation, a mechanism for surveillance of national trade policies has been put in place.

The decade saw a fuller participation of the developing countries in multilateral trade negotiations than before, a greater willingness to discuss new issues and an increased acceptance of a liberal trade regime as a necessary condition for economic growth, as well as a stronger demand that the rich and powerful countries themselves abide by the rules of liberal trade.

Alongside the efforts to strengthen the multilateral trading system were significant developments antithetical to multilateralism. Regional trading blocs were emerging or were being strengthened. The European Community was enlarged by the inclusion of Greece, Portugal and Spain and was moving towards the goal of a single market by 1992. With the free trade agreement between Canada and the United States, a new, large trade bloc emerged. A number of other preferential trading areas already exist. Efforts were made to strengthen some of these arrangements. At the Conference on Asia-Pacific Economic Cooperation, held in 1989, 12 countries of the Pacific rim took a tentative step towards a loose trade arrangement. The impact of the emerging trading

blocs on the world trading system is unclear. It need not be damaging to the growth of world trade so long as non-members are not discriminated against. But their emergence is altering the multilateral character of the trading system.

Current world economic trends and short-term outlook

As in most of the 1980s, the average growth rate combined large differences in growth experiences among countries in 1989 (chap. II). The developed market economies grew by 3.5 per cent in 1989 compared with 4.3 per cent in 1988. Growth was stronger than expected and the longest period of expansion in these economies in post-war history thus continued. A major benefit of the continuing strength of these economies was a further decline in the rate of unemployment, though it remained high in a number of countries. The rate had been declining since 1983, when it reached a historic high of 8.5 per cent, to 6.7 per cent in 1988 and further to 6.2 per cent in 1989.

The continued strength of these economies significantly pushed up their rate of inflation. The increase in consumer prices accelerated in 1988 to 3.6 per cent from 3.3 per cent in 1987, and despite a slow-down of growth, prices increased by 4.8 per cent in 1989. Part of the increase, at least in some countries, was due to changes in indirect taxes. This was particularly true of the Federal Republic of Germany and Japan. The response has nevertheless been a tightening of monetary policy in almost all countries. Interest rates rose in all major economies, with especially large increases in Japan, the Federal Republic of Germany and the United Kingdom. Short-term interest rates in the major economies rose to their highest level since 1984.

A further slow-down in economic activity is expected in the developed market economies in 1990 and some recovery in 1991. Inflation should decelerate only slightly in the current year, and settle at a similar pace next year. Despite the continuation of large external and fiscal imbalances, the increase in gross fixed investment will likely continue to exceed the expansion of output, helping to reduce some inflationary pressures. On average, the rate of increase in per capita incomes should remain above 2 per cent, similar to what has been achieved since 1983.

The slow-down of growth in the developing countries in 1989 was one of the sharpest in recent years. The average rate of growth declined from 4.5 per cent in 1988 about 3.4 per cent in 1989, which raised per capita output by just over 1 per cent. But growth experiences varied widely.

The economies of South and East Asia grew more slowly in 1989 than in 1988 but still achieved a vigorous growth rate of over 6 per cent. This raised per capita output by over 4 per cent in a region that has the largest number of the poor in the world. A steep decline in the growth rate in China, to about 4 per cent in 1989 from 11 per cent in 1988, was the most important feature of the slow-down in the region, but India's growth also declined to a more usual level from the high of 1988.

In the western hemisphere the rate of growth remained under 1 per cent in 1989 and per capita output fell for the second consecutive year. A symptom of the economic difficulties of the region was the acceleration of inflation to unprecedented levels. Many of the countries continued to suffer a massive transfer of financial resources, largely as a result of the debt crisis. Policies of adjustment and stabilization have been pursued in most countries but have not so far succeeded in reviving growth.

In Africa, the modest improvement in growth in recent years continued in 1989 but was not enough to prevent another fall in per capita output, which has persistently declined over the 1980s. The average rate of growth of total output edged up to about 3 per cent, still below the rate of growth of population. The improvement was partly due to an increase in the export revenue of the energy-exporting countries, but a modest improvement in agricultural output was also a significant factor. While critical problems persist, a large number of countries have been pursuing policies of economic reform which are beginning to produce isolated results.

In West Asia, the cessation of hostilities between the Islamic Republics of Iran and Iraq in 1988 has greatly improved the growth prospects of these two large countries of the region. A substantial increase in oil prices in 1989 and in the volume of oil exports largely accounted for a 2.5 per cent growth of these economies during the year. Economic stabilization measures resulted in slow growth in the Mediterranean countries.

In the developing countries, even though growth in 1989 was at its lowest in six years, it is expected to decline further in 1990 before accelerating in 1991. As in 1989, the overall result will be heavily influenced by developments in a few major economies. In China, growth is expected to improve modestly in 1990 and 1991 as the benefits of stabilization measures are realized. Among the other Asian countries, the newly industrializing economies are likely to continue to decelerate in 1990 as a result of various constraints, including a slowing in demand for their exports and capacity limitations, particularly in labour markets.

In Latin America, the economic picture is always dominated by the performance of the three largest economies, all of which have uncertain prospects for the next few years, depending on the outcome of stabilization measures that are currently being implemented. In particular, Brazil is expected to experience a major decline in output in 1990, followed by a sizeable, but incomplete, rebound the following year. It is likely that Argentina will be able to achieve only very modest growth in 1990, but should attain better results in 1991. Similarly, if Mexico's present recovery effort is not derailed, its rate of growth should improve for the next few years. The Mediterranean countries are also in the process of stabilizing and reforming their economies and, if successful, should have a similar recovery pattern.

In Africa, the changes in the overall rate of growth depend less on the performance of a few key economies than on a limited number of externalities that affect many countries, such as the weather and commodity prices. Even assuming no negative shocks from either of these sources, growth in

Africa is unlikely to improve much in 1990 but should do so moderately in 1991 as the results of economic reform begin to appear more widely across the continent. Similarly, assuming that oil prices in dollar terms remain at their average level of 1989 in 1990 and then increase somewhat in 1991, the West Asian economies will improve their rate of growth slightly in 1990 and 1991.

That the prospects for economic growth in Eastern Europe and the Soviet Union were not propitious had been realized when the plans for 1989 were formulated in late 1988. However, even the modest objectives of such plans were not reached. The changed political situation induced labour disputes, street demonstrations and migration, which directly affected output. Other contributory factors included chronic internal market imbalances, constraints in core sectors such as fuels, raw materials and transport, constraints of trade within CMEA, and the dim outlook for trade with market economies, owing to a slow-down in the world economy and lingering payments problems for many countries of the group.

On the whole, in Eastern Europe, economic activity in 1989 contracted, with country performances ranging from a 2 per cent growth to a 10 per cent decline. For the Soviet Union, growth slowed to about 2.4 per cent, or about half the planned rate.

As the political drama was unfolding, machinery for central control was rapidly unraveling without a substitute at hand. Domestic stability largely hinged on the ability to correct the monetary overhang inherited from the past and to formulate an alternative co-ordination mechanism. Lasting economic reform depended on the success of stabilization. But only Poland succeeded in putting in place in early 1990 a far-reaching stabilization programme while other countries were struggling with various policy packages which appeared inadequate as a foundation for broad-based market-oriented economic reform. Progress with economic reform, as a result, remained disappointing in a majority of these economies (see chap. VI).

The outlook for these economies for 1990 remains clouded. Policy objectives for most countries of the area have not yet crystallized; only the Soviet Union has an explicit plan for the year and still attempts to adhere to it. The fluidity of the socio-political situation in most countries precludes firm commitments of policy makers to steady growth. Uncertainty prevails with respect to the way in which the reforms will be undertaken, the costs of the reforms and how these costs will be shared by the various segments of the society.

On the basis of the fragmentary information available, real growth in Eastern Europe and the Soviet Union in 1990 will probably be negative. Even if Eastern Europe succeeds in weathering the worst of the problems of adjustment, output will almost certainly decline by 2 per cent or more. In the Soviet Union, even with substantial growth in agriculture, domestic imbalances and bottlenecks are likely to depress economic activity well below plan targets.

The national and international policy agenda

In only a few years the agenda for international co-operation has been greatly modified by the accumulation of important developments and events, ranging from the ascendancy of new technologies and new perceptions of economic policy to political and economic transformations of historic dimensions. At the same time, the challenge of world poverty remains undiminished, and development has regressed in large parts of the world.

In recognition of this new and complex situation, the United Nations General Assembly, at its eighteenth special session, unanimously adopted, on 1 May 1990, a declaration spelling out an agreed understanding of the national and international policies called for in order to revitalize the world economy and, in particular, to address the problems of developing countries.

Box I.1 Declaration adopted by the United Nations General Assembly at its special session on international economic co-operation and development

We, the States Members of the United Nations,

Solemnly proclaim our strong commitment to a global consensus to promote urgently international economic co-operation for sustained growth of the world economy and, in particular, to the revitalization of economic growth and development of the developing countries so as to realize the basic right of all human beings to a life free from hunger, poverty, ignorance, disease and fear. To that end, we adopt the present Declaration.

1. This is a time of positive transformation in international relations. The reduction in international political tensions, the increasing integration of the world economy and the broad movement towards economic and political reform will create an opportunity for strengthening international economic co-operation based on the need to provide just and equal opportunities to all peoples to enable them to develop their full potential.

2. We strongly affirm the need to revitalize growth and

development in the developing countries and to address together the problems of abject poverty and hunger that continue to afflict far too many people in the world. The international community has a responsibility to give strong support to the efforts of the developing countries to solve their grave economic and social problems through the creation of a favourable international economic environment.

3. In an increasingly interdependent world, the developing countries should play an important role in the growth and expansion of the world economy for the progress and prosperity of all peoples.

4. Each country is responsible for its own economic policies for development, in accordance with its specific situations and conditions, and for the life and well-being of all its citizens. National policies also need to take fully into account the obligations of all countries to international economic co-operation.

Assessment of the 1980s

5. In the 1980s, progress in developed and developing countries has been uneven. The decade was marked by an increasing gap between those groups of countries as well as by relatively slow growth and large global financial and trade imbalances. Developed market-oriented countries have succeeded to a large extent in controlling inflation and in maintaining sustained, though modest, growth. However, many countries, particularly developing ones, have encountered serious difficulties in their attempt to adapt to structural changes, to benefit from the economic growth of the industrialized countries and to promote the well-being of their citizens.

6. External and fiscal imbalances in some of the countries whose economies have the largest impact on the world economy have contributed to international monetary instability and led to higher interest rates. In the late 1980s, such imbalances have started to narrow; none the less they remain large.

7. For many developing countries, the 1980s have been viewed as a decade lost for development. Living conditions in Africa and Latin America and the Caribbean, and in parts of Asia, have deteriorated, and economic and social infrastructure has eroded, impairing stability and prospects for growth and development. Other developing countries have been able to achieve economic and social progress.

8. The position of developing countries in international trade and finance has substantially weakened, further widening the gap between those countries and the developed ones. External indebtedness emerged as a main factor in the economic stalemate in the developing countries. Their capacity to service debt was seriously weakened as interest rates grew and terms of trade deteriorated. This problem has contributed to the fall in investment and the cessation of new financial flows. A long-term downward trend in the prices of commodities had devastating effects for commodity-dependent developing countries.

9. As a result, there was a large net transfer of resources from the developing to the developed countries, depriving the former of much needed resources for development. This made the process of adjustment more difficult and complicated the tasks of coping with its social consequences and obtaining the necessary political support for reform.

10. Eastern European countries were not appropriately involved in the world economic system. Their need for comprehensive reform and transformation grew and, in the late 1980s, fundamental political and economic changes began to take place. These countries face problems of adaptation to the scientific, technological and structural changes taking place in the world economy.

11. As the world changes around us, we must respond positively. The 1980s marked the beginning of fundamental rethinking towards the achievement of economic development. A gradual convergence of views on economic policy, including the need for sound macro-economic policies and enhanced competition, is emerging. Flexibility, creativity, innovation and openness must be integral parts of our economic systems.

Challenges and opportunities for the 1990s

12. The most important challenge for the 1990s is the revitalization of economic growth and social development in the developing countries, which calls for sustained growth of the world economy and favourable external conditions. This major challenge has to be addressed in the context of the increasing interdependence and integration in the world economy.

13. It will be essential to stem the increasing marginalization of the least developed countries and to reactivate their growth and development through comprehensive national action and international support measures.

14. Finding an early and durable solution to the international debt problems, meeting the increasing needs for development finance, creating an open and equitable trading system and facilitating the diversification and modernization of the economies of developing countries, particularly those that are commodity-dependent, are conditions for the revitalization of growth and development in the developing countries in the 1990s and require continued concerted efforts.

15. There is a pressing need to improve the international economic environment in order to ensure the success of national policies. Countries can then take advantage of the major advances in science and technology and the globalization of markets and thereby enhance their human capital and modernize their economies.

16. Economic development must be environmentally sound and sustainable. The deterioration of the environment is a cause of grave concern for all countries. Growing environmental problems, such as pollution, desertification, deforestation and climate change, increasingly pose a serious threat to the future growth of the world economy.

17. Countries have to adapt their national policies to facil-

itate open exchange and flexible responses to the changing world economy. Effective national policies have a critical role to play in achieving sustained, non-inflationary economic growth in all countries. Such policies should be supportive of investment as well as of efficient allocation and mobilization of resources in order to achieve durable growth.

18. The eradication of poverty and hunger, greater equity in income distribution and the development of human resources remain major challenges everywhere. Economic and social progress requires that growth be broadly based, offering equal opportunities to all people, both women and men, to participate fully in economic, social and political activities.

19. There is a need to integrate the Eastern European countries into the world economy and the international economic system. This should generate positive impulses for world trade and development.

20. The revitalization of economic growth and development of the developing countries will have to be undertaken against the backdrop of these opportunities and challenges. Our collective efforts will be needed to ensure that the rapidly changing realities result in a positive transformation in favour of the economic development of all countries, particularly of the developing countries.

Commitments and policies for international development co-operation

21. Reactivation of economic growth and development in the developing countries will require a concerted and committed effort by all countries. The present opportunity to restore a long-term approach to development and move beyond short-term adjustment must be seized. The States Members of the United Nations will endeavour to take all necessary steps to reverse the adverse trends of the 1980s, address the challenges of the 1990s and move into a more productive decade. Such actions should take into account the responsibility of each country for its own development and should be in accordance with its capacity and its impact on the international economy.

22. The major industrialized countries influence world economic growth and the international economic environment profoundly. They should continue their efforts to promote sustained growth and to narrow imbalances in a manner that can benefit other countries. The co-ordination of macroeconomic policies should take full account of the interests and concerns of all countries, particularly the developing countries. Efforts should be made to enhance the effectiveness of multilateral surveillance aimed at correcting existing external and fiscal imbalances, promoting non-inflationary sustainable growth, lowering real rates of interest, and making exchange rates more stable and markets more accessible.

23. In accordance with their legislation, development objectives and national priorities, developing countries should continue to work towards keeping control over inflationary tendencies, promoting domestic savings, achieving favourable conditions for domestic and foreign investment, modernizing their economies, and increasing their international competitiveness.

24. However, economic policies should have as their ultimate objective the betterment of the human condition and the enhancement of the contribution of all persons to development. The full utilization of human resources and the recognition of human rights stimulate creativity, innovation and initiative.

25. A primary objective must be to respond to the needs of and maximize the potential of all members of society. Health, nutrition, housing, population policies and other social services are a key to both improving individual welfare and successful development. Education and training, which must be available to all, are essential for improving the quality of human resources and for sustaining economic growth. The international community should support efforts to arrest the current escalation of extreme poverty and hunger. It is essential to reverse the present deterioration of this grave situation.

26. A durable and broad solution of the external debt problems of the developing debtor countries should continue to be given urgent attention, and the serious debt-servicing problems of some other countries should be further addressed with a view to an early solution. Recent initiatives and measures to reduce the stock and service of debt or to provide debt relief for developing countries should be broadly implemented. Relief measures should aim at the resumption of vigorous growth and development in these countries and should address all types of bilateral debt of debtor developing countries. Serious consideration should be given to continuing to work towards a growth-oriented solution of the problems of developing countries with serious debt-servicing problems, including those whose debt is mainly to official creditors or to multilateral institutions.

27. Substantial concessional resources will be called for to enable developing countries, especially the least developed ones, to cope with the challenges of the 1990s. Developed countries should implement the undertakings they have made to attain the agreed international target of devoting 0.7 percent of gross national product to official development assistance and 0.15 percent to the least developed countries. Developed countries should enhance the quantity and quality of their aid. Appropriate additional resources for the least developed countries should be considered at the Second United Nations Conference on the Least Developed Countries. The special development problems and needs of the island and land-locked developing countries should also be addressed.

28. Scientific and technological capability is increasingly important in the development of developing countries. Developed countries and international organizations should support the efforts of developing countries to create and develop endogenous capacities in this area

29. The current threat to the environment is the common concern of all. All countries should take effective actions for the protection and enhancement of the environment in accordance with their respective capacities and responsibili-

ties, and taking into account the specific needs of developing countries. As the major sources of pollution, the developed countries have the main responsibility for taking appropriate measures urgently. The economic growth and development of developing countries are essential in order to address problems of the degradation and protection of the environment. New and additional financial resources will have to be channelled to developing countries. Effective modalities for favourable access to, and transfer of, environmentally sound technologies, in particular to developing countries, including on concessional and preferential terms, should be examined.

30. Multilateral financial institutions should be in a position to respond to the increasing development needs of developing countries in the 1990s. They should be provided with adequate resources to support long-term development, to facilitate structural reform and to finance programmes to alleviate the adverse social consequences of adjustment for poor and vulnerable groups.

31. Countries should seek to reduce expenditures for military purposes, thereby opening up the possibility of enhanced spending on social and economic development for the benefit of all countries, in particular the developing countries. In this context, the feasibility of channelling some of these reductions through financial mechanisms for development should be explored.

32. An open and credible multilateral trading system is essential for the promotion of growth and development. Any present or future trends towards unilateralism, bilateralism and the erosion of the multilateral trading system must be arrested. Protectionism should be resisted everywhere; commitments to standstill and roll-back of protectionism should be honoured. It is vitally important that the Uruguay Round of multilateral trade negotiations result in a balanced outcome, preserving and strengthening the multilateral trading system, enabling trade liberalization and increased market access for the exports of developing countries. The principles underlying the multilateral trade system should be reaffirmed, and international organizations in the area of multilateral trade should be strengthened as a part of the process of attaining these objectives.

33. Commodity exports will continue to play a key role in the economies of most developing countries and to make a crucial contribution to export earnings and investment. There is a need for better functioning of commodity markets and more stable and predictable conditions. Diversification helps the developing countries to increase and stabilize their export earnings. All countries and multilateral institutions should undertake measures to support these endeavours.

34. Regional economic integration is important in expanding trade and investment in developing countries. Developing countries should strive to promote economic integration and strengthen economic and technical co-operation among themselves. These efforts should be encouraged and supported by the developed countries, as well as by the international organizations.

35. Eastern European countries should be supported in their efforts to integrate themselves into the international economy, including, as appropriate, their adhesion to international institutions. This will benefit their own people and the rest of the world; it must not detract from the high priority placed on international development co-operation with the developing countries. Their integration will strengthen the role of Eastern Europe as a dynamic trade partner and as a market and source of technology.

36. The United Nations system has a large role to play in international co-operation for revitalizing development in the 1990s. All its Member States have a responsibility for making it more effective and efficient. The United Nations is a unique forum in which the community of nations can address all issues in an integrated manner. Its many specialized agencies make an indispensable contribution to development. They have a major responsibility in the great task of revitalizing growth and development in the 1990s.

37. Member States agree to work for fruitful results at the forthcoming Second United Nations Conference on the Least Developed Countries, in the elaboration of a new international development strategy, the World Summit for Children, the eighth session of the United Nations Conference on Trade and Development in 1991, the United Nations Conference on Environment and Development, to be held in Brazil in 1992, and the international meeting on population in 1994.

38. The States Members of the United Nations pledge themselves solemnly to advance the multilateral dialogue, to respond to the challenge and commitments contained in the present Declaration through national policies and enhanced international co-operation and to keep the implementation of the Declaration under political review.

The declaration addresses not only issues of international co-operation but also national policy needs, reflecting a new perception of the close relationship between them. The international economic environment is determined by the national policies of the countries that influence world markets most. Developing countries are vulnerable to external factors, but their national policies are essential to their success, which affects their financial partners and their ability to attract support for their objectives. The declaration makes it clear that all parties have to assume their responsibilities to overcome the roadblocks to renewed growth.

All policies of sovereign States are nationally decided, but an increasing number are now formulated in a framework of international understandings, agreements and treaties which derive from the mutual and common interests of States participating in the world economy, creating a more stable and equitable world and protecting the planet.

The declaration adds up to an agenda which takes into account new perceptions of economic policy and of the role of the State and the private sector and of men and women themselves in the generation of wealth and development. It reflects the new awareness of global environmental threats. It also focuses sharply on the alarming prospect of a world economy running on two tracks, with one part of the world

progressing fast and another left behind.

While the declaration addresses all critical economic issues and gives broad orientations for the road ahead, its implementation will require more specific measures. In generally recognized issues such as the international debt crisis, the hyperinflations in developing countries, the poverty in much of the world and the inadequate assistance to the poorest countries, the economic decline of the African continent or the distorted flow of world savings, more detailed commitments will be necessary. Delays or failure to make progress in this direction and agree on decisive and collective action to improve the state of the world would raise the question of whether Governments are ready to commit themselves in international co-operation. This issue is relevant not only to the deliberations about international and economic affairs in the United Nations but also to the more technical negotiations in specialized bodies.

Governments, at present, appear cautious. It would seem as if they were operating under increasing constraints. To say, as is often done, that this is only a matter of political will begs the question why Governments sometimes are able to proceed with bold and visionary initiatives and launch important and costly international undertakings, while at other times they are reluctant and apparently powerless.

Such a question raises profound issues of political theory, and there may be no general answer. But Governments will do internationally what they find to be in their interest and what they can afford. The interest may be immediate or long-term, selfish or idealistic, strategic or commercial, short-term or visionary, but there has to be an interest.

Many suggestions for a more coherent management of the world economy, for freer trade or stable monetary conditions, have the objective of improving overall conditions, but their implications for individual countries' welfare or control, real or imaginary, over their economic destiny are rarely clear. There is then confusion over where interests lie.

Even more contentious are suggestions for international action that involve significant commitments of public funds and radical changes of fiscal policy, whether in rich countries or poor. Here there is an asymmetry between foreign policies aiming to attract foreign resources and those that involve committing domestic resources. The first can be pursued without much risk of conflicts among branches of national Government, whereas those that involve the commitment of resources for foreign uses will in all countries be the subject of vigilant scrutiny by treasuries and political bodies.

That is why the present strains on public finances everywhere are significant to an assessment of the international agenda. In the past, a reserve of resources from a rapidly growing public revenue has been essential to the exercise of active foreign policy. In times of rapid expansion of the economy, revenues tended to increase faster than the claims on them, but in times of slow growth, the opposite occurs, and today the political realities are such that even Governments in the richest countries are overcommitted domestically and find it difficult to mobilize resources for use in foreign policy. Governments in acute budgetary distress are not in a position to take foreign policy initiatives. Several developing countries are in acute crises and in the process of negotiating programmes of co-operation with international financial institutions and bilateral donors; they cannot be expected to make serious commitments in other bodies.

The degrees of freedom in international economic relations have been narrowly circumscribed. The economic savings from disarmament should provide a relief to the budgetary constraint. The peace dividend has the potential to transform the resource situation. But without more decisive policies, it might be too meagre and entirely absorbed in the innumerable calls for public resources that already exceed public revenues.

In contrast to the impoverishment of Governments, there has been a large increase in the international capital market and the supply of private financial resources. The problems of indebted developing countries have been greatly magnified by their extensive reliance on this market in the 1970s and their loss of credit in the 1980s. This left them with lingering debts on borrowed capital which did not produce the growth of output from which the debts were expected to be repaid. It is this situation that has produced the sharp drop in net financial transfers to which much attention is given in this *Survey*. A natural question is whether to make up for this loss by increasing official finance and domestic savings as an alternative to the reliance on the private capital market which proved an unreliable ally in the 1980s.

The answer must be that this is a false choice. In the short run there is no alternative to the use of official sources to restore order and consolidate debts in a manner that makes it possible to resume growth and regain creditworthiness. Financial rehabilitation is a clear priority. But in the long run, developing countries should be keyed in to the great pool of the international financial market, if only because that is where the money is. Official funds should still accomplish a catalytic role. They would remain important, in particular, for the weakest and poorest countries which are so far inhibited by their production structures from participating fully in the world economy.

Chapter II

TRENDS IN GLOBAL OUTPUT AND POLICIES

Global economic growth slowed in 1989 after an unusually rapid expansion in 1988. Compared to an increase of 4.4 per cent in 1988, world output grew by 3.1 per cent in 1989. The slow-down was widespread, affecting all major groups of countries, but was most pronounced in China and Eastern Europe (see table II.1). The global pattern of growth broadly conformed with expectations, both overall and in its various parts, but the pace of growth, although slower, was somewhat better than anticipated in the developed market economies and most developing regions.

There were no major unforeseen global economic shocks in 1989. The most important developments for the world economy were political rather than economic. The widespread repercussions of these changes will affect economic events in the medium and long-term more than they did in 1989.

The deceleration in the developed market economies in 1989 involved a substantial slow-down in some of the countries that had grown most rapidly in the preceding year, partly offset by stronger growth in some of those that had been making more modest progress. Some of the countries of Eastern Europe recorded negative growth, partly as a result of the problems associated with the changes being introduced in their systems of economic management. The economic slow-down in the developing countries in 1989 was more pronounced than in the developed market economies but less so than in the economies of Eastern Europe and the Soviet Union.

The overall result for the developing countries disguises the fact that the slow-down was concentrated mostly in a few countries, predominantly in Asia, that are either large (and therefore carry a large weight in the total), or grew rapidly in 1988, or both. The sharp deceleration in China from its rapid pace of expansion of recent years accounted for a substantial part of the overall result. Growth in India was also about 3 percentage points less than in 1988, although it still exceeded 5 per cent. Finally, while the four Asian newly-industrializing economies remain among the most dynamic in the world, they grew more slowly than in 1988.

These instances of deceleration in the developing countries were partially offset by a more widespread but less sizeable acceleration in many of the more slowly growing economies. West Asia, in particular, performed better than in 1988, while there were lesser improvements in Africa and Latin America. Even with this recovery, none of these regions increased output sufficiently to keep pace with population growth. However, there were some signs that the deterioration and stagnation that had characterized these regions for

Table II.1. Growth of population and output, by region, 1981-1991

	Population 1989 (millions)	Population growth rate (annual percentage)	Gross domestic product 1985 (billions of 1980 dollars)	Rate of change of gross domestic product (annual percentage)					
				1981-1986	1987	1988	1989[a]	1990[b]	1991[b]
World	5 201	1.7		2.8	3.5	4.4	3.1	2.2	3.0
Developed market economies	807	0.5	7 640	2.3	3.2	4.3	3.5	2.7	3.1
North America	273	0.8	2 866	2.5	3.4	4.6	3.1	1.9	2.7
Western Europe	356	0.2	3 467	1.7	2.6	3.6	3.4	3.4	3.5
Developed Asia	177	0.5	1 060	3.3	4.4	5.5	4.7	4.3	4.1
Eastern Europe and the Soviet Union[c]	402	0.9		3.2	2.6	4.1	1.2	-1.2	0.2
Developing countries	3 992	2.4	2 217	2.7	4.1	4.5	3.4	3.1	4.5
Western hemisphere	439	2.1	822	1.0	2.8	0.4	0.7	-1.0	4.0
West Asia	127	3.3	343	-1.2	-1.2	1.3	2.5	4.0	3.0
South and East Asia	1 633	2.2	606	4.9	6.4	8.2	6.2	5.5	6.0
Africa	594	3.1	305	-0.9	0.7	2.4	2.8	3.0	3.0
Mediterranean	79	1.6	141	3.1	3.7	3.2	2.1	0.0	4.0
China[c]	1 120	1.4		9.2	10.6	11.4	3.9	5.0	5.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat. Data on population and population growth rates are those published by the Department in *World Demographic Estimates and Projections, 1950-2025* (United Nations publication, Sales No. E.86.XIII.3)

[a] Preliminary estimates

[b] Forecast, based on Project LINK and Secretariat estimates. For the groups of developing countries, estimates are rounded to the nearest half percentage point

[c] Net material product; data for 1981-1989 are government estimates

most of the decade might be ending and, that over the medium term, a modicum of growth in per capita terms might finally result. Such an outcome will depend heavily on the overall state of the world economy, as well as on the willingness and ability of Governments and their citizens to adhere to ongoing programmes of economic reform.

The economic opportunities offered by recent political developments have reinforced the perception that the developed market economies may be able to sustain their present period of expansion well into the 1990s. This contrasts with a common view of only a few years ago that slower long-term growth was likely.

There was a widespread acceleration in the rate of increase in prices in 1989. Inflation became of greater concern to policy-makers around the world, although both the magnitude and the tolerance of the problem varied widely: in some of the developed market economies, Governments became concerned at signs that inflation might reach 5 per cent annually, whereas it exceeded 500 per cent in a number of developing countries and 5,000 per cent in countries in Latin America where hyperinflation was rampant.

The reasons for the acceleration of inflation varied, although over-heating (as manifested in high rates of capacity utilization and large wage demands) stemming from the high rate of growth in 1988 was a widespread factor. This was the case in those developed market economies that grew the fastest in 1988, but it also applied to many of the countries in South and East Asia that have been growing rapidly for the past several years. Reflecting the increasingly advanced economic structures in these countries, their economic challenges are becoming more akin to those of the developed market economies and the appropriate policy responses are correspondingly similar.

For many other countries, the sources of inflation were somewhat different. Particularly in Latin America, the inflationary process is bound up with the region's external debt problem through its repercussions on the fiscal deficit and the domestic money supply. In other regions, economic adjustment and reform is contributing to inflationary pressures: the removal of subsidies and price controls, particularly on essentials, inevitably raises the domestic price level in the short term. Currency depreciation will have a similar effect, depending on the degree of import dependence and the composition of imports. The former type of inflationary pressure has been prevalent in Eastern Europe and the Soviet Union, while both have applied, albeit to varying degrees, in African countries undertaking economic reform and adjustment.

The developed market economies: preparing for landing

The unusually long period of economic expansion in the developed market economies continued in 1989, albeit at a slower pace. The slow-down was primarily attributable to a deceleration in those economies that had expanded most vigorously in 1988: in four of the seven major industrial countries, growth in 1989 was at least 1 percentage point lower than in 1988 (see table A.1). Of this group, only the Federal Republic of Germany registered a significant improvement over its performance the previous year.

The smaller countries fared more evenly, both among themselves and compared to the previous year. Several of these countries slowed down in 1989, but mostly marginally: only Greece decelerated by more than 1 per cent, but it still grew by more than 2.5 per cent. Denmark, Ireland, the Netherlands, New Zealand and Norway increased their growth rate by at least a percentage point, with Denmark, New Zealand and Norway reversing the declines they had suffered the previous year. Spain was able to maintain growth of close to 5 per cent, while Belgium, Finland, Ireland and the Netherlands grew by at least 4 per cent. Overall, the effect of this change in the pattern of growth was almost to eliminate the difference that persisted during the previous years of the decade between growth in the largest developed market economies and in the smaller members of the group.

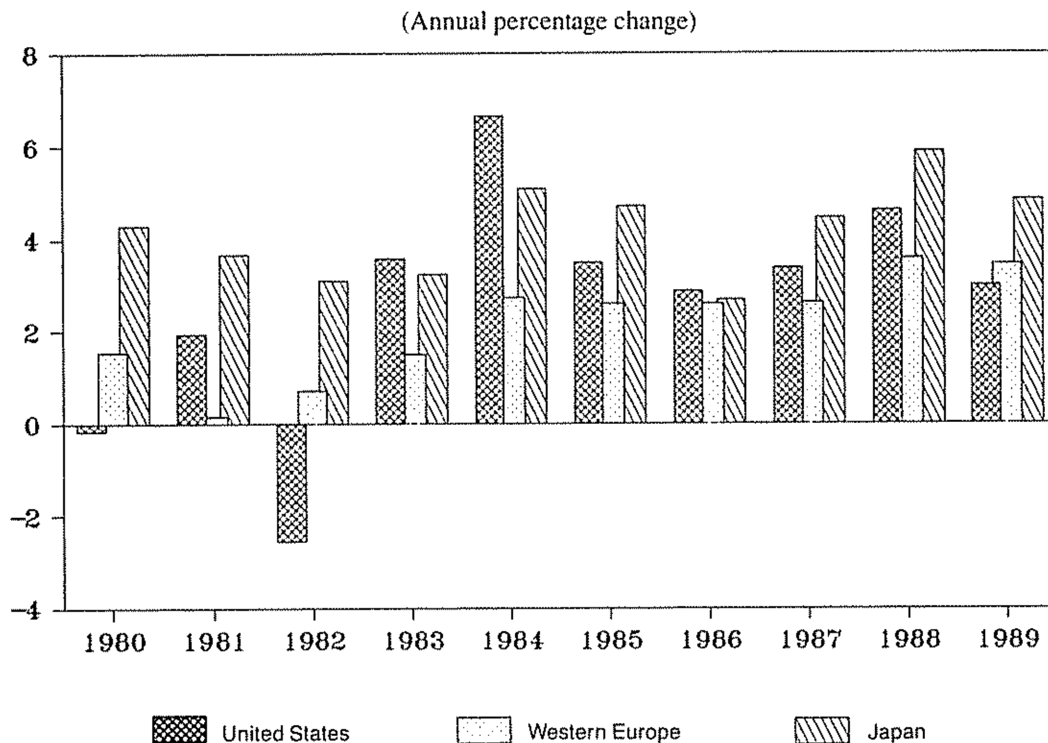
For most of the 1980s, Japan and North America had higher growth than Western Europe; this last region was generally perceived as acting as something of a brake on global growth. During the last few years of the 1980s, the situation was partially reversed: Western Europe accelerated its growth and seems likely to be able to sustain the higher rate, while Japan and North America have slowed (see figure II.1). Japan continues to be the most rapidly growing of the industrialized countries but seems unlikely to continue to expand as rapidly as it did in the later years of the 1980s. This desynchronization of the cyclical elements in the growth of the different regions has been one of the factors contributing to the sustained growth of the developed market economies as a group (see chap. VIII).

A number of factors have contributed to the acceleration in Western Europe. From a medium-term perspective, many of these countries have been engaged in a process of structural change and supply-side adjustments that are now yielding results. This process has been encouraged by policy measures and by a number of other developments, notably the prospect of a unified market in 1992. This started an investment boom in Western Europe a few years ago; the resulting increase in capacity is allowing many economies to achieve medium-term rates of growth that were considered unattainable in the mid-1980s. Looking ahead, the stimulatory effect of 1992 has now been reinforced by the prospects offered by the opening-up of Eastern Europe and the beneficial impact this is likely to have on exports and related investments.

Within Western Europe, investment remained buoyant in 1989 although there was some slow-down from the rapid growth of the previous year. The surge in investment contributed to the growth of exports from the Federal Republic of Germany, because of that country's role as a major supplier of capital goods. Although export demand remained high in the Federal Republic of Germany in 1989, there was a shift towards consumption demand. In France and Italy, on the other hand, exports began to assume greater importance in 1989. This resulted in an improvement in the French trade balance, but in Italy imports also increased and the trade balance deteriorated.

Figure II.1. Growth of output in Western Europe, Japan and the United States, 1980-1989

(Annual percentage change)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat

In almost all the major industrial countries, capacity utilization reached its highest level of the decade either in 1988 or 1989; in addition, unemployment decreased almost universally (see table A.2) and labour markets gave signs of being tight in a number of countries. Although unemployment remained high by long-term standards in Western Europe, it fell substantially in several countries. New Zealand was the only developed market economy in which unemployment increased during the year; in several other countries, such as Belgium, Canada, Finland, the Federal Republic of Germany, Portugal, Sweden, the United Kingdom and the United States, it was at its lowest level of the decade. This was particularly surprising in North America where growth slowed during the year.

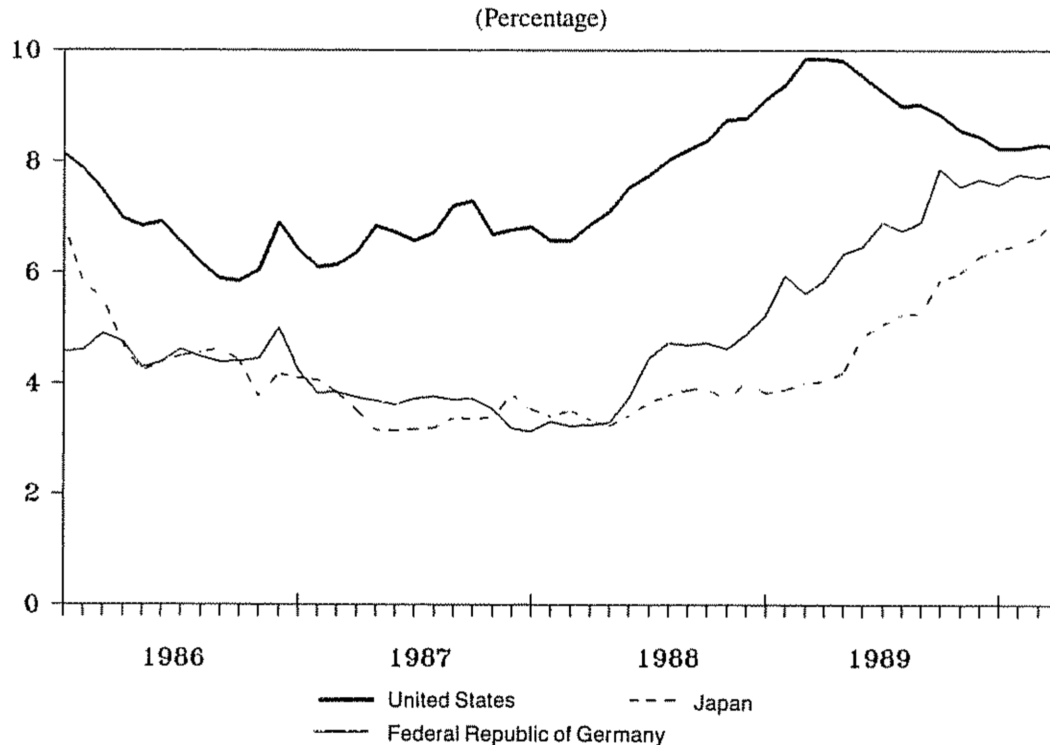
In addition to these direct physical limitations on growth, the changed conditions in domestic markets contributed to the slow-down indirectly as the acceleration of inflation induced policy makers to adopt more restrictive measures. Rising prices for energy, and to a lesser extent food, during the year were common sources of inflationary pressure. The average increase in consumer prices in 1989 was more than 1 per cent greater than in the previous year (see table A.3).

Anxieties about inflation prompted Governments to tighten policy, particularly in the fastest-growing economies. As for most of the decade, reliance continued to be placed heavily on monetary policy. Short-term interest rates resumed the steady climb that had been in evidence since 1987, with only a brief interruption following the global stock market crash that year (see figure II.2). In several instances, the increase in nominal interest rates in 1989 was greater than the rise in inflation, implying an increase in the already-high real rate of interest.

A major concern in the developed market economies for the past two years has been whether it would be possible to achieve a gradual return to a sustainable long-term pattern of economic growth, a "soft landing", or whether a major disruption in the world economy would result—a "hard landing". Initially, this problem was seen mostly in terms of reducing the external imbalances, the question being whether this would involve a major slow-down in the United States and hence in the world economy generally. More recently, concern about the imbalances has diminished, despite their persistence. Instead, attention has shifted to whether some of the major developed market economies would be able to move from their recent rapid growth, with its incipient inflationary tendencies, to a more modest rate of growth without bringing on an excessive slow-down, possibly a recession, in the process. Here again, attention has focused on the United States, partially because of its key role in the world economy, but also because it was the first of the major industrial countries to go into the upswing. Doubts about the ability to engineer a soft landing arose essentially because the response to the policy measures that would be adopted was unknown: reliance was placed overwhelmingly on monetary policy.

Figure II.2. Short-term interest rates in the Federal Republic of Germany, Japan and the United States, 1986-1989

(Percentage)



Source. IMF, *International Financial Statistics*

The United States began to introduce restrictive monetary measures in 1987. By 1989, there was evidence of slowing in the economy, and fears of a recession began to outweigh concerns about inflation. The deceleration, coupled with some relaxation of monetary policy, caused short-term interest rates in that country to decline somewhat as the year progresssed. This was contrary to the trend in other countries, most of which either continued to or began to adopt more restrictive monetary postures in 1989. In Australia, short-term interest rates rose from an average of slightly over 15 per cent in 1988 to almost 18 per cent during the course of 1989; in Japan, from about 4 per cent to almost 6 per cent; and in the United Kingdom, from 12.5 per cent to 14.5 per cent.

The economy of the Federal Republic of Germany was not among the most rapidly expanding in 1988, but its greater momentum in 1989 prompted several increases in domestic interest rates: nominal rates almost doubled in the twelve-month period. The result was a widespread ratcheting-up of short-term interest rates throughout Western Europe. Coupled with the increased rates in Japan, this high interest rate régime has made it more difficult to reduce rates in the United States early in 1990, even though the slowing of the domestic economy suggested that it might be prudent to do so.

Rethinking the imbalances

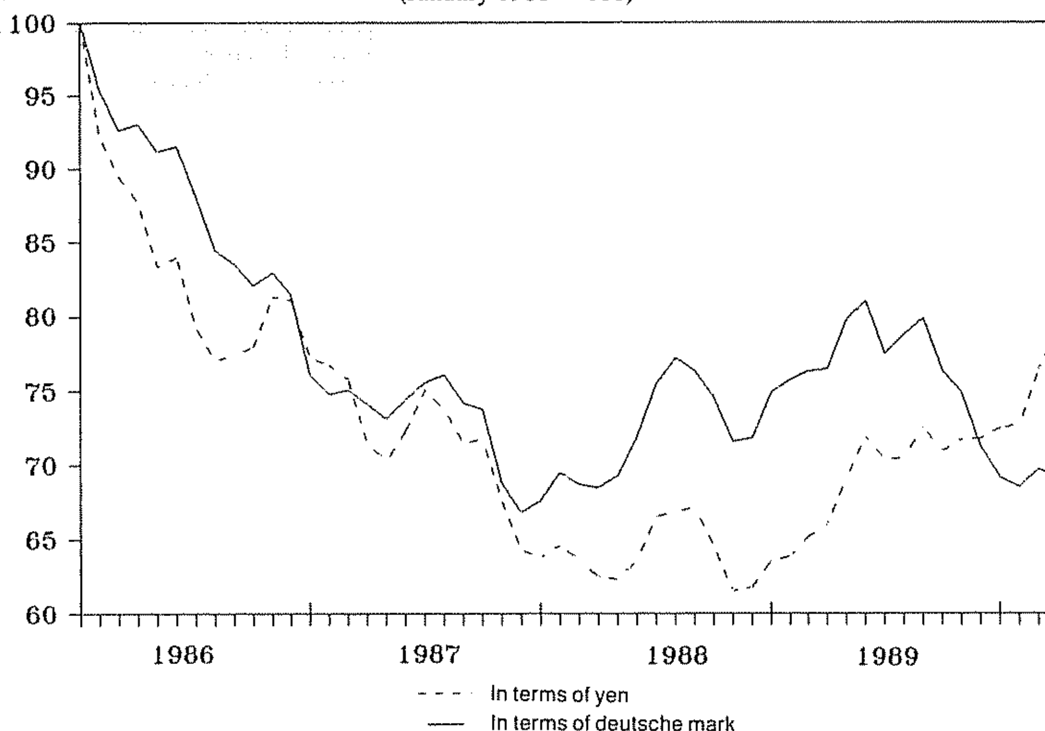
The external imbalances among the developed market economies remained large in 1989, although they declined in relation to GDP and some of them declined in absolute value. The Japanese current account surplus fell by more than a quarter in dollar terms (see table A.10). The surplus of the Federal Republic of Germany, on the other hand, increased marginally and seemed to be moving in an upward direction (see table A.9), coming close to that of Japan. The trade deficit of the United States decreased in 1989 by about the same amount in dollars as Japan's surplus (see table A.11). On the other hand, large external imbalances emerged in a number of other countries (notably Australia, Canada and the United Kingdom) in the final years of the 1980s.

External imbalances may arise from the underlying determinants of imports and exports. Under such circumstances, international capital flows are a response to imbalances in trade flows. However, external imbalances can also be the result of international flows of capital. Although these are only two different ways of approaching the same phenomenon, they can lead to very different policy conclusions.

International flows of capital are generated by differences between domestic savings and domestic investment: capital moves from countries with an excess of savings to those with

Figure II.3. Exchange rates of the dollar against the deutsche mark and the yen, 1986-1989

(January 1986 = 100)



Source: IMF, *International Financial Statistics*

a deficit. If there is no change in international reserves, such flows of capital have to be reflected in a trade surplus for capital-exporting countries and a deficit for capital-importing countries. Thus, the low level of savings in the United States, combined with an excess of savings in the Federal Republic of Germany and Japan, could be seen as one important underlying cause of the trade imbalances of the 1980s. In addition to reduced rates of household savings, a major reason for the low level of total savings in the United States was the fiscal deficit.[1]

The two-way interaction between the trade balance and international flows of capital explains movements in key exchange rates, for example in 1989 and early 1990 (see figure II.3), which seem perverse when seen merely from the point of view of trade balances. The narrowing of the Japanese trade surplus in 1989 reduced the net inflow of earnings from foreign trade, making it insufficient to meet the large Japanese demand for financial capital for portfolio and direct investment abroad: i.e., the total availability of savings in Japan (including savings received as a result of net trade earnings from abroad) was less than the Japanese demand for investment at home and abroad. The result was excess demand for foreign currency, resulting in downward pressure on the yen despite the fact that Japan continued to have a large trade surplus.

The future direction of the external imbalances and exchange rates among the developed market economies depends on the nature of this interrelationship between flows of trade and capital. The trade effects of the depreciation of the yen against the dollar in 1989 and early 1990, if it persists, may increase the Japanese surplus and the United States deficit.[2] On the other hand, the surplus of the Federal Republic of Germany is partially the result of the demand for capital goods stemming from the surge in investment in Europe and is one reason for the deteriorating balances in other countries in the region. It may decline if there is any fall-off in the pace of investment in Europe. In addition, it is likely to be reduced by the unification of Germany, as the surplus of the Federal Republic is offset by the deficit of the Democratic Republic.

If international flows of capital are the dominant influence on the external imbalances, different conclusions follow. First, trade measures alone are unlikely to reduce the imbalances unless there is a reduction in the difference between total savings and investment in any of the surplus or deficit countries and in the relative interest rates which induce short-term capital movements. Without such changes, any initial reduction in the trade imbalances would cause further depreciation against the dollar, as happened with the yen in 1989.

[1] See *World Economic Survey 1989* (United Nations publication, Sales No. E.89.II.C.1), chap. VII.

[2] However, some observers argue that Japanese foreign investment in import-substituting automobile manufacturing in the United States may have permanently reduced Japanese automobile exports to that country. This trade used to account for about half the Japanese-United States trade imbalance.

There are reasons to expect changes in the relationship between total savings and investment in some of the affected countries. For example, the slow-down in the United States economy in 1989 and early 1990 raised its fiscal deficit above expectations. In the absence of any change in other aspects of savings and investment behaviour, this would cause the external imbalance to widen. Viewed from a longer term perspective, there was increasing recognition in early 1990 that the United States fiscal deficit was excessive in absolute amount and there were signs of greater political determination to reduce it. This would reduce the savings-investment imbalance in the United States and hence the external imbalance. There is also some evidence that the personal savings rate in the United States is beginning to increase, after a decline in the 1980s. This would decrease the savings-investment imbalance in the United States and correspondingly reduce its external imbalance.

Much of the uncertainty surrounding the interaction between trade and capital flows stems from the globalization of international financial markets in the 1980s, which has radically changed the context and conduct of international policy among creditworthy countries. Over the medium to long term, both trade and savings and investment relationships have a bearing on external imbalances. The evidence of the 1980s suggests that these relationships tend to be long-term in nature and not susceptible to rapid change. Sizeable imbalances are therefore likely to persist for some time. Exchange rates and interest rates will continue to provide an equilibrating mechanism between the different flows involved. At the same time, however, the exchange rate is likely to be greatly affected by market sentiments. These can change rapidly, causing exchange rates to fluctuate considerably in the short-term from their underlying equilibrium values (see chap. IV).

Eastern Europe and the Soviet Union: at the cross-roads

Events in Eastern Europe and the Soviet Union in the course of 1989 and early 1990 demonstrated that the reform of highly centralized economies requires stabilization before it can be launched with a reasonable expectation of success. This stabilization has to address two different sets of issues (see chap. VI). The first is to correct the imbalances inherited from the administrative economic model. The second is the need to formulate an operational co-ordinating mechanism to replace central planning. Implementing the necessary economic reforms involves short-term costs, such as unemployment (see below), as well as potential benefits in the longer term. The size of the costs depends largely on the aims of the reform and the specific problems that policy makers are trying to address and decisions have to be made on the distribution both among the different segments of society and over time. The lack of a firm socio-political consensus in these countries has made this task difficult.

The rapidly escalating uncertainty in these countries in 1989 was reflected in, *inter alia*, the macro- and micro-economic performance of each country and in growing obstacles to maintaining the traditional trade and payments régimes of the Council for Mutual Economic Assistance (CMEA) (see chaps. III and IV). Part of the uncertainty was the result of totally unexpected developments. There were several forms of social unrest. One was large-scale emigration, particularly from the German Democratic Republic,[3] but also from Bulgaria[4] and the Soviet Union.[5] There were also various types of labour friction, including strikes, particularly in Poland in the first half and in the Soviet Union in the latter part of 1989. On the other hand, Czechoslovakia's economic performance benefited from the peaceful and extraordinarily rapid political transition after 17 November 1989 and the fact that it took place without emigration or substantial social tensions. In the Soviet Union, the lingering after-effects of the earthquake in Armenia in late 1988 and the civil strife and political friction in some regions also exerted a negative effect on output.

Output in 1989

The plans laid down for Eastern Europe and the Soviet Union for 1989 envisaged an acceleration of economic growth, but this was not to be. Acute difficulties over reform programmes and serious external payments problems impeded progress from the beginning of the year, and the socio-political events of the second half of the year caused economic growth in Eastern Europe to come to a near standstill. The highest rate of growth of net material product was 1.9 per cent for the German Democratic Republic; at the opposite end of the spectrum was a substantial decrease in Romania (see table II.2). Bulgaria and Hungary also reported negative growth, while in Poland output stagnated. Only Czechoslovakia's growth, although modest, was close to its target. For the Soviet Union, growth slowed to 2.4 per cent. The slow-down reflected weak performances in all the main economic sectors in most countries. A main reason for the weakness was the stagnation in the efficiency with which capital and other resources were used.

Preliminary estimates indicate that industrial output in the Soviet Union grew by 1.7 per cent in 1989 and in Eastern Europe barely at all (see tables II.2 and A.4). In the former, there was more solid growth in consumer manufactures, largely reflecting the high priority attached to restoring market balance.[6] Soviet oil production fell 3 per cent and coal

[3] Total emigration in the second half of 1989 may have amounted to some 343,000, moving chiefly into the Federal Republic of Germany. Some 220,000 of these were able-bodied, young, skilled individuals. The trend continued into 1990, with an outflow of over 2,000 per day until the elections in the German Democratic Republic in March.

[4] This involved essentially 380,000 of the Turkish minority, leaving primarily for Turkey, before the border was closed in late August 1989; perhaps 80,000 of those who moved originally have since returned.

[5] In 1989, 228,600 people—more than twice the number in 1988—emigrated permanently from the Soviet Union (*Pravda*, 14 January 1990), chiefly to Israel and the United States.

[6] *Pravda* (Moscow), 28 January 1990, p. 1.

Table II.2. Eastern Europe and the Soviet Union: selected macro-economic indicators, 1980-1989

(Annual percentage rate of growth)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
Net material product produced										
Eastern Europe	0.1	-1.9	0.1	3.9	5.3	3.7	4.6	3.2	3.1	-1.7
Soviet Union	3.9	3.3	3.9	4.2	2.9	1.6	2.3	1.6	4.4	2.4
Total	2.7	1.7	2.8	4.1	3.6	2.2	3.0	2.1	4.0	1.2
Industrial output										
Eastern Europe	3.0	-0.6	1.2	4.4	4.8	4.1	4.6	3.5	3.5	-0.2
Soviet Union	3.6	3.4	2.9	4.2	4.1	3.4	4.4	3.8	3.9	1.7
Total	3.4	2.3	2.4	4.3	4.3	3.6	4.4	3.7	3.8	1.2
Agricultural output										
Eastern Europe	-3.7	1.8	1.6	0.9	7.0	-1.1	5.3	-0.8	1.4	-0.1
Soviet Union	-1.9	-1.0	5.5	6.2	-0.1	0.1	5.3	-0.6	1.7	0.8
Total	-2.5	-0.1	4.2	4.4	2.2	-0.3	5.3	-0.7	1.6	0.5
Investments										
Eastern Europe	-2.2	-7.2	-4.4	2.3	2.2	3.9	3.9	4.7	2.6	-2.5
Soviet Union	2.2	3.7	3.5	5.6	1.9	3.0	8.3	5.7	6.2	0.6
Total	0.8	0.3	1.2	4.7	2.0	3.2	7.1	5.4	5.3	-0.2

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

[a] Preliminary

production 4 per cent, but natural gas output increased 3 per cent. The trade-off between the expansion of energy output and overall economic efficiency continues to present a major problem.

The weakness of the industrial sector in Eastern Europe in 1989 stemmed from the contraction in Hungary, Poland and Romania and the near stagnation in Czechoslovakia; only Bulgaria and the German Democratic Republic reported sizeable growth. In the latter case, the disorganization caused by the substantial outflow of skilled workers in the second half of the year and the political transitions in late 1989 contributed to a contraction in output during the last quarter.

Agricultural performance remained well below expectations. Preliminary estimates for the seven economies suggest growth of less than 1 per cent, in spite of fairly good harvests in Bulgaria, Poland and the Soviet Union.[7] The best overall agricultural performance in Eastern Europe was in Poland; in Hungary, there was a contraction after the strong performance in 1988. Livestock production was weak throughout the region except in Czechoslovakia, partially because of setbacks in the production of feed in the preceding year and lingering external payments constraints. Partial data suggest that investment throughout these countries was below targets in 1989 and probably contracted. Bottle-necks in transportation and distribution in many countries contributed to this weak performance.

Domestic absorption in 1989

Information on the use of domestic income in 1989 is sketchy beyond the fact that intentions regarding absorption levels for the group as a whole could not be attained. Targets for export volumes were not met, whereas, except for Hungary and Poland, those for imports were overfulfilled in an effort to supply domestic markets.

The real value of retail sales increased only marginally in several of these economies, although a large increase was reported by the Soviet Union, reflecting efforts to stem popular discontent with the inability to increase domestic output decisively. Part of this improvement in the domestic market was made possible by making military inventories of consumer goods available for civilian use, but it was achieved primarily through a sharp deterioration in the external accounts. Data on retail sales in Hungary and Poland suggest that austerity was enforced roughly as originally intended. Money incomes in many cases grew more rapidly than nominal retail sales which further strained domestic markets (see chap. VI).

Pent up consumer demand has inhibited reform measures. Consumer market imbalances loomed large in discussions about price and financial policies. The problems created by these imbalances were exacerbated by significant budget deficits and by reports of hidden price increases by manufacturers of consumer goods. The extent of the market imbalances

[7] Wheat output in Poland reached a record 8.3 million tons and increased some 13 per cent in the German Democratic Republic. In Bulgaria, Czechoslovakia and Romania, wheat harvests were lower than in 1988 but still above average. In Hungary, output declined by 10 per cent to a level well below normal.

and the nature of price policies varied considerably, but a common feature was the search for acceptable trade-offs between deregulating prices and protecting levels of personal consumption.

In 1989, it is estimated that investment outlays in Eastern Europe contracted by over 2 per cent and increased in the Soviet Union marginally. However, the desired improvement in the efficiency of investment and capital use did not materialize.[8] Even in the reforming countries, the hoped-for replacement of budget financing by enterprise financing does not appear to have improved investment discipline, mainly because of rigidities in the wholesale trade of investment goods and continued administrative controls over investment activity.

A priority area of concern in 1989 was to bring about stability in government finances. A striking measure of *glasnost* in this respect was the disclosure in 1989 of substantial fiscal deficits that, over the years, have accumulated into sizeable domestic debts. These budget deficits prompted far-reaching fiscal and price measures in 1989. Reducing military expenditures, scaling down large state-financed investment projects, eliminating many subsidies and resorting to price controls were among the remedies adopted.

In the case of the Soviet Union, the 1989 budget deficit of 90 billion roubles (roughly 10 per cent of GDP) was added to a domestic national debt of over 400 billion roubles.[9] Deficits have traditionally been financed chiefly through loans from the central bank, and in 1989 too they were partly met through the issuance of money, exacerbating inflationary pressures.[10] Under the current stabilization effort, the Soviet budget deficit is due to be reduced to 60 billion roubles in 1990.

The 1989 budget deficit in Hungary amounted to 50 billion forint, leading to a domestic national debt of 1,100 billion forint or about 65 per cent of GDP—among the highest in Europe. As part of the country's stabilization efforts, that deficit is to be cut to less than 10 billion forint. Domestic debt service is estimated to claim roughly 15 per cent of fiscal revenues in 1990.

The prospect of unemployment

Policy-makers in the countries pursuing stabilization and economic reforms are aware of the prospect of new and sizeable unemployment. This raises two issues. One has to do with the social aspects of unemployment. It may be difficult for the population at large to accept substantial unemployment levels, as the right to a job has become deeply ingrained. Without agreed new rules on acquired rights, stabilization opens the door to arbitrary decisions. This appears to be already causing discontent because the prospect of unemployment is occurring at a time of austerity in incomes and consumption. These phenomena are often difficult to reconcile with political expectations. In Poland, for example, the trade union movement has been in the vanguard of the movement demanding more pluralistic decision-making.

The other problem is whether society should institute a social safety net, including explicit provisions for unemployment allowances, and to what degree, relative to prior earnings, this security should be provided and for how long. The German Democratic Republic has introduced unemployment benefits to offset the involuntary layoffs due to the large emigration wave.[11] Poland's version took effect in February 1990: the unemployed receive 70 per cent of their most recent wages for three months, 50 per cent for the next six months, and 40 per cent thereafter without any time limit. Refusal to take up a job offer cuts benefits. In addition to direct financial transfers, the safety net includes an incentive scheme to encourage job creation, job retraining and relocation benefits. Quite apart from the social and political difficulties, it remains to be seen whether the budget will be able to finance these provisions at a time of a rapid escalation of unemployment.

Hungary also put an unemployment programme in place in 1989[12] but its provisions are less generous. Beginning in 1990, for one year, the unemployed receive unemployment benefits amounting to 55 to 70 per cent of their gross average monthly earnings for the last 12 months of employment; for the next 12 months, they automatically qualify for an unemployment allowance, amounting to 75 per cent of the previous month's unemployment benefits.[13] Retraining grants for firms and individuals were introduced in 1983[14] and there are also public works' programmes organized by local government, low-interest state loans for private ventures by the unemployed and other provisions. The number of unemployed has remained low, however.[15]

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[8] For example, the Soviet authorities refrained from commissioning new capital projects because only half the capacity to be put on stream materialized. In addition, shortcomings in the use of two thirds of the new capacity commissioned in 1988-1989 were reported (see *Pravda*, 28 January 1990)

[9] S. Dzarasov, "Reforma i rubl", *Planovoe khozyaistvo*, No. 12 (1989), p. 26.

[10] See R. Lokshin, "K razrabotke balansov denezhnykh dokhodov i raskhodov naselenia" (On the preparation of population money income and expenditure balances), *Planovoe khozyaistvo*, No. 1 (1990), p. 74

[11] Interview with Christa Luft, Deputy Prime Minister in *Neues Deutschland*, 6 February 1990, p. 5. Unemployment in early February 1990 amounted to roughly 50,000, although the number of advertised job vacancies remained high

[12] An unemployment scheme introduced in Hungary in 1957, which allowed Ft 600 per month for six months, remained in legal force until the mid-1980s. Because it was apparently never applied, the provision was completely forgotten when the need arose to introduce a safety net (*Heti Világgazdaság*, 24 December 1983)

[13] *Heti Világgazdaság* (Budapest), 27 January 1990

[14] *Figyelő* (Budapest), 27 October 1983

[15] At the end of September 1989, the number was less than 15,000. Some 5,000 individuals qualified for benefit payments, 4,600 were employed by local government in public works, 370 asked for retraining and less than 600 applied for "restart loans" (*Figyelő* (Budapest), 11 January 1990)

Prospects for reform and growth in 1990

Much of what happens in 1990 in the economic domain will be the outcome of the reforms under way, in conjunction, especially in Hungary, Poland and the Soviet Union, with stabilization measures. Major transformations towards the discipline of the market in both the micro-economic and macro-economic domains are envisaged. In the micro-economic sphere, changes in property rights, pricing, labour remuneration, enterprise financing and the autonomy of firms are to be undertaken. At the macro-economic level, there is a need to replace the central planning mechanism by instruments and institutions to implement monetary and fiscal policies that will bring about greater stability. Since some of the societies in question still harbour a strong preference for state intervention, egalitarianism and social security, there may also be a need to formulate appropriate price and income policies.

Czechoslovakia has committed itself to a firm course of reforms, including marketizing the economy. Instead of the sudden release of market forces combined with draconian stabilization measures, the Government is aiming at the gradual phasing out of the planning system. In the short run, policy makers are putting together a package of reform measures, while maintaining the slow, but stable, growth experienced for nearly two decades. They hope, however, that the loosening of constraints on markets over a period of three years, with unemployment amounting to perhaps 2 per cent and open inflation rising to 25 per cent as subsidies are eliminated, will enable economic growth to increase to between 3 and 6 per cent in the medium term.

In Bulgaria and Romania, the socio-political situation has been so fluid that concrete policies, regardless of their time horizon, are still unclear. In early 1990, Bulgaria was involved in a broad socio-political discussion on the nature of desirable reform and the preceding stabilization policies required. Critical components of the reforms still had to be formulated and a social consensus on the speed and equity of the stabilization process had yet to emerge.

Developing countries: the quest for resumed growth

The international economic environment brought mixed fortunes to the developing countries in 1989. The improvement in the international price of oil over its average in 1988 provided immediate benefit to energy-exporting countries and imposed a cost on energy-importing countries, while the collapse of cocoa and coffee prices was a severe blow to the lower-income countries that rely heavily on those products for their export revenue. As for the past several years, manufactures were the most rapidly expanding component of world trade, but the impetus from that source was less than in 1988 (see chap. III), mostly because of the slow-down in the developed market economies.

For most developing countries, the consequences of external indebtedness remained, directly or indirectly, the overriding influence on their economic growth in 1989. On the positive side, the concept of commercial debt reduction began to be applied, albeit to a limited number of countries, and the developing countries' stock of debt increased only marginally when measured in dollars (see table IV.3). On the other hand, international interest rates rose for the second consecutive year, posing a further threat to the many developing countries whose debt-servicing capability is already precarious, despite extensive rescheduling.

These changes in the global economic environment in 1989 were insufficient to disturb the underlying regional differences in economic circumstances among developing regions. Different externalities and their differentiated effects are a major reason for the continued diversity in the performance of the developing countries. The rapidly-growing East Asian economies have diversified their economies to the extent that the most important external factor affecting their growth is the world market for manufactures. These economies fared well with the growth in such trade in the 1980s, particularly with the unexpected spurt in the last few years of the decade. The modest slow-down in world trade in 1989 had a negative effect on those countries that were in the vanguard of this export-oriented growth process, although those in the early stages continued to fare well.

The links of other groups of countries with the world economy are in sectors that did not fare so well in the 1980s. Most striking of these were the West Asian countries, all of which, directly and indirectly, rely heavily on the international oil market. The collapse of this market in the 1980s had a negative economic effect on all these countries and neither recovery nor adjustment to the new market conditions are yet complete, despite the direct and immediate benefits of higher oil prices in 1989.

For the majority of countries in Africa, the dominant link with the rest of the world is through primary commodities. One consequence of the decline in the commodity-intensity of global output has been a decrease in Africa's share of world trade. From Africa's point of view, however, commodity exports remain central to the economic livelihood of many countries. During the 1980s, the prices of many commodities declined to their lowest real levels for several decades, to the detriment of exporting countries. Contrary to previous experience, the acceleration in economic growth and world trade in the latter half of the decade did not have a major favourable impact on the prices of commodities: the prices of minerals, metals and agricultural raw materials picked up with the unusually rapid expansion in 1988, but otherwise there was little improvement (see chap. III and table A.6). The deterioration in these markets was attributable partly to short-term factors, but mainly to long-term structural trends that are unlikely to be reversed to any significant extent in the foreseeable future. In 1989, this was demonstrated in the collapse of the coffee and cocoa markets: these are a small part of world trade but of paramount importance to many African economies.

Developing countries in other regions are less dependent than Africa on primary commodities. Several Latin Ameri-

can economies, particularly the larger ones, are as diversified as those in South-East Asia, so that the effect of changes in commodity prices on their economies is more dampened than in most African economies. Because of its large burden of commercial debt, the primary external influences on Latin America's economic performance in the 1980s were actions and sentiments in foreign financial centres. Changes in international interest rates or changes in the willingness to lend to them have an immediate effect on these countries' external position.

Latin America: battling inflation

Latin America experienced its second consecutive year of negative per capita growth in 1989 (see figure II.4). This region was in the throes of a deep financial crisis, with hyperinflation besieging a number of countries and public finances in serious disarray. The growth of output in many countries remains constrained by the stagnation of investment, limited capital inflows and the burden of debt servicing. As discussed below, these long-term structural problems are an important reason for the shorter-term difficulties being experienced by several countries in the region.

Because of the increase in international interest rates in 1989, many countries experienced renewed difficulties in servicing their external debt: arrears mounted in Argentina, Ecuador and Peru, and Brazil suspended payments to commercial banks. The culmination of lengthy negotiations on the re-financing of Mexico's debt—one of the first applications of the principles embodied in the Brady initiative—and agreement on re-scheduling for Costa Rica and Venezuela were the only tangible progress in addressing the external debt problem (see chap. IV below).

International commodity markets (see chap. III below) brought little relief to Latin America in 1989. The growth of the region's energy-exporting countries not only declined in 1989 but became negative, primarily because of stabilization measures. On the other hand, growth in the energy-importing countries improved, having itself been negative in 1988. Lower coffee prices brought about by the collapse of the International Coffee Agreement had less effect on the export earnings of most of the Central American countries than on African countries.

Among the energy-exporting countries, there was a decline of at least 8 per cent in the GDP of Venezuela, brought about by the short-term effects of that country's far-reaching efforts at external adjustment. Peru suffered a decline of somewhat greater magnitude, following a similar drop in 1988. Growth in Ecuador was negligible after the previous year's rebound from the set-back caused by the oil pipeline accident in 1987. Mexico, on the other hand, benefited not only from higher oil prices but also from improved domestic and international confidence in its economy, prompted by the adoption of the Government's Pact for Stability and Economic Growth, lower inflation and the finalization of its external debt re-financing package. Some flight capital recovered, particularly in the export-oriented and capital good industries. GDP grew by an estimated 3 per cent in 1989, despite a bad harvest.

The other two major economies in the region suffered a further erosion of internal balance in 1989. In both Argentina and Brazil, policy makers were preoccupied throughout the year with the need to extricate their countries from hyperinflation. There was temporary success in Argentina (see below), but negligible progress in Brazil prior to elections early in 1990. The effects of inflation on growth in 1989 were very different, however. In Argentina, there was a decline of more than 5 per cent in GDP. In Brazil, a consumer boom in the latter part of the year produced overall growth of more than 3 per cent, following a modest decline in 1988.

Chile stood out as an exception to the regional pattern by completing its sixth year of expansion and by increasing output by about one tenth in 1989; exports, as well as both domestic consumption and investment, expanded vigorously. Recognizing the danger of over-heating, the Government has since tightened monetary policy, but devalued the currency to maintain the trade surplus and hence the country's debt-servicing capacity.

Following a bout of extreme hyperinflation in the mid-1980s,[16] Bolivia has regained an element of economic stability as a result of the New Economic Policy introduced in 1985. Despite a drought in 1989, GDP increased by about 3.5 per cent, above population growth, and there was a slight recovery of investment. Nevertheless, the economy remains in a precarious situation, with severe external and internal constraints.

Most of the smaller economies in the region fared less well. Costa Rica and Guatemala increased per capita output by about 2-3 per cent, but the remaining countries in Central America were restrained by the direct and indirect consequences of political hostilities and military conflicts. Extremely harsh economic conditions prevailed in Nicaragua and Panama. In the Caribbean, many of the smallest countries continued to expand, but some of the larger countries faced difficulties. Cuba and Jamaica registered negligible growth, while Trinidad and Tobago experienced yet another decline in output.

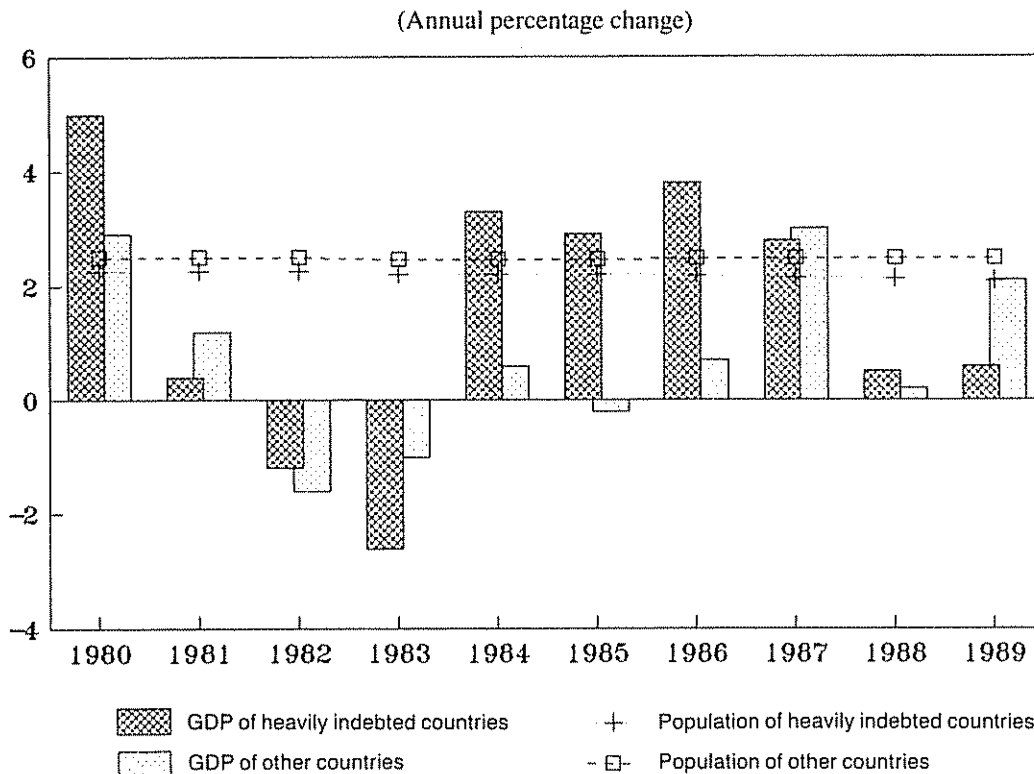
Although there has been some export diversification, commodities still account for about 75 per cent of total export revenues and the region remains highly vulnerable to price oscillations in international markets. Both the unit value of exports and the terms of trade of the region declined by more than 20 per cent during the decade.

In the interest of greater efficiency, many countries of the region have been opening their domestic markets to foreign competition. Chile, Colombia, Costa Rica, Guatemala, Mexico and Venezuela, among others, have embarked on trade liberalization programmes in recent years. These have usually included a more flexible exchange rate policy, a simplification of the country's tariff structure, a reduction of

[16] For a detailed examination of Bolivia's economic crisis and the response, see *World Economic Survey 1989* (United Nations publication, Sales No. E.89.II.C.1), chap. VIII.

Figure II.4. Latin America: growth of output and population in heavily indebted and other countries, 1980-1989

(Annual percentage change)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat

import taxes, the abolition or reduction of non-tariff trade barriers and the gradual elimination of subsidies and incentives to domestic industry. However, some of the countries that have adopted a more liberal attitude towards imports have seen their trade surpluses shrink and have faced renewed difficulties in meeting their external debt obligations.

Preliminary estimates suggest that Latin American exports grew by about 2 per cent in real terms in 1989, contrasting sharply with growth of about 8 per cent in 1987 and 1988. Even though it has diversified its exports, Brazil was adversely affected by the collapse in the price of coffee and, to a lesser extent, of cocoa. As a result, the value of Brazilian exports failed to maintain the rate of increase of the past few years. With the benefit of a higher oil price, Mexico replaced Brazil as the region's leading exporter.

Elsewhere, lower coffee prices were offset by an increase in the volume exported, by the higher prices of bananas and sugar and by an expansion of non-traditional exports. For example, the value of exports of Costa Rica, Guatemala, Honduras and Nicaragua improved over the previous year, while Colombia's loss of coffee revenues was offset by higher oil prices and an increase in other exports. El Salvador and Haiti were less able to adjust to reduced coffee prices.

For the decade as a whole, the volume of exports grew by almost 60 per cent, while imports declined by 9 per cent (see figure II.5). This contrast between the region's export and import performance points to its two overriding development problems: its exports have lost purchasing power and the gains in export revenue have had to be used for debt service rather than for the imports that are necessary for growth.

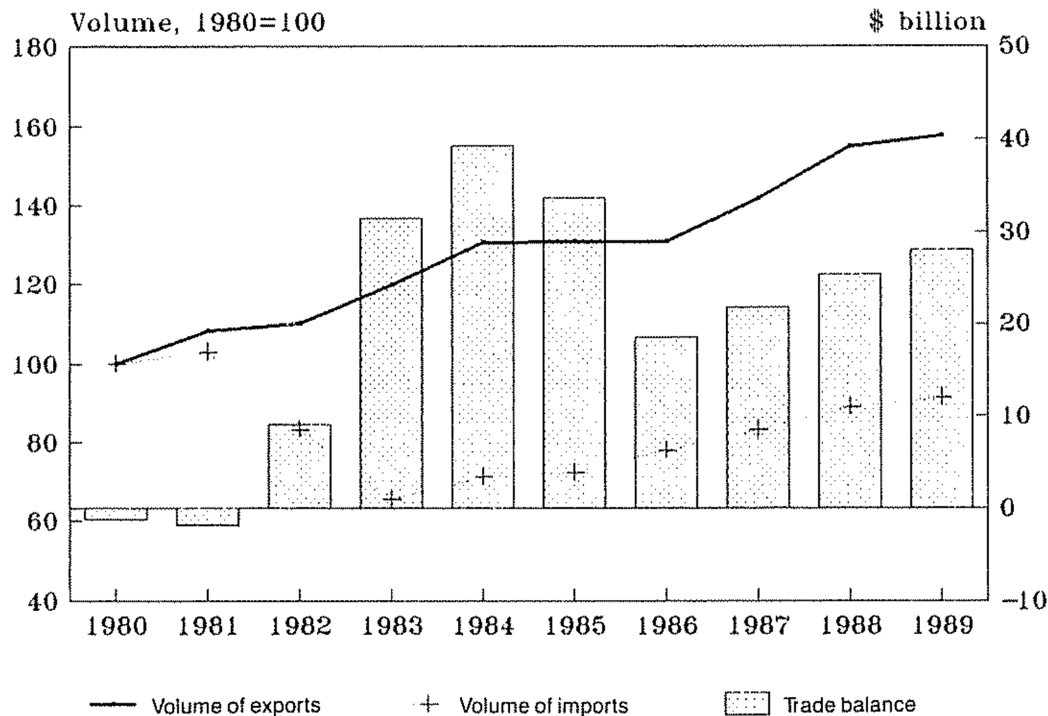
The region's trade surplus increased from about $25 billion in 1988 to $28 billion in 1989. This improvement came mainly from the three countries—Argentina, Peru and Venezuela—that experienced a deep contraction in economic activity. Brazil's surplus declined but still accounts for more than half of the total. Chile's surplus decreased, while Mexico had an estimated deficit of about $200 million in 1989 (compared with surpluses of $1.7 billion in 1988 and $8.5 billion in 1987), even though the price of oil—still Mexico's main export—increased by about 20 per cent in international markets.

Stabilization efforts in 1989

Plans to control inflation or break hyperinflation were a central feature of many Latin American economies in 1989. Most focused on price and monetary controls; a few included fiscal measures, particularly higher income taxes and lower current expenditures.

During the first half of 1989, Argentina witnessed the collapse of the Primavera Plan, which had temporarily reduced the rapid acceleration of inflation and slowed the economic recession. Despite high domestic interest rates, capital flight intensified because of the widening fiscal deficit and the lack

Figure II.5. Latin America: volume of imports and exports and merchandise trade balance, 1980-1989



Source Economic Commission for Latin American and the Caribbean

of confidence in the Government's economic policy. Government revenues were eroded by accelerating inflation and monetary policy was ineffective in containing increases in liquidity.

Correcting the fiscal deficit and its inflationary financing were the priority of the new Government inaugurated in July 1989. Increases of 200 to 600 per cent in public sector prices were authorized; subsidies and tax incentives were to be reduced and/or temporarily suspended; a price agreement was negotiated with the private sector and a 90-day price freeze decreed (although not before prices had been adjusted); wages were to be negotiated by collective bargaining but were not supposed to exceed limits fixed by the Government; the austral was devalued by more than 100 per cent and remained fixed for some time; the public sector was to undergo tax reform and privatization, and autonomy was to be granted to the Central Bank.

The measures were only partly implemented and only temporarily successful. Given the price freeze, the monthly inflation rate fell from about 200 per cent in July to 6 per cent in October. Nominal interest rates fell and the Central Bank's international reserves were partially restored. Fiscal adjustment, however, proved more difficult. The money supply increased and the difference between the fixed official exchange rate and the parallel rate widened. A new round of measures was announced, including further increases in public prices and another devaluation. Price controls on private sector goods were relaxed and the Government's short-term domestic debt obligations were rescheduled. The package was badly received and provoked a rush to the dollar, thus intensifying the crisis. Inflation reached 40 per cent per month in December 1989.

A new finance minister emphasized the liberalization of the economy. All price controls were removed and the exchange rate was unified into a single floating rate. In order to avoid uncontrolled depreciation, an effort was made to curb liquidity by restricting money supply. Bank withdrawals were limited and short-term deposits were frozen and converted into long-term government bonds.

The shortcoming of the strategy was that the fiscal deficit could no longer be financed through the expansion of the domestic debt. Since the budget could not be balanced in the short term, printing money was the only alternative available. In the first quarter of 1990, inflation continued to increase.

In Brazil, measures to control inflation resumed with the adoption of the Summer Plan in early 1989. This included monetary reform, complete de-indexation, devaluation of the exchange rate and a price and wage freeze. On the fiscal side, the prices of goods supplied by the public sector were readjusted, expenditures were to be cut, the number of public servants reduced and public enterprises privatized. Monetary policy was to be restrictive in order to avoid speculation on inventories and to curb consumption. After four months of relatively low inflation, the consumer price index re-

sumed its previous growth. The Plan collapsed and indexation was reintroduced.

As in Argentina, adjustments in the public sector—except for occasional price realignments—were postponed. This was an important reason for the persistence of inflation. However, monetary policy also exerted inflationary pressure. When prices were thawed in April 1989, monetary policy was loosened.

Negative real interest rates meant increasing difficulties for the Government in financing its domestic debt. Rates were consequently raised and remained positive for the rest of the year. However, larger interest payments implied higher fiscal deficits and excess liquidity created by the Government. Monetary policy became endogenous to the inflationary process. Inflation was about 1,800 per cent in 1989 and reached a monthly rate of 73 per cent in February 1990. The new Government that took office in March 1990 introduced another draconian stabilization plan. Its success in combating inflation is difficult to anticipate, but it is likely to produce a recession in Brazil in 1990.

In Peru, the rapid economic recovery of 1986-1987 left the country with severe price distortions, exhausted international reserves, a rising public sector deficit and annual inflation that accelerated to 1,700 per cent in 1988. The Government's economic policy in 1989 aimed at decreasing inflation by reducing the fiscal deficit. Many subsidies were suspended and the prices of public sector services were raised. In January 1989, a four-month schedule of adjustments of government-controlled prices, including the exchange rate and the minimum wage, was adopted to avoid speculation in anticipation of future government action on prices.

Monthly inflation stabilized at around 45 per cent in February-March, falling to about 25 per cent during the following month, due mainly to lags in adjusting prices and to economic recession. Minimum wages declined by 50 per cent in real terms during the first 10 months of the year and Government expenditure fell as a result. The decrease in purchasing power also led to a contraction in other components of domestic demand and a fall in overall output. Manufacturing was further hurt by the limited access to imports.

Austerity measures were relaxed during the second half of the year when the Government announced a looser monetary and wage policy and a programme to promote a modest recovery of the economy. Access to imports was eased and some signs of recovery were noticed by year end. Pressure on the inti, however, intensified and monthly inflation accelerated to 30 per cent towards the end of the year. Overall, inflation was almost 3,800 per cent in 1989.

In Nicaragua, annual inflation was some 33,600 per cent in 1988. A stabilization package announced in January 1989 included cuts in subsidies, the dismissal of public servants, cuts in defence expenditures and adjustments in public prices and tariffs. Monetary policy was to be restrictive, with credit limited and interest rates positive in real terms. Inflation was brought down, but at the cost of lower economic activity, widespread scarcities, a rise in unemployment and a large fall in real incomes. Manufacturing and construction were severely hit.

By mid-year, adjustments had to be made because agricultural output was about to be compromised for lack of credit. The resulting increase in liquidity forced the Government to devalue the official exchange rate, and the direct and indirect effects of import prices, such as oil and transport, caused inflation to accelerate again. Interest rates were then raised to ease pressure on the exchange rate. The annual inflation rate was about 1,700 per cent in 1989, but the monthly rate had stabilized at 6 per cent in the last quarter. The public sector deficit was estimated at 5 per cent of GDP at year end.

Measures to reduce inflation were also adopted in Ecuador. As in the other countries of the region, the acceleration of inflation in Ecuador was linked to the deterioration of the fiscal budget, brought about in this case by lower oil revenues and difficulties with the supply and distribution of agricultural products. The adjustment programme centred on tight monetary policy, reducing the fiscal deficit and stabilizing the currency. Reserve requirements were raised and credit, particularly to the public sector, was restricted. Fiscal measures included a rise in controlled prices and tariffs, cuts in subsidies and spending and a programme to improve tax administration. Wages were adjusted (but by less than inflation) and the currency was devalued, also by less than inflation in order to control the rise in prices. Exports stagnated and contributed to the overall slow-down of the economy brought about by the stabilization plan. In the second half of the year, the Government attempted to reactivate the economy by removing certain import controls, maintaining a competitive exchange rate and decreasing reserve requirements. Salaries, however, remained constrained. Inflation for the year was 54 per cent, compared with 85 per cent in 1988.

In Mexico, the annual inflation rate fell for the third consecutive year—from over 50 per cent in 1988 to about 20 per cent in 1989. The country's Pact for Stability and Economic Growth, which is an extension of the Pact for Economic Solidarity, involves agreements among the Government, labour, the business sector and farmers whereby prices are frozen but occasional adjustments may be made. High real interest rates have been required to contain pressure on the peso and to avoid capital flight, but they have jeopardized efforts to reduce overall public sector borrowing. Interest payments on domestic debt now exceed those on external debt, even though the latter is more than double the former. High interest payments caused the Government's financial expenditures and the domestic debt to increase in 1989, even though there was a surplus on the primary balance.

In Venezuela, the exchange rate was devalued and unified in 1989, a tight monetary policy was adopted, credit was restricted and interest rates were raised. Price controls were removed except for some basic goods. Public sector prices were adjusted and subsidies reduced or eliminated in an attempt to decrease the public deficit. Wages were raised and an employment freeze was temporarily implemented in order to provide some relief from adjustment measures. Reaction to the price increases was nevertheless violent

The immediate effect was an increase in the monthly inflation rate from 1.1 per cent in January 1989 to 21.3 per cent in March. It later receded owing to the sharp fall in demand brought about by cuts in government expenditures, limited credit, reduced consumer purchasing power and higher unemployment. The collapse of domestic demand affected output severely, particularly in construction and manufacturing. The oil industry and some sectors of metal manufacturing that supply the international market were among the few activities that grew in 1989. Nevertheless, the annual inflation rate was over 80 per cent, compared with about 35 per cent for 1988, even though the public deficit was reduced.

Inflation, the public deficit and external debt

The preceding summary of some of the recent experience of inflation and hyperinflation in Latin America leads to some general observations.

In the first place, the problems encountered in seriously destabilized countries have been fairly similar. Governments of these countries have attempted stabilization programmes with similar objectives and have experienced similar obstacles, usually resulting in the abortion of the programmes. Other programmes, slightly different in approach, have been attempted, only to suffer the same fate. There have been numerous efforts and almost as many failures to control inflation in Latin America in the 1980s, and it is natural to ask why this has been so.

The political economy of many Latin American countries—and many others too—includes a long tradition of using the Central Bank to paper over short-term conflicts between important political groups in order to maintain national unity. In the 1970s, Latin American countries were able to do this and, at the same time, grow with inflation under a reasonable degree of control. This raises the question of why there was such generalized financial disorder in the 1980s.

The answer lies in the sudden change in the world economy in the early 1980s, when the industrialized countries chose to check inflation by monetary restraints and to slow down growth. This brought commodity prices down and raised interest rates. This combination of high interest and low commodity prices made it impossible to maintain the service on external debts which had been contracted on the premise that the opposite conditions would prevail. This triggered the debt crisis and a sudden switch from a positive to a negative net transfer of resources to Latin America. The cessation of new lending and the rising interest burden on past debt resulted in a switch from positive to negative inflows of resources to Latin America of the order of $40 billion between 1981 and 1983 (see table IV.1).

Government deficits that used to be met from external sources had to be cut, but higher debt-service payments increased the financial burden on the public sector (see table II.3). Moreover, public expenditures on teachers, doctors and other public servants could not be reduced as quickly as export prices fell or as rapidly as bankers ceased making new loans. The pressure to finance government expenditure in an inflationary fashion became irresistible to the most responsible of Governments. Once inflation accelerated, it produced calls for devaluation, new taxes and subsidies and a rapid degeneration of the economic policy process.

Inflation is basically the simplest of all economic phenomena but, when the creation of money becomes part of the political process, inflation becomes the most impenetrable economic problem of all. Nevertheless, a solution to the problem is indispensable.

Africa: the elusive recovery

The growth of output in Africa during 1989 is estimated at 2.8 per cent which, for the third consecutive time, was a slight improvement over the previous year's performance. Despite the improvement, the increase in output fell just short of population growth, adding another year to a decade of economic decline. The result was, nevertheless, the best for the past few years and an examination of the reasons for the improvement is as important as the quantitative result itself.

Economic performance in the Eastern and Western subregions in 1989 was better than in the Central and Northern ones (see figure II.6). There was, however, some narrowing

Table II.3. Selected Latin American countries: interest payments by the non-financial public sector, 1980, 1983 and 1987

(Percentage of gross domestic product)

	1980	1983	1987
Argentina	0.8	5.0	3.4
Brazil[a]	0.4	1.6	1.4
Colombia[a]	0.8	1.3	2.6[b]
Ecuador	2.2	3.3	5.1[b]
Mexico	1.1	4.6	4.6
Peru[a]	2.0	2.8	0.9
Venezuela	2.1	2.6	2.9[b]

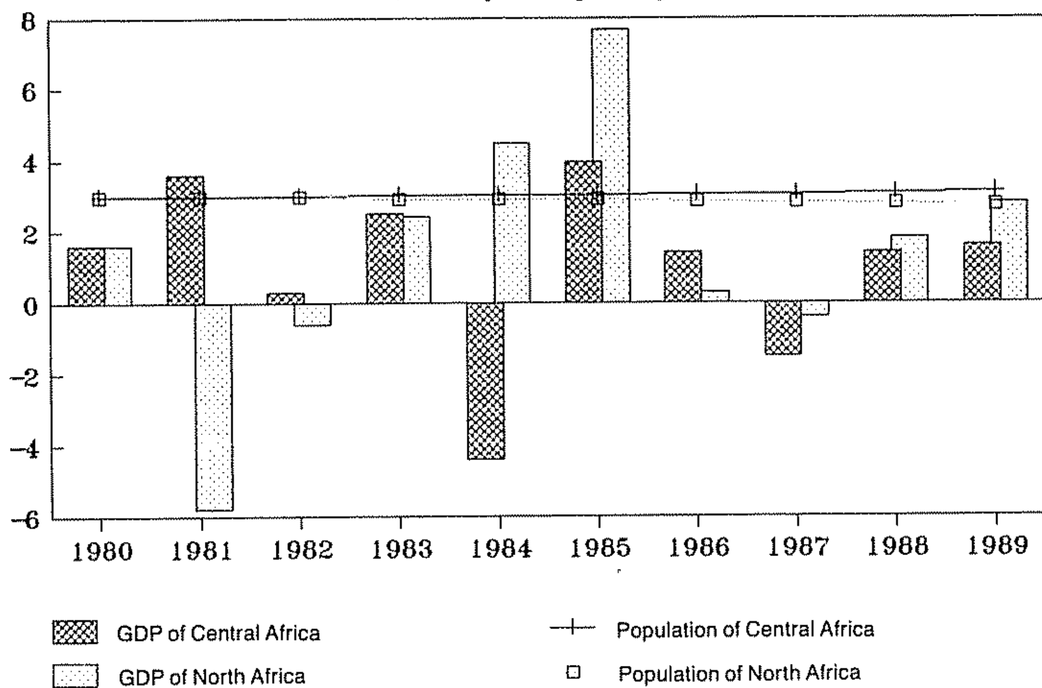
Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on national and international sources.

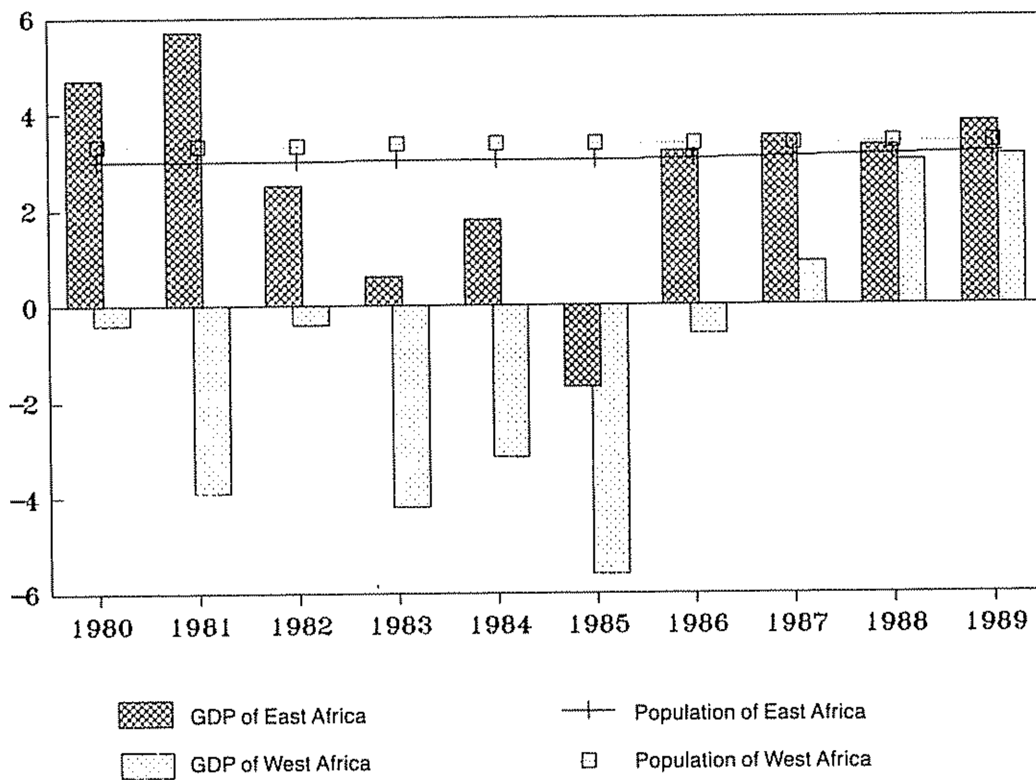
[a] Central Government only.

[b] 1986.

Figure II.6. Africa: growth of output and population by subregion, 1980-1989

(Annual percentage change)





Source Economic Commission for Africa

in the range of growth experienced by individual countries. Only a handful of countries experienced a decline in GDP in 1989, compared to 15 in 1987 and 8 in 1988. On the other hand, only about a quarter of the countries in the region experienced growth of over 4 per cent in 1989—about the same as in 1987, but less than in 1988. For the majority of African countries, the average performance of the region in 1989 was representative, in that the growth of output was about the same as, or less than, the increase in population.

The engine of growth in 1989 was agriculture, helped by favourable weather conditions in most of the continent. Even so, the growth of agricultural output barely matched that of population. Policies to encourage food production resulted in gains in a number of countries and the region's cereals crop was close to the record level of 1988, at about 91 million tons. However, there were major decreases in production in a few countries—for example, a fall of about a quarter in Niger and a fifth in Chad. The production of cassava, a traditional staple, increased by 3 per cent over the 1988 level and production of other tubers also rose. Nevertheless, shortages, and in some cases near-famine situations, continued in such countries as Angola, Chad, Ethiopia, Malawi, Mali, Mozambique, Niger and the Sudan. In Ethiopia, the combination of civil war and drought was threatening the lives of hundreds of thousands of people in early 1990. In some other countries, serious crop damage was inflicted by grasshoppers and localized droughts.

Oil-exporting countries benefited from higher oil prices and some also increased export volumes in 1989 (see chap. V); this was a main reason for the higher growth in North Africa in 1989. In sub-Saharan Africa, other constraints limited the benefits that the energy-exporting countries derived from improved market conditions. Nigeria, for example, had a trade surplus for the year but it was still insufficient to enable the country to service its debt (see box II.1). Similarly, mineral-producing countries were unable to reap all the potential benefits offered by improved prices in international markets because persistent long-term productive weaknesses, reinforced by short-term foreign exchange constraints, prevented them from increasing output.

The collapse of cocoa and coffee prices was a severe blow to the export earnings of producers such as Burundi, the Central African Republic, Côte d'Ivoire, the Gambia, Ghana, Rwanda and Uganda. As part of their structural adjustment programmes, several of these countries had raised the domestic producer prices of these commodities in an effort to increase production and hence exports. However, such moves were frustrated by developments in the international market: in some countries, such as Cameroon and Côte d'Ivoire, producer prices had to be reduced by as much as 50 per cent in 1989. Ghana lost $200 million as a result of the drop in cocoa prices, while the loss experienced by 25 countries belonging to the Inter-African Coffee Organization was around $250 million in 1989 (over $100 million by Uganda alone) and might reach $1.5 billion in 1990. Some countries, such as Cameroon and, to a greater extent, Nigeria, had their losses in cocoa and coffee earnings offset by higher oil revenue.

The improved availability of domestic agricultural raw materials and of imported vital inputs and spare parts combined to produce positive growth in the manufacturing sector in many countries in 1989. Capacity utilization increased, but remained very low.

The region's export earnings increased by about 16 per cent to $67 billion, but this was essentially the result of increases in the prices of oil and minerals; the volume of exports is estimated to have fallen by more than 8 per cent. The value of imports increased by 10 per cent to $76 billion. The direction of trade flows is still basically the same as in colonial times, although imports from Asia are increasing. Inter-African trade accounted for less than 5 per cent of total exports in 1989; this points to both the scope for and the severe constraints on this form of regional co-operation.

In spite of the recovery of exports, African external debt continued to mount, exceeding $250 billion. Reflecting, but also contributing to, the difficulties that the region encountered during the 1980s, the stock of debt is some 150 per cent larger than it was a decade ago and equivalent to about 40 per cent of the continent's GDP. Debt relief to Africa has been limited in relation to the magnitude of the problem (see box IV.2). Inflows of official development assistance (ODA) continued to be less than debt service obligations.

It is difficult to judge the implications of Africa's performance over the past few years for its medium-term prospects. On the one hand, there are signs that new policy measures are beginning to have a positive impact in some countries and that these benefits will be consolidated over time, particularly as policies and measures are refined on the basis of lessons learned in their application. On the other hand, questions remain about the efficacy of some of the policies being pursued, and the anticipated benefits have been slow in forthcoming. Some may have been more apparent than real in that favourable results may have been at least partially attributable to factors other than revised policies. Most obviously, good weather in 1988 and 1989 was one important source of recent growth. In some countries, reform-related surges in the inflow of external resources have boosted growth, but may be difficult to maintain over the longer term as they do not appear to have set in motion the general increases in the rate of investment and the volume of exports that are necessary to ensure sustained growth.

The uncertainties regarding the impact of reform have prompted an intense dialogue in Africa and the international community regarding the solutions to Africa's development crisis. In 1989, the adoption of the "African Alternative Framework to Structural Adjustment Programmes"[17] and the release of the World Bank's *Sub-Saharan Africa: From Crisis to Sustainable Growth*[18] were important additions to the international discussion. The question is no longer whether African countries should make fundamental structural changes in their economies, since the overwhelming

[17] A/44/315, annex.

[18] World Bank, *Sub-Saharan Africa: From Crisis to Sustainable Growth* (Washington, D.C., 1989).

majority agree that this is indispensable; the outstanding issues revolve around the nature of the changes required and how they should be brought about.

The debate on policy reforms

Several African countries have implemented economic reforms in recent years using internally-generated strategies rather than a conventional externally-promoted adjustment programme. For example, Kenya has adopted a pragmatic approach to adjustment with tangible results. For most of the 1980s, the country resisted calls for import liberalization and export promotion measures and eschewed proposals for a reduction in its fiscal deficit. Budget deficits remained around 7 to 8 per cent of GDP, but external concessional flows were substantial. Careful sequencing of exchange rate adjustments, often taking place at a time of abundant domestic supply, helped to narrow the margin between the parallel and the official exchange rate and limited inflationary pressures. The country's diversification effort was also partially successful: tea and horticultural products became major exports, the tourism industry developed and progress in import substitution manifested itself in the availability of domestically manufactured goods on the local market. The result, despite low commodity prices, was growth in GDP of about 4 per cent annually and tolerable inflation

In the case of the Gambia, price and exchange rate policies have made an important contribution to the country's recent high growth and low inflation. Before the introduction of an auction market for foreign exchange at the beginning of 1986, the differential between the official and parallel markets was 35 per cent; by the middle of the year, it had been virtually eliminated through a real devaluation of 40 per cent. As a result, imports declined and customs revenue rose. Increased production of groundnuts, initially, and cotton and rising income from tourism were the main reasons for the country's sound external position. Other reasons for the country's success have been domestic stability, the confidence of donors, efficient foreign investment and enlarged tax revenues (through better tax collection and increased trade).[19]

Other countries have also fared well without a formal structural adjustment programme. Botswana invested its export bonanza from diamonds to lay the foundation for long-term growth while at the same time satisfying basic needs. Cape Verde performed well without a formal structural adjustment programme by liberalizing most sectors of the economy, attracting foreign investment and increasing remittances from nationals abroad. In the case of Sao Tome and Principe, a limited form of privatization was effective in raising production: public ownership of state farms was maintained while management was handed over to the private sector, helping to increase cocoa production by one third in just one year. Zimbabwe used incentive goods (such as health and education facilities) and subsidies on utilities in the rural sector to encourage agricultural production. These success stories demonstrate that structural reform does not need to be associated with narrow short-term financial criteria.

The supply response in agriculture

The success of an export-oriented strategy and of other measures that affect domestic prices depends largely on the response of supply to the changes in prices. Because of the importance of the agricultural sector as a source of both domestic food supplies and exports, particular attention has been given to adjusting the prices of agricultural products and inputs. There were circumstances, for instance in Ghana, Guinea and the United Republic of Tanzania up to the early 1980s, when the real official producer prices for key agricultural products were so low that it was uneconomic to sell in the legal market. Peasants thus reverted to pure subsistence farming or went into smuggling. In such distorted situations, a price increase normally generates a strong response in terms of the quantity of the product put on the market. However, once such extremes are corrected, the elasticity of supply in African agriculture is known to be low, although it tends to increase with time and with the level of diversification and marketization of the economy (because it is directly related to the farmers' financial ability to allocate more advanced factors to production).[20]

In a study of nine African countries, there was no statistically significant evidence of any price elasticity of supply in eight of them: the only exception was Kenya, with a long-run coefficient of only 0.16 per cent.[21] Price elasticities appear to be low on the input side also: only one third of fertilizer use appears to be explained by price.[22] Owing largely to low man-land ratios, to the seasonal character of agricultural labour and to its highly uncertain returns, the supply of labour itself is thought to be quite inelastic.[23]

Even when an increase of the producer price in real terms is appropriate, it may conflict with other objectives. For example, the removal of export taxes can be difficult for Governments that are endeavouring to increase their fiscal receipts.[24] Similarly, policies aimed at increasing the prices of food crops raise questions on distributional grounds, since a large part of the rural, as well as the urban, population in Africa is a net food buyer. Policies centred on the privatization and deregulation of markets for agricultural inputs and outputs which were previously handled by inefficient paras-

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19 These achievements were being jeopardized in early 1990 by a border dispute with Senegal

20 Gerard Gagnon, "Les réformes macro-économiques. l'agriculture et la planification de projets agricoles" (Agence canadienne de développement international, January 1990)

21 See M. E. Bond, "Agricultural responses to prices in sub-Saharan African countries", IMF Staff Papers, No. 30 (1983). Similar results have been obtained by A. Chibber, "Raising agricultural output: price and nonprice factors", *Finance and Development* (June 1988)

22 Gerard Gagnon, *op. cit*

23 C. L. Delgado and J. W. Mellor, "A structural view of policy issues in African agricultural development", *American Journal of Agricultural Economics*, vol. 66, No. 5 (1984)

24 J. M. Rao, "Taxing agriculture: instruments and incidence", *World Development*, vol. 17, No. 6 (1989), p. 809

Box II.1. The challenge of adjustment: Nigeria

Nigeria, in contrast with most sub-Saharan countries, is large in terms of both population and land area and has oil and gas resources which should finance sufficient imports to meet basic consumption and development needs. The country's dependence on the international oil market has been at the source of its recent economic woes, but it should also have placed Nigeria in a better position than less well-endowed African countries to undertake and benefit from structural reform.

Nigeria did not engage in extensive international borrowing until 1978, when a fall in the price of oil and its other exports required the country to borrow $16 million on international capital markets. Thereafter, anticipating a recovery in the oil market and pursuing an ambitious investment programme, the country's international borrowing continued apace. External indebtedness now exceeds $32 billion and the ratio of debt-service payments to exports is more than 30 per cent. The country faces persistent difficulties in servicing its debt; debt-rescheduling is an almost continuous exercise.

It was the further drop in oil prices in 1986 that led to the formal adoption of a structural adjustment programme centred on the restoration of an equilibrium exchange rate and the elimination of domestic price distortions, especially the anti-rural bias. The programme was intended to last until June 1988, but was later extended. Financing from the World Bank and rescheduling from Western creditors was secured and a stand-by arrangement with IMF organized.

A contractionary fiscal policy in 1986 and 1987 reduced the budget deficit to 3 per cent of GDP. During 1988, when the bad harvest of 1987 was putting pressure on food prices and domestic opposition to austerity was mounting, the authorities eased fiscal and monetary policies and the fiscal deficit returned to 7 per cent of GDP, despite retrenchment in the latter part of the year. The process was repeated in 1989: the budget was initially conservative, but was relaxed later under the pressure of urban unrest. Despite such discontinuities, public expenditure has decreased in real terms since the early 1980s. However, the weight of debt service has increased, at the expense of domestic capital formation and recurrent expenditure.

The Government has been trying to eliminate inefficient and counterproductive state intervention and to obtain some budgetary relief. Agricultural commodity boards have been abolished and the trade and export of cash crops has been liberalized. These measures, coupled with devaluation, have increased the domestic prices of traditional export crops, especially cocoa. Many state enterprises have been partially or fully privatized, mainly by selling equity to private investors, while others have been restructured in order to improve their efficiency. Private investment has also been encouraged: full foreign ownership is now allowed in most manufacturing activities, while administrative investment norms have been liberalized and procedures speeded up.

Trade policy has been aimed at liberalization and export promotion. Import licensing has been abolished, tariffs lowered and simplified and some import bans lifted (although not on certain food staples). The overall degree of protection is now lower and imports are less controlled, although not fully liberalized. Export promotion measures have included fiscal and credit incentives and exporters are allowed to retain their foreign currency in domiciliary accounts.

An auction system for foreign exchange was adopted in September 1986, resulting in a real depreciation of more than 60 per cent. However, the market was not completely freed, as a multiple exchange rate system was introduced. Overall real depreciation exceeded 60 per cent. Initially, the differences among the different legal markets and the parallel market were negligible and the first and second tier exchange markets were unified in July 1987. Meanwhile the naira continued to depreciate, particularly after the relaxation of domestic policy early in 1988. Inflation soared, real interest rates became strongly negative and capital flight and speculative imports resumed. The Government tried to defend the naira by controlling the auction rate, causing the differential with the market rate to increase to 50 per cent by the end of the year. At the beginning of 1989, the Government unified the foreign exchange markets, allowing the naira to depreciate nominally and restoring equilibrium in real terms. This policy was maintained throughout the year, while monetary policy was tightened again. Interest rates have been largely deregulated, but the results so far are mixed, because the Central Bank is not in a position to control the behaviour of a number of banks operating in the country.

Nigeria's structural adjustment efforts have achieved limited results to date. As a result of the increased relative price

tatals sometimes run into further problems, as the following examples of grain market liberalization in Madagascar, Malawi and Mali demonstrate.

The liberalization of the rice market in Madagascar started in 1983, but was not extended to the two main surplus areas until 1989. Until 1985, producer prices rose modestly and those offered by private traders were not much above the official price. Retail prices, on the other hand, almost doubled between 1983 and 1985, to more than triple the producer price. Traders were speculating at the expense of both consumers and producers, while the Government, still controlling the main surplus areas, was able to maintain an official retail price much lower than the market one.[25]

[25] See E. Berg, "The liberalization of rice marketing in Madagascar", *World Development*, vol. 7, No. 5 (1989), p. 721.

of tradeables, non-oil exports have increased (from $0.6 billion in 1986 to $0.9 billion in 1988), as has the proportion of local goods and raw materials purchased by the manufacturing sector. However, non-oil exports are still only at the levels of the 1970s and the amounts involved remain small compared both to oil exports and to debt service obligations. Manufactured exports have not shown much growth so that traditional cash crops (mainly cocoa) continue to account for most non-oil exports.

In other areas, there has been negligible structural change. The increase in the availability of foreign exchange improved capacity utilization in the manufacturing sector in 1987 and 1988, but it fell again in early 1989 and has always remained below 50 per cent. Those sectors which are more dependent on domestic resources have increased their capacity utilization more than those most heavily dependent on imports.[a] This suggests that, even with changed relative prices, the lack of foreign exchange is still a binding constraint. Because large firms are at an advantage under the new auction system, the fact that they consistently show higher rates of capacity utilization than small firms reinforces this conclusion.

Changes in relative prices have had little impact in terms of encouraging technological innovations that will substitute domestic raw materials for imports. The proportion of local raw materials used in the manufacturing sector rose from 38 per cent to 42 per cent between 1986 and 1988 - a small improvement compared to the changes in relative prices. Moreover, investment in manufacturing continues to be very low, with practically no expansion of the productive base or technological progress.

Agricultural production has been helped by the elimination of anti-rural distortions and by the maintenance of selective support policies (such as subsidies on fertilizer and exports and bans on food imports). Food self-sufficiency has increased, but at the cost of a decrease in food availability per capita and an increase in malnutrition. Moreover, weather has been the main factor explaining the recent agricultural recovery: the numerous structural constraints which impede the exploitation of productive potential remain. Overcoming the lack of rural infrastructure, the inadequate supply of suitable technologies, the absence of an effective rural credit framework and inadequate irrigation facilities will need substantial new investment.

As in many other African countries, the contractionary nature of Nigeria's adjustment measures have so far failed to resurrect private investment, despite dramatically reduced labour costs, more favourable fiscal and operating conditions and improved export incentives. This has been due mainly to the great difficulty of restructuring an import-consuming and import-substituting manufacturing sector in a short time without adequate foreign exchange resources.[b] Although there has been some new investment in the production of agricultural raw materials by industrial firms, agriculture has generally not been seen as a viable alternative investment opportunity.

The adjustment programme has corrected the previous anti-rural and anti-export biases, but the overall supply response of the economy to changes in relative prices has been insufficient to solve the economy's major problems. The discrepancy between the country's accumulated debt burden and its export potential persists. Some major rescheduling of both public and private external debt has taken place in recent years, but it appears to have merely postponed the problem of fundamental external imbalance.

Meanwhile, the standard of living of the population has worsened markedly. Real wages have fallen by close to 60 per cent, while the real income of self-employed peasants is estimated to have declined by 35 per cent. Unemployment, especially among young school-leavers, continues to be very high, despite the fall in real wages. There has been a deterioration in essential social services, particularly health and education.[c] The desired removal of the urban-rural differential has been achieved, but it has been brought about by a process of generalized and steep impoverishment. The deterioration in the living standards of the poor, reflected in increased mortality and malnutrition and declining school enrolment ratios, has been greater than that of the economy as a whole. This implies a worsening of income distribution in favour of the urban élite.

[a] However, the increased demand for local raw materials from the wood and furniture industries is accelerating deforestation

[b] The limited amount of venture capital which responded to the short-term capital gains offered by privatization might have had a marginal effect in crowding out other possible new investments

[c] In some case, basic health and education services, which were previously free, are now sold. As a result, poorer people are often excluded

When the major surplus areas were opened to the free market, producer prices increased by more than 150 per cent, reducing the differential with retail prices. This increase was spurred by the tense demand situation (imports were being severely curtailed) and by the destruction of the official marketing structure. As more traders were attracted into the market, commercial margins fell and all net rice sellers benefited from the price increase. Production increased, but the extent of the gain is unclear. The official estimate showed an increase of 3.1 per cent in 1986 (which would imply a negligible short run supply elasticity), but some observers suggest better results. Production increased again in 1987, but fell in 1988 owing to a drought. Nevertheless, uncertainties in the market allowed parastatals to buy a record volume of paddy in 1988, after many years of decline.

Malawi experienced favourable agricultural growth in the 1970s and, although the country is often viewed as a success-

ful case of the application of laissez-faire policies, there was significant state intervention in agriculture. Government controls were, however, limited to smallholders: the Agricultural Development and Marketing Corporation (ADMARC) had a monopoly on all crops except higher quality tobacco. This primarily estate-produced export could be sold freely at auction, allowing the estate owners to collect almost the full international price.[26] During the 1970s, the estate tobacco sector boomed, while the rest of agriculture stagnated.[27]

Malawi's economy ran into problems in the early 1980s. Since then the country has been receiving World Bank and IMF assistance. ADMARC was considered inefficient and financially unsound, mainly because of its centralized bureaucracy and its high internal and external transport costs. Private trading in smallholders' products was therefore legalized, but ADMARC was retained as a buyer of last resort and to ensure market stability and food security. ADMARC'S reduced range of activities was expected to enable it to improve its financial position.

The Government was encouraged to take these actions before the 1986/87 harvest season. However, the required licences for private traders were not distributed in time, resulting in illegal trade, which could not be controlled or monitored. Lower than expected supply and increased demand (stemming from a flow of refugees from Mozambique) forced up the consumer price of maize. Uncontrolled private trade in maize burgeoned and ADMARC was unable to purchase its target quantity, raising concern about the possibility of shortages. This situation was exacerbated in the following crop season (1987/88). ADMARC also experienced an increase in its operating costs, firstly because it was left to operate in distant, poorly serviced areas deserted by private traders and secondly because it still had to distribute fertilizer in markets where it no longer had purchasing functions. Lack of control over quality and storage were further problems.

Apart from the need for more careful planning, this experience raised some policy issues. Competition among traders was supposed to increase the price paid to producers but, because of the possibility of collusion among traders, ADMARC was still expected to act as a buyer of last resort to ensure a guaranteed price to smallholders. This should have reduced the risk faced by the smallholders from both the supply side and the demand side and facilitated a shift away from subsistence towards commercial production.

However, in order to give up traditional methods of subsistence production in favour of risky ventures (such as hybrid varieties and cash crops), poor farmers require not only a guarantee regarding the minimum price they will be offered for their commercial production, but also an assurance that supplies of food will be available at reasonable prices. Without this guarantee, smallholders will not switch to non-edible, albeit high-value, cash crops because of the unacceptable risk of a possible shortage of food for family consumption. Since it was unable to purchase its target quantity, ADMARC could not provide this guarantee.

In Mali, the Office malien des produits agricoles (OPAM) used to have a legal monopoly on the grain trade. In practice, however, since official producer prices were too low, it was able to buy only a fraction of the commercial cereal crop (itself a very low share of total production) and supplied only some government employees and institutions; the rest was sold unofficially at higher prices, to the detriment of most final consumers. In the 1970s, OPAM also distributed imported grains at low official consumer prices, thus running deficits.

As a result of donor pressure, the Cereals Market Restructuring Project (PRMC) was launched in 1981. However, the activities of private traders under PRMC were limited by liquidity constraints, lack of credit and inadequate storage facilities. At the same time, the role of OPAM became more difficult because it was both operating in a market open to private traders and handling food aid distribution, thus trying to balance food security with the need to guarantee minimum farm prices. Paradoxically, OPAM ran into a severe crisis in 1985/86 and in 1986/87, when two bumper harvests pushed down market prices. The official price was then excessively high and OPAM lost even its traditional clients and could not repay its debts.[28]

Consumers were probably the main beneficiaries of PRMC. In addition to the effect of the large influx of food aid on consumer prices initially, lower risks probably reduced marketing margins and made food less costly for consumers who, especially in rural areas, had previously relied mainly on the parallel market to purchase grains. For producers, the assumption that liberalization would raise producer prices proved wrong. Moreover, the very desirability of raising prices could be questioned on distributional grounds because approximately half of the rural households were net buyers of grains, while net sales were highly concentrated among rich and fully equipped farmers in the better-endowed irrigated areas. This situation is not peculiar to Mali, but is quite common in Africa.[29]

Higher prices primarily benefit rich farmers because others lack the financial and other resources necessary to increase production. Moreover, even their effect on food production is limited: surveys show that, once their own consumption needs are met, fully-equipped farmers "prefer to invest additional resources in less risky enterprises, such as cotton production and nonfarm businesses.... Such enterprises are generally much more profitable and less risky than producing coarse grains for the commercial markets".[30]

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[26] R. E. Christiansen and L. A. Stackhouse, "The privatization of agricultural trading in Malawi", *World Development*, vol. 7, No. 5 (1989).

[27] *Ibid.*, p. 738, notes 4 and 5.

[28] J. M. Staatz, J. Dioné and N. Nango Dambélé, "Cereals market liberalization in Mali", *World Development*, vol. 7, No. 5 (1989), p. 709.

[29] M. Weber, J. Staatz, J. Holtzman, E. Crawford and H. Bersten, "Informing food security decisions in Africa: empirical analysis and policy dialogue", *American Journal of Agricultural Economics*, vol. 70, No. 5 (1988).

[30] *Ibid.*, p. 713.

Similarly, poor farmers' short-run price elasticity of supply for basic staples is very low. Increasing the poor farmers' ability to supply grain markets "would entail improving [their] access to input markets, credit, and a reliable cash crop to help amortize the investment in agricultural equipment".[31] Other studies have led to similar conclusions in other Sahelian countries. Public intervention to stabilize cereal prices seems necessary to make grains attractive as a commercial venture for all farmers.

The mixed results of these market reforms suggest some policy conclusions. First, the positive effects of liberalization are directly related to the magnitude of the inefficiencies and biases in the previous parastatal régime. Second, in the unstable reality of African agriculture, it is important to ensure that the removal of the ban on private trade and of the monopsonic position of public parastatals does not result in the total breakdown of the parastatals, because they should continue to play a role in handling and distributing food aid shipments, stabilizing the market against excessive seasonal and year-to-year fluctuations and acting as a buyer of last resort. Third, careful research, analysis and planning are required for market liberalization; haste, ignorance and ideological bias can severely damage reform attempts. Fourth, it cannot be assumed that the benefits of reform will be evenly distributed. Rich farmers usually profit the most from liberalization, while in the short-term poor people in urban areas and some in rural areas are negatively affected. If no compensatory measures are taken, their standard of living and nutritional level are likely to fall, at least in the short and medium term. Finally, although there is scattered evidence of a positive supply response, it is generally modest and tends to taper off as soon as the main inefficiencies are eliminated. Further progress has to be achieved through policies which attack the long-run supply constraints

Long-term constraints to agricultural growth

Many longer-term impediments to agricultural development in Africa extend beyond areas that can be addressed simply by changing relative prices. They include physical limitations: on average, soils are poorer and more fragile than in other regions, rainfall is often less and more unpredictable, and the cumulative results of past and present agricultural practices are depleting natural resources at a faster pace. Desertification has become a major threat presenting another subsidiary set of difficulties (see box II.2). The potential for cost-effective irrigation is deemed to be low.[32] The dispersion of the population is often another impediment to intensified agricultural practices.

These negative factors are not only harder to overcome, but are also different from those experienced by South and East Asia. They largely explain the limited scope for technological transfer between Asia and Africa and are one reason for the inability of the African agricultural research and development institutions to develop appropriate new varieties, inputs and cultivation practices. Inadequately qualified personnel, the brain-drain and a lack of organizational infrastructure are additional impediments to improving agricultural productivity in Africa. If these problems are addressed and research is re-oriented towards crops that are both cultivated and consumed by the poor rural population, the supply response of the agricultural sector to improved market conditions would be enhanced.

The vastness and diversity of the African continent defies any attempt to apply a standard formula for policy measures designed to achieve agricultural transformation. Measures which might prove effective in addressing certain issues in some countries can prove futile, and even have perverse effects, in others. To avoid such pitfalls, reform programmes have to be internally generated and command widespread support.

In many of the agricultural and other reform programmes in Africa in the early and mid-1980s, large segments of the population were either marginalized or adversely affected. This lack of popular participation weakened reform because success depends heavily on the willingness of the people to accept short-term losses; this will happen only when they believe that their Government is working for their long-term benefit. In the "second-generation" of reform programmes that are now being implemented, there is greater cognizance of the importance of fuller participation and of the need to take into account the indirect, particularly social, consequences of such measures. To this extent, at least, the reform efforts of the 1980s have yielded positive results.

The need for longer-term measures

There is increasing recognition that short-term adjustment measures alone are insufficient for attacking the deep-rooted development problems of sub-Saharan Africa. The World Bank report identifies three major reasons for the crisis in sub-Saharan Africa: low levels of investment, low rates of return (in part a consequence of inadequate past investment in and maintenance of infrastructure and services) and rapid population growth.[33] Capital formation in sub-Saharan Africa fell from over 20 per cent of GDP at the beginning of the 1980s to 15 per cent in 1989; this is insufficient to maintain existing capital, as evidenced by the decaying public buildings, deteriorating transport system and collapsing social services throughout the continent. In order to restore growth, strategies have to focus on reviving investment and making it efficient.[34]

At present, investment in machinery and equipment is seriously hampered by balance-of-payments problems, which are largely attributable to the need to meet debt-servicing requirements and stagnant or falling export revenues result-

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[31] *Ibid.*, pp. 713-714

[32] Many observers are pessimistic about the value of large-scale capital-intensive schemes in Africa, although less so about small-scale schemes. FAO, *Irrigation in Africa South of the Sahara* (Rome, 1986)

[33] World Bank, *Sub-Saharan Africa: From Crisis to Sustainable Growth* (Washington, D.C., 1989)

[34] The World Bank estimates that $5 billion is required only to rehabilitate sub-Saharan Africa's road infrastructure and a further $700 million each year to avoid further deterioration (World Bank, *Sub-Saharan Africa* ..., pp. 175-176)

Box II.2. Desertification and agricultural development in Africa

Desertification is a world-wide phenomenon, but its economic impact is greatest in Africa. The majority of countries in Africa are stricken to varying degrees and desertification has an important bearing on their overall economic position and prospects. Agricultural production per capita is declining in many African countries (see chap. IX, sect. B) and desertification is continuing, demonstrating another of the vicious circles of poverty. On the one hand, subsistence farmers[a] are forced to use agricultural practices which cause desertification; on the other hand, desertification leads to a loss of agricultural production and to poverty.

Extended periods of drought have occurred in Africa for thousands of years[b] and Africans have developed farming systems which enable them to cope with the physical and chemical soil constraints, the low quantity and high variability of rainfall and the high temperatures. Nomadic grazing and shifting cultivation with periods of fallow up to 30 years were used for centuries, rainfall variability being the most severe risk that African farmers faced. The precautionary measures used to deal with periods of drought included saving real assets (such as livestock, land, grain and household items); diversification of production and other income-generating activities; and the development of systems of reciprocal obligation among households.

When a period of drought occurs, action is taken in three stages. First, farmers use their insurance mechanisms; these include the sale of non-productive assets, a change of grazing, cropping and planting practices, the reduction of current consumption, the consumption of wild foods and the use of interhousehold transfers and loans. Next, productive assets (such as livestock, tools and land) are sold, food and money are borrowed from merchants and moneylenders, and consumption levels are further reduced. In the last stage, people migrate in distress.

The high rate of population growth in Africa makes precautionary measures and the first two stages of the coping strategies more difficult. Larger populations lead to larger herds of livestock, shorter fallow periods, use of marginal land, improper irrigation methods and a higher demand for fuelwood. This results in overgrazing, overtrampling, overcultivation, waterlogging, salinization, alkalinization, cutting of vegetation and deforestation. These abuses make natural resources more vulnerable to the climate and lead to desert-like conditions. Yields decline and the scope for the precautionary accumulation of assets also decreases. Coping strategies also fail for a variety of reasons: there are no assets to sell, too many people are migrating and looking for additional sources of income, interhousehold transfers break down because too many people are in distress or are trying to sell their assets and prices are plummeting. These failures are an important cause of famines.[c]

Commercialization of agriculture has often contributed to these failures. Farmers who live on what they produce are vulnerable only to the risk of variations in output, but commercialization adds the risks of variations of price and market availability. Deteriorating terms of trade, either between domestic and foreign output, between labour and foodgrains or between livestock and foodgrains, compound the problem. Such additional risks and uncertainty increase the possibility of famine. Subsistence farmers will tend to favour traditional practices and avoid technological change for fear of a loss of output, however temporary. Moreover, with the exhaustion of insurance mechanisms and the sale of productive assets, one of the few remaining alternatives is dissaving of natural resources in the form of overgrazing, overcultivation, deforestation and improper irrigation. Thus, poverty and increased uncertainty related to commercialization might lead to desertification.

In some cases, government policies have contributed to the problem. Partly because of seasonal absenteeism and the declining political power of pastoralists, large areas of dry pasture have been allocated for such other uses as national parks, irrigation schemes, large-scale mechanized farming, official grazing reserves, individual ranches, state farms, stock routes and official holding grounds.[d] This has weakened the property rights of pastoralists and thereby discouraged environmentally sound practices. In addition, Governments have put wells on marginal rangelands, sometimes as compensation, or have welcomed the (temporary) sedentarization of pastoralists, which, among other things, simplifies food relief. These measures have increased desertification through overtrampling, overgrazing and other inappropriate practices. Moreover, temporary settlements tend to become permanent. Finally, many countries in Africa are highly dependent on agricultural exports both for taxes and for foreign exchange earnings. The need for such revenues has encouraged overexploitation of natural resources.

There are three additional reasons for the partial breakdown of traditional insurance mechanisms. First, the reduction and protection of some wild animals has reduced the scope for "fall-back hunting". Secondly, civil strife and political differences have impeded the movement of pastoralists and farmers in search of grazing areas, employment or food aid. Finally, trading possibilities across the Sahara have declined because of political difficulties and competition from motorized traders.

Although adequate data are lacking for recent years, the trend towards increased desertification seems unlikely to be reversed in the near future since some of the factors that determine it are becoming more pronounced, especially in the Sudano-Sahelian zone (see the table). The climate also appears to have been unusually hostile in recent years. Prolonged periods of drought have become more frequent over the past two decades; for example, the rainfall in sub-Saharan West Africa between April and October of each year from 1968 to 1985, except 1969, was less than the average for the period 1941-1985.[e] In addition to drought, there were downpours causing massive soil erosion in 1985 and 1987 and in 1988, particularly in Burkina Faso, Mali and the Sudan; in other parts, rainfall was deficient in 1988. In 1989,

parts of Ethiopia suffered from drought and Mozambique from flooding.

In 1984, the general assessment of the United Nations Plan of Action to Combat Desertification made it clear that the goal of arresting desertification by the year 2000 was no longer feasible. One of the most important obstacles was insufficient financing. Other factors were the low priority given by national authorities to desertification control efforts; inadequate national machineries to plan and carry out anti-desertification projects; and the dearth of economically and socially acceptable approaches for addressing land degradation projects at the grassroots level.[f]

Despite the difficulties, there have been successes. Sand-dune fixation projects have shown good results in Burkina Faso, Mali, Mauritania and Morocco, for example. Soil erosion has been combated effectively in Burkina Faso, Ethiopia and Kenya. There are successful reforestation projects in such countries as Burkina Faso, Ethiopia, Kenya, Madagascar, Senegal, the Sudan and Zambia. Finally, an increasing number of research and training facilities have been established.

There is no single factor which can be singled out as the key to successful conservation programmes,[g] but there are some factors which can contribute. Farmers should be involved from the beginning and should be convinced of the benefits for them in the short run, implying that the method used should not only conserve the environment but also increase production. Land tenure systems are an important prerequisite if the farmer is to reap the benefit. Conservation practices should be practical and appropriate for local conditions. Finally, since implementing projects can be expensive in time and labour, incentives are required to induce farmers to take up conservation work.

Notwithstanding such micro-economic measures, efforts to fight desertification are likely to fail if the pressures on the natural resources persist. Poverty eradiction, improvement of the internal and external terms of trade, population control and public insurance programmes should go hand-in-hand with anti-desertification projects and efforts to raise agricultural productivity. Such an approach should include removal of any economic bias against agriculture; research into and development of indigenous crops which are drought resistant and suitable for African soils; development of early warning systems, supported by arrangements providing some form of social security and employment protection; integration of livestock and crop production (to provide manure and draft power) and of crop production and forestry (to prevent erosion, produce fuelwood and generate organic matter to improve soil structure); and better management of water resources and development of low-cost and small-scale irrigation schemes.

Trends in factors influencing desertification, 1977-1988

(Annual percentage rates of change)

	Africa		South of Sudano-Sahel		Sudano-Sahel		North Africa	
	1977-1985	1985-1988	1977-1985	1985-1988	1977-1985	1985-1988	1977-1985	1985-1988
Population	3.0	3.0	3.1	3.1	2.9	3.0	2.8	2.8
Livestock	1.3	1.7	1.6	2.0	0.7	0.6	0.8	2.2
Fuelwood	2.9	3.0[a]	3.2	3.3	2.5	2.3	2.4	2.3
Charcoal	3.1	2.9[a]	3.3	3.4	..	1.5	2.4	1.2

Source: *World Population Prospects 1988* (United Nations publication, Sales No. E.88.XIII.7); FAO, *FAO Production Yearbook 1987* and *1988*; and FAO, *FAO Forest Products Yearbook 1987*

[a] 1985-1987

[a] In the African context, "farmers" includes pastoralists, frequently nomadic

[b] Michael H. Glantz, "Drought in Africa", *Scientific American*, vol. 256, No. 6 (June 1987), pp. 36-37

[c] See Amartya Sen, *Poverty and Famines: An Essay on Entitlement and Deprivation* (Oxford, Oxford University Press, 1981).

[d] Jon Moris, "Failing to cope with droughts: the plight of Africa's ex-pastoralists", *Development Policy Review*, vol. 6 (1988), p. 281; see also Robert Repetto and Thomas Holmes, "The role of population in resource depletion in developing countries", *Population and Development Review*, vol. 9, No. 4 (December 1983), pp. 617-618

[e] UNEP, *Environmental Data Report* (Oxford, Basil Blackwell, 1987), pp. 108 and 116; see also Jon Moris, *op. cit.*, pp. 272-273; and Bingu Wa Mutharika, "Special assistance needs for Africa, with special reference to sub-Saharan Africa", *Development: Seeds of Change*, vol. 2, No. 3 (1987), p. 31

[f] See UNEP, "Implementation of the Plan of Action to Combat Desertification 1987-1988", report of the Executive Director, 28 February 1989 (UNEP/GC.15/9/Add.4); and UNEP, "General assessment of progress in the implementation of the Plan of Action to Combat Desertification, 1978-1984", report of the Executive Director (UNEP/GC.12/9). On the other hand, ECA notes that despite "very little concrete evidence ... there are encouraging indications that many Governments are taking to build institutions". It reports that "by 1986, 48 of the 50 ECA member States had established machinery for ... coordination" among countries of the region (*Survey of Economic and Social Conditions in Africa, 1985-1986* (United Nations publication, Sales No. E.88.II.K.1), p. 72)

[g] FAO, *African Agriculture: The Next 25 Years* (Rome, 1986).

Table II.4. Africa: government views and policies regarding population growth and fertility, 1980 and 1989

(Number of countries)

		View			Policy		
		High	Satisfactory	Low	None	Decrease	Increase
Population growth	1980	18	26	6	31	12	6
	1989	29	17	4	14	23	3
Fertility	1980	21	24	5	36	11	3
	1989	32	15	3	21	25	3

Source: Trends in Population Policy (United Nations publication, Sales No E 89 XII 13)

ing from the continuing weakness of commodity prices Because most African countries lack an enabling environment, there is little foreign direct investment; on the contrary, the domestic private sector continues to accumulate assets abroad while the public sector accumulates debts, both domestic and foreign.

The difficulties created by the lack of investment are compounded by the increasing burden imposed on existing infrastructure by a rapidly expanding population. Population in Africa is growing by about 1 percentage point faster than in any other continent. If the rate of growth of population had been the same as in Latin America in the 1980s (but without any negative effects on production), Africa would have been able to avoid the decline in per capita output that was its hallmark for the decade. African Governments are increasingly recognizing the constraint that population growth is placing on development, as reflected in their changing attitudes towards population policy during the 1980s (see table II.4). As with investment, however, more needs to be done to make these policies efficient and effective. In the case of both population and investment, additional domestic and external resources are needed to translate revitalized policies into action.

West Asia: riding the roller coaster of oil prices

The firming of oil prices in 1989 had a positive direct and indirect impact on almost all the economies of West Asia, including the energy-importing countries Encouraged by the rise in oil revenues, most of the energy-exporting countries in the region relaxed their tight fiscal policies. The rise in government spending—although moderate—added to the increase in aggregate demand and helped the region to sustain the economic turnaround that began in 1988. In addition, although political tensions continue, the end of hostilities between the Islamic Republic of Iran and Iraq allowed more attention to be devoted to economic and social development in 1989. Preliminary figures indicate that the region's real GDP increased by 2.5 per cent in 1989 compared to 1.3 per cent in 1988. However, this was insufficient to reverse the downward trend in per capita GDP (see figure II.7); per capita GDP again declined, although only marginally.

Disparities between the two subgroups of the West Asia region remain stark. The net energy-exporting countries enjoy levels of per capita GDP that are among the highest in the world, despite the fact that the average plummeted about one third between 1980 and 1988 During the same period, per capita GDP increased by about one sixth in the net energy-importing countries, but it is still only about one sixth of that in the other countries in the region. The two least developed countries in the region showed mixed results during the 1980s; after a period of sustained growth in the first half of the 1980s and some set-backs thereafter, output in Democratic Yemen has been almost stagnant for the past two years. Yemen, on the other hand, recorded substantial positive growth throughout the 1980s; for the decade as a whole, growth of GDP averaged over 6 per cent annually.[35]

Favourable external demand conditions and firming oil prices encouraged most producing countries of the region to increase oil production (see table A.18), to invest in new capacity and to embark on new exploration (with additional reserves being discovered in Oman, Saudi Arabia and the Syrian Arab Republic). In addition to the rise in export earnings from oil, other sectors contributed more to the economic expansion than in previous years: the petrochemical industries benefited from rising world demand and higher prices and, although confronted with lower international prices, the aluminium sector performed well. The good performance of these industries led to an increase in value added in the manufacturing sector.

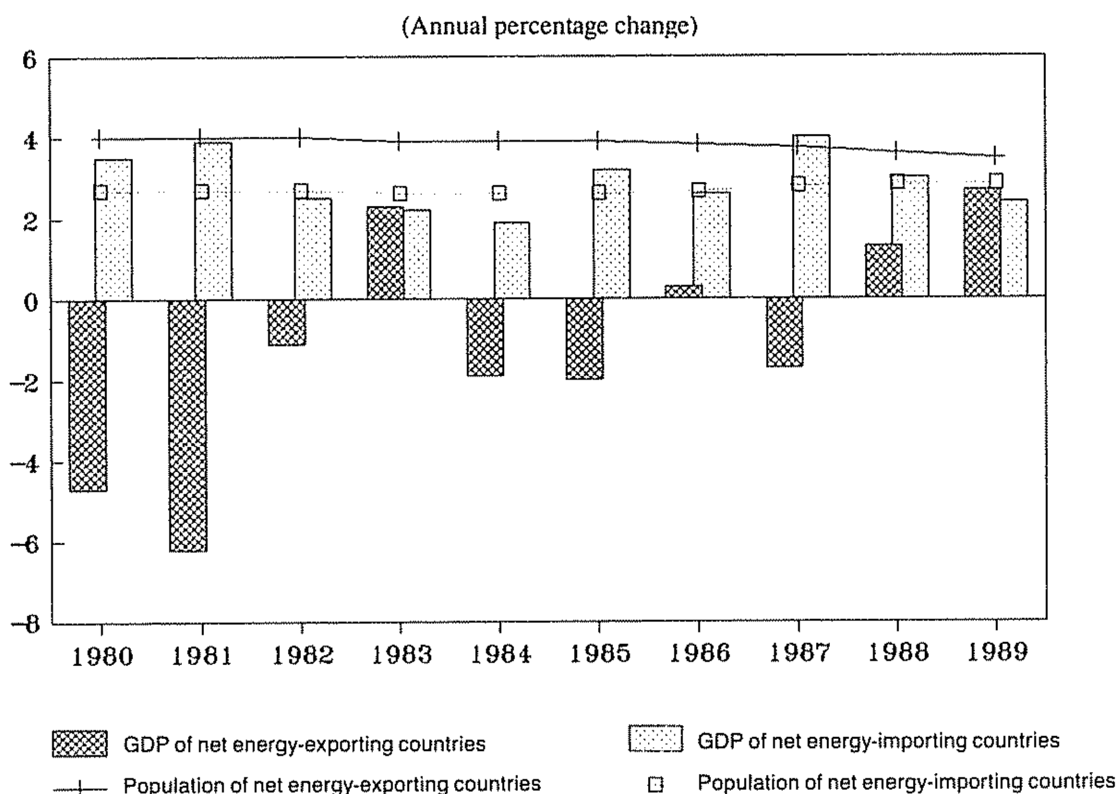
After several years of contraction, the construction sector continued the expansion started in 1988, benefiting from reconstruction projects in the Islamic Republic of Iran and Iraq and from growth in public works and housing in such countries as Kuwait, Oman and the United Arab Emirates. After several years of decline associated with plummeting oil revenues and unmanageable debt levels, the banking sector also continued its recovery. By contrast, the agricultural sector performed badly in 1989, owing partly to the drought in the Syrian Arab Republic (one of the region's major agricultural producers) and partly to the poor performance of Jordan and Yemen.

During 1989, the region's balance of payments benefited from the increase in both the price and volume of oil exports.

[35] On 22 May 1990, the Yemen Arab Republic and the People s Democratic Republic of Yemen merged to form a single sovereign State called the Republic of Yemen

Figure II.7. West Asia: growth of output and population of energy-importing and energy-exporting countries, 1980-1989

(Annual percentage change)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat.

Non-oil exports (mainly aluminium, copper, phosphates, fertilizer, cotton, leather products, perfumes, fruit and vegetables) also grew, thanks to the general revival of economic activity in the region and to the increased competitiveness induced by currency depreciation. However, the good performance on the trade account was offset in some countries by a deterioration in the services and transfer accounts due to increased debt-service payments and declining private transfers. Meanwhile, since most countries in the region remain heavily dependent on imports, increased government outlays and a rise in private spending caused imports to continue to rise. Although the good trade performance helped to narrow the current account deficit, only Kuwait and the United Arab Emirates recorded current account surpluses in 1989. However, following the steady devaluation that began in mid-1988, Jordan was able to reduce its large deficit through a decline of about one quarter in its imports and an increase of about half that size in its exports, mainly of phosphates and potash.

To finance their current account deficits, most of the energy-exporting countries continued to draw down international reserves. On the other hand, the energy-importing countries, faced with shortages of reserves, again resorted to external borrowing to finance their current account deficits, thus exacerbating their debt-service burden. Some of this borrowing, as well as that undertaken by a few energy-exporting countries, has been associated with purchases of military equipment. Mounting debt-service payments, coupled with foreign exchange shortages, required such indebted countries as Iraq, Jordan and the Syrian Arab Republic to undertake rescheduling. Even two less-indebted countries (Democratic Yemen and Yemen) faced debt-servicing problems in 1989.

As part of a concerted effort to improve its economic situation, Jordan reached agreement on, and began to implement, an IMF adjustment programme and then embarked on negotiations with its foreign creditors (mostly Governments) through the Paris and London Clubs. In an agreement with Paris Club members in July 1989, most of its outstanding debt and part of its interest payments and arrears were rescheduled with 10 years' maturity, including 5 years' grace. In negotiations with the London Club in September 1989, it was agreed that principal repayments would be rescheduled over 11 years, with a 5-year grace period, during which only interest would be paid; arrangements were also made regarding interest arrears.[36]

[36] Economist Intelligence Unit, *Jordan: Country Report*, No. 1 (1990), p. 18.

In mutual agreement with its individual creditor countries, Iraq continues to opt for bilateral debt rescheduling. In September 1989, France agreed to reschedule $1.24 billion of Iraq's outstanding interest and principal repayments due between May 1988 and December 1989, while agreement was reached in December 1989 on the rescheduling of $767 million owed to Italian companies. During the same month, Japan agreed to accept oil as a medium of payment for all outstanding debts owed by Iraq.

Inflation remained high in the energy-importing countries of the region in 1989 and re-emerged in the energy-exporting countries. In the former group, the enlarged external imbalances prompted currency devaluations which, in turn, led to an increase in inflation. The reduction of consumer subsidies because of budgetary adjustment also contributed to the worsening of inflation rates in these countries, as did the fact that fiscal deficits were financed mainly from domestic sources, particularly from credit expansion by the banking system. Preliminary figures indicated that inflation rates in the energy-importing countries rose to around 25 per cent in 1989.

After several years of reducing inflation through deflationary fiscal policies, inflationary pressures emerged again in most of the region's energy-exporting countries in 1989, mainly because of increased domestic demand. However, except in the Islamic Republic of Iran, Iraq and the Syrian Arab Republic, inflation is not a serious problem, prices in most of these countries increasing at rates ranging from 3 per cent to 6 per cent in 1989.

Unemployment has become a matter of concern in the countries that in the past two decades were exporting labour. The rise in unemployment in 1989 (to 9.3 per cent in Jordan and 8.3 per cent in Yemen) was due mainly to the short-term problem of returning migrants being superimposed on the longer-term problem of high population growth rates. The growing population includes a disproportionately large number of young people seeking their first job and thus puts additional pressure on the labour market.

Although most energy-exporting countries do not face unemployment problems, they also are concerned about the possibility. The slight economic recovery in 1988 and 1989 has been insufficient to absorb the increase in their labour force; as a result, these countries continue to apply restrictive measures with regard to expatriate workers, thus reducing the effective demand for foreign labour and closing the valve that was previously open to the unemployed in the labour-surplus economies of the region.

During 1989, the countries of West Asia continued their economic restructuring: diversification aimed at expanding the productive base; the promotion of downstream investment activities; the creation of viable financial market infrastructures; and the privatization of some state-owned enterprises. The 1989 budgets of most of the countries of the region were framed when oil prices were lower and the prospects of recovery not encouraging. Government revenues were projected to decline or, at best, to stagnate compared to 1988, while government spending was forecast to increase moderately. Increased government outlays were aimed at stimulating economic growth; this represented a shift in most countries from the previous conservative fiscal policies that had been adopted in response to plummeting oil revenues and fiscal and external imbalances.

The unexpected increase in oil revenues caused budget deficits in 1989 to be lower than projected in most countries. To finance their budget deficits, most countries planned to borrow on the local capital market by issuing Treasury Bills and development bonds. The use of domestic borrowing as a means of financing the budget deficit reflects a new strategy aimed at avoiding the usual drawing down of reserves. However, the response to these initiatives has been disappointing since commercial banks, as well as private investors, have been unenthusiastic about buying government bonds.

As a result, domestic borrowing was generally insufficient to finance the entire budget deficit and so provisions were also made for external borrowing. In addition, steps were taken by several countries to raise non-oil fiscal revenues. For example, labour taxes and passport and immigration fees have been increased in Bahrain; higher domestic fees and taxes adopted in Kuwait; taxes on company profits introduced in Oman; and a variety of direct or indirect tax measures implemented in Jordan.

One of the features of the monetary policy in the region has been to keep domestic interest rates close to international rates, such as LIBOR. The differential against domestic interest rates increased in 1989 and induced an outflow of funds abroad, causing several countries to attempt to discourage capital flight. In January 1989, the Kuwaiti Central Bank raised the discount rate from 5 per cent to 7.5 per cent. In March 1989, the Bahrain Monetary Agency raised the discount rate by 1 percentage point and abolished the ceiling on commercial bank interest rates for deposits of over six months. The Central Bank of Oman raised the domestic interest rate on time deposits from 8.5 per cent to 9.5 per cent and that on lending from 10.5 per cent to 11.5 per cent. The Central Bank of Iraq raised interest rates for commercial banks and other lending institutions by 1 per cent to 8 per cent from September 1989. In Jordan, interest rates were deregulated at the beginning of 1990.

The medium-term adjustment process

No group of countries is as dependent on one area of economic activity as the energy-exporting countries of West Asia are on oil: it dominates their output and is an even more important part of their public sector activities and export earnings. While some of the economies of the region have no oil reserves, they have not been immune to developments in international oil markets because of their intimate economic linkages with their energy-exporting neighbours.

The magnitude of most of these links is such that they are important to economic growth in both groups of countries: a large part of the labour force of the energy-importing countries works in the energy-exporting countries[37] where, in

[37] For example, over one third of the Jordanian labour force works in net energy-exporting countries

turn, it accounts for a significant portion of the total labour force;[38] the remittances of these workers represent a large share of their countries' export earnings;[39] capital inflows from the energy-exporting countries finance a large proportion of the government budgets in the energy-importing countries,[40] although they are a less important part of total fiscal expenditures in the source countries; and exports to the energy-exporting countries are a major part of the trade of the energy-importing countries.[41]

During the 1970s, the energy-exporting countries accumulated huge trade and budget surpluses as a result of the quadrupling of oil prices. Aware of their high degree of dependence on and vulnerability to the international oil market, a primary objective was to diversify and expand their economic base. Because the magnitude of the task was believed to be beyond the capability of the private sector at that time, Governments assumed a large part of the responsibility for the diversification effort, particularly in the industrial sector. Recognizing the limitations imposed by their small domestic markets, the Governments of the region also emphasized the creation of joint ventures among themselves as a means of fostering their development. The result was that the government budget became the principal instrument for the economic development of these countries in the 1970s. Public expenditure—mainly on large-scale infrastructure and industrial enterprises but also on social services—rose rapidly. The private sector also expanded, primarily in the construction and services—trade and banking—sectors.

The rapid expansion of demand put pressure on domestic resource availability, creating a large demand for imports and for skilled and unskilled labour. The emphasis on investment, combined with the limited industrial base, produced a large demand for imports of capital and intermediate goods from the developed market economies, but some of their other requirements, notably of foodstuffs, were supplied by the neighbouring energy-importing countries. There was also an inflow of migrant workers from several countries; because of their geographical proximity and cultural affinity, most were from neighbouring energy-importing countries, for which workers' remittances became an important component of financial inflows. Another part of these inflows—in the form of development assistance—also came from the energy-exporting countries. By providing the means to finance these various external flows of resources, the rise in oil prices served as a stimulus to the region as a whole, not only to those that benefited directly.

Despite their efforts to diversify, the domestic economic activities of the energy-exporting countries continue to be dominated by the oil sector and by the State. Industrial development has focused mostly on downstream activities in the oil sector—such as refining, gas liquefaction and the production of petrochemicals—and to a limited extent on non-durable consumer goods. There are few backward or forward linkages with other sectors, such as the capital and intermediate goods industries. Imports are relied upon to meet such needs. The oil sector still accounts for the overwhelming share of government revenue, and government expenditure is still the largest component of domestic demand: in Saudi Arabia, for example, government spending is about 50 per cent of GDP. There has, however, been some diversification in the source of foreign exchange earnings since income from foreign investment has become sizeable for many countries. In the case of Kuwait, for example, income from foreign portfolio investments now exceeds oil revenue.

The drop in oil prices in the 1980s led to a collapse not only in the export receipts but also in the government revenue of the energy-exporting countries. However, most of the development activities being financed by the former oil revenues were medium- and long-term in nature and could not be readily curtailed. Similarly, previous increases in income had built up the momentum of consumer demand, a large part of which was met by imports. Public sector expenditure and imports both continued to rise. Because of the rapidity and magnitude of the change in revenue and the lags involved in cutting expenditure, most of these countries suddenly confronted fiscal and trade deficits (see figure II.8). Initially, these were financed by drawing on their accumulated reserves, by some international borrowing and, to a lesser extent, by issuing bonds and bills domestically.

Over the longer term, efforts were made to tighten fiscal policy by reducing public expenditure and broadening the tax base. Defence is the largest item of current public expenditure in these countries and was largely immune from reduction, particularly in view of the conflicts in the region for most of the 1980s. On the other hand, many countries suffered cuts in public expenditure on education and health. However, capital expenditures were the heaviest hit by the cuts in government spending. Governments gave greater attention to rationalizing capital expenditures, undertaking economic and social feasibility studies of projects and increasing productivity through the use of appropriate technology. On the revenue side, fees were introduced on public services. Despite such measures, fiscal deficits in the region remain large: even with its oil wealth, Saudi Arabia has a chronic budget deficit.

The contraction in public expenditure in the energy-exporting countries had multiplier effects throughout the region. Private expenditure also fell, trade slowed down, labour flows were reversed, workers' remittances reduced and public sector financial flows from the energy-exporting countries to the energy-importing countries were cut. Because the latter were a major source of government revenue in the energy-importing countries, their decline produced government deficits in those countries also: Jordan's public sector deficit was equivalent to about one fifth of GDP in 1989. However, these countries did not have as good access to international capital markets as their neighbours and consequently a greater proportion of their budgetary adjustment

[38] Saudi Arabia has a population of 8 million, in addition to which there are some 2 million expatriate workers in the country

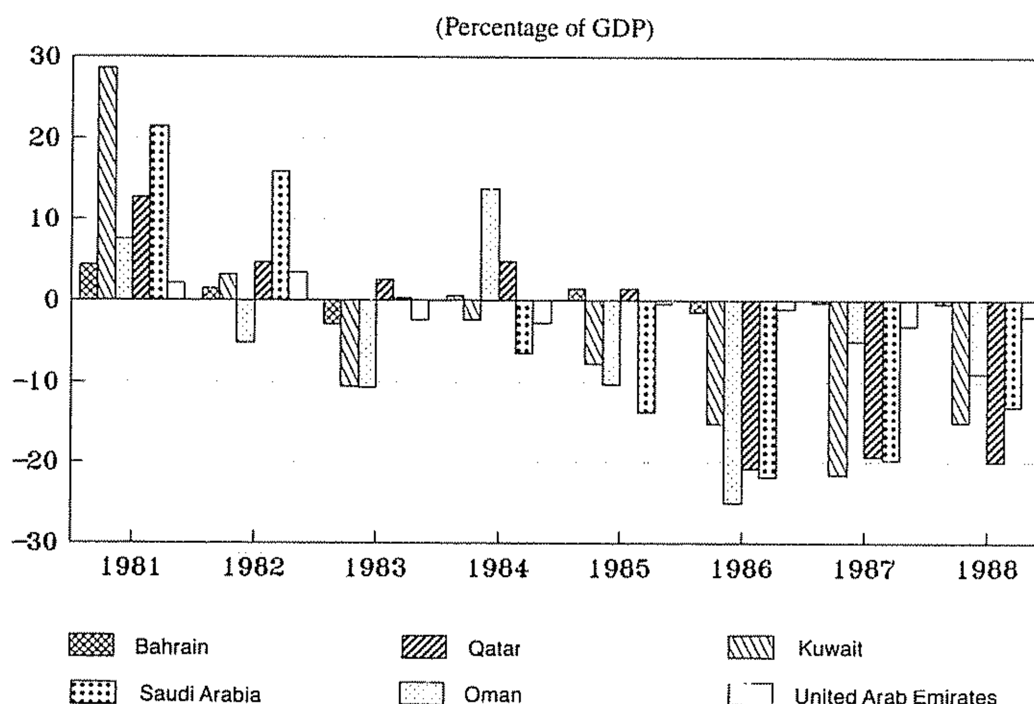
[39] In Jordan, remittances were equivalent to about two thirds of total foreign receipts from goods and non-factor services in 1984

[40] Support by other countries in the region accounted for about one half of Jordan's public revenues in 1983

[41] Half of Jordan's exports are to other countries in the region

Figure II.8. West Asia: budget balances in selected countries, 1981-1988

(Percentage of GDP)



Source: Department of Economic and Social Affairs of the United Nations Secretariat, based on *Survey of Economic and Social Developments in the ESCWA Region in the 1980s* (United Nations publication, Sales No. 90.II.L.2), table 7.2 and Secretariat estimates.

had to take the form of fiscal tightening, domestic borrowing or monetary expansion.

The energy-importing countries also encountered balance-of-payments pressure following the collapse of oil prices. This occurred in part because of the decline in private and official financial flows and in import demand from the energy-exporting countries. However, the energy-importing countries also receive a substantial part of their export earnings from primary commodities and were therefore among those that suffered losses in their terms of trade in the 1980s. These negative factors outweighed the benefits of the lower oil price and the resulting deterioration in their external position has required these countries to devalue their currencies, introduce quantitative restrictions on imports and draw down their international reserves.[42] Despite such measures, some of these countries had to resort to external commercial borrowing in order to finance their import requirements and are now facing growing difficulties in meeting their debt-service obligations.

In confronting these internal and external imbalances, the energy-importing countries have not only adopted conventional demand management measures, but have also begun to introduce structural reforms. The fiscal measures adopted in their attempts to restore internal balance have been similar to those of the energy-exporting countries: spending has been reduced and rationalized, tax rates raised and collection improved. Here also, development expenditures were more severely affected than current revenues, although the salaries of public servants were frozen in some instances. Raising revenue has proved more difficult since, as in the energy-exporting countries, most of it comes from taxes on trade and other indirect taxes. Where they are in effect, income taxes, for example in agriculture, have a low yield.

Privatization is being pursued as a means of improving efficiency and reducing public expenditure in the region. One of the complications in implementing this strategy is the limited size of the local capital markets. Another is the fact that regional joint ventures are the only viable solution in certain areas and these may not be attractive to the private sector. Although, for example, the Gulf Co-operation Council has decided to support private sector regional ventures, the results to date have been disappointing, partially because of the lack of an agreed approach.

Among the energy-importing countries, Jordan initiated a privatization programme in 1986 as part of its effort to revitalize the economy. In earlier years, the Government had used the indirect benefits from the oil boom to create public enterprises in tourism, industry, agriculture, transportation and, particularly, large-scale mining. Iraq started a privatization programme in 1985 when it sold 42 entities with a turnover of almost $400 million; in 1987, it privatized a further 47 companies. The process has since slowed, although the number of enterprises under consideration for privatization in the different countries is considerable.

[42] The international reserves of this group of countries fell from about five months of imports in 1982 to about 2.4 months in 1988 (ESCWA, *Developments in the External Sector of the ESCWA Region in the 1980s* (August 1989), pp. 178-179).

South and East Asia: a slow-down from rapid expansion

In 1989, total output in South and East Asia rose by 6.2 per cent and, with population growing at about 2 per cent a year, the region as a whole experienced another year of rising per capita incomes. The region continued to be the fastest growing in the world, even though growth was about 2 percentage points lower than in 1988 (see table II.1). The brunt of the slow-down was borne by the most rapidly expanding economies in the region; these were unable to maintain their extraordinary expansion of 1988 and returned to rates of growth that characterized the previous several years. This deceleration narrowed growth differentials within the region (see figure II.9).

Trade continues to be a main engine of growth in East Asia, both directly and indirectly. The acceleration of trade in 1988, particularly the fact that it was concentrated in manufactures, gave a disproportionately large stimulus to the more export-oriented economies of the region. Similarly, its slowing, coupled with some other factors, had an amplified negative effect in 1989, notably for the original newly industrializing economies of Hong Kong, Taiwan Province of China, the Republic of Korea and Singapore.

There are, however, signs of changes in the pattern of the region's growth and trade. In the early 1980s, a large proportion of the exports of the region, including those from Japan, were to North America and Europe. Protectionist measures in these markets dampened this growth in the latter part of the decade; for Japan, initially, this tendency was reinforced by the appreciation of the yen. To circumvent the loss of international competitiveness that this implied for their domestic operations, Japanese companies undertook foreign direct investment, *inter alia*, to locate their more labour-intensive processes in lower wage areas within the region. This boosted intra-regional trade and, while trade with North America and Europe continued to expand, it did so less rapidly than within the region.

This contributed to the export growth of the newly industrializing economies and, largely because of their success, these economies are now encountering the type of pressures formerly felt by Japan, including rising wage costs. As part of their efforts to relieve these pressures and in response to external demands, the Governments concerned have appreciated their currencies; in the Republic of Korea, for example, the currency appreciated about 30 per cent against the dollar between 1986 and 1989. The overall result has been a reduction in the global competitiveness of these countries, a consequential slowing of their export growth and, because exports are such a large component of their GDP, a lower overall rate of economic growth. As in Japan, domestic demand, fueled on the large gains in income achieved during the 1980s, has become an increasingly important source of the overall growth of these economies.

At the same time, another limited group of countries in the region has been emerging as a "second generation" of export-oriented economies. China (in its special economic zones), Indonesia, Malaysia, the Philippines and Thailand, in particular, have achieved large increases in the export of manufactures and semi-manufactures in the latter half of the 1980s. As with their predecessors, this process is gaining momentum from large inflows of foreign direct investment from corporations wishing to capitalize on these countries' lower wage costs. The entrants into such ventures now include corporations not only from Japan but also from the "first generation" of newly industrializing economies which, like Japan before them, find themselves faced with higher labour costs in their home markets and appreciated currencies; they also wish to move from labour-intensive to technology-intensive manufacturing. This "domino effect" is a further stimulant to intra-regional trade, as well as to overall growth in the countries concerned and the region as a whole. Indeed, results for the past few years suggest that this group of countries is beginning to replace the original four export-oriented economies as the engine of growth in the region (see figure II.9).

In South Asia, the large economies, partially because of their size, have been less trade intensive, but there are signs that some of them are also receiving a new stimulus from the export of manufactures. Indian exports have grown by an annual average of about 10 per cent for the past few years, prompted in part by currency depreciation. On a smaller scale, Bangladesh has experienced a surge in textile exports. Foreign direct investment has played a less important role than in East Asia, although investment by nationals living abroad is emerging as a source of capital for some countries (and, from the point of view of foreign exchange availability, a replacement for the declining flow of workers' remittances).

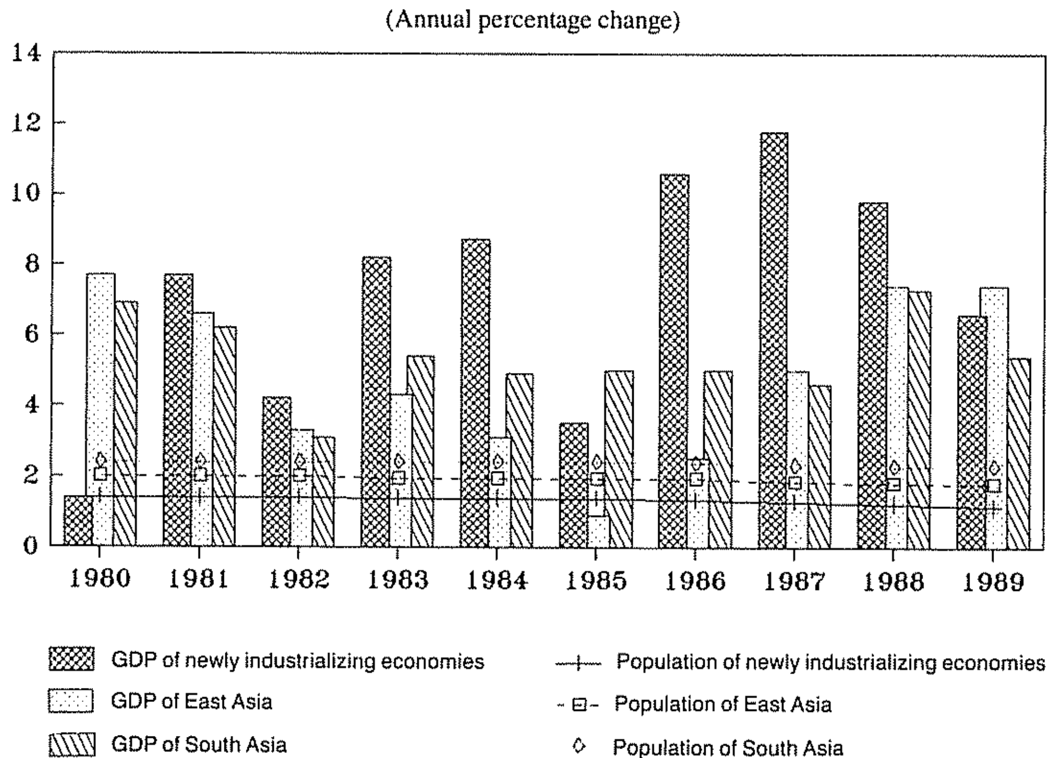
Reasons for the slow-down

These medium-term developments in the trading environment provide part of the backdrop to the slow-down in economic growth in the region in 1989. For the region's newly industrialized economies, the softening of foreign demand for their manufactured exports was key: their surplus on current account was reduced by more than half (from $17 billion to $7.9 billion), mainly because the Republic of Korea's surplus fell from $14.2 billion to $5.3 billion. The rate of growth of the region's exports fell from almost 30 per cent in 1988 to less than 10 per cent in 1989. Again, the Republic of Korea accounted for much of the drop, its exports growing by less than 3 per cent in 1989 compared to close to 30 per cent in 1988. Economic growth in 1989 was led by domestic demand, fueled by high government and private consumption. However, this was not sufficient to counter the adverse effects of weaker exports, labour disputes and double-digit wage increases; growth of close to 7 per cent, while still among the fastest in the world, was only about half of the rate achieved in 1988.

Robust domestic demand also offset slower growth in exports in Singapore and provided the impetus for the sustained rapid expansion of all key sectors, especially manufacturing, whose output grew by 50 per cent between 1986 and 1989. Private sector consumption has been spurred by full employment and large gains in real wages; domestic investment has also been exceptionally strong. This strong domestic demand caused imports to rise at a higher rate (13.3 per cent)

Figure II.9. South and East Asia: growth of output and population by subregion, 1980-1989

(Annual percentage change)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat.

than exports (10.5 per cent) in 1989—a marked change from preceding years.

Hong Kong's exports expanded 16 per cent in 1989, but this was only half their growth in 1988. In addition, domestic consumption fell in reaction to developments in China and investment was adversely affected by the accumulation and consolidation of assets by middle- and upper-income households preparing to emigrate. The economy is also suffering from an acute shortage of labour. The result was growth of only 3.5 per cent in 1989, after 13.8 per cent and 7.3 per cent in 1987 and 1988, respectively.

The "second generation" of newly industrializing economies was able to sustain its export-led growth in 1989, despite the weaker expansion of world trade and softer prices for the primary exports on which these economies continue to be partially dependent. A high level of domestic demand and the effectiveness of policy measures to enhance efficiency were contributory factors. The volume of exports of these countries rose 16 per cent and imports grew 20 per cent in 1989, with the current account balance shifting from a small surplus in 1988 to a deficit of $2.3 billion in 1989. The increase in trade is partially the result of continuing trade liberalization measures.

In Indonesia, firmer oil prices and a further devaluation of the currency led to a 20 per cent rise in exports; however, imports surged also, partially because a rising level of private and foreign investment accelerated imports of capital goods. Sound macro-economic policy and several years of economic reforms continued to yield positive results. The diversification of exports from oil to non-oil products has succeeded to the extent that the latter comprised 60 per cent of total exports in 1989, thanks to a robust manufacturing sector.[43] This, in turn, was made possible by the steadily increasing levels of domestic and foreign investment. The performance of agriculture was outstanding and a strong expansion in tourism led to an improvement in the service sector.

Malaysia's economy has exhibited remarkable vigour for the past two years, underpinned by strong external demand for its manufactures and commodities and robust domestic demand. Private investment, particularly in manufacturing industries, increased significantly, as business conditions and overall confidence in the economy improved. Private consumption, with a strong demand for consumer durables in evidence, has helped to raise the level of imports by about 25 per cent.

[43] For a description of Indonesia's diversification away from oil, see *Economic and Social Survey of Asia and the Pacific 1989* (United Nations publication, Sales No. 90.II.F.4).

In the Philippines, there was a deceleration in the growth of GDP as a result of higher inflation and interest rates, some supply bottle-necks and the tenuous political situation in late 1989. The expansion of the manufacturing sector slowed owing to the emergence of cost-push pressures, such as higher prices for energy and raw materials, higher interest rates and an increase in the minimum wage, as well as the erratic supply of electric power. The agricultural sector, however, posted its best performance in eight years by growing 4 per cent.

Thailand, the fastest growing among the South-East Asian countries, has been remarkably successful in expanding output despite an overstretched service sector, a fully utilized skilled work-force and some infrastructural bottle-necks. Economic growth in 1989 was more buoyant than initially expected and was broad-based. The economy has been particularly receptive to foreign investment: net inflows reached $1.5 billion in 1988 and are likely to reveal a sharp increase when complete data are released for 1989.

In South Asia, a combination of domestic factors, natural disasters, a shortage of external funds and the austere policies adopted to control government deficits and inflation contributed to the weaker growth of GDP in 1989. Although the agricultural sector of India performed remarkably well and total exports grew more than 20 per cent, output contracted in some industrial subsectors, such as chemicals, fertilizers and steel; employment generation in the sector as a whole has been negligible. Despite the increase in exports, the balance of payments is under strain because the rapid overall expansion of recent years, combined with the liberalization measures introduced in 1988, has produced a surge in imports; in addition, inflows of overseas labour remittances have decreased.

Myanmar's economy continued to deteriorate in 1989. Agriculture recorded some growth but its prospects are bleak owing to shortages of fertilizers. Foreign exchange difficulties were compounded by a slow-down in foreign aid inflows. In Nepal, despite growth of about 4.5 per cent in the dominant agricultural sector, there was a sharp fall in the rate of growth of GDP in 1989. The civil unrest that wracked Sri Lanka for most of 1989 had severe repercussions on that economy as industry, transport, distribution and exports were severely disrupted. In addition, poor weather led to a contraction of output in the agricultural sector. In each of these economies, export revenue fell as a result of softer prices for some export commodities and various disruptions to supply. Imports were reduced by policies intended to improve the external payments situation.

Pakistan's slower rate of growth was attributable partly to austere fiscal measures and partly to the fact that the manufacturing sector grew at about half its rate in 1988. Slower growth of exports contributed to the latter. On the other hand, Bangladesh grew by more than 4 per cent owing to a record rice harvest; garment exports continued to expand strongly, allowing imports to rise and facilitate growth.

Fiji made up the ground lost in two years of sharp economic contraction with the strong recovery of its two main sectors—sugar and tourism. Confidence in the economy, absent in the previous two years, was reflected in higher trade levels and a rebound in investment. Papua New Guinea's marginal growth in output in 1989 was the result of the closure of a major mining concern, a stagnant agricultural sector (because of weak international commodity prices) and an austere fiscal package. The exports of these countries fell by about 5 per cent in 1989, partially because of softer commodity prices. Fiji's sugar exports grew by almost 20 per cent, but both Papua New Guinea and the Solomon Islands experienced reductions in their exports of about one tenth. Imports into the three countries rose 5 per cent—a reflection of renewed confidence in Fiji, a continued import boom in Papua New Guinea and some increase in the import of basic necessities in the Solomon Islands.

Cooling the overheating

The rapid rate of economic growth in several Asian countries during the past few years has led to some overheating. This has manifested itself in bottle-necks in infrastructure, labour shortages, labour disputes and pressure on prices. The individual Governments concerned have generally responded by making fiscal and monetary policies restrictive, on occasion to offset substantial capital inflows but primarily to prevent a generalized resurgence of inflation.

In the Republic of Korea, one of the Government's main objectives was the reduction of the current account surplus. Measures included the continued appreciation of the currency, the relaxation of import restrictions and the reduction of tariffs. Outflows of foreign direct investment were encouraged through tax and other incentives; most of the resulting investment has taken place in the lower labour cost countries of South-East Asia. Fiscal policy remained generally restrictive and there was a fiscal surplus in 1989. However, the restraining effects were neutralized by wage increases, by speculation in the property markets and by the shortages of food caused by the poor harvest.[44] An accommodative monetary policy and the continued strength in domestic consumption and investment led to a 23 per cent rise in domestic credit in the first three quarters of 1989, compared to 16 per cent for the entire year of 1988.

Fearing a resurgence of inflation, monetary policy was reversed in May 1989. The central bank introduced a reserve requirement to restrict the credit extended by banking institutions and also issued bonds at market rates of interest, replacing the fixed-interest funds which had previously been used as a key instrument of liquidity control. Interest rates rose in the first half of 1989 but began to recede as the financial position of the non-bank financial institutions improved, labour disputes started to ease and speculation in the real estate market began to cool.

In the South-East Asian economies, fiscal policies were also generally cautious. While strong economic growth had

[44] In the first three quarters of 1989, manufacturing wages rose 24 per cent, following a 19.4 per cent increase in 1988. Housing costs surged by 30 per cent after an 11.8 per cent increase in 1988.

improved government revenue, there was pressure on these Governments to increase outlays on infrastructure and basic social services. As inflationary pressure showed signs of increasing, monetary policies were tightened.

In the Philippines, a restrictive government spending programme, together with higher than expected tax revenues, resulted in a fiscal deficit equal to 1.4 per cent of GNP, substantially less than the target. The high level of revenue reflected improved tax collection, increased import duties from a higher level of imports and growth-related income. During the year, monetary policy was progressively tightened in response to rising prices and the downward pressure on the peso. Measures included raising the discount rate by 2 percentage points to 12 per cent and increasing reserve requirements on long-term deposits to 7 per cent. It was also decided that the reserve requirements against short-term and long-term deposits should be gradually standardized and eventually increased to 20 per cent. These measures, together with the Government's action to reduce excess liquidity in order to abide by the IMF base-money target, raised bank lending rates to nearly 25 per cent during the last quarter of 1989.

Fiscal policy remained restrained in Thailand in 1989 and the Government was able to maintain a budget surplus. However, with an accommodative monetary policy, liquidity continued to increase rapidly. The money supply (M2) increased 26 per cent and bank lending rose 28 per cent in 1989. As a result, inflation accelerated somewhat, although it remained below 6 per cent.

In Indonesia, ongoing medium-term structural reforms were reinforced by short-term monetary and fiscal measures designed to maintain internal and external balance. The country's economic reform programme, initially aimed at liberalization and export diversification to reduce dependence on oil, was broadened in 1988 and 1989 to include certain structural reforms (such as the elimination of non-tariff barriers, a reduction in export regulations, the deregulation of the shipping industry and the relaxation of foreign investment), various financial and banking reforms (for example, the elimination of a foreign borrowing ceiling on private domestic banks and reduced reserve requirements) and measures aimed at increasing competition and improving the domestic capital market.

In addition, an expansionary fiscal policy was adopted in 1989 after several years of restraint. Total recurring and development expenditures grew substantially, although over half the routine expenditures were earmarked for external debt servicing, making the budget less expansionary than it appeared. The increase in spending was to be financed by both domestic revenues (generated from a widening tax base and stepped-up tax collection) and foreign sources. However, the higher-than-anticipated price of oil was an additional bonus which resulted in additional revenue and a decline in the budget deficit from 2.6 per cent to 2 per cent of GDP. Monetary policy, however, remained tight in order to reduce inflation and to control the outflows of capital that were resulting from higher interest rates abroad and fears of devaluation at home. The domestic lending rate reached 22 per cent; combined with growth in agricultural productivity, this reduced inflation from 8 per cent in 1988 to 6 per cent in 1989.

In most South Asian economies, the main concern of fiscal policy in 1989 was the reduction of the chronic and large budget deficits. In Bangladesh, government efforts to improve the efficiency of tax collection began to show results; revenues in the first quarter of 1989 were 20 per cent higher than in the same period of 1988. In Myanmar, the economic recession of the past several years and the serious foreign exchange shortage has led the Government to liberalize its policies governing foreign investment.[45] To combat inflation, it has continued fiscal and monetary restraint, bringing inflation down from over 30 per cent in 1988 to about 25 per cent in 1989. Sri Lanka's fiscal policy in 1989 was cautious; government spending was restrained and subsidies on certain basic products were reduced. Monetary policy was directed towards controlling the inflation resulting from the shortages of many commodities caused by civil unrest.

In India, ballooning interest payments, increasing defence expenditures and continuing subsidies have made it difficult to reduce the fiscal deficit; it now exceeds 2 per cent of GDP. Cutting subsidies has proved to be problematical in three distinct areas: first, in officially distributed food, where the resulting price increase would run counter to election promises to keep food prices affordable to the poor; second, in fertilizers, because of the powerful farm lobby; and third, in exports, where decreased assistance would undermine export promotion efforts. The continued budget deficits have meant a high rate of monetary expansion, despite concerns about increased inflation.

Pakistan's fiscal reforms are backed by IMF through an $800 million structural adjustment facility, to be combined with flows from bilateral and multilateral donors. In 1989, the Government introduced an austere budget, designed to lay the foundation for more broad-based and balanced growth in the medium term. The measures included the introduction of new taxes, an increase in the price of government services and a decrease in government subsidies. The immediate impact was to aggravate inflation because of higher prices for government services and lower subsidies for flour and edible oils. Inflationary pressure was aggravated by an expansive monetary policy and a gradually depreciating rupee. Other reforms launched during 1989 were intended to make Pakistan more attractive to foreign investors; they included streamlining foreign investment procedures and providing foreign firms with tax concessions and the right to remit profits.

Few Governments in the region both felt the need and were in a position to stimulate their economies in 1989. However, in Hong Kong, the Government was faced with an economic slow-down and announced a $16 billion infrastructure package starting in 1991 to counter the weak domestic demand resulting from increased emigration and the collapse in busi-

[45] After a 26-year ban on foreign participation in oil exploration, Myanmar granted gas and oil exploration rights to two foreign companies. Foreign companies are also bidding for some mining concessions.

ness confidence. Despite this measure, the outflow of human and financial capital is likely to continue to pose difficulties. In Fiji, fiscal policy was cautious at the outset of 1989—a reflection of the uncertainty that surrounded economic prospects at that time. However, as the economic environment began to improve (because of the recovery of the sugar and tourism sectors), income taxes were reduced, primarily to stimulate domestic demand. However, another reason for these measures was to stem the tide of professionals emigrating from the country. The Solomon Islands' fiscal and monetary policies were also relatively accommodative, with increased tax revenues and borrowings used largely to finance its growing recurrent expenditure. However, with inflation at 17 per cent or more for the past two years, fiscal and monetary policies are likely to be made more restrictive.

The Government of Viet Nam was successful in introducing a large degree of stability into its economy in 1989 through the use of very restrictive monetary measures, a reduction in the fiscal deficit and a major devaluation (see chap. VI). This followed an acceleration in the previous year in the pace of economic reform, most particularly in the decollectivization of agriculture. The result was that, compared with more than 300 per cent in both 1987 and 1988, the annual rate of increase in prices was reduced to about 25 per cent in 1989. Economic growth slowed only from about 6 per cent to somewhat over 3 per cent—a contrast with the more severe setbacks suffered by most countries undertaking corrective measures of such magnitude. Agricultural output, particularly of food grains, increased markedly and the country was able to export some 1-2 million tons of rice. This contributed to its improved trade performance: the value of exports increased by about 50 per cent, while the value of imports was relatively unchanged. Nevertheless, export revenue still covers only about two thirds of the import bill.

China: catching its breath

In China, a drastic stabilization programme produced not only a marked deceleration from the previous year (see table II.5), but also the lowest rate of growth since the beginning of economic reform in 1978. A highly contractionary monetary policy, supplemented by a non-expansionary fiscal policy, succeeded in accomplishing the Government's objective of reducing inflation (which fell to under 10 per cent in the fourth quarter). External economic policy focused on reducing the trade deficit and slowing down the accumulation of foreign debt, particularly since rising debt service ratios and current account deficits were exacerbated by the suspension of foreign credit after the political upheavals in June. A major currency devaluation was announced in late December 1989 as a means of correcting the external imbalance.

The Government equated the need for economic stabilization with increased centralization rather than further reform: reversion to government monopoly in the distribution and pricing of certain goods was considered an important means of controlling inflation and improving supply. A decision regarding key state enterprises effectively reverts to the use of output quotas and centralized distribution of output and supply of inputs. This tendency has been supported by organizational changes in the Government, such as the reinstitution of the State Economic Commission whose function is to oversee the fulfilment of economic plans. In the external sector, there are direct controls on imports and exports and on the contracting of foreign debt.

Major reforms proposed prior to 1989 in pricing, credit allocation, labour and wage policies, enterprise management, distribution and ownership of production have been postponed. However, the continued revision of laws relating to foreign direct investment and of policy towards the "open" areas and special economic zones reflects the importance accorded to the continued inflow of foreign exchange and technology.

Contractionary monetary and fiscal policies have been in effect since the last quarter of 1988. Monetary policy relied primarily on the tightening of credit because the structure of the banking system, the rudimentary capital market and the lack of financial accountability of enterprises make interest rates ineffective in the allocation of credit. The slow-down in the growth of the money supply (from 20 per cent in 1988 to 4 per cent in 1989) was the result of a lower rate of expansion of credit in the first three quarters. In the fourth quarter, because the liquidity squeeze was threatening to paralyse major state industries and disrupt the procurement of agricultural products, there was a substantial increase in credit. Agriculture, state industries producing energy and intermediate goods and export-oriented enterprises were accorded priority within the restricted credit available. The largest contractionary impact of the credit squeeze was on the private and collective non-agricultural sectors.

Although interest rates on loans were raised substantially, real interest rates remained negative until late 1989. Rates for medium- to long-term investment credit were lower than interest rates on savings deposits, exacerbating the excess demand for credit. Higher interest rates and reduced inflationary expectations increased bank savings deposits by 35 per cent in 1989 (compared to 24 per cent in 1988).

The fiscal deficit increased to 2.4 per cent of GNP in 1989, but its financing was non-expansionary because about three quarters was financed by domestic bonds, greatly reducing the reliance on bank credit and foreign debt. There was a decline from 1988 in capital expenditures and an increase in price subsidies, enterprise subsidies and expenditures in agriculture. As in the economic contractions in 1981-1982 and 1985, the central budget had to accommodate the reduction in spending because fiscal decentralization had reduced the Government's ability to control the spending of local government entities.

Growth of output

The decline in the growth of industrial output reached a nadir in October 1989, with a decline that month of 2.1 per cent compared with 1988 and growth of under 1 per cent in the fourth quarter. The durable consumer goods and machinery goods industries were the worst affected because of the decline in the growth of consumption and the credit and investment squeeze. Output of power increased by 7 per cent, while production in the mining and raw materials processing

Table II.5. China: selected measures of economic performance, 1988-1990

(Annual percentage rate of change)

	1988	1989[a]	1990[b]
Gross national product	11 2	3 9	5.0
Net material product	11.4	3 7	--
Industrial output	17 7	6 8	6.0
Agricultural output	3.0	3.3	4 0
Gross fixed investment	18.5	-20 0	--
Value of retail sales	28 0	8 9	--
Retail price index	18 5	17 8	--[c]
Value of exports	20 5	10.5	--
Value of imports	28.0	7 0	--

Source: State Statistical Bureau, *Report on National Economic and Social Development in 1989*, and other government sources

[a] Preliminary.

[b] Target

[c] Less than 10 per cent

industries rose 6.1 per cent in the first half of the year and 8.4 per cent in the second. In contrast, the rate of growth in other manufacturing industries declined from 14.1 per cent to 2.1 per cent in conformity with the Government's emphasis on infrastructural and intermediate goods industries.

Grain output increased to 407.5 million tons after four years of stagnation. About half the growth was attributable to an increase in yields and the other half to the expansion in acreage.[46] Among other major crops, cotton and sugar output declined by about 8 to 10 per cent and production of oil crops by 2 per cent. Besides favourable weather, a major factor in the increase in yield was the change to a state monopoly in the distribution of agricultural inputs. This increased the availability and usage of chemical fertilizers, pesticides and other yield-enhancing inputs and stabilized their prices. Another benefit was the improvement in agricultural infrastructure, which had been seriously neglected since the beginning of the 1980s. The distribution of a large proportion of the major crops is still controlled by the State, with continued subsidies on the retail prices of non-staples and rationing of grain and oil in urban areas. The official procurement prices of agricultural commodities remain substantially below those in the free market, depressing supply.

Reflecting government priorities, the decrease in total gross fixed investment was less in state enterprises than in private and collective enterprises Fixed investment in the state sector was over 60 per cent of the total, but the economic contraction resulted in a decline in capital construction, with new projects accounting for only 21 per cent of investment in 1989 compared to 41 per cent in 1988.

Incomes and prices

Urban cash income per capita declined by about 3 per cent in real terms, owing primarily to the reductions in wage increases during the first three quarters. Wage increases in the fourth quarter were substantially higher because of the customary year-end bonus payments and there was a further centrally mandated increase in January 1990, retroactive to October 1989, suggesting that the Government wishes to stem the decline in real wages.

Rural real income declined by 7 per cent, primarily because there was a decline in the output of some crops and a slow-down in non-agricultural industries and in contract employment. Personal consumption declined by approximately 8 per cent in real terms in 1989 owing to the decline in the growth of real income and the end of hoarding, itself a response to the postponement of price reform and to a commitment by the Government to contain inflation. Retail prices rose more than the value of retail sales, reflecting a decline in the volume of sales. The slow-down in demand had a moderating effect on inflation, but increased reliance on the administrative control of prices was also a crucial factor.

The annualized rate of increase in the retail price index declined from almost 25 per cent in May 1989 to 6.4 per cent in December, with the annual increase in urban areas (16 per cent) being less than in rural areas (18.8 per cent). Increases in the prices of non-staple foods appear to have stabilized, while prices of consumer durables declined owing to the sharp fall in demand and the resultant growth in inventories. The increase in the prices of producer goods began to moderate. The value of sales of intermediate goods declined even though prices rose by 21 per cent. In contrast, the value of sales of agriculture inputs increased by 23 per cent, of which higher prices accounted for some 19 per cent.

Economic retrenchment has resulted in a decline in urban employment and rural non-agricultural employment. There has been a wave of return migration to rural areas and, within rural areas, a reversion to farming by some of the workers

[46] *Sing Tao Jih Pao*, 2 February 1990, p 19.

displaced by the consolidation of rural industries. An estimated 80 million "surplus" farmers were still employed in farming at the end of 1988, suggesting a rate of underemployment of almost 17 per cent.

External sector

The rapid growth of 1988 aggravated external imbalances in the first half of 1989, while the suspension of foreign loans after June 1989 reduced the availability of financing for the current account deficit. With the deceleration of growth in 1989, stricter import controls and the credit squeeze, the growth of imports slowed in the second half of the year. The pressure on imports is being accentuated by the rise in debt-service demands in 1989 and into the early 1990s. As a part of the efforts to correct the external imbalance, the currency was devalued by 21.2 per cent in late December 1989. Some administrative measures, such as import controls and recentralization of the authority to trade, have also been adopted.

The volume of exports is estimated to have increased by 8.1 per cent, largely because of the slow-down in domestic price increases and the increased credit available to the export sector. Imports rose 6.6 per cent in 1989, while the terms of trade improved by about 1.8 per cent after an extended period of deterioration. The value of exports increased to $52.5 billion and imports to $59.1 billion, but there was a 20 per cent decline in revenue from tourism (about $400 million), reducing the net inflow of service payments. The value of mineral fuels exports continued to decline in 1989, while exports of manufactured goods increased by more than 30 per cent and accounted for more than 70 per cent of total exports in the first nine months, reflecting a continuing shift in the structure of exports. Imports were also predominantly (80 per cent) manufactured goods, although imports of grain increased 76 per cent, reflecting the continued need to supplement domestic production. The current account deficit is estimated to have been less than $3.5 billion in 1989.

The devaluation has substantially narrowed the gap between the official exchange rate and the rate in the foreign exchange adjustment centres and has reduced the subsidies paid by the Government to sustain exports at world prices. Except for "essential" items (such as grain, sugar and fertilizers), the increase in the prices of imports is being passed through to the domestic market. In response, domestic producers of tradable goods have raised prices but, in the contractionary environment, the overall inflationary effect has been small.

The continued trade deficit and the international financial consequences of the political upheaval in June caused foreign exchange reserves to decline from $17.6 billion at year-end 1988 to $14.2 billion at the end of September 1989, but they recovered to $16.4 billion by late December 1989. The financial problems included runs on overseas branches of Chinese banks, a sharp decline in tourism and the suspension of some foreign credit. While such sanctions had essentially ended by early 1990, the credit rating of the country has declined.[47] Since loans from private sources constitute about two thirds of China's foreign debt, the decline in access to credit, and the increase in its cost, will be substantial.

The net increase in China's foreign debt in 1989 was small, with the total being approximately $44 billion by the end of September 1989, 84 per cent of which was medium and long term. The ratio of total debt service to exports was an estimated 11 to 12 per cent in 1989 and is expected to stay below 15 per cent even when repayment peaks in 1992. Government policy has aimed to curtail foreign debt by recentralizing the issuance of government guarantees to ensure that projects approved by the central Government receive priority over local projects.

The flow of foreign investment increased by 4 per cent to $3.3 billion in 1989. This relative stagnation is attributable to factors above and beyond the political uncertainties resulting from the upheavals in June. The worsening domestic shortages of inputs and infrastructural services resulting from the overheating of the economy created severe bottlenecks for foreign ventures, while the economic slow-down in the latter part of the year has led to reduced sales in the domestic market, particularly in motor vehicles and consumer goods. The credit and foreign exchange squeeze in effect since late 1988 created further obstacles. These factors and, in particular, recentralization adversely affected the special economic zones. The growth of industrial output and exports decelerated and the growth in foreign investment was less than in the coastal regions because of the increased costs in the zones.

Improving the conditions for foreign direct investment is a priority of the Government and one of the few areas where continued reform is being promoted. A pending amendment to the Foreign Investment Code will allow greater flexibility in the duration of foreign investments and also increase the control of foreign investors. There is also a renewal of the unsuccessful attempts of the early 1980s to promote foreign investment in technology-intensive and infrastructural industries rather than labour-intensive manufacturing. While the labour force in selected coastal regions possesses the requisite skills for the preferred industries, infrastructure remains inadequate and there is intense competition from other countries in the region for foreign investment in more technology-intensive industries.

The slow growth of foreign investment in 1989 was accompanied by a change in its sources. Investment contracts with Japan totalled $280-300 million in 1989, but have stagnated since 1985. However, investment from Hong Kong has continued to grow (totalling approximately $3.5 billion in 1989) and investment from Taiwan Province of China was $600 million in 1988 and $700 million in 1989.[48] The latter can be expected to accelerate if, as expected, the Taiwanese ban on direct trade and financial transactions is lifted. The Republic of Korea has also recently begun to invest in China.[49]

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[47] Japan External Trade Organization, *China Newsletter*, No. 82, September-October 1989, pp. 12-13.

[48] *Sing Tao Jih Pao*, 7 February 1990, p. 13.

[49] *Sing Tao Jih Pao*, 19 Janaury 1990, p. 19 and Foreign Broadcast Information Service, *Daily Report: East Asia*, 5 December 1989, p. 24.

Short-term outlook for the world economy

Policy assumptions in the forecast

The forecasts for the growth of world output in 1990 and 1991 are based on a number of assumptions. With regard to the policy environment, it is assumed that fiscal stimulus will be reduced in each of the seven larger developed market economies with the exception of the Federal Republic of Germany where the small fiscal surplus of 1989 is expected to be followed by a deficit of more than $50 billion in 1990 and 1991 as a result of the unification process with the German Democratic Republic. Reflecting the priority accorded by policy makers to combating inflation, monetary policy in the major developed countries is assumed to remain restrictive, despite the present slower growth. Short-term interest rates in both the Federal Republic of Germany and Japan are assumed to increase by about 150 basis points in 1990 in response to inflationary pressures and, in the case of Japan, to prevent further depreciation of the yen against the dollar. In the United States, the short-term interest rate is assumed to be about 60 basis points lower in 1990 than in 1989. The narrowing of the interest rate differential between the United States and the Federal Republic of Germany and Japan is one reason to expect the dollar to depreciate in 1990.

It is assumed that the Soviet Union and the countries in Eastern Europe will persist in their efforts to transform their economies, but with wide differences in their reliance on external financing. The Soviet Union is expected to seek external finance on commercial terms, allowing moderate increases in its current account deficit. The German Democratic Republic is expected to receive large capital inflows, mainly from the Federal Republic of Germany; these will finance a trade deficit reaching $20 billion in 1994. Capital inflows to other countries in the region are expected to be smaller since most of them are already constrained by relatively large external debts.

Regarding the developing countries, it is assumed that those engaged in adjustment programmes because of extremely high inflation or difficulties in servicing external debt, essentially in Latin America, will continue to exercise restraint over government expenditures. International financial support for these efforts in the form of debt relief or additional capital is assumed to increase somewhat. In the case of African countries, it is assumed that external financing will be sufficient to allow trade deficits to increase moderately in real terms over the next five years.

In Asia, the newly industrializing economies are expected to continue increasing public expenditures and allowing their exchange rates to appreciate. A number of other Asian countries are pursuing nearly opposite policies, seeking to encourage high rates of export growth supported by inflows of foreign direct investment.

The dollar price of oil is assumed to remain at about its 1989 level in 1990 and to increase by 4 to 5 per cent in 1991. Prices of non-fuel primary commodities, on average, are expected to decrease by an additional 6 per cent in 1990 and thereafter to rise at an average annual rate of 3 to 4 per cent—somewhat less than the expected increase in prices of manufactured exports.

Forecasts for 1990 and 1991

Growth in the developed market economies is expected to slow to about 2.7 per cent in 1990 but to recover to 3.1 per cent in 1991 (see table II.1). The slow-down is expected to be more pronounced in Japan and the United States than in Europe. Growth in Western Europe is projected to fall by only about a half a percentage point in 1990 because acceleration of growth in the Federal Republic of Germany is expected to offset declining growth rates in most other countries of the region and because investment is expected to remain strong in anticipation of the unified internal market after 1992.

Reflecting mainly the slower pace of world economic activity, growth in the volume of world trade is expected to slow from about 7 per cent in 1989 to about 6 per cent in 1990, but should increase in 1991. Exports of manufactures are expected to continue to increase faster than total world trade, while the growth in exports of raw materials is expected to slow markedly.

In Canada and the United States, higher interest rates are expected to reduce domestic demand, especially housing and private investment, and slowly growing world demand is expected to reduce the growth of exports, especially in the United States. In Japan, the continued impact of a more restrictive monetary policy and a slow-down in the growth of exports is expected to reduce the growth of GNP by more than half a percentage point in 1990 and by even more in 1991. In the Federal Republic of Germany, private consumption is expected to be stimulated by the reduction in income tax in 1990 and exports will increase because of the additional demand for both investment and consumption goods from the German Democratic Republic, especially in 1991. Growth of GNP is forecast to average about 4 per cent in 1990 and 1991.

Capacity utilization rates are expected to remain high in most developed market economies and to increase in the Federal Republic of Germany. This means that inflation will remain of concern to policy makers who will be reluctant to relax the currently restrictive stance of monetary policy. The average inflation rate in the developed market economies is expected to remain in the region of 4 per cent in 1990 and 1991.

Owing to the slow-down in economic activity and, to a lesser extent, to labour flows from Eastern Europe to the Federal Republic of Germany, unemployment in these countries is expected to worsen slightly in 1990 and remain high in 1991. There will continue to be significant differences among countries owing to different trends in labour force participation and demographic factors, with unemployment rates in Japan and North America continuing to be considerably lower than in Europe.

Large global trade imbalances—and the capital flows that finance them—are expected to persist. The recent trend to-

wards a reduced United States trade deficit is forecast to come to an end in 1990 and 1991 as a lagged result of the strengthening of the dollar in 1989. The trade deficits of France and Italy are expected to increase by similar amounts, owing in part to the strengthening of their currencies against the dollar. In the United Kingdom, slower growth of GNP is expected to reduce the trade deficit by about $10 billion in 1990. Canada's trade surplus is expected to increase by $4-5 billion per year in 1990 and 1991 owing to its slowing growth, on the one hand, and expanded exports to the United States on the other. Japan's trade surplus is expected to fall from $75 billion in 1989 to about $68 billion in 1990 and 1991. In the Federal Republic of Germany, little change is expected in its trade surplus of about $80 billion. However, its surplus *vis-à-vis* the German Democratic Republic is expected to increase by $4 billion in 1990 and an additional $7 billion in 1991, with corresponding reductions with the rest of the world. Among the newly industrializing economies of Asia, the trade surpluses of the Republic of Korea and Taiwan Province of China are expected to decline by about $4 billion and $2.5 billion, respectively, in 1990, with little further change expected in 1991.

Financing these imbalances is not expected to pose a problem in the immediate future. Recently, interest rate differentials favouring the dollar over the yen and the deutsche mark disappeared (or have even been reversed when account is taken of expected trends in exchange rates). The smaller flows from the Federal Republic of Germany and Japan expected in 1990 are, however, likely to be just about offset by sustained flows from West Asian oil-exporting countries and by increased capital flows from Canada. These flows are likely to be transitory, however, and it remains uncertain whether capital will continue to flow towards the United States in the medium term without further increases in interest rates.

Net capital flows to developing countries are expected to increase slightly and to be accompanied by changes in their composition. Increased lending by multilateral financial institutions and official bilateral sources are expected to result in an increase in net transfers to sub-Saharan Africa in 1990 and 1991. In a number of heavily-indebted countries in Latin America and the Caribbean, these same factors, plus interest payments, debt-equity swaps and increases in other foreign direct investment, are expected to result in a small increase in net capital flows. Recent increases in interest rates raised interest obligations, offsetting the benefits expected from the reorganization of external debt. Net transfers from Latin America and the Caribbean to the developed market economies are therefore expected to remain large. However, the improved prospects for net capital flows are likely to be more than offset by the slow-down in world demand for developing countries' exports, at least for those heavily dependent on primary commodities. Countries in that category, those heavily burdened with debt and those restraining domestic demand to dampen inflation are all likely to experience slower growth in 1990.

In South and East Asia, growth of GDP is expected to decline to about 5.5 per cent in 1990 but to improve slightly in 1991. In most countries in the subregion, both increases in domestic demand and exports are expected to weaken in 1990. The challenges facing the newly industrializing economies, some resulting from the very success of their export-oriented growth strategies, are expected to slow growth in most of them. Their export growth is expected to decelerate faster than domestic demand, with the latter playing a relatively more important role as a determinant of overall growth in the future. Growth in most other countries of South and South-East Asia is also expected to slow down in 1990 but will none the less remain high in some of them, such as Indonesia, Malayasia and Thailand. India and Pakistan are both expected to have a growth rate of about 5 per cent.

Restrictive monetary policies and other such measures are expected to continue in China. Nevertheless, growth is expected to recover and approximate the official target of 5 per cent in 1990. The Government's sectoral priorities continue to be agriculture and large and medium-sized industries producing energy and key intermediate goods. Inflation is expected to decrease to 15 per cent in 1991, and the trade deficit is expected to decline to $1.8 billion in 1991, with exports growing at about 6 to 7 per cent per year, significantly faster than imports.

In West Asia, output expansion is expected to accelerate from the modest performance achieved in 1988 and 1989.

Most developing countries in Latin America and the Caribbean are expected to experience faster growth than in 1989 but, because of the anticipated recession in Brazil (forecast to reduce GDP by more than 5 per cent in 1990), the output of the region is expected to decrease by 1 per cent in 1990. Growth in Africa is projected to remain in the region of 3 per cent in 1990 and 1991. This implies at best a stagnation in per capita output in the region until 1992.

The outlook for Eastern Europe and the Soviet Union for 1990 is predicated essentially on two factors: the need to pursue stabilization in some countries and the short-term policy focus of those countries that still have to define the nature of their future economic reform. During their present transitional phase, the short-term growth prospects of these countries are poor and highly uncertain. Output of the region is likely to decline by at least 1 per cent in 1990; in 1991, the decline is expected to stop, setting the stage for slowly accelerating growth thereafter.

In the Soviet Union, the domestic economic problems are such that, even with substantial growth in agriculture and trade, domestic imbalances and bottle-necks are likely to depress economic activity. Averting a contraction, while at the same time coming to grips with the worst of the economic difficulties, would be a good performance. The scope for a substantial injection from domestically produced consumer goods and the potential benefits from the conversion of military installations seem limited in the short term.

Eastern Europe may experience a pronounced recession in 1990: in both the German Democratic Republic and Poland, output is expected to fall by at least 4 per cent. Even if the region succeeds in weathering the worst of the reform and adjustment requirements, growth is likely to be negative by at least 2 per cent, depending on the output forgone as a result of the stabilization efforts of the German Democratic Republic, Hungary and Poland.

Chapter III

INTERNATIONAL TRADE

Overview

Trends

The proposition that trade is an engine of growth seemed amply confirmed in 1989 when the volume of world merchandise trade, growing at 6.7 per cent, continued to lead the expansion in the world economy. While this represented a slow-down from the 9.0 per cent recorded in 1988, it none the less marked the fifth consecutive year in which the increase in world trade exceeded the increase in world output (see figure III.1).

Despite this performance, there are some clouds on the international trade horizon. These include growing concerns about the proliferation of bilateral trade arrangements, as well as about the formation of trading blocs and their eventual impact on the global trading system. Then, too, there is apprehension about protectionism and the tendency for some countries to substitute "managed trade" for free trade. Tensions are also mounting owing to difficulties in reaching agreement on key agenda items of the Uruguay Round of multilateral trade negotiations.

Moreover, the average growth of exports cloaks large differences between countries and regions. For example, the export volume of the industrial countries grew by 7.3 per cent in 1989. Meanwhile the Eastern European economies registered a decline of 1.3 per cent in their export volume. Exports of the developing countries grew by about 7 per cent but there was a very wide range of experience among countries: from 3 per cent in the countries of sub-Saharan Africa to over 9 per cent in the four newly industrializing Asian economies, all of which continue to achieve great economic success with their export-led growth strategies.[1]

In terms of value, world trade expanded nominally by $532.6 billion in 1989, or 9.1 per cent, thus pushing the value of both world exports and imports over the $3 trillion mark for the first time (see table III.1). As recently as four years ago, the value of world trade was hovering around the $2 trillion level.

Looking at the export side, developing countries suffered only a modest decrease in their export revenues, as opposed to the developed countries as a group, which faced a decline from 14.2 per cent to 8.2 per cent. The Eastern European countries and the Union of Soviet Socialist Republics registered a sharp drop in the growth of their exports in value terms, from 5.2 per cent to 0.6 per cent.

Price movements varied greatly, as seen in unit values. Rising oil prices boosted export unit values of the energy exporters by over 10 per cent in 1989, compared with a decline of close to 10 per cent the previous year. For several other developing countries, declining trends in some non-fuel primary commodity prices, notably coffee and cocoa, reinforced the effects of weak volume growth. Conversely, price developments were favourable for cotton, tea and tobacco. For example, there was an almost 20 per cent increase in the price of cotton. All in all, divergent trends in commodity prices translated themselves into substantial differences in export and import performance among developing countries. Meanwhile, dollar export unit values for manufactures only increased some 3 per cent in 1989, less than half than in 1988, so growth in value terms slowed down, even among the dynamic exporters of manufactures in Asia.

While the prognosis is that in 1990 the growth of the volume and value of world trade will once again exceed the growth of world output by a sizeable margin (5.9 and 8.8 per cent versus 3.0 per cent), the longer-run outlook for world trade will be heavily affected by policy decisions in the coming months. The end of the year should see the scheduled conclusion of the Uruguay Round of multilateral trade negotiations. It should then be clearer whether the international trading system will enjoy the fruits of further multilateral liberalization or whether there will be increasing reliance on bilateral arrangements, with some of the trade diversion that this often implies. The year as a whole should shed light on the effects of the Free Trade Agreement between Canada and the United States and the transformation of a number of centrally planned economies into more market-oriented ones.

Sources of growth

The buoyancy of world trade over the past few years in terms of both volume and value has been a surprise and requires some explanation. As noted in the *World Economic Survey, 1989*[2] rising incomes undoubtedly account for a large part of the growth of trade, as do cheaper and improved transport and communications networks. At the same time, new growth poles have appeared. Thus, the Asia and Pacific region has been leading the world in economic growth and in that region consumer spending is soaring. Retail sales in Hong Kong in May 1988 were 20 per cent higher than in May 1987. Sales of cars and commercial vehicles rose 45 per cent in Thailand between mid-1987 and mid-1988. Consumer spending in India rose between 10 per cent and 20 per cent from 1987 after rains broke a three-year drought. Over the next few years, the global trading system may also see some fall-out from the recent initiative in Japan to open up its markets to increased foreign imports. At the same time, the consumerism of the United States, together with its taste for foreign goods, has undoubtedly played a role in swelling trade flows. The recent emergence of a number of trading blocs may also have given an impetus to trade.

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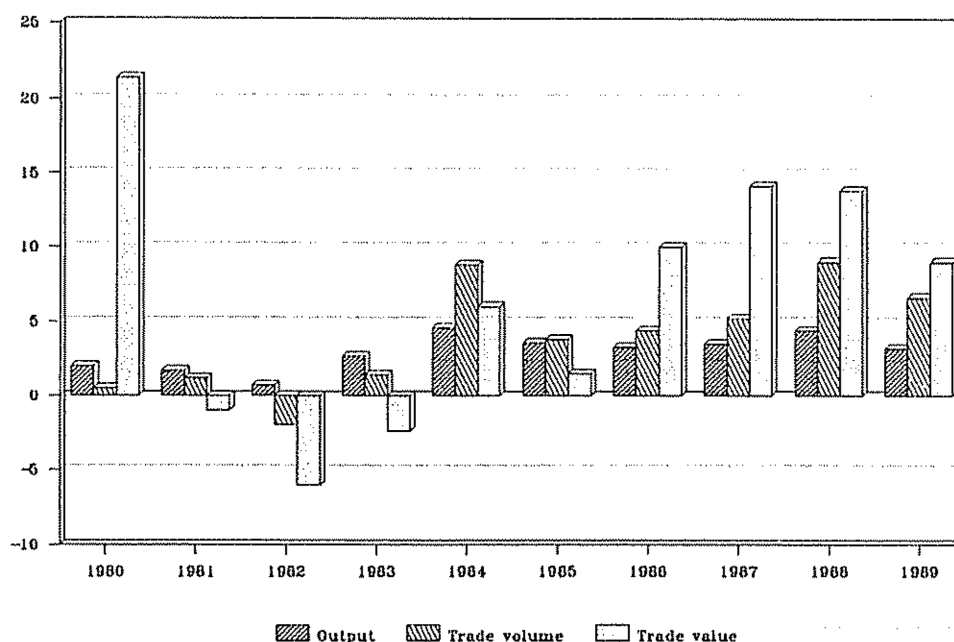
[1] IMF, *World Economic Outlook*, Spring 1990, table 24

[2] United Nations publication, Sales No E 89 II.c 1, chap III

Figure III.1. Trade and output, 1980-1989

(Percentage change over preceding year)



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

Table III.1. World trade, 1980 and 1985-1990

(Percentage change over preceding year)

	1980	1985	1986	1987	1988	1989	1990[a]
Volume of world trade	0 5	3.8	4.5	5 3	9.0	6 7	5.9
Exports	-0.8	3 7	5 2	5 7	8 9	6.5	6 1
Imports	1 8	3.9	3.7	4 9	9 1	6 8	5 6
Value of world trade							
Exports	-1 4	1.4	10 3	17 4	13 6	8 9	9 1
Imports	-0.5	1 6	9.7	16 8	14.0	9.2	8.6
Value of exports							
World	-1.4	1.4	10.3	17.4	13 6	8.9	9 1
Developed countries	-2.1	3.2	16 8	17 0	14.2	8.2	9.7
Developing countries (including China)	-0 4	-2 6	-7 3	22.4	14.8	14.2	8.8
Eastern Europe and the USSR	1.2	-1.3	10.8	9.5	5.2	0.6	3.5
Eastern Europe	-1.3	2.6	9.8	9.0	8 3	2 0	5 4
USSR	3 8	-4.9	11 8	10.0	2.2	-0.8	1 5

Source: Department of International Economic and Social Affairs of the United Nations Secretariat

[a] Preliminary estimate

The above review would suggest that trade elasticities have actually grown over the past few years. An alternative hypothesis is that the much-discussed relapse into protectionism has not really been all that serious and that trade elasticities have not been reduced as much as was feared. That protectionist demands have increased since the mid-1970s is not subject to debate. However, it has been argued that such demands have been relatively ineffectual since there are many ways in which exporters can get around trade barriers and continue to increase their export earnings.[3]

Protectionism, however, affects only specific segments of trade. Accordingly, unprotected trade flows may have grown more than adequately to compensate for any declines due to the imposition of new barriers.

Trading blocs

It was suggested above that the formation of trading blocs may have been one factor in the growth of trade over the past few years. Trading blocs do not necessarily create trade, however, and a great deal of concern has been voiced over the possible fragmentation of the trading system into such blocs and the trade diversion that this might imply.

The countries of the industrial world, apart from Japan, all belong to one of four free trade groups: the European Community (EC), the European Free Trade Association (EFTA), the United States-Canada Free Trade Agreement, and the Australia-New Zealand Closer Economic Relations Agreement. There is little question that the value of intra-bloc trade of three of these groups during the period 1980-1988 has substantially outperformed the growth of world trade (see table III.2). However, trade between regions has been as dynamic a force in world trade as trade within regions, North American trade with Western Europe being the exception (see table III.3). Secondly, while industrial countries have fared well as regards intra-bloc trade, developing countries have had less success. These issues are discussed at greater length below. At this point, it suffices to note that regional blocs—rather than being the leading edge of world trade growth—may be but one manifestation of a broader interest in foreign markets stimulated by the progressive integration of national markets into the global economy. From this perspective, the broad importance of multilateral trade liberalization and the strengthening and extension of the multilateral trading systems is evident, even for those pursuing regional trading initiatives.

Trade flows and trade balances among country groups

Developed market economies

In 1989, the value of exports of the industrialized countries expanded 7.2 per cent; imports expanded 8.5 per cent. There was a marked deterioration in the balance of trade of these countries as a group. Moreover, large imbalances continue among them, a factor which has shaped trade objectives and accounts for some of the pressures toward unilateralism, bilateralism, and "results- oriented" trade policy.

Continuing the trend of 1988, the United States trade deficit declined to $113 billion in 1989, its lowest level since 1984. This represented an 11 per cent drop from the gap of $127 billion in 1988, but for the sixth consecutive year the deficit remained above $100 billion (see table III.4).

In a global sense, the counterpart to the United States deficit is found in the surpluses of the Federal Republic of Germany and Japan. Both of these declined in 1989, that of Japan from $95 to $77 billion, or almost 19 per cent, and that of the Federal Republic of Germany from $77.2 to $74.6 billion. From a United States perspective, Japan increasingly appeared to be the source of the United States trade problem. The United States has virtually eliminated its trade deficit with Europe and has reduced it considerably with other partners. Japan's percentage of the United States trade deficit, however, is on the rise.

The persistence of this bilateral deficit has created a belief in the United States that exchange rate changes and market forces do not work when it comes to trade with Japan. But United States exports to Japan during the period 1980-1988 increased at a greater pace, per annum, than United States exports to the world, or to EC or EFTA.[4] However, since United States imports from Japan in 1988 were over two and a half times United States exports to that country, exports to Japan have to grow more than two and a half times as fast as imports to diminish the imbalance. Even twice as fast would not suffice. This is a difficult assignment for United States export performance and it is therefore not surprising that some have looked to unilateral and bilateral solutions as an easy fix.

This search for solutions to United States export failures in foreign countries has been termed a "crowbar" to pry open closed markets. Others see it as tearing away at the concept of multilateralism and threatening the GATT system itself. Moreover, it has been pointed out that "you can't pursue trade balance goals through trade policy agreements".[5] More pertinent would be changes in American macro-economic policy to raise the savings rate, deal with the budget deficit and improve the competitiveness of the economy. Moreover, the rapid rise of new actors on the world trade scene should prompt increased preoccupation among most

[3] See, for example, Jagdish Bhagwati, *Protectionism*, (Cambridge, Massachusetts, MIT Press, 1988)

[4] The annual average rate of growth of United States exports to the European Community is 3.6 per cent; EFTA, 0.2 per cent; Canada, 8.6 per cent; Japan, 7.3 per cent; and the world, 4.5 per cent

[5] Fred C. Bergsten, Director, Institute for International Economics, Washington, D.C., as cited in *Bilateral Trade Agreements*, Hearing before the Subcommittee on International Trade of the Committee on Finance, United States Senate, 13 March 1989 (Washington, D.C., United States Government Printing Office)

industrialized countries with technological changes and competitiveness. In the newly industrializing countries and Japan, trade performance is seen to be due to "created" comparative advantage and many maintain that the correct response to this development lies not in negotiating new bilateral trade agreements but in the active pursuit of "innovation policies".[6]

Curing the United States trade deficit, which dominates

Table III.2. Intra-bloc trade of some major trading blocs

	Value of intra-bloc trade (millions of dollars)			Share of world trade (percentage)			Share of intra-bloc trade in bloc's (percentage) total trade		
	1980	1987	1988	1980	1987	1988	1980	1987	1988
EC[a]	355 833	559 705	634 379 (7.5)	17 8	22.5	22 5	53 6	58 8	59.8
EFTA	17 767	23 665	25 215 (4.4)	0.9	1 0	0 9	15.3	14.8	14.2
United States-Canada	75 284	128 751	148 207 (8.8)	3 8	5.2	5 2	26.7	37 9	35 3
Australia-New Zealand	1 627	2 177	3 163 (8 7)	0 1	0.1	0.1	6.1	6 7	7.6
Centrally planned economies of Eastern Europe and USSR	78 657	117 700	126 459 (6 1)	3.9	4 7	4 5	50 1	55 7	55 7
Latin American Integration Association	10 982	8 802	8 438 (3 3)	0.6	0 4	0 3	13 8	11 2	9 5

Source: Department of International Economic and Social Affairs of the United Nations Secretariat

Notes: Figures in parenthesis are annual average rates of growth, 1980-1988. Growth of world trade: 4.4 per cent per annum

[a] Prior to 1986, excludes Portugal and Spain.

Table III.3. Inter-bloc trade

	Value of trade (billions of dollars)		Share of world trade (percentage)	
	1980	1988	1980	1988
North America (Canada and United States) with Western Asia (Japan and other Asia)	49 660	90 609 (7.8%)	2 5	3.2
Western Europe (developed market economies of Europe) with Asia (Japan and other Asia)	30 129	70 786 (11.2%)	1.5	2 5
North America (Canada and United States) with Western Europe (developed market economies of Europe)	75 323	90 174 (2.3%)	3.8	3 2

Source: Department of International Economic and Social Affairs, United Nations Secretariat

Notes: Figures in parenthesis are annual average rate of growth, 1980-88. Growth of world trade: 4 4 per cent per annum.

[6] See, for example, Sylvia Ostry, *Governments and Corporations in a Shrinking World: Trade and Innovation Policies in the United States, Europe and Japan*, (New York, Council on Foreign Relations Press, 1990)

global trade policy at the present time, is also contingent on a buoyant international economy that would enable the United States to reduce its trade deficit by expanding exports rather than reducing imports. Growth in the rest of the world, especially in developing countries, and an improved United States trade situation are thus compatible and complementary objectives.

Developing countries

The value of exports of the developing countries as a whole increased some $80 billion or 12 per cent in 1989, slightly less than in the previous year. The rate of expansion was highest among energy exporters, which reflected stronger oil prices, and lowest among energy importers.

Developing country imports grew 11 per cent in 1989 in value terms. The fact that merchandise imports expanded somewhat less than merchandise exports, together with an improvement of over 4 per cent in their terms of trade, implied a $12.1 billion improvement in the balance of trade of the developing countries as a group (see table III.5). To the extent that it reflects the emergence of a net negative transfer of indebted countries, the swing from trade deficits to trade surpluses in energy-importing developing countries shown in the table is to be regarded not as a positive phenomenon but as a disturbing one. The energy exporters (both surplus and deficit) improved their trade balances, while the group of four newly industrializing economies experienced a deterioration in their trade balance, as did other energy importers as a whole. The former is largely due to the shift in the Republic of Korea's trade balance in 1989 and the latter in large part to the deterioration in the balance of trade of Brazil.

The composition of developing countries' trade flows over the past eight years has changed markedly. World trade, as a whole, has veered towards manufactures. By 1988, manufactures accounted for three fourths of world exports in value terms (see figure III.2). This trend has been even more extreme for non-oil developing economies: in 1980, manufactures accounted for 42 per cent of their exports; by 1988, the proportion was 68 per cent.

Developing countries are not only exporting more manufactures, they are also exporting more and more sophisticated manufactures. Thus, world exports of chemicals, machinery and transport equipment as a proportion of total manufacturing exports increased from 58 per cent in 1980 to 61 per cent in 1988. For developing market economies, excluding members of the Organization of the Petroleum Exporting Countries (OPEC), the share increased from 33 per cent to 43 per cent of their total manufacturing exports.[7]

This increase in exports of sophisticated manufactures from a number of developing countries has created what has been termed a "double squeeze" for industrialized economies.[8] The older, labour-intensive industries face competition from newly exporting economies, such as Malaysia and Thailand, as well as from some newly industrializing countries, such as Brazil. At the same time, however, the newer, high-technology industries face competition from Japan and more advanced newly industrializing countries as well. In this atmosphere calls for protectionism become louder and trade policy has begun to respond to these calls.

Eastern Europe and the Soviet Union

In 1989, the foreign trade and payments of Eastern Europe and the Soviet Union changed suddenly. Import volumes for some countries, particularly the Soviet Union, increased considerably faster than export volumes, owing largely to the felt need in the latter half of the year to relax import constraints. The result was a marked deterioriation in the current account.

Table III.4. Developed market economies: trade balance[a], 1980-1989

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
All developed market economies	-70.0	-31.4	-24.5	-22.2	-46.7	-38.3	-3.0	-22.0	-3.4	-29.7
Seven major industrialized countries[c]	-33.5	-0.1	0.7	-12.0	-46.6	-39.1	1.3	-10.2	9.9	-8.5
Federal Republic of Germany	7.9	15.3	24.0	20.6	21.6	27.2	54.0	68.0	77.2	74.6
Japan	2.1	20.0	18.1	31.5	44.3	56.0	92.8	96.4	95.0	77.1
United States	-25.5	-28.0	-36.4	-67.1	-112.5	-122.1	-135.1	-159.5	-127.2	-113.2
Other developed market economies	-36.5	-31.3	-25.2	-10.2	-0.1	0.8	-4.3	-11.8	-13.3	-21.2

Source: Department of International Economic and Social Affairs of the United Nations Secretariat

a On an f.o.b. basis

Preliminary (based, in part, on Secretariat estimates)

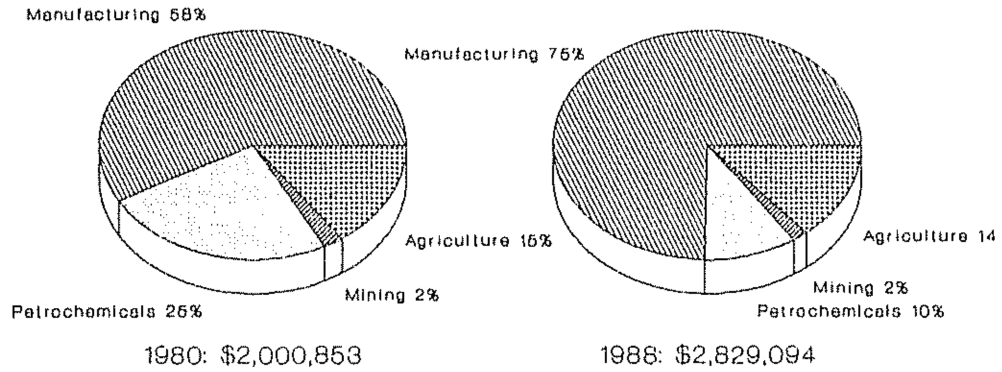
Canada, France, Federal Republic of Germany, Italy, Japan, United Kingdom and United States

7 *Monthly Bulletin of Statistics*, vol. XLV, No. 5 (May 1990), special table C

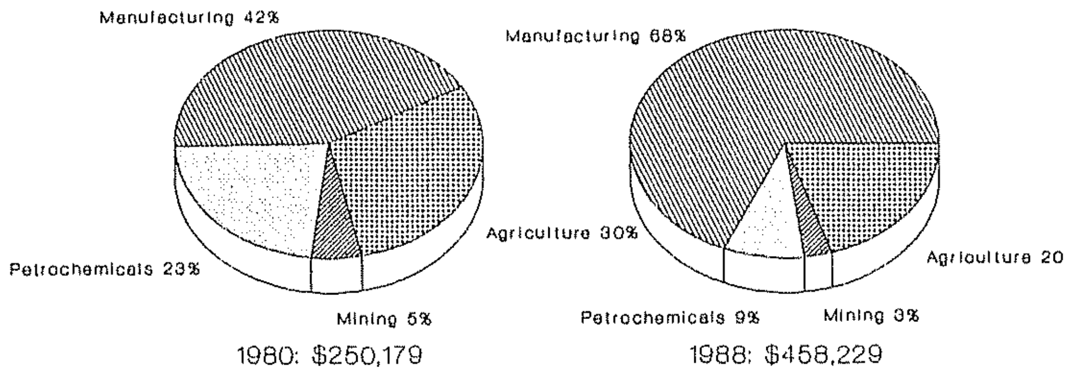
8 Jagdish Bhagwati, "United States trade policy at the cross-roads", (draft)

Figure III.2. Composition of exports, 1980 and 1988
(Millions of dollars, current prices)

World



Developing countries*



Source: UN/DIESA

*Excluding exports of countries members of OPEC

Table III.5. Developing countries: trade balance,[a] 1980-1989

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
All developing countries	112.5	64.3	33.3	33.5	63.8	37.9	5.9	50.4	35.5	47.6
Surplus-energy exporters	140.8	106.0	60.6	34.8	36.0	34.6	10.0	24.5	15.8	27.6
Deficit-energy exporters	32.3	11.6	9.8	23.9	35.3	34.7	9.6	23.6	10.4	17.1
Energy-importing countries	-57.8	-56.7	-45.6	-29.2	-7.5	-5.1	4.5	5.6	19.9	11.3
Newly industrializing economies	-9.2	-9.0	-7.4	-2.5	6.6	8.8	19.0	25.2	22.5	18.1
China	-2.8	1.7	4.2	2.0	0.0	-13.1	-9.1	-1.7	-5.3	-4.2

Source: Department of International Economic and Social Affairs of the United Nations Secretariat

[a] On an f.o.b. basis.

Many of these developments arose because of newly emerging policy considerations. However, the dilemmas faced by most Eastern European policy makers differed considerably from those with which the Soviet Union had to come to grips, owing to divergent developments in the terms of trade and growing domestic supply problems. Whereas the terms of trade of the Soviet Union continued to deteriorate, mainly on account of an unfavourable adjustment in intra-CMEA prices, Eastern Europe benefited from continued improved terms of trade.

Because of these differing movements in the terms of trade, growing difficulties with national economic reform agendas, particularly in the Soviet Union, lack of agreement on how to proceed with CMEA economic reform and increasing divergences among economic mechanisms in the European members of CMEA, intra-group trade and payments relations came under rapidly increasing strain during the course of the year. These problems had negative repercussions on the volumes of intra-group trade that countries were willing or able to sustain. As a result, what should have been a year of celebration around the fortieth anniversary of CMEA turned out to be a watershed in CMEA relations.[9] By late 1989, several policy makers in Eastern Europe were calling if not for the abolition of the CMEA at least for major revisions in traditional integration policies, institutions and policy instruments.

The trade balance for Eastern Europe and the Soviet Union combined deteriorated by at least $11.5 billion in 1989 (see table III.6). The bulk of the overall deterioration was incurred *vis-à-vis* convertible currency partners. In large part, it was due to a decline of roughly $9 billion in the the Soviet Union's balance, which fell from an estimated surplus of some $3.4 billion in 1988 to a deficit of approximately $5.4 billion in 1989, spread over all major partner country groupings.

Eastern Europe's trade surplus with the world declined some 30 per cent, from $9.2 billion in 1988 to $6.2 billion in 1989, reflecting changes *vis-à-vis* other planned economies and developing countries. The largest deteriorations were sustained by Bulgaria, Hungary and Poland.

In CMEA relations, several Eastern European countries (including the German Democratic Republic, Hungary and Poland) took special measures to curb exports in order to stave off the accumulation of surpluses in transferable roubles.[10] In addition to the impact of Eastern Europe's terms-of-trade gains *vis-à-vis* the Soviet Union, CMEA export opportunities were constrained by below-plan exports of the Soviet Union. Thus, Soviet exports to socialist countries—here taken as a proxy for CMEA trade—stagnated. Import volume decreased by perhaps 4 per cent but this was insufficient to avoid a trade deficit of $6.5 billion with respect to Eastern Europe. The counterpart was Eastern European surpluses. Efforts by some Eastern European countries to reduce exports to the Soviet Union were, on the whole, successful.

External payments constraints were largely responsible for the weak trade performance with non-CMEA partners. Imports from such countries rose for both Eastern Europe and the Soviet Union, in most cases as a consequence of the deliberate decision by mid-year to improve domestic supplies. As a result, the trade balance of the Soviet Union showed a $9 billion turn-around and became negative to the tune of about $5.4 billion. Matters were less dramatic in Eastern Europe's relations with third parties. The trade surplus with developed market economies deteriorated marginally to some $1.3 billion in 1989, but this was largely on account of the sizeable trade surplus ($3 billion) maintained by Romania. In relations with developing countries, the trade surplus deteriorated by about $1.3 billion.

Volume changes for Eastern Europe and the Soviet Union lagged considerably behind the 7 per cent growth rate of world trade in 1989. Export volumes for Eastern Europe may have contracted by perhaps 3 per cent; for the Soviet Union, they stagnated. Imports into Eastern Europe con-

[9] For a broad review of these efforts, see "Economic reform and integration in centrally planned economies", *World Economic Survey 1989* (United Nations publication, Sales No. E.89.II.C.1), chap. VI.

[10] Because such surpluses cannot be mobilized in the short run, they in fact amount to involuntary loans at a rate of return that cannot be imputed to the lender. Settlements in CMEA are ostensibly multilateral through accounts managed by the International Bank for Economic Co-operation (IBEC) in Moscow. Interest earned is a claim of the surplus country on IBEC, not on any one deficit country in particular. IBEC itself is not involved in the bilateral trade negotiations, which is one of the reasons for the problematic "worth" of interest earnings on transferable rouble accounts.

Table III.6. Eastern Europe and the Soviet Union: trade balance, 1980 and 1987-1989

(Billions of dollars)

	1980	1987	1988	1989
Eastern Europe				
World	-5 8	4 3	9 2	6 2
Intra-group[a]	-1 8	0 8	4 9	3 4
Developed market economies	-3 8	1 2	1 4	1 3
Developing countries	-0 2	2 3	2 9	1 6
Soviet Union				
World	8 0	11 7	3 4	-5 4
Intra-group[a]	4 1	3 7	0 1	-3 0
Developed market economies	0 2	0 5	-2 7	-6 5
Developing countries	3 7	7 5	6 0	4 2
Total				
World	2 2	16 0	12 6	0 8
Intra-group[a]	2 3	4 6	5 0	0 3
Developed market economies	-3 6	1 7	-1 3	-5 2
Developing countries	3 5	9 8	8 9	5 7

Source: Department of International Economic and Social Affairs of the United Nations Secretariat

[a] China, Eastern Europe, USSR, Viet Nam and Asian planned economies.

tracted slightly (about 1 per cent), but those for the Soviet Union rose very substantially (about 7 per cent), more because of the urgency of easing the rapidly growing supply crisis in the Soviet Union through imports, particularly of foodstuffs and consumer manufactures, than to underlying economic strengths.

Intra-group trade stagnated. There was a decline in its volume of about 1 per cent, according to preliminary estimates. Eastern Europe's exports contracted by about 5 per cent, while imports stagnated, largely on account of Czechoslovakia and Romania, as all other members of the group reported cut-backs in import volumes in 1989.

Trade with market economies showed a diverse performance. Bulgaria and Romania reported sharply contracting export and import volumes, exports contracting more than imports. Soviet imports from market economies rose by 23 per cent. Other countries reported gains for both exports and imports, with import growth from market economies stronger than export growth for all but Czechoslovakia.

There were no spectacular changes in average trade prices. Even in the case of the Soviet Union, whose prices in CMEA trade were being further adjusted to the average lower world prices of the preceding five years[11], the deterioration in the terms of trade of some 5 per cent was almost completely offset by gains in the terms of trade with market economies. On balance, the Soviet Union's terms of trade may have declined by perhaps 1-2 per cent. Eastern Europe's terms of trade improved *vis-à-vis* both socialist countries (some 4 per cent) and market economies (perhaps 2 per cent), for a net gain of about 3 per cent.

As a result of the developments of late 1989 and early 1990, the relationship of the countries of Eastern Europe and the Soviet Union with various international organizations has been changing dramatically. Thus, most Eastern European countries have signed trade and co-operation agreements with the European Community and would like to broaden them into formal associations which they hope will in due course enable them to work out a "normalized" status within the framework of European economic integration. For example, in December 1989, the Soviet Union and the 12-nation European Community signed an agreement on a 10-year trade pact. Similarly, the end of 1989 saw the revival of the United States-USSR Joint Commercial Commission, a body set up in 1972 to foster trade links between the two countries and suspended in 1975. Meanwhile, several countries—notably Hungary—are exploring some association status with EFTA.

As regards relations with global economic organizations, all countries of Eastern Europe and the Soviet Union will soon enjoy some association with the General Agreement on Tariffs and Trade (GATT). The German Democratic Republic has asked for observer status and the Soviet Union was granted observer status in mid-May. Bulgaria's request for accession, earlier placed in limbo, is now being activated. Czechoslovakia, as a dormant contracting party, and Poland and Romania, as "special" parties, are seeking a reassessment of their actual and potential role in GATT.

Bulgaria and Czechoslovakia have requested accession to the World Bank and the International Monetary Fund. It is expected that these requests will soon be processed and that

[11] In accordance with the formula for computing CMEA trade reference prices, world market prices (WMPs) of 1984-1988 were to be the key guide in the negotiations of actual 1989 transaction prices. For exporters of fuels, in particular, this implied a further funnelling through of the decline in WMPs of the mid-1980s into CMEA relations.

Box III.1. An option for reforming the CMEA trade régime

A three-phased approach to reforming the CMEA trade régime could be considered. At the core is the question of how to ensure that domestic economic decision-making, especially in the micro-economic sphere, will not be overburdened by the administrative commercial regulations so pervasive in CMEA relations. In the short run, central authorities that have signed commitments as part of formal trade and payments agreements may feel compelled to abide by them. To do so, *ex post* subsidies and taxes need to be instituted to ensure that the transition to competitive pricing, including the introduction of world market prices, is not obstructed. Differences between domestic and such artificial CMEA prices must be absorbed by the central budget. There may, as a result, be a net aggregate subsidy expenditure or tax revenue, as in the erstwhile price-equalization account in the orthodox planned economy.[a]

The second step would be for each reforming CMEA member to negotiate its sequence of trade and payments arrangements as much as possible on the basis of micro-economic efficiency criteria, by a rational pattern of resource allocation. Trade obligations adopted for "reasons of state" should be subsidized or taxed, as the case may be, from the general budget. Regarding the bulk of trade, however, government negotiators must ensure that trade commitments are economically rational.

The final step consists of reforming basic CMEA economic relations. The growing sentiment for CMEA-wide reform should be exploited, even by countries whose economies continue to be overwhelmingly oriented towards central planning. Direct enterprise relations across borders should be encouraged, even in the absence of market pricing, provided no quantum limitations are imposed.

Hungary and Poland have already committed themselves to radical economic reform. Czechoslovakia has committed itself to a similar course over the next several years. Circumstances will require that the German Democratic Republic do likewise, although economic merging with the Federal Republic of Germany will usher in its own problems. Relations among these countries could increasingly be based on simple market relations conducted by enterprises guided by the profit motive, provided that a solution can be found for the imbalances likely to emerge.

There are possibilities of tiered integration in CMEA. CMEA countries would stand to gain from pursuing their own integration, perhaps through a customs union, as an integral component of the reform process. The economic merits of such a union, which could be called the Central European economic union, are straightforward.[b] The member countries would essentially trade manufactures. Most-favoured-nation tariffs on this trade are fairly high (on average at least 20-25 per cent). Relations with the German Democratic Republic could soon become subject to the European Community's external tariff, which on average is low, but not for many products of direct interest to the Central European countries, which encumbers some of the traditional flows among them.

Ample room remains for building up-scale economies in products that are not at present easily marketed outside CMEA, though not because of inferior quality. Effective regional specialization would enable these countries to maintain fairly buoyant levels of trade, while they restructure their own economies to reflect both intra-group and world demand requirements.

A Central European economic union would primarily be trade-creating if allowed to function on the basis of market-type economic relations among autonomous firms (see box III.2). The economic structures of these countries are mostly competitive, rather than complementary, and there is scope for substantial economies of scale. Apart from these gains, an economic union in Central Europe would strengthen the market orientation of these economies and enable them to undertake structural adjustments in a more orderly fashion and at a lower cost than if such adaptations were forced upon them through direct competition with world markets. Moreover, such subregional co-operation would elicit considerable support on the part of Western European economies as it would not be seen as an alternative to joining "Europe". Rather, its usefulness would derive from its potential to facilitate the transition, both in terms of the time required and the costs incurred, towards the full integration of CMEA into the world economy.

[a] For details on how this worked, see *World Economic Survey, 1989* (United Nations publication, Sales No. E.89.II.C.1), chap. VI.

[b] Since the late nineteenth century, some such Central European integration scheme has been proposed from time to time, usually in the context of far-reaching political aspirations. The designation used here is meant to be purely geographical.

the two countries will join both institutions. Romania, whose position in these two organizations has been dormant since late 1984, is expected to revive its active participation in both. This would leave only the German Democratic Republic and the Soviet Union outside the Bank and the Fund. Both countries have been exploring channels of association.

All of these formal changes should be seen in the context of the desire of the majority of CMEA countries to deepen their involvement in global commercial, financial and monetary networks, as well as in the major integration movements in Europe.

Three broad developments are likely to determine trade and payments developments in Eastern Europe and the Soviet Union. The first stems from the unsettled nature of CMEA, the second derives from the continuing constraints arising from convertible currency debt. Finally, the buoyancy of East-West trade will in large measure be a function of the degree to which the efforts of the developed market economies to provide assistance to reforming countries will indeed materialize.

The *de facto* disintegration of CMEA, not only as a regional economic organization but also as a framework for clearing trade and payments by unorthodox means, is likely to hamper regional economic integration in the short run.

In an effort to check the build-up of transferable rouble balances, some countries have sought to place their trade on a hard currency basis (see chap. IV) or redirect their trade to hard currency markets. The forceful compression of trade with what used to be the transferable rouble area will exert negative effects on capacity utilization, employment and the profitability of many export-oriented branches.

Commodities

Medium-term commodity price outlook

Primary commodities continue to be the economic mainstay of a fair number of developing countries. It is thus a matter of no little consequence that the overall index of dollar prices of non-fuel commodities showed no increase for 1989 over the 1988 level and, given current expectations, may register a 5 per cent decline in 1990 relative to the 1989 value.[12] In contrast to the situation in 1988, when a large number of developing countries enjoyed an increase in their primary export prices quarter-by-quarter, the combined dollar index of non-fuel commodity prices fell steadily during the course of 1989, so that in the fourth quarter the index was over 6 per cent lower than in the first quarter. Nor does this trend appear to be abating if the first three months of 1990 are any indication: the combined index for the first quarter of the year is likely to be more than 12 per cent lower than the corresponding figure for the first quarter of 1989.

The combined index incorporates a variety of primary commodities, which did not behave similarly during the course of 1989 (see figure III.3). The index of food commodity prices increased almost 6 per cent, and is expected to grow roughly 2.5 per cent in 1990. Despite what appears to be a gradual decline in the growth of world consumption of agricultural raw materials since 1987, the overall price index for these commodities held firm in 1989 and may well increase 2—2.5 per cent in 1990. At the other end of the spectrum, and more typically, the prices of (1) beverages, (2) vegetable oilseeds and oils, and (3) minerals either declined (beverages and oils) or held steady (minerals). Moreover, all three are expected to show considerable price declines in 1990 (by 19, 13 and 17 per cent, respectively.)[13]

Beverages and minerals are, of course, completely disparate commodities. None the less, the price behaviour of both is representative of the dilemma facing primary commodity producers since supply factors and slack demand have in both cases affected their prices.

Beverages: coffee and cocoa

International prices for coffee and cocoa remained depressed for much of the 1980s; only briefly, in 1986 for example, did prices recover from their secular decline. Structural rather than cyclical factors were responsible for this persistent fall. During the commodity boom of the mid-to-late 1970s, traditional as well as potential producers were stimulated to increase production by expanding crop areas and developing new and efficient breeds. As trees began to mature and bear fruit seven to nine years later, supply surpassed demand substantially, creating a glut. When the market was awash with supply, demand stagnated, not because of lagging growth in importing countries, but because consumption was inelastic. In addition, some countries released previously built-up stocks. Others endeavoured to produce more in order to maintain their revenues as prices fell, which only depressed prices further.

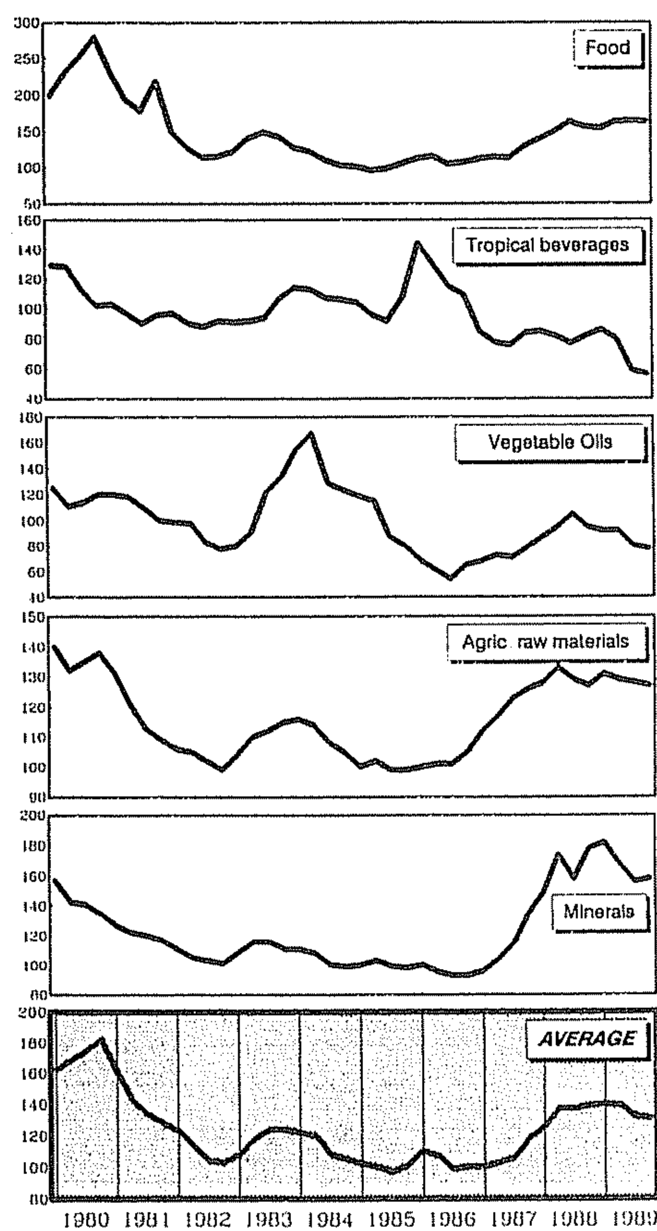
Coffee prices were thus at a 14-year low at the end of 1989, reaching their lowest levels in real terms since the 1930s. Cocoa prices are at their lowest point in real terms since 1945. Beverage prices in general will be over 30 per cent lower in the first quarter of 1990 compared with the first quarter of 1988.

The short-term outlook does not suggest an upturn soon. For example, prospects for a return to International Coffee Agreement export quotas are not bright and much depends on the position of Brazil as the main supplier and the United States as the main consumer. Given existing production policies in major producing countries, as well as the dumping of heavy supplies on the world market by heavily indebted West African countries, excess supply is likely to persist. There is little prospect of consumption rising, partly because of the

[12] Based on estimates as of March 1990.

[13] Aggregates of UNCTAD, *Monthly Commodity Price Bulletin*.

Figure III.3. Non-fuel commodity price indices, 1980-1989 (1985 = 100)



Source: UNCTAD, *Monthly Commodity Price Bulletin*

slower growth expected in world economic activity in 1990 and partly because of recent changes in market sharing arrangements.[14]

However, it will be rather difficult in the short term to cut production in the hope of propping up prices, since producer countries—in dire need of foreign exchange earnings not only to pay for essential imports but to service their debts—find it difficult to abide by the terms of producer agreements. Moreover, reducing production would add to an already high rate of unemployment. In the long run, though, production is likely to be reduced and even abandoned by some countries, forcing farmers to shift to other crops, as has already happened in Madagascar and Rwanda.

Minerals

Consumption of all base metals fell sharply in the second half of 1989 after 6 years of fairly sustained levels. This was largely attributable to reduced industrial activity in the United States, as well as to increased supplies, though there were some upward price spikes due to supply shocks—for example, problems at a large copper mine in Chile.

The consumption of aluminium, copper, nickel and zinc reached all-time peaks in 1987 and 1988 thanks to the recovery in industrial production in the major market economies since 1982, particularly in the United States and Japan. The positive influences on the world's mineral markets were due to the resurgence in construction activity, consumer spending, and capital investment in the major metal-consuming countries.

In developing countries during the same period, patterns of consumption were uneven. Some South-East Asian countries attained considerable growth rates and became substantial consumers of metals. In Latin America, Brazil, Chile and Peru increased their metal consumption. China became a substantial importer of aluminium, copper (concentrated and refined) and zinc during the period 1983-1985.

Although consumption grew steadily from 1982 onwards, the existence of large stocks of refined metals served at first to stabilize and even depress prices. Eventually, however, producer stocks were drawn down. In the absence of substantial excess capacity, this led to the increases in metal prices in 1987 and 1988.

These price gains continued into at least the first half of 1989, reflecting a slight tightness of supply and providing a fairly comfortable situation for producers, who gradually increased production levels. However, the subsequent slowdown in the growth of industrial production, especially in Japan and the United States, coupled with an expansion in production, led to a 23 per cent decline in metal and mineral prices (in dollar terms, on an average annual basis). This drop reflected steep declines in three minerals: nickel (48 per cent), aluminium (34 per cent) and copper (31 per cent).[15]

The price declines continued into January and February 1990, as recorded on a monthly basis. Large price increases in March at least momentarily arrested the period of declining prices that had begun in mid-1989.[16] Metal prices in

[14] Some African countries, Ethiopia and Madagascar, for example, are losing the barter partners in CMEA.

[15] *IMF Survey*, 7 May 1990.

[16] *Ibid.*

March rose 11 per cent, following a cumulative decline of 15 per cent from August 1989 to February 1990. The sharpest increases were for lead (36 per cent), nickel (33 per cent), zinc (15 per cent), copper (11 per cent) and aluminium (8 per cent). None the less, prices as of March 1990 were still well below their corresponding levels in March 1989.[17]

The longer-run prognosis is that new and advanced materials will be developed, especially materials which are cheaper, more efficient and more corrosion-resistant than existing ones. These could be mineral substitutes, such as plastics, or new alloys using more exotic minerals. In either case, the implication is a shift in demand.

Policy dilemmas and failed solutions

The policy predicament facing primary product producers—namely, the low price elasticity of demand for their product—is illustrated by the situation of mineral producers. As figure III.4. shows, while the volume of exports increased in most years of the 1980s, the value of exports has risen and fallen, largely following changes in export prices. In 1990, while exports will continue to increase in volume, their value is expected to drop 4 per cent.

Producer countries have looked to commodity agreements to stabilize export prices, or to compensatory financing to offset export losses. However, international commodity agreements have been disappointing.

The sixth five-year International Tin Agreement, which came into force in 1982, used buffer stocks and export controls to maintain prices between a prescribed floor and ceiling. It was long deemed a successful arrangement. However, it collapsed in 1986 as a result of oversupply and the financial impossibility of adding to ever-growing buffer stocks. The Tin Council went bankrupt because its operations in futures failed when the market turned.

As the tin market plunged, a new organization was formed: the Association of Tin Producing Countries (ATPC), which included all the former members except Brazil and China. The group set out to organize a scheme, aimed at limiting exports and bringing down the large stock overhangs. Brazil and China have to some extent followed ATPC policies, which have succeeded in reducing stocks and raising prices, helped by rising demand, especially in 1989. But the production of tin has also increased and the market today faces great uncertainty regarding future prices.

The International Rubber Agreement of 1979, which was the first international agreement concluded under the Integrated Programme for Commodities, entered into force in 1982.[18] A successor agreement was reached in 1987 and entered into force on 29 December 1988, after long and difficult negotiations. The new agreement has broad support from the Governments involved. The agreement covers a large portion of the parties concerned, some 90 per cent of exporters and 70 per cent of importers, and is thus a major achievement among consumer-producer agreements. Today price adjustment is semi-automatic, and stabilization is achieved in line with longer market trends. Though it has been successful in stabilizing prices, many producers have called for stronger price support.

The 41-member International Cocoa Organization failed in September 1989 to agree on new price support measures. The result was the lowest cocoa prices in 14 years. Disputes about the floor price and new buffer stock limits were the main causes. Yet, by the end of March 1990, the disputes were partly resolved as all price support provisions were frozen and the previous agreement was extended for two years. The financing of the storage of the organization's stockpile of 250,000 tons is not yet resolved. Under the new plan these stocks would be frozen during the life of the agreement.

In a not unsimilar scenario, the International Coffee Agreement—which has smoothed price and supply fluctuations for the past 27 years—collapsed in July. The organization suspended export quotas and price controls. Prices plunged some 50 per cent to reach a 14-year low by the end of the year. However, in February 1990, talks had resumed among seven Latin American coffee producers about a new agreement on export controls.

One escape from some of these problems has been sought in compensatory financing. However, drawings in 1989 under the IMF Compensatory and Contingency Financing Facility assisted only three countries: Algeria, Jordan and Mexico, with combined purchases amounting to SDR 808 million.

The European Community's STABEX scheme is another compensatory arrangement. Transfers to States members of the Africa, Caribbean and Pacific (ACP) group from the STABEX scheme to compensate for shortfalls in cocoa, coffee and timber earnings amounted to $444 million in 1987 and covered only one third of ACP countries. Given the downward spiral in prices, even a renewed STABEX agreement for the 1990s under the fourth Lomé Convention will be of little help because any increase will be too small in a situation where all coffee and cocoa producing members of ACP will want to draw on the facility.

Terms of trade effects

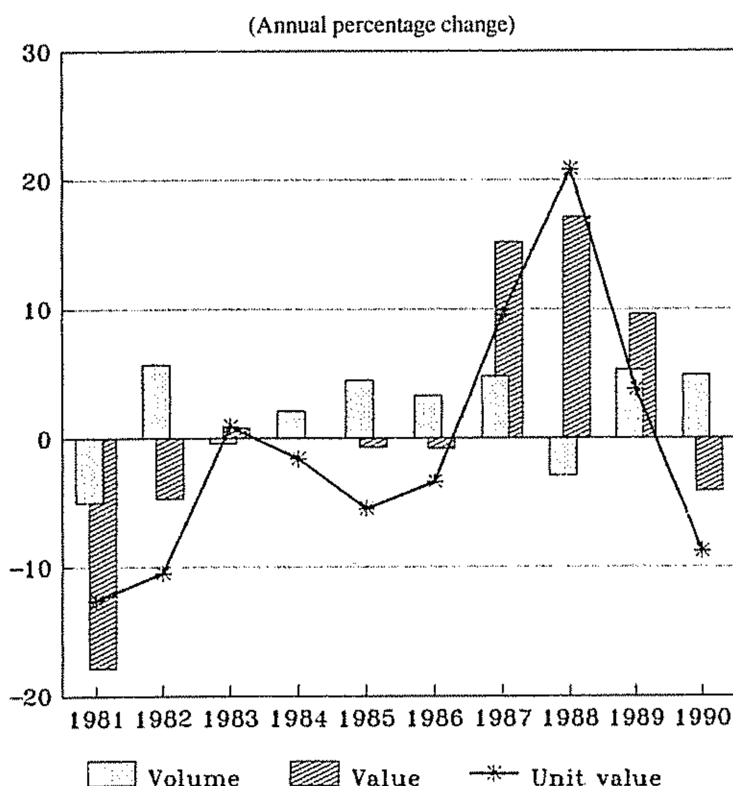
The old and acrimonious debate about whether there was a persistent and secular decline in the terms of trade of developing countries was largely based on the assumption that they were essentially commodity producers. Today more than half of the exports of developing countries are manufactures, produced by a small number of rapidly industrializing countries. The largest exports of commodities come from the United States and some other industrialized countries.

[17] A combination of strikes, production problems and a fall in some metal stocks led to market concerns over availability, putting upward pressure on prices.

[18] The Integrated Programme for Commodities, a scheme devised by UNCTAD, envisages international commodity agreements of the buffer stock variety for each of 10 to 18 primary commodities. These individual agreements are linked to a "Common Fund" made up of contributions from both producers and consumers.

Figure III.4. Exports of mineral—exporting developing countries: volume vs. value

(Annual percentage change)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from the International Monetary Fund, *World Economic Outlook*

But the unexpectedly steep and persistent fall in commodity prices in the 1980s has dealt a severe blow to the many developing countries that rely almost exclusively on commodities for their export revenues. It should not be forgotten that their losses have been gains to their customers. Many industrialized countries, notably European countries and Japan, have benefited greatly from cheap commodities in the 1980s. Developing countries that export one or a few commodities also import others, especially as their industrialization picks up, and the newly industrializing countries have benefited from the commodity price trends. Figure III.5 shows the terms of trade of the major groups of developing countries over the past decade. The terms of trade of the newly industrializing countries did not actually change much over the decade, whereas those of the 15 most heavily indebted countries declined continously. Over the course of the decade, this latter group of countries, together with Africa and the Middle East, have clearly lost ground. The terms of trade of these groups have dropped anywhere from 25 per cent to 50 per cent.

The uncertain future of multilateralism

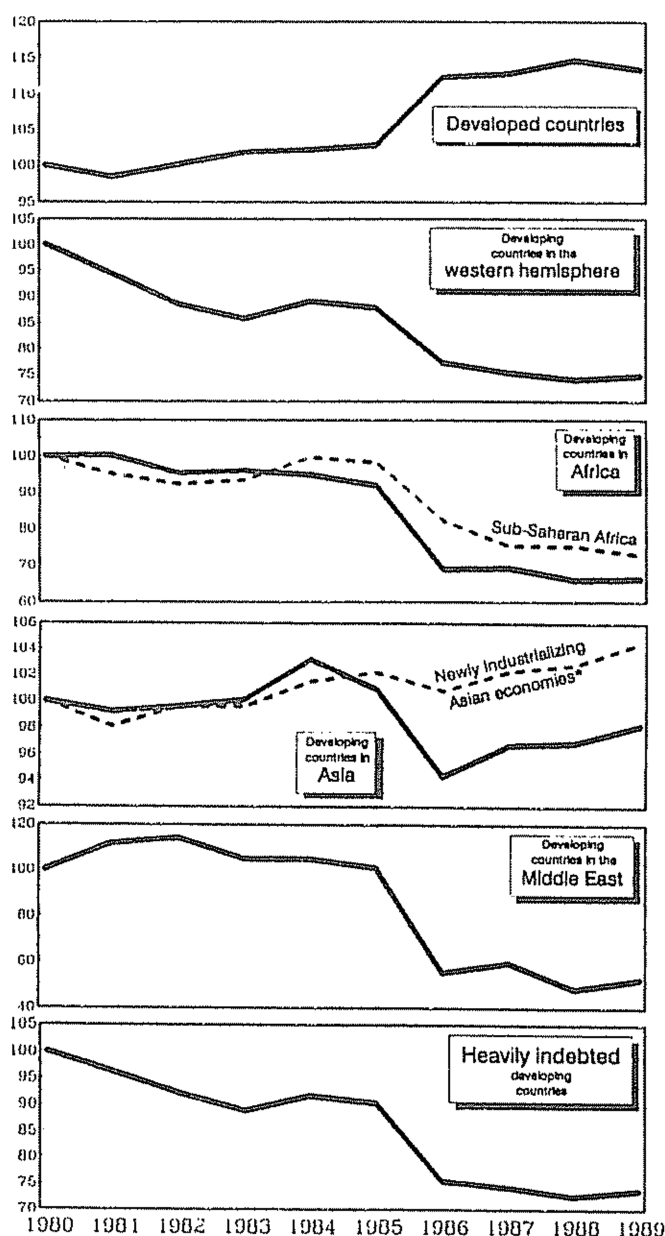
The global trading system seems to be approaching a cross-roads. On the one hand, there is a strong impetus toward further liberalization. On the other, there is increasing reliance on so-called "managed" trade and a "results-oriented" trade policy, and a growing inclination to seek bilateral solutions to trade problems and to form trading blocs.

It is generally conceded that a liberal trade régime is superior to a highly restrictive one in terms of generating economic efficiency and growth. Several rounds of multilateral trade negotiations have succeeded in reducing tariff levels substantially.[19] At the same time, however, beginning in the mid-1970s, there has been a proliferation of non-tariff measures (NTMs) which shows few signs of waning. According to one study, in 1987 non-tariff measures reduced world commerce by about $330 billion, and the restrictive effects of such measures in 1989 were estimated to be three or four times as great as those of tariffs.[20]

19 For example, to averages of under six per cent in Canada, Japan, the United States and Western Europe

20 Gary Hufbauer, "Beyond GATT", *Foreign Policy*, No 77, (Winter 1989-90)

Figure III.5. Terms of trade of selected country groupings, 1980-1989 (1980=100)



Source: International Monetary Fund

* Hong Kong, Republic of Korea, Singapore, and Taiwan Province of China

In 1989, there were new developments in "managed" trade and bilateralism. The trade policy initiative which attracted attention most was the inclusion of the "Super" and "Special" Section 301 provisions in the United States Omnibus Trade and Competitiveness Act of 1988.[21]

The Act enumerates several measures aimed at opening foreign markets to United States exports. Section 301 stems from previous trade legislation which required the enforcement of those United States rights that emanate from trade agreements and specifies the actions to be taken in response to foreign trade practices judged pernicious to United States exports.

Supplemented as of 1989 by "Super 301", the definition of unfair trade practices has been expanded beyond individual commodities to include general patterns of trading behaviour. The Super 301 provision directs the United States Trade Representative to identify priority practices, which, if eliminated, would significantly increase United States exports, and priority countries, based on the number and pervasiveness of their trade barriers. Once a country has been "cited", the administration has 12-18 months to negotiate the removal of the barriers. If the talks are unsuccessful, the Government can then levy tariffs of up to 100 per cent on selected imports from the "offending" country. In 1989, Japan was cited for its refusal to buy United States commercial satellites and super computers and for its barriers to American lumber. India was named for restricting foreign investment and the operation of foreign-based insurance companies, and Brazil for its import-licensing practices. On 30 March 1989, the United States released its inventory of global trade barriers, listing 35 countries and two regional trading blocs which in its view maintained the most important obstacles to American exports. Japan was accused of maintaining the most barriers, followed by the European Community, Canada, the Republic of Korea, India and Brazil. The administration had until the end of April to designate the countries and practices which would be given "priority" in trade policy in 1990.[22]

The second arm of Section 301 is the "Special" provision, designed to enhance the Government's ability to negotiate improvements in foreign intellectual property régimes. This statute requires the United States Trade Representative to identify foreign countries denying protection of intellectual property rights and market access to United States firms relying on such protection and to determine which of those are "priority countries", triggering a six-month investigation. In 1989, significant progress was made in various negotiations and no countries were identified under Special 301. Rather, 25 countries were singled out for special attention, 17 of them being placed on a "Watch List" and the other 8 on a "Priority Watch List".

Activities in which one country unilaterally passes judgement on the trade practices of other countries are not in conformity with the spirit of GATT. Another major example of an attempt to resolve trade problems through bilateral channels is the United States "Structural Impediments Initiative", which was launched in July 1989 to seek fundamental changes in the workings of the Japanese and United States economies in order to reduce trade barriers. For its part, the

[21] See *World Economic Survey*, chap. III, for a further discussion of this Act

[22] In comments before the Senate Finance Committee towards the end of April, the United States Trade Representative recommended that Japan should not again be cited since it had "moved further this year than any other country" in opening its markets to United States exports

United States has verbally agreed to effect concrete economic changes which would meet Japan's demand for a restoration of United States competitiveness, for example by bolstering savings and investment and improving education. The *quid pro quo* consists of a Japanese pledge to make it easier for foreigners to invest in Japan and do business there.[23]

Protectionism in the second half of the 1980s

In the second half of the 1980s several developing countries liberalized their import régimes with the clear objective of improving their development prospects, though trade barriers in general remained high. Socialist countries introduced market-oriented policy reforms and started to decentralize their foreign trade management. The Uruguay Round of multilateral trade negotiations of Multilateral Trade Negotiations was fitfully pursued. But protectionism in developed market economy countries does not appear to have abated significantly: non-tariff measures due to expire in the period were generally renewed and new measures were introduced.

Trade frictions between members of the Organisation for Economic Co-operation and Development (OECD) continued and, in a number of instances, induced retaliatory action. Agriculture remained a major source of tension, especially with regard to domestic support policies and the use of export subsidies. Solutions to major trade problems continued to be worked out principally on a bilateral basis. New trade legislation—such as the United States Omnibus Trade and Competitiveness Act of 1988—has been perceived as reinforcing this trend. In the European Community, new legislation extended the scope of anti-dumping provisions. Anti-dumping and countervailing duty actions are sometimes used for protectionist purposes and as a remedy for economic difficulties, including structural adjustment problems. Finally, throughout the 1980s there has been growing recourse to voluntary export restraints (VERs).

The continued recourse to trade restrictions is unmistakable.[24] For instance, during the period 1987-1989, Australia and New Zealand negotiated VERs with the United States on bovine meat in order to avoid import quotas. Australia introduced a tariff quota on certain cheeses and Austria imposed a quota on broken rice. The European Community extended VERs on manioc with Thailand and Indonesia and concluded agreements with China on manioc and sweet potatoes, and with the German Democratic Republic on sheep and goat meat. Dessert apples from the southern hemisphere were made subject to surveillance, quotas, and temporary suspension of imports. Canada extended the supply management programmes for manufactured milk and later for broiler hatching eggs and chicks.

In textiles, still under the Multifibre Arrangement, which limits third world exports of textiles and clothing to OECD countries, the United States concluded agreements with previously unrestrained exporters. Canada concluded a bilateral restraint agreement with the German Democratic Republic on hosiery. In footwear, South Africa increased duties, while France and Italy restricted imports from the Republic of Korea through voluntary export restraints and from Taiwan Province of China through bilateral quotas.

In steel, the European Community concluded a VER with Venezuela, while the United States brought imports from China and Trinidad and Tobago under the Steel Import Programme. The United States also extended import relief measures on specialty steel. Recently introduced VERs affecting other industrial products are, for instance, the Orderly Marketing Arrangements the United States concluded with China concerning certain chemicals and with Japan and Taiwan Province of China concerning machine tools. The United States has also resorted to tariff increases as a sanction against allegedly unfair trade practices by trading partners.

On the other hand, a number of non-tariff measures were eliminated during the second half of the 1980s. In some cases, Governments suspended national legislation under which quantitative import restrictions had been maintained. For instance, Australia lifted quantitative restrictions on sugar imports that had been justified under the Sugar Agreement Act and the Protocol of Provisional Application to the General Agreement on Tariffs and Trade. A number of other non-tariff measures which were liberalized had been challenged under the GATT dispute settlement mechanism. For example, Japan continued to implement the market-opening measures announced in 1988 and Sweden abolished quantitative restrictions on imports of apples and pears. In some instances, safeguard actions under article XIX of GATT were allowed to lapse. Effective 1 December 1985, Canada removed quantitative import restrictions from all categories of footwear except for certain footwear for women and girls. Remaining import controls were progressively relaxed and totally phased out by November 1988.

Certain States members of the European Community eliminated quantitative restrictions on imports originating in Japan, with further eliminations to be expected, until the remaining hard-core national measures are dealt with in connection with the completion of the single market at the end of 1992. The European Community has also decided to abolish most of the quantitative restrictions on imports from Hungary and Poland, effective 1 January 1990. Sweden announced the removal of quantitative restrictions on imports of textiles and clothing, including bilateral agreements in the framework of the Multifibre Arrangement, by 31 July 1991.

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[23] Proposed measures include the opening of more supermarkets and department stores, which tend to stock foreign goods, as well as putting more Government money into housing and public works, which could then use foreign goods and services like those offered by American construction companies.

[24] For a list of border trade measures which were introduced or renewed since the Uruguay Round of multilateral trade negotiations was launched in September 1986, see UNCTAD document TD/B/1240/Add.1 (December 1989).

Finally, liberalization with respect to certain tropical products resulted from concessions in the context of the Uruguay Round of multilateral trade negotiations.

Two indicators can be used to analyse non-tariff protectionism: trade coverage ratios and frequency indices. The first measures the value of imports affected by NTMs as a share of all imports. The second indicator expresses the number of trade flows covered by NTMs as a share of the total number of trade flows. A profile of NTMs is constructed by computing these indicators for selected NTMs and for specific groups of products and trading partners. Trends in trade intervention are analysed by calculating these indicators for a number of years, using the trade flows of a fixed base year as a reference point. Table III.7, using the first indicator, shows a 20 per cent increase in import coverage ratios, broadly measured, between 1981 and 1989, and only a marginal increase in the same ratio narrowly measured, for a selected number of developed market economies and for all non-fuel products.

An analysis of the national trade policies of selected industrialized countries shows that the 1986 trade coverage of NTMs, applied in 1989, amounted to some 23.4 per cent which, in monetary terms, is the equivalent of some $205 billion, or $138 billion if only NTMs included in the narrow definition are considered.[25] In Japan, Switzerland and Sweden, NTMs were concentrated in agriculture. Conversely, in Australia, Canada, the United States and New Zealand, NTMs were principally applied to industrial products. In most industrialized economies, products covered by trade policies and/or legislation with a strong sector-specific character accounted for a very large part of imports subject to NTMs, particularly those falling under the narrow definition. This illustrates the concentration of managed trade in a small number of product clusters, which are often affected by a number of overlapping NTMs.

New or proposed trade agreements in 1989

The year 1989 saw the signing of many bilateral and regional economic agreements throughout the world. In Asia, the Asian Pacific Economic Co-operation Forum was formed, as were the Arab Maghreb Union and the Arab Co-operation Council among the Arab countries. Progress was made within the European Community and other free trade areas and the fourth Lomé Convention was signed at the end of the year.

The work towards completing the European internal market, with its deadline of 31 December 1992, is well under way. The Commission of the European Communities transmitted to the Council the final proposal on completing the free movement of capital, goods, services and labour. By March 1989, about half of the decisions enumerated in the White Paper, which is the accepted schedule for the path towards completion of the Common Market, had been adopted or agreed upon. Among these are important strategic decisions, such as the liberalization of capital movements, which will be totally free by July 1990, mutual recognition of diplomas of education, and the opening up of public procurement to competitive bidding. However, the harmonization of private income taxation and value-added taxes is lagging, as are the efforts towards the free movement of persons. These issues still require unanimity, while most other issues decided by the European Parliament merely require a qualified majority. As internal frontiers are abandoned, the formalities conducted at external frontiers must be valid throughout the Community, and member States can no longer be free to intervene later on for further controls. In the same vein, in order to ensure a united approach, efforts to press ahead with a Community Customs Code proceeded.

Other vital areas of progress towards 1992 were the alignment of industrial technical standards and a move towards a common policy on testing and certifying products. Discussions have also been held by the European Community and the United States on the issue of technical regulations and industrial standards.[26]

However, important aspects of the Community's external régime after 1992 have not yet been defined. Access to the market could be limited if existing national quantitative restrictions were to be replaced by Community-wide restrictions. Special interests within the Community, particularly in the automobile sector, are pressing for restrictive national régimes to be adopted on a Community-wide basis. In this event, barriers against the rest of the world may increase in certain sectors, with adverse consequences for third country exporters.

The more liberal the Community's external régime after 1992, the greater the benefits to the Community and the rest of the world. The substantial real income gains from the external market programme can be expected to increase the demand for imports from the rest of the world if the European Community market remains free of discriminatory treatment of foreign suppliers.

Current events in Eastern Europe have speeded up trade negotiations between the European Community and almost all of the Eastern European countries. In July, the Community and Poland agreed on an economic co-operation and trade pact. The pact, running over five years, is to phase out European Community quotas on Polish industrial goods and cut Community tariffs on selected farm products. The agreement went farther than the one signed with Hungary in 1988, partly because Poland's economic difficulties and needs are viewed as being greater. In December, a bilateral economic co-operation and trade accord was signed with the Soviet Union. The principal elements of the accord are the granting of mutual most-favoured-nation status, and the elimination, by 1995, of all quantitative restrictions on import quotas on Soviet goods entering the Community.

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[25] The broad definition, unlike the narrow, includes certain measures not considered non-tariff measures by some countries—such as anti-dumping or countervailing actions.

[26] In 1988, the European Community accounted for some 23 per cent of United States exports.

Table III.7. Import coverage ratios of all selected non-tariff measures applied by selected developed market economy countries on all products, excluding fuels, 1981-1989

	1981	1982	1983	1984	1985	1986	1987	1988	1989
Broad category[a]	19.4	19.9	20.1	20.2	20.8	22.0	22.7	22.0	23.4
Narrow category[b]	14.0	14.1	14.0	14.3	14.3	14.8	15.0	14.4	14.3

Source: UNCTAD, Trade Control Measures Information System.

Notes: Countries covered include Austria, Canada, European Community (10), Finland, Japan, New Zealand, Norway, Switzerland and the United States

Ratios have been computed using 1986 import trade weights. Computations were made at the tariff-line level and results aggregated to relevant product group levels

[a] Including certain para-tariff measures, import deposits and surcharges, variable levies, anti-dumping and countervailing actions, quantitative restrictions (including prohibitions, quotas, non-automatic licensing, state monopolies, voluntary export restraints and restraints under the Multifibre Arrangement and similar textile arrangements), import surveillance, automatic licensing and price control measures

[b] Measures included in the "broad" category less para-tariff measures, import deposits and surcharges, anti-dumping and countervailing actions, automatic licensing and import surveillance measures

The Community has emphasized that 1992 will not result in higher measures of external protection and that priority is given to creating harmony between the Uruguay results and the 1992 programme. Yet fears of a "fortress Europe" exist among many of the Community's trading partners, based on experiences of rules of "local content" and Community banking laws. One such example is the internal quarrel over Nissan cars made in the United Kingdom. The Nissan Corporation of Japan wants such cars to pass into France above and beyond the country's quota on Japanese cars, to which France argues that they have less than 80 per cent local content and should therefore be included in the quota.

The fourth Lomé Convention between the European Community and the ACP States was signed at the end of 1989, after more than a year of negotiation. The new Convention will run for 10 years rather than 5. The Convention is the main channel for aid through the European Community to the developing countries. Apart from its commitments to provide development assistance through the Community, which is only a modest part of the official development assistance extended by Community members, bilaterally and multilaterally, the fourth Convention provides improved access to the European market for some 40 ACP products, most importantly, veal, beef and rum. The arrangement allows for extended fruit and vegetable access during the Community off-season. ACP manufactured exports already enjoy duty free and quota free access to the European market, and 96 per cent of ACP agricultural produce enters duty free.

A key objective of the new Convention is to encourage the production of high value-added products and their export from ACP countries. The new Convention also places greater emphasis than its predecessors did on the private sector in stimulating growth and diversifying ACP economies.

In the course of 1989, Turkey's application for membership in the European Community was rejected, as had been long expected. The Community stressed the inappropriateness of taking in any new members before 1992. Austria applied for membership in July, but negotiations on admittance will not begin in earnest until after 1992.

Meanwhile the European Community has started negotiations with EFTA on the prospect of a European Economic Space (EES), EFTA is a group held together by its stress on limited objectives. So far, it has aimed at being no more than a free trade area and the idea of a customs union has been dismissed from the start, as has the concept of eventual political union. EFTA aims have been achieved in parallel with a loss of members. With the departure of United Kingdom in the early 1970s, the group's influence declined significantly. In the 1980s, Portugal also left to join the European Community and Austria has applied to do the same. As the Community hurries towards a single market, the EFTA economies have thus conceded that they will have to sacrifice some independence. The proposal is that in exchange for access to the European Community market, EFTA countries will accept the "four freedoms" or the movement of capital, goods, services and people. These include European Community rules such as harmonization of industrial standards and open public procurement. The European Community accepts that EFTA need not be a party to the Common Agricultural Policy, the Community's trade policy or the complete removal of frontier controls. Much pulling and hauling is expected as to which rules should apply. But the institutional arrangements to govern EES are difficult. Joint decision-making would mean changing the Community's constitution which it is reluctant to do. The aim of negotiations is to implement EES by 31 December 1992, parallel to the completion of the internal market.

The Eastern European countries are turning towards the West to enhance their trade. Poland and the Soviet Union have signed agreements with the European Community; the United States has granted Hungary most-favoured-nation status and, together with the European Community, has given its support to Soviet observer status in GATT.

The United States agreed in 1989 to ease restrictions on high-technology exports to the Eastern Europe and the Soviet Union. The Co-ordinating Committee on Export Controls, which handles the issue, consists of the countries of the North Atlantic Treaty Organization (except Iceland), Japan

and Australia. A far-reaching liberalization of sales of second generation personal computers was agreed upon. Later sales of some sophisticated telecommunication equipment and more advanced main-frame and desk-top computers were allowed to Poland and Hungary.

The private sector has been quick to sign deals with Eastern Europe. The number of joint ventures, many of them trade-related, had soared past 3,300 by the end of 1989, up from 188 at the beginning of 1988. In Poland, joint ventures are up from 13 to 400 over a period of 21 months. European partners constitute a large majority, and approximately 50 per cent of the agreements are in manufacturing, mainly of computers and office equipment. The increase is likely to be even sharper in the years to come, leading to greater integration between Eastern and Western Europe.

The United States-Canada Free Trade Agreement is being implemented according to schedule; an accelerated pace of tariff removal has been suggested. If passed by the two Governments, duties on another 400 products are to be eliminated by April 1990. The Agreement programme, which came into effect on 1 January 1989, includes three different check points for tariff reductions: 1 January 1989, 1 January 1993 and 1 January 1998, when the Agreement is to be fully implemented.

Bilateral trade between Canada and the United States grew by $30 billion, to $220 billion in 1989, making it the world's largest bilateral trade flow. United States direct investment in Canada has doubled during the past two years. Attractive social programmes combined with a comparatively well educated workforce have led to this result. A favourable exchange rate has also had a positive effect. However, the most controversial part of the agreement is yet to be resolved. Negotiations on export subsidies are to start in May of 1990 and the issue is politically sensitive owing to disputes about countervailing duties. In any case, the large volume of trade already taking place between the two countries indicates that substantial gains from trade are already being reaped, limiting the scope for trade diversion. At the same time, the similarity between the production structures of the two countries raises the scope for trade creation. Each country will contract the relatively inefficient segments of its industries and benefit from previously unexploited economies of scale, particularly for Canada, whose market would increase 12-fold, compared with an 8 per cent increase in the United States.

Whatever their size, the real income gains in both countries resulting from free trade can be expected to increase the demand for imports from the rest of the world. This income effect can be expected to offset losses incurred by third countries on account of trade diversion.

The Caribbean Basin Initiative (CBI), which was launched in 1984, provides for duty-free access to the United States market for most goods produced in the 23 beneficiary countries. Excluded are textiles and apparel, petroleum, footwear, flat goods (gloves, luggage, belts, wallets) and canned tuna. The programme runs over 12 years, but legislation to enhance it is at present being considered by the United States Congress. The most significant feature of this proposed legislation is the establishment of CBI as a permanent fixture. The current programme aims at promoting economic development through private sector initiatives and its goal is to expand exports from Caribbean countries by diversifying production and export bases. Although there has been a decline in overall export earnings for CBI countries, the above-mentioned goal is being met. Trade between the United States and the basin area is growing strongly. Imports to the United States grew by 14 per cent, to $7 billion in 1989, constituting 75 per cent of the area's total exports, while corresponding United States exports grew by 20 per cent, to $9.4 billion.[27] Much of this growth is a reflection of increasingly close trade ties rather than of strong economic growth in the region.

The CBI programme also contains provisions for increased United States economic assistance. Economic aid has almost tripled since the programme's implementation and assistance efforts have focused on improving the business climate to increase private investment. The result has been more than $1.5 billion in new investment since 1983, creating more than 100,000 new jobs.[28]

The United States-Israel Free Trade Agreement introduced in 1985, is well under way (it is scheduled for completion in 1995). Two categories of products remain covered by tariffs, one category containing "import sensitive items" amounting to 15 per cent of total bilateral trade.[29] The Agreement does not include primary products, that is farm, forest or fishery products.

Increased economic co-operation has been achieved in relations between the United States and Mexico. In 1989, the United States agreed to give preferential treatment to 43 items on a list provided by Mexico, containing 63 items, and promised not to restrict Mexico's lucrative exports of car parts. Much fine print is still to be agreed upon, but a boost in Mexican sales to the United States seems certain. Meanwhile, in March 1990, the two Governments began preliminary discussions which could lead to a pact similar to the one that, in 1989, eliminated trade barriers between the United States and Canada. However, such an agreement, which could pave the way for a North American common market, is controversial in Mexico since keeping foreign competitors out and subsidizing domestic production has long been a keynote of Mexican economic policy. The obstacles which must be overcome are formidable, including the issue of the immigration of Mexican labour to the United States and the question of United States ownership and exploitation of natural resources in Mexico.

In China, the increasing integration with other countries in the Asia and Pacific region, which had resulted from rapid economic growth and an open-door policy, was interrupted

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[27] *Caribbean Basin Report*, March 1990.

[28] *Caribbean Basin Initiative*, 1989 Guidebook.

[29] Processed tomato products, certain categories of olives, dehydrated onions and garlic, citrus fruit juices, freshly cut roses, certain bromine products, and certain gold jewellery.

Box III.2. Motives for regional integration

The theory of economic integration pioneered by Viner[a] shows that there is no general presumption about whether a customs union or free trade area increases or reduces the real income of member countries and the world. The outcome depends on the balance of so-called trade creation—the substitution of low-cost partner imports for domestic production—and trade diversion—the substitution of high-cost partner imports for low-cost imports from third countries. Even if trade creation outweighs trade diversion, the resulting increase in world trade may be at the expense of the efficient allocation of world resources if trade diversion is significant. The gains from integration are likely to be largest (a) if barriers against third countries are low as there is then little scope for trade diversion; (b) if the partner countries produce a similar range of products, as the scope for trade creation will then be large and each partner will contract its relatively inefficient industries and expand the efficient ones; and (c) if the arrangement covers a large proportion of world trade, as the probability that a third country produces a large range of products more efficiently than the partners is then small and therefore so is the scope for trade diversion.

Subsequent contributions to the literature have demonstrated that the effects of regional integration cannot be evaluated solely on the basis of their trade-creating and trade-diverting effects. A trade-diverting customs union may improve the welfare of member countries (although it misallocates world resources) if a customs union is viewed as a mechanism for promoting industrialization through regional import-substitution.[b]

More recently, the analysis of the effects of preferential trade arrangments has shifted away from those static considerations to the dynamic effects of integration under an imperfect market structure. A number of empirical studies have shown that the expansion of markets through regional integration may result in significant economies of scale for the partner countries.[c] Additional gains in efficiency may result from greater competition among the partner countries.

Customs union theory was developed using preferential tariff reductions as the starting point of the analysis. However, non-tariff barriers have become a more important impediment to trade than tariffs following successive rounds of multilateral tariff reductions in the post-war period. Non-tariff barriers to trade include different national standards, Government procurement policies that favour domestic producers, voluntary export restraints, and trade distorting subsidies. In addition, anti-dumping, countervailing, and safeguard measures are being used as tools of "administered protection".[d]

Recent integration initiatives among industrial countries aim at removing non-tariff barriers to trade. Gains in efficiency through a reduction in market segmentation caused by non-tariff barriers was the major reason for launching the internal market programme in the European Community. The same is true of the United States-Canada Free Trade Agreement, which was additionally motivated by Canada's interest to avoid "administered protection" in its trade with the United States.[e]

Impatience with the slow and cumbersome process of multilateral negotiations has contributed to recent initiatives by industrial countries to liberalize trade on a bilateral basis. It is noteworthy that the bilateral discussions that led to the United States-Canada Free Trade agreement were initiated following the failure of the 1982 GATT Ministerial Meeting to launch multilateral trade negotiations.[f] The main motivating force behind the trend towards regionalism in the industrial countries thus appears to be the need to reduce non-tariff barriers to trade and to diffuse trade tensions, which is perceived to be easier to achieve on a regional than on a global basis. The expected gains are increased productive efficency through the achievement of economies of scale, the adoption of cost-reducing technologies, and a reduction in market segmentation, which creates monopoly rents and imposes administrative costs.

A different set of reasons seems to underly the trend towards preferential trading among developing countries. Tariffs continue to be more important than non-tariff barriers in these countries. The elimination of tariffs among a group of partner countries is thus viewed as a means of achieving industrialization through regional import substitution by "swapping" markets for each other's products. Regional integration among developing countries has also sometimes aimed at economizing on foreign exchange by setting up clearing accounts for intra-area trade. Such internal clearing accounts exist for most regional trading groups among developing countries, including the Latin American Integration Association, the Central American Common Market, and the Caribbean Community. This objective also underlies recent integration initiatives in Africa. Most recently, there has been increased focus on opening markets in a broader way and thus integrating members of preferential trading arrangements into the global trading system.

[a] J. Viner, *The Customs Union Issue*, (London, Carnegie Endowment for International Peace, 1950)

[b] C.A. Cooper, and B.F. Massell, "A new look at customs union theory", *Economic Journal*, 1965, pp. 242-247; and Cooper and Massell, "Towards a general theory of customs union for developing countries", *Journal of Political Economy*, vol. 73 (1965), pp. 461-476

[c] D. Cox and R.G. Harris, "Trade, industrial policy and Canadian manufacturing", (Toronto, Ontario Economic Council, 1984)

[d] J.M. Finger, H.K. Hall and D. R. Nelson, "The poltical economy of administered protection", *American Economic Review*, vol. 72, No.3, (June 1982), pp. 452-466

[e] Department of Finance of Canada, "*The Canada-United States Free Trade Agreement: An Economic Assessment*, (Ottawa, 1988), pp. 21-23

[f] R.M. Stern, P.H. Trezise and J. Wally, eds. *Perspectives on a United States-Canada Free Trade Agreement*, (Washington, D.C., The Brookings Institution, 1987), p. 4

by the political events in June 1989. As a result, China experienced the withdrawal of some foreign businesses and its application to join GATT was put on hold.

But integration among the Asia and Pacific economies proceeded, and November 1989 saw the creation of the Asian Pacific Economic Co-operation Forum (APEC). The region is booming and the aim of APEC is to facilitate the flow of trade in the region and at the same time campaign for freer trade throughout the world. The initiative was launched by Australia and at present includes 12 countries which together account for more than half of world gross national product and for 40 per cent of world exports: Australia, Canada, Japan, New Zealand, Republic of Korea, the United States, as well as the members of the Association of South-East Asian Nations (ASEAN)—Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand. In a joint statement it was stressed that APEC was not intended to be a restrictive trade bloc and it was anticipated that China, Hong Kong and Taiwan Province of China would be future members. The main conclusion was that the Asia and Pacific countries should press their case at the ongoing Uruguay Round of multilateral trade negotiations. This might be hard to put into practice since the 12 member countries have very different trade policies. Japan, the Republic of Korea and Taiwan Province of China and for example, protect their farmers from cheap food from Australia, New Zealand and the United States but want to sell these countries their cars and other consumer goods. Still, APEC may well become an important new force on the global economic stage.

The Australia-New Zealand Closer Economic Relations Agreement was signed in 1983, with the objectives of liberalizing trade between the two countries, strengthening their relationship and improving their mutual efficiency and competitiveness. The nature of the Agreement is now approaching that of a free trade area. By 1 July 1990, all tariffs and quotas are to be eliminated on goods originating within the two countries and no anti-dumping actions will be allowed on such goods. In addition, efforts are being made to eliminate all export subsidies by the same date.

In the Arab world, two new economic trade entities were formed in 1989. The Arab Maghreb Union proclaimed the formation of a common market, a major goal of which is to boost intra-Union trade by allowing free movement across borders. But potential problems are seen in the diversity of the economies, which range from the economically planned systems of Algeria and the Libyan Arab Jamahiriya (although both countries have recently instituted some free-market reforms), along with poverty-stricken Mauritania, to the more open economies of Morocco and Tunisia. The Arab Maghreb Union was modelled after the European Community, and reportedly is aimed at meeting the challenge of the unified European market planned for 1992 with a more integrated North African market. Currently, Algeria, Tunisia and Morocco, the most populous Maghreb States, conduct two thirds of their total foreign trade with the European Community and only about 1.5 per cent with each other.[30] Because it is based realistically on mutual economic benefits, the Union may be more stable than previous political unity pacts in the region.

Simultaneously, the leaders of Egypt, Iraq, Jordan and Democratic Yemen signed an agreement creating another regional common market, the Arab Co-operation Council. This pact brings together countries with a combined GNP of $100 billion, exports of $15 billion and imports of $30 billion. Its formation, along with the Arab Maghreb Union means that there are now three Arab regional groupings, the third being the six-member Gulf Co-operation Council (GCC) established in 1981.

The agreement between the European Community and GCC signed in June 1988, came into force on 1 January 1990. The agreement, which merely calls for economic co-operation between the two groups, is to be followed by a trade agreement. The proposal is for a free trade area, but with three exceptions. The Community wants to protect its petrochemical industry; the Gulf States want to protect their fledgling industries; and provisions on agricultural trade are demanded by the Community. Most Community exports now enter the Gulf area virtually duty free, but the entry of GCC petrochemicals is blocked by the Community's quotas and tariffs of 12-14 per cent.

As non-multilateral trade agreements (multilateral in the GATT sense) proliferate, the long-term outcome is far from clear. To begin with, free trade agreements hardly ever usher in totally free trade. Sectors of products covered by tariffs remain, as do non-tariff barriers.

In the above review, some of the exemptions have been deliberately enumerated in order to show the great variety of petty producer interests which, in many countries, prevail over consumer interests. For the most part this is of little concern, and the costs can be presumed to fall on the protectionist countries themselves. Very different issues arise in the context of major industries locked in global combat over large traditional markets, such as automobiles, or the new markets where technology rather than price is decisive. At present, dynamic industries tend to be oriented towards the conquest of world markets rather than the protection of a limited domestic outlet. This creates an important constituency for free trade.

Progress in the Uruguay Round

In the 1980s, protectionist pressures have been fostered by large shifts in the relative roles of major trading partners and groups and the emergence of important new players on the world trade scene. The tendency has been to resort to bilateral and regional solutions rather than finding multilateral solutions within the context of the GATT framework.

The Uruguay Round of multilateral trade negotiations, scheduled for completion in December 1990, is far more ambitious than its seven predecessors, having broadened its

[30] *Financial Times*

coverage to include such areas as agricultural trade, and trade in services and intellectual property.[31]

To conduct the negotiations, a Trade Negotiations Committee was established. It had two subsidiary bodies, the Group of Negotiations on Goods and the Group of Negotiations on Services. The former was further divided into 14 negotiating subgroups. Contracting parties to GATT undertook to observe a "standstill"—in other words, to forswear new restrictions—and to "rollback" trade-restricting measures deemed to be inconsistent with GATT. A Surveillance Body was established to monitor compliance with these commitments.

A mid-term review to assess the progress made in the Uruguay Round, was undertaken by the Trade Negotiations Committee in Montreal in December 1988.[32] The results were disappointing since negotiators were unable to agree in four areas: agriculture, trade-related aspects of intellectual property rights, safeguards, and textiles and clothing. Negotiations broke down and the mid-term review was put on hold on the understanding that the Trade Negotiations Committee would meet again in April 1989, with the objective of adopting a mid-term package of decisions and completing the work begun in Montreal.

The April meeting did, in fact, succeed in adopting decisions covering the four areas. These, together with the 12 other decisions, including those on standstill and rollback, adopted at Montreal, constituted the mid-term package of results. Moreover, the negotiating groups quickly reconvened after the Trade Negotiations Committee had completed its mid-term review.

As regards tariffs, the objective is an overall cut of one third in rates. The importance of reducing and eliminating tariffs and expanding the scope of tariff concessions was reiterated at the mid-term review meeting.

The critical importance of reducing or eliminating non-tariff measures was reaffirmed at the mid-term review meeting and, after lengthy consultations, the group on non-tariff measures adopted procedures for the conduct of its negotiations.

Market access for a variety of natural resource-based products, including the three categories of non-ferrous metals and minerals, forestry products, and fish and fisheries products, is affected by subsidies and other non-tariff support programmes. The stated objective is the fullest liberalization of trade in these goods, but there has been a United States proposal to add energy-related products to the three existing categories and to move fish and forestry products to the group on agriculture. A number of countries have expressed support for this approach, but others think that the group's original mandate should be maintained.

In July 1989, the group on tropical products completed its review of the tariff and non-tariff situation in this sector. ASEAN has proposed that all duties on unprocessed tropical products by industrial countries be eliminated and that duties on semi-processed and processed items be substantially reduced. Developing countries would make contributions consistent with their individual development, financial and trade needs. Little concrete progress has been made in this area.

Proposals have been tabled for the phasing out of restrictions under the Multifibre Arrangement by the year 2000, or earlier. On the other hand, proposals have been submitted calling for the integration of the textile and clothing sector into a strengthened GATT. Negotiations have focused on eliminating restrictions on the need for transitional safeguards and on the extent to which exporting countries should reduce their own restrictions on textiles and clothing.

Agriculture has so far been exempt from the normal regulatory framework of GATT. While the high cost of protection and subsidies has led to recognition of the need for multilateral discipline, a wide disparity of views emerged between the European Community and the United States.[33] The United States would like to see the complete phasing out within 10 years of all agricultural subsidies and import barriers. The European Community, seeing this as politically infeasible, would prefer modest agreements on short-term measures, leaving basic reforms to be negotiated over the longer run. A number of developing countries (Peru, Egypt, Jamaica, Mexico and Morocco) have called for specific commitments to compensate net food-importing developing countries for the negative short-term and medium-term effects of agricultural reform.

Several GATT articles are under review, such as those dealing with trade restrictions for balance-of-payments purposes, customs unions and free trade areas, and state trading enterprises. Work is also being undertaken on a variety of disparate items, including the Anti-dumping Code, the Agreement on Technical Barriers to Trade, the Government Procurement Code, the Agreement on Import Licensing Procedures and the Customs Valuation Code.

A comprehensive agreement on safeguards is essential. Article XIX of GATT allows temporary restrictions on imports where domestic production is seriously affected and thus permits the imposition of otherwise prohibited trade restrictions. However, the article has led to an increasing incidence of trade-restrictive measures taken outside the legal GATT framework. As such, it is a prime target for review.

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[31] Services, consist of the three broad categories of transportation. travel and other private services

[32] For further details. see *World Economic Survey. 1989*. chap. III

[33] For example, according to estimates by the OECD secretariat (in *Agricultural Policies, Markets and Trade: Monitoring and Outlook* (Paris, 1988), table III.3) cited in UNCTAD, Uruguay Round of multilateral trade negotiations: *Papers on Selected Issues* (Geneva, 1989), the annual average costs (in billions of dollars) to Governments of existing agricultural subsidization policies over the period 1984-1986 were: United States, 69.5; Canada, 6.0; EEC (excluding Portugal and Spain), 70.4; and Japan, 44.3. Moreover, according to OECD figures, the increase to consumers in food prices due to agricultural support mechanisms is 49, 36 and 14 per cent. for dairy products. cereals and meat, respectively (See GATT. *News of the Uruguay Round*. 21 November 1989 (NUR 032))

Under active discussion is the imposition of an initial time-limit for safeguard measures, with any extension requiring justification as well as accompanying adjustment measures for the industry concerned. Under consideration also is the imposition of objective criteria to be used at the national level in determining "serious injury". One particularly sensitive issue is whether safeguards should be non-discriminatory or whether selective action against imports from particular supplying countries should be permitted.

The GATT subsidies code permits the imposition of countervailing duties to offset the adverse effects on domestic producers from imports of competing products which are subsidized in their country of origin. The code, however, has been difficult to interpret. The group on subsidies and countervailing measures is tackling the issue. While there is widespread support for controlling trade-distorting subsidies, differences remain as to the appropriate disciplines required. Moreover, some countries view subsidies as policy instruments for achieving socio-economic goals and hence have expressed opposition to the concept of prohibiting subsidies, as such.

The mid-term review agreement included a comprehensive overhaul of the rules and procedures for the dispute settlement system of GATT. In particular, to make the system more efficient, time limits were established for the conclusion of various phases of the dispute settlement process. The new rules and procedures are being applied on a trial basis from 1 May 1989 to the end of the Uruguay Round.

The negotiations on the functioning of the GATT system are aimed at improving and strengthening GATT as an institution, enhancing its ability to monitor trade policies and enabling it to play a more active role in global economic policy-making. To this end, it was decided at the Montreal meeting to establish a trade policy review mechanism for the regular evaluation of the trade policies of individual countries every two to six years, depending on the share in world trade of the country in question. The review mechanism is currently in effect.

According to the Punta del Este mandate, GATT should also seek to increase its contribution to achieving greater coherence in global economic policy-making through strengthening the relationship of GATT with other relevant international organizations. At the mid-term review, the GATT Director-General was requested to prepare a report on the matter, as a first step, in consultations with the International Monetary Fund and the World Bank. This report was presented to the Group on the functiong of the GATT system at the end of 1989.

Three new areas are being taken up in the Uruguay Round of multilateral trade negotiations: intellectual property, trade-related investment and trade in services. GATT has thus far expressly exempted patents, copyrights and other intellectual property rights from its mandate. However, such laws clearly affect both the volume and composition of international trade and hence industrial countries have argued that GATT rules are needed to adequately protect intellectual property rights. Many developing countries, on the other hand, have argued that the group examining this issue should confine itself to the trade-distorting or trade-restrictive aspects of intellectual property rights, rather than concerning itself with the establishment of new regulatory régimes which they feel fall under the domaine of the World Intellectual Property Organization.

Trade-related investment measures, are another set of new issues in the Uruguay Round. The thrust of this undertaking is to identify the trade restrictive and distorting effects of such investment and to suggest means of avoiding them.

The relative growth of services over the past two or three decades is now an acknowledged feature of the world economy and the inclusion of services in the Uruguay Round of multilateral trade negotiations negotiations is one of its more distinctive—and controversial—features. Should an agreement on services eventually be concluded, it is likely to include insurance, banking, tourism, construction services and communications and other information-related services, such as data processing. According to one estimate, by the mid- to- late 1980s, these and other tradeable services accounted for over 25 per cent of world trade.[34] Negotiations in this area are proceeding under the auspices of a special group—namely, the Group of Negotiations on Services. In December 1989, the Group adopted a draft document which was designed to serve as the basis for further negotiations. As of early this year, plans called for the completion of a draft framework in July. Negotiations are expected to provide for a framework for progressive liberalization of trade in services, as well as for increasing participation in service sector activity by developing countries.

It is too early to comment on the eventual outcome of the Uruguay Round of multilateral trade negotiations. How great will the commitment of the developed countries be? How easy or difficult will the European Community find it to liberalize internally and externally at the same time? Some of the greatest gains could come in such "new" areas as services and intellectual property. However, most developing countries have not been active in these negotiations; they maintain that their particular needs and interests have not been given due regard in the traditional areas. The "Informal Group of Developing Countries", in a statement made in February 1990, noted "with deep concern the current lack of balance in the negotiations", which it attributed to a failure of developed countries to engage meaningfully in the traditional areas while pressing for far-reaching results in the new ones.

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[34] John Peterson, "International trade in services: the Uruguay Round and cultural and information services", *National Westminster Bank Quarterly Review*, August 1989

Box III.3. Farm trade

Farm subsidies established by industrial countries have long been a problem for other agricultural producers. In order to protect their agricultural sector, industrial countries keep prices high and build up large surpluses of foodstuffs that are then dumped on the world market and undercut exports of other countries.

For example, during the period 1984-1986, the total cost of support policies in the major industrial producers[a] amounted to $185 billion annually, which amounts to a producer subsidy equivalent of almost 40 per cent.[b] Total support of the dairy industry in the United States during 1986 equalled $1,400 per cow. Until now, attempts to reform these policies have failed. Fundamental production and trade distortions remain.

Yet proposals for the liberalization of farm trade have been presented. A major push for negotiations came from a group of 14 mostly developing countries, known as the Cairns Group,[c] and co-ordinated by Australia. Together, they account for about one quarter of the world's agricultural trade. The Cairns Group has indicated its intention of obstructing the Uruguay Round of multilateral trade negotiations unless the European Community and the United States revamp their agricultural policies. The Group has triggered a number of proposals. In October 1989, the United States proposed eliminating export subsidies within 5 years and phasing out domestic support over 10 years. Simultaneously, all non-tariff measures would be converted to tariffs and be phased out over 10 years. The proposal also seeks reforms in market access, export competition, internal support and sanitary controls.

A month later, the Cairns Group suggested an alternative. This called for a freeze, followed by a phase out, of agricultural export subsidies over a maximum of 10 years, as opposed to the 5 years in the United States proposal. Like the United States proposal, it called for improved market access through a reduction in existing tariffs and the conversion of non-tariff measures into tariffs, together with a substantial decrease in domestic support measures that distort agricultural trade. The Group's aim is to fully integrate farm trade into the GATT system. The main difference from the United States proposal is in the concessions to be made to developing countries. The Cairns Group states that Government assistance, direct or indirect, is essential for the development of market-oriented agriculture. Thus, the Group calls for a longer time-frame for developing countries to compete reform commitments. Also, the Cairns proposal calls for preferential treatment, with the cuts in market access barriers being lower than the generally agreed target, provided countries are committed to agricultural reforms and to the GATT talks on free trade.

In turn, the European Community has come up with an alternative plan of its own. The Community is not willing to negotiate its dual pricing system under which Community prices differ from world prices, and insists on being allowed to balance concessions in some areas against increased protection in others.

The Community plan includes the gradual reduction of supports in a first five-year phase, but it offers no certainty about what would happen thereafter, and it only partially accepts the idea of converting non-tariff barriers into customs duties. A large gap remains between the Community and the other two protagonists. Community officials themselves call the plan a "pragmatic approach".

[a] Australia, Austria, Canada, Japan, New Zealand, the United States and the European Community.

[b] Peter Winglee, "Agricultural trade policies of industrial countries", *Finance and Development*, vol. 26, No. 1 (March 1989), p. 9.

[c] Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand and Uruguay.

Conclusions

At the same time that a major multilateral effort such as the Uruguay Round is nearing completion, there is concern that unilateral and bilateral initiatives will undermine its results.

There is apprehension that in 1992 the European Community will turn into a "fortress", which foreign goods will not be able to penetrate. However, past experience suggests that 1992 will mean greater rather than less openness. Nevertheless, by increasing Europe's competitiveness, a successful 1992 process might raise a number of challenges for Europe's trading partners.[35] The tenacious current account imbalances of the Federal Republic of Germany, Japan and the United States have had a great impact on trade policies because the United States, in particular, has attempted to deal with macro-economic issues through bilateral negotiations.

One depiction of trade policy has been "the carrot of multilateralism ... complemented by the stick of bilateralism"[36] This view suggests that bilateral free trade agreements complement multilateral trade liberalization efforts and that such agreements are not designed to, nor do they, replace the GATT system. They can, however, act to spur needed changes.

According to this logic, neither the free trade agreements between the United States and Israel and the United States and Canada, nor the Australia-New Zealand Closer Economic Relations Agreement have weakened the GATT system, rather they encourage the reach for higher and improved levels of liberalization. Similarly, according to some American policy makers, new bilateral or plurilateral trading arrangements between the United States and the countries of the Pacific Rim, particularly Japan, are needed to spur trading partners in the Uruguay Round. Bilateral talks may supplement existing rules where GATT is weak and even point the way for future GATT agreements.

However, many would argue that bilateralism and multilateralism are substitutes, not complements, and that the current pursuit of bilateral agreements undermines the GATT system. Proponents of this point of view maintain that there are generic problems with bilateralism. The lessons of the 1930s thus teach that bilateralism is no reliable mechanism of international economic regulation.[37] Moreover, concern has been voiced that weaker economies, and especially developing ones, may be marginalized in the process of bloc formation.

Logic and efficiency, however, suggest reforming GATT where necessary. It is clear, for example, that the system for the judging of disputes needs reworking, as do rules on subsidies and unfair trade. The Uruguay Round is currently addressing many of these issues and the success of the negotiations would represent an important boost for multilateralism. However, besides the issues squarely on the table in the Uruguay Round, including the need to consolidate and streamline the system as it at present operates among traditional GATT members, the global trading system now faces the complex process of accommodating itself to changes in the world which stem from the breakdown of the boundaries between existing economic systems. This may be the biggest challenge to the global trading system in the 1990s.

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[35] See, for example, Albert Bressard, "Beyond interdependence: 1992 as a global challenge", paper prepared for the Council on Foreign Relations Study Group on Europe, America and 1992, 24 February 1989.

[36] Bressard, *op cit.*

[37] See also, Michael Aho, "More bilateral trade agreements would be a blunder: what the new President should do", *Cornell International Law Journal*, vol 22, No 1 (Winter 1989).

Chapter IV

INTERNATIONAL FINANCE AND THE NET TRANSFER OF RESOURCES

The level of investment and consumption in a country partly depends on whether domestic production is supplemented by resources from abroad or whether some domestic production is transferred to other countries for their use. Although many mechanisms exist for transferring resources, including those embodied in the changing prices of traded commodities and in inter-affiliate transactions of transnational corporations, especially large transfers have taken place in the 1980s through international flows of capital and capital servicing. The economic effect on nations has been marked and has provoked substantial interest at the United Nations in monitoring trends in net international financial transfers, especially as they affect the economic growth and development of the developing countries.[1] Trends in net international financial transfers are also important to other groups of countries and they call for policy actions pertaining to all the major country groups. Thus, international financial transfers are the focus of the present chapter.

The international pattern of financial transfers in 1989 was in many ways typical of that in recent years. By far the largest net absorption of resources was that of the United States (see figure IV.1).[2] As will be discussed below, however, the $95 billion net transfer to the United States was more than a third below the 1987 peak of $154 billion, which marked progress in the adjustment of the United States balance of payments and the use by the United States of the world's financial savings. In addition, the United Kingdom absorbed about $30 billion in financial resources from the rest of the world in 1989 for the second year in a row. This is a departure from the earlier pattern of rather small net transfers in or out of that country (see table IV.6 below).

The Federal Republic of Germany and Japan were the largest suppliers of financial transfers, as in previous years, although the smaller developed market economies and Eastern Europe also transferred financial resources abroad. The Soviet Union became a net recipient of financial resources from the market economies in 1989, as will be discussed below, and the Eastern European countries seem poised to see their net resource outflow turned into an inflow owing to several major international policy initiatives. Indeed, one concern is the ability of those countries to properly absorb a significant volume of external resource while their economic strategies and priorities are still being forged in new political institutions. The net transfer of the developing countries raises entirely different issues, as discussed below.

The net financial transfer of the developing countries

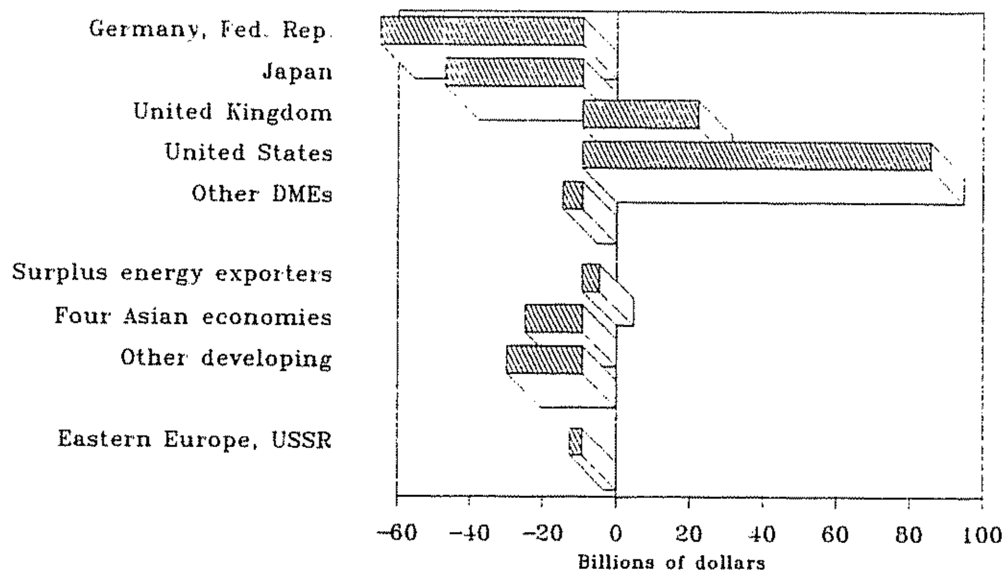
As a whole, the developing countries are still transferring resources abroad, as they have been since 1984 (see table IV.1). But there are essentially three separate stories behind the overall flow. One involves the energy-exporting countries that have been denoted "capital-surplus countries" in this *Survey* throughout the 1980s. They have actually been net recipients of financial transfers from abroad since 1982, as weakening oil prices and a major military conflict in the Gulf area cut deeply into their ability to transfer resources abroad. With more peace in the region and a rebound of oil prices, this group of countries reached the largest surplus in its combined current account balance since 1982 (see table A.13). They thus once again became exporters of capital, but since the earnings of $15 billion on their net stock of external capital exceeded the capital outflow, they still enjoyed a positive net transfer; i.e., they were able to absorb more goods and non-factor services (and pay for the labour of foreign workers) than they would have if solely restricted to the earnings from their exports.

The large net transfer made by four generally small Asian economies constitutes a second net-transfer story. They comprise a group of very successful exporters of manufactures, namely, Hong Kong, the Republic of Korea, Singapore and Taiwan Province of China. Their aggregate net transfer of financial resources was about $16 billion in 1989, down from $23 billion the year before, owing mainly to the sharp cut-back in the trade surplus of the Republic of Korea. The resource outflows, which reached substantial amounts only in recent years, are likely to decline in 1990 by roughly $5 billion, but will continue for several more years. The ability to make those transfers provided opportunities to reduce the vulnerability to adverse international economic trends and reinforce economic linkages with trading partners. Official reserve levels have quadrupled over the past five years to a level of $112 billion (see table A.14). By 1989, the official reserves of Taiwan Province of China had grown larger than those of every developed market economy except Japan. External debt levels have also been reduced; in particular, the

[1] Indeed, this chapter was prepared partly in response to Economic and Social Council resolution 1989/112 of 28 July 1989 on the net transfer of resources from developing countries and its impact on their economic growth and development; in addition, see General Assembly resolution 44/232 of 22 December 1989 on trends in the transfer of resources to and from the developing countries and their impact on the economic growth and sustained development of those countries

[2] Net resource transfers are measured here on an expenditure basis, which is the concept of net transfers that is most closely related to standard categories of national income accounting (see box IV 1). The estimates themselves are based on balance-of-payments data, which tend to be the best available for such calculations, despite various shortcomings Perhaps the best known one is that when the current account balances of all the world's countries are summed, they do not come close to zero as they would if all data were accurate (for example, see table A 7) However, a major portion of the error appears related to the inability to identify all financial flows and income of capital. The aggregate net transfer calculation avoids that difficulty by looking only at the sum of the two flows together (of course, exercises such as shown in table IV 2 and box IV.1, that attempt to distinguish particular flows of capital and the associated income payments of a country or group of countries, are still fraught with much uncertainty)

Figure IV.1 Net international transfer of financial resources in 1989*



Source: UN/DIESA, based on data of IMF and national sources
* Expenditure basis

Republic of Korea reduced its debt by almost 30 per cent in three years to a level of $34 billion at the end of 1989.[3] At the same time, the private sectors of these countries have been investing abroad at a rapid pace in both financial and direct investments, especially in the major developed market economies and in the developing economies of Asia and the Pacific.

The contrast could not be greater between the net financial transfer experience of these four economies and that of most of the other economies that the *World Economic Survey* has long called "capital-importing developing countries". The latter have made net resource transfers abroad since 1984, but in a totally different context. The resource transfers of the four Asian economies were made because rapid growth created financial surpluses as savings grew more rapidly than the capacity of the local economies to absorb them in investment. Output per capita grew, on average, by almost 7 per cent a year in the four economies and supported a rate of gross investment that averaged 29 per cent of GDP. In a closely watched sample of 15 heavily-indebted developing countries, in comparison, GDP per capita *fell* by 0.6 per cent per year through the decade and the investment share averaged only 20 per cent of GDP.[4] In a different group of developing countries, that of sub-Saharan Africa, excluding Nigeria,[5] output per capita has also fallen through the decade—an average decline of 0.4 per cent a year—and investment averaged 19 per cent of GDP.

The drop in investment and growth in the two groups of countries had various causes, but the role of the reduction in the net transfer of resources seems firmly established (see, for example, figures IV.2 and IV.3). The steep drop in the transfer of resources to them was brought about by a curtailment of imports and a redirection of output towards exports, in a context of depressed domestic economic conditions. The phenomenon of a net outward transfer of resources could not have been more different from that in the four Asian economies, where it was associated with rapid growth of export volume that permitted a rapid growth of imports, or from the case of the capital-surplus energy exporters where export earnings surged on the sudden rise in international petroleum prices some years back. It is thus not hard to understand why Governments of the highly constrained developing countries have had grave and protracted difficulties, as discussed in chapter II, in bringing about economic stabilization and structural adjustment.

A scenario of enhanced net resource transfers

Nevertheless, in country after country, the need for domestic economic stabilization and structural adjustment has been accepted and major reform programmes have been instituted. The prognosis for macro-economic stabilization over the next few years is thus good, but the pay-off in rising levels of output and income may be disappointing. The outlook under the policy assumptions and industrial country

[3] Based on data of the World Bank Debtor Reporting System, as of March 1990

[4] The countries, which were the initial target of the strategy proposed by the United States in 1985 for resolving the developing country debt problem, are Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, the Philippines, Uruguay, Venezuela and Yugoslavia

[5] Nigeria is excluded because its large economy would otherwise mask the trends in the many smaller economies of the region; it is included, however, in the 15-country sample

Table IV.1. Net transfer of financial resources of groups of developing countries, 1980-1989[a]
(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Surplus energy exporters	-91.4	-44.6	2.0	26.4	17.8	11.5	28.7	11.8	15.8	5
Capital-importing economies	31.9	49.1	31.0	-5.9	-33.0	-24.4	-16.5	-47.8	-40.8	-36
of which										
Africa[c]	--	14.8	13.9	7.7	1.9	-1.5	5.4	-0.2	3.9	3
Latin America and the Caribbean	11.4	14.0	3.4	-25.6	-35.2	-31.4	-15.0	-19.3	-22.4	-28
Four recent surplus economies in Asia[d]	6.9	3.9	-0.3	-4.1	-8.3	-10.9	-22.7	-28.5	-23.4	-16
Other Asia and Europe	13.7	16.4	14.0	16.1	8.5	19.3	15.8	0.2	1.0	4
All developing countries	-59.5	4.5	33.0	20.5	-15.2	-12.9	12.1	-36.0	-24.9	-32

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on IMF data, official national and other sources (country coverage is that of table A.13)

a Expenditure basis (negative of balance on payments of goods, services and private transfers, excluding investment income)

b Preliminary estimate

c Excluding Libyan Arab Jamahiriya and South Africa.

d Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

trends discussed in chapter II pointed to a contraction in output in the Latin American region as a whole, zero growth in the Mediterranean region and growth at less than the rate of population increase in Africa in 1990. Some recovery is projected for 1991, except in Africa, where per capita income is expected to slide yet again. The momentum of these developments, taken three additional years into the future under the baseline scenario, yields an average growth rate of output in the recovery period 1991-1994 of only 4 per cent a year in Latin America and less than 3 per cent annually in Africa, although the Mediterranean region would register almost a 5 per cent annual average.

In light of these projections, the question arose whether additional financial support measures might raise output and income levels without jeopardizing the stabilization gains being won at such high cost. This led to the construction of a scenario that could be run as an alternative to the baseline. It traced the consequences of an assumed annual improvement in the net transfer of the capital-importing countries beginning at $6 billion in 1991 and rising to $30 billion in 1994. In the latter year this is equivalent to increasing imports by 8 per cent over the baseline level. The flows were allocated to the imports of countries or regions where GDP growth is constrained by the resource transfer problem. Thus, no additional capital flows were allocated to the rapidly growing countries in Asia nor to the high income oil-exporting countries. It was further assumed that as incomes rise, the recipient countries would mobilize their own savings potential and increase domestic investment by 50 per cent more than the additional flows; accordingly, nearly all of the capital flows would be used to finance imports of intermediate goods or capital goods.[6]

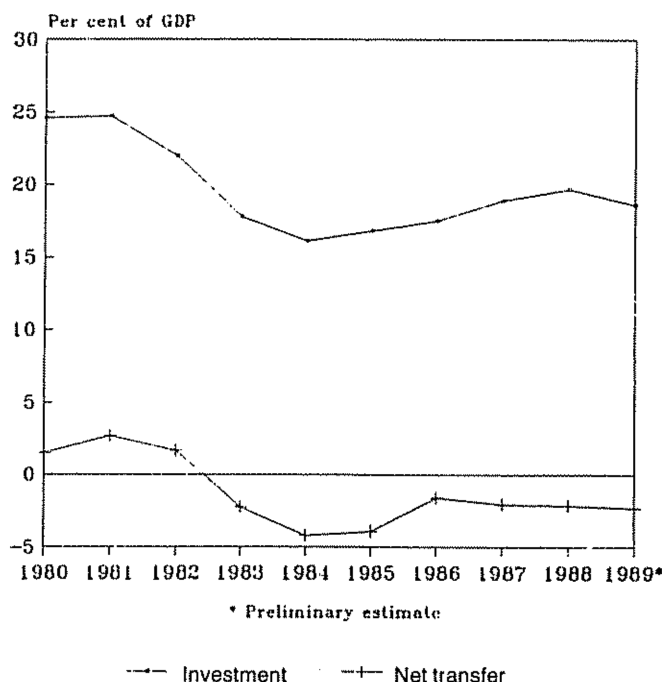
In such a scenario, GDP would grow almost 1 per cent faster each year in the affected countries. As seen in figure IV.4, the increment in output would be greatest in the relatively more advanced economies of Latin America and the Caribbean and in the Mediterranean region. In Africa it would mean the difference between rising and falling income per capita as the average rate of output growth would reach 3.7 per cent a year, exceeding population growth. In the least developed countries of Asia, output would also rise faster.[7]

Moreover, after four years of stronger growth, domestic resources for investment would have substantially increased in a stabilized macro-economic environment in which major distortions in market prices would have been corrected. The countries would be poised for a surge in growth, with rising productivity emanating from increasingly sophisticated investment, as domestic as well as foreign entrepreneurs would commit themselves to long-run projects conditioned on confidence in the economies and their domestic policy.

6 Since output could be expanded more than proportionately to investment owing to the low rates of capacity utilization currently prevailing in the manufacturing sector in many countries, and because final consumption had been held down as a consequence of adjustment policy, implicit import elasticities remained relatively low, averaging about 1.3, about the same as in the baseline scenario

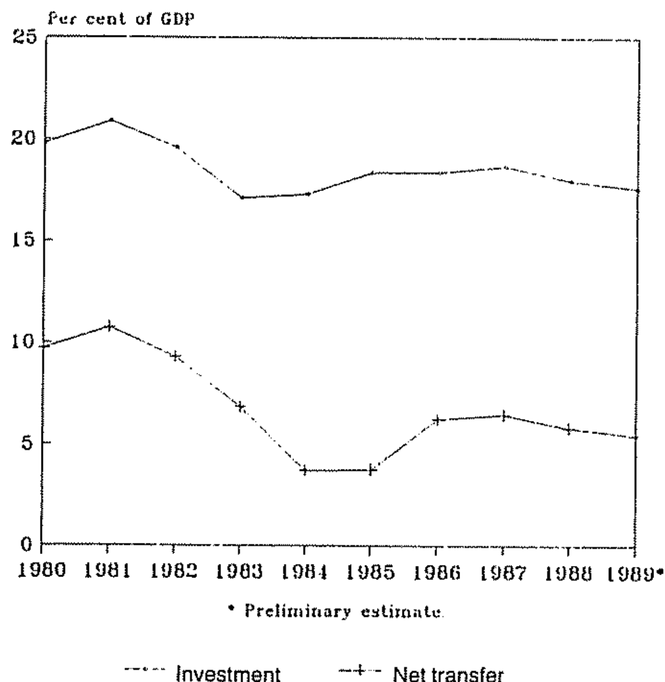
7 A recent study prepared for WIDER's project on a medium term development strategy came to broadly similar conclusions using a very different methodology. Detailed analyses were undertaken for 18 representative developing countries and the results were extrapolated to all developing countries. Additional capital requirements estimated for the decade were $40 billion in 1990, rising to $60 billion in 2000. When adjusted for the same country coverage as in the LINK scenario reported above, this would be equivalent to $27 billion in 1990. These additional flows were found to be associated with an increase of 1 per cent in the average annual rate of growth of output capacity and a somewhat greater increase in total output, given the present high degree of underutilization of capacity in many countries (see Lance Taylor, "Foreign resource flows and developing country growth". World Institute for Development Economics Research of the United Nations University (Helsinki, mimeo., 1990)

Figure IV.2 Investment and net financial transfer of 15 highly indebted developing countries, 1980-1989



Source: UN/DIESA, based on data of IMF and the World Bank

Figure IV.3 Investment and net financial transfer of sub-Saharan Africa, 1980-1989



Source: UN/DIESA, based on data of IMF and the World Bank (excluding Nigeria)

Conceptualizing such a scenario will not necessarily make it happen, even if it would benefit industrial countries to arrange such an enhanced transfer to the developing countries. The scenario entails an increase in world trade that feeds back into higher growth in the industrialized economies, raising their output slightly. But if the Governments of industrial countries merely wish to increase their rate of growth they could in the short run do so more directly. They have, however, other stakes in wishing to avert a further widening of the economic gaps that divide the world community, and as the military conception of international security recedes, an economic one advances. Even a fraction of the savings from reduced military spending would suffice to transform the prospects for international development.

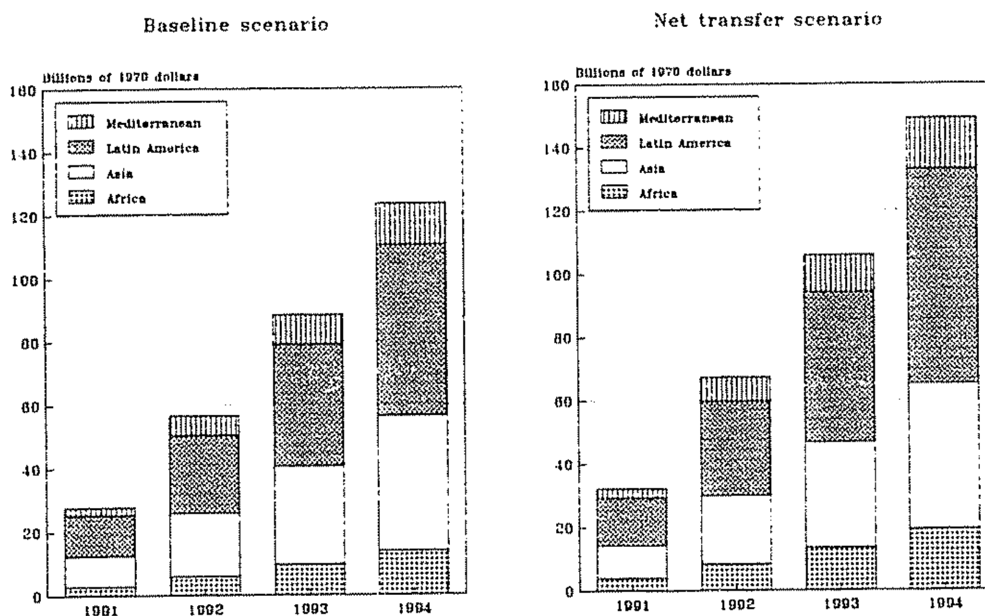
Moreover, the sudden switch in financial flows in the 1980s was due to the withdrawal of private credit from countries in debt-servicing difficulties, and much attention has to be given to the possibilities of affecting the net financial transfer by realistic restructuring of such debts.

Financial composition of the net transfer

At the beginning of the 1980s, the capital-importing developing countries were receiving net financial transfers on the order of $30 billion to $40 billion a year. In recent years they have been making net outward transfers of a comparable magnitude, as table IV.1 indicated. In order to trace the evolution of the net financial transfer, table IV.2 brings together data for a sample of 96 capital-importing countries for which adequate information could be assembled.[8] The table shows first that the overall transfer became less negative in 1989. This was the case whether the transfer is measured on an expenditure basis, as has been done elsewhere in this chap-

[8] The data in table IV.2 differ somewhat from those published in *World Economic Survey 1989* (United Nations publication, Sales No. E.89.II.C.1), chap. IV. The current estimates are for a slightly different sample of countries and a new financial flow was added to the measure (the transfer calculated on the earlier basis is shown as a memorandum item). The aim all along has been to make the country coverage as inclusive as possible (countries are added when their data are available for almost all of the years shown in the table; countries are dropped from the sample when data cease to be published by IMF or the World Bank). This year, private grants were added as a component in the net transfer. They include expenditures by non-governmental organizations, but they are also in large measure personal transfers by overseas residents (excluding workers' remittances and pension payments, which are viewed as closer in concept to labour income). Although the national data on which these estimates are based are believed to distinguish very imperfectly between types of private transfers, it was considered better to possibly overstate the transfer than continue to exclude it entirely. Private transfers have made small but, indeed, steadily increasing contributions to the overall net transfer picture. Finally, on the suggestion of certain users of these data, an effort was made to isolate asset outflows from developing countries as one of the panels in the table. This is difficult, owing to well-known measurement problems (see, for example, the conference volume edited by Donald R. Lessard and John Williamson, *Capital Flight and Third World Debt* (Washington, D.C., Institute for International Economics, 1987)). However, the more consistently identified flows are separated from the unexplained residual that includes net transfers related to foreign assets of developing country residents.

Figure IV 4. Additions to GDP of developing countries under two scenarios, 1991-1994



Source: UN/DIESA

Box IV.1. Measuring the net transfer of financial resources of developing countries

Estimates of the net transfers of financial resources to and from developing countries presented in the *Survey* and other reports of the Department of International Economic and Social Affairs have often been cited, but estimates published by other international bodies have been interpreted to mean that the international transfer situation is either worse or better. The differences in these measures require explanation.

As used in reports of the Department, the net transfer of financial resources is defined as the difference between net capital inflows and net international income payments to capital. It is the same size, but with opposite sign, as the balance of trade in goods and non-capital services.[a] If the net transfer is positive, the trade balance is in deficit—more goods and services are imported than exported, and thus more can be consumed and invested than could be achieved out of domestic production alone. If the net transfer is negative, some portion of the value of domestic production is unavailable for domestic use.

Although the concept is straightforward at this level of generality, there are many ambiguities in its application. One is that increases in official foreign reserves are considered investments abroad in the United Nations System of National Accounts (SNA), although they also have the character, especially in developing countries, of an inventory investment by the Government in holdings of foreign currencies. As annual changes in reserves are often quite large, the Department has for several years published two measures of the net transfer. One is the "net transfer on an expenditure basis", which includes the change in reserves as part of international financial flows. This measure is most consistent with national income accounting wherein the net transfer adds to or subtracts from standard measures of aggregate domestic expenditure. It is also the measure used by the IMF in its *World Economic Outlook*. The other measure, denoted the "net transfer on a financial basis", implicitly treats reserve changes as part of investment.[b] Of the two measures, the second is the measure of the net transfer that is more frequently cited in the press and in official debates.

But while the Department estimates that the net financial transfer of the developing countries was an outflow of $23 billion in 1988, the World Bank estimated it was an outflow of $52 billion and the Organisation for Economic Co-opera-

[a] Foreign exchange inflows arise from exports, income earned abroad, capital inflows or the drawing down of reserves; they are used for imports, repatriation of income earned domestically by foreigners and foreign investors, capital outflows or additions to reserves. Thus, the value of all foreign exchange inflows excluding capital-related items minus all uses of foreign exchange, again excluding capital-related items, will be the same size as the net flow of capital and capital-servicing plus the net change in reserves.

[b] Expressions for the two measures of the net financial transfer in terms of standard SNA variables were derived in *World Economic Survey 1986* (United Nations publication, Sales No. E.86.II C.1), pp. 163-164. Conceptual issues in measuring the net transfer have also been a focus of the international review and revision of the SNA that is currently under way (see Inter-Secretariat Working Group on National Accounts, "System of National Accounts (SNA) review issues" (ST/ESA/STAT/SER F/2/Rev 4, February 1990), paras. 175-229).

tion and Development (OECD) estimated it to be an inflow of $17 billion.[c] While different sources of data are used in some of the components of the measures and the Department estimates pertain to a smaller sample of countries (96) than used by the Bank and OECD, the differences in the statistics are primarily due to definitional differences.

The World Bank has long published estimates of the net transfer as part of its reporting on the debt situation of developing countries. Its measure pertains only to debt-related flows, i.e., disbursements of loans minus principal and interest payments. In the early years, the Bank's data—and hence its resource transfer measure—pertained only to the medium-term debt of the debtor Government or the debt guaranteed by it. Today, it includes estimates of short-term debt, non-guaranteed medium-term debt (basically claims on the private sector), and the use of IMF credit. The Bank's net transfer measure is thus more inclusive now. One could decompose the Department's measure and one part would correspond to the Bank's measure. This is done in the first panel of the accompanying table, where it may be seen that the component corresponding to the World Bank concept of the net transfer was an outflow of $42 billion in 1988, $35 billion in 1987 and so on in earlier years. The Bank's own aggregate estimate is of a somewhat larger net outflow in recent years, but it is generally close to the value for the 96-country sample used here.[d]

Like the World Bank, OECD has a long history of publishing data on net transfers, but only at first with respect to the official development assistance (ODA) of member countries of the Development Assistance Committee of OECD. Today, OECD data on the net transfer include estimated flows of ODA from other sources, grants by non-governmental organizations, direct investment and credits to developing countries from all foreign sources. These data embody two conceptual differences with the Department's net transfer measure.[e]

First, only transfers that pertain to flows initiated abroad and their servicing are included, which is an obvious consequence of the OECD's interest in the development assistance efforts of its member countries. Thus, reductions in the net transfer that are due to capital outflows from developing countries do not appear in OECD calculations, nor would repatriation of assets add to the net transfer. By the same token, instead of net private grants received, the calculation includes gross grants from foreign non-governmental organizations. These factors alone, however, account for little of the difference between the OECD and Department's net transfer measures, as can be seen by comparing the line denoted "net financial transfer from abroad" in the second panel of the table with the Department line. This transfer from abroad is estimated to have been negative: a net outflow of $10 billion to $23 billion a year since 1984. The principal reason is that the net transfer associated with developing country foreign assets has not been very large in most years. Although capital outflows were unusually large in some countries in some years, especially in the early 1980s and again in 1988, the stock of overseas assets also produces considerable income annually that flows back to the countries and is captured in their balance-of-payments data.

The second conceptual difference also grows out of the focus on development co-operation efforts. OECD includes some items in the net transfer that do not appear in the balance of payments of recipient countries, either because the expenditures take place outside the country or the foreign exchange inflows associated with the programmes are small. The largest such item is technical assistance, which OECD values at the cost to the donor in supplying it. On the assumption that none of the cost of official technical assistance to developing countries is included in the balance of payments, those expenditures could be added to the Department's net transfer estimates which would then more closely approximate the OECD concept.

Finally, it has been the convention to treat IMF lending as a monetary or reserve-related phenomenon and exclude it from statistics on development financing and debt. OECD continues that tradition by excluding the net transfer associated with IMF lending from its net transfer calculation (although it includes short-term bank credits which are also not development financing). That adjustment to the Department figures would capture most of the remaining conceptual difference between the two measures. These adjustments also take the Department numbers much of the way to the OECD's own estimate of the net transfer for a larger group of countries. Thus, under the OECD concept, the net transfer of financial resources for the 96-country sample in recent years appears to have been less negative and in some years positive. As measured by OECD itself, the net transfer was estimated to have become negative in 1984-1985; it turned positive since then, but never recovered the levels of the beginning of the decade.

It can be argued, in sum, that the OECD concept is of limited value in analysing the actual net transfer of financial resources to or from the countries concerned. It measures in

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[c] See World Bank, *World Debt Tables*, 1989-90 edition, vol. I (Washington, D.C., December 1989), p. 78; and OECD, *Development Co-operation in the 1990s*, Report of the Chairman of the Development Assistance Committee (Paris, December 1989), p. 219. In other analyses which go beyond the scope of the present discussion, estimates are constructed of the "real value" of the transfer, defined as the financial transfer measured in constant prices and exchange rates plus a correction for the real income gains or losses from changes in the terms of trade.

[d] Indeed, the World Bank data set is the source of virtually all the debt-related data used in the Department's net transfer calculations. The major difference in country coverage of the two data sets is the inclusion by the Bank of several European countries that are not classified as developing for purposes of the *World Economic Survey*.

[e] OECD publishes a related measure, the "net resource flow" that should not be confused with the net transfer. The net resource flow which, according to OECD data, averaged $103 billion a year from 1980 to 1988, corresponds to the capital flow from which the interest and dividend servicing costs are subtracted in deriving the net transfer measure (see *Development Co-operation in the 1990s*..., p. 150).

part what resources OECD countries are mobilizing for development; the 16 per cent annual growth of technical assistance expenditures since 1986 as shown in the table is a notable example. But it does not purport to measure the foreign exchange value of the aggregate net transfers that developing countries are making abroad and the restrictions thereby imposed on their ability to invest and grow.

In any event, the *shift* in levels of net transfers, whatever the measure, clearly points to similar magnitudes and the same direction. The shift on the order of $60 billion to $70 billion between 1980 and 1988, as measured by the Department and the World Bank, is mirrored by a decline of about $50 billion in the OECD measure of net transfers during the same period.

Reconciliation of the net financial transfer of capital-importing developing countries, 1980-1988

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
	From UN/DIESA to World Bank measure								
UN/DIESA net transfer (financial basis)	36.8	33.8	7.0	-1.2	-10.6	-19.4	-11.1	-16.6	-22.1
minus									
Direct investment net transfer	-5.0	-0.9	-3.0	-3.3	-2.5	-1.2	-0.8	1.7	6.3
minus									
Official and private grants	12.4	12.9	11.4	11.8	12.8	14.0	14.5	15.8	16.6
minus									
Net transfer on financial assets[a]	13.3	0.7	-9.9	-4.1	--	4.1	9.3	0.9	-2.8
equals									
World Bank net transfer measure on DIESA sample of countries	16.1	21.1	9.4	-5.6	-20.9	-36.4	-34.1	-35.1	-42.2
plus									
Difference in coverage[b]	3.5	1.6	-3.0	3.2	-1.0	0.2	-4.1	-5.2	-9.8
equals									
World Bank net transfer measure	19.6	22.7	6.4	-2.4	-21.9	-36.2	-38.2	-40.3	-52.0
	From UN/DIESA to OECD measure								
UN/DIESA net transfer (financial basis)	36.8	33.8	7.0	-1.2	-10.6	-19.4	-11.1	-16.6	-22.1
minus									
Net transfer on foreign assets	13.5	1.8	-9.4	-3.9	--	4.0	9.2	0.3	-3.1
of which:									
Direct investment	0.1	1.1	0.6	0.2	0.1	-0.2	-0.1	-0.6	-0.3
Financial assets[a]	13.3	0.7	-9.9	-4.1	--	4.1	9.3	0.9	-2.8
minus									
Net private grants	1.2	1.2	1.2	1.6	2.1	2.5	3.4	3.5	4.2
plus									
Grants by non-governmental organizations	2.4	2.0	2.3	2.3	2.6	2.9	3.3	3.3	3.6
equals									
Net financial transfer from abroad	24.5	32.8	17.4	3.5	-10.1	-23.0	-20.4	-17.1	-19.6
plus									
Technical co-operation expenditures	6.9	7.1	7.2	7.6	7.5	7.9	9.4	11.4	12.3
minus									
Net transfer on IMF lending	3.5	6.0	4.8	8.4	1.3	-2.6	-5.0	-7.4	-6.8
equals									
OECD net transfer measure on DIESA sample of countries	27.9	34.0	19.9	2.6	-3.9	-12.5	-6.0	1.6	-0.5
plus									
Difference in coverage[c]	36.8	17.3	2.4	11.9	2.7	7.6	13.5	20.6	17.4
equals									
OECD net transfer measure	64.7	51.3	22.3	14.5	-1.2	-4.9	7.5	22.2	16.9

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of IMF, OECD and the World Bank.

[a] Calculated as a residual and thus including net transfers associated with unrecorded debts.

[b] Larger number of economies covered (data reported by 111 debtor countries, with World Bank estimates for certain components), but excluding generally small amounts of short-term inter-official lending (liabilities constituting foreign authorities' reserves).

[c] Larger number of economies covered (163), with data based on reports of member Governments of OECD and estimates by the OECD secretariat.

Table IV.2. Net transfer of financial resources of the capital-importing developing countries, 1980-1989[a]

(Billions of dollars; sample of 96 countries)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Transfer through direct investment										
Net investment flow	5.5	9.0	6.4	5.5	5.6	6.3	5.6	8.7	14.1	13
Net dividends and other income	-10.5	-9.9	-9.4	-8.8	-8.0	-7.5	-6.4	-7.0	-7.8	-9
Net transfer	-5.0	-0.9	-3.0	-3.3	-2.5	-1.2	-0.8	1.7	6.3	4
Transfer through private credit										
Medium-term and long-term foreign borrowing										
Net credit flow	35.4	48.3	40.6	26.5	17.8	11.6	7.7	1.4	6.5	6
Interest paid	-24.2	-31.2	-37.2	-35.2	-39.9	-38.9	-34.6	-33.9	-39.2	-42
Net transfer	11.2	17.0	3.4	-8.7	-22.0	-27.3	-27.0	-32.5	-32.8	-36
Short-term borrowing and domestic outflows[c]										
Net transfer	0.9	-17.3	-27.2	-18.9	-12.7	-8.6	1.8	3.2	-10.1	7
Transfer through private grants (net)	1.2	1.2	1.2	1.9	2.1	2.5	3.4	3.5	4.2	4
Transfer through official flows										
Official transfers (grants)	11.1	11.7	9.2	10.2	10.7	11.5	11.1	12.3	12.4	12
Net official credits	23.2	28.8	31.6	27.7	25.0	16.5	16.0	12.0	16.0	22
Interest paid	-5.8	-6.8	-8.3	-9.7	-11.3	-12.8	-15.6	-16.9	-18.2	-22
Net transfer	28.6	33.7	32.5	28.2	24.5	15.1	11.5	7.5	10.2	13
Total transfer (financial basis)	36.8	33.8	7.0	-1.2	-10.6	-19.4	-11.1	-16.6	-22.1	-7
Use of official reserves[d]	-12.8	2.7	15.9	-8.0	-19.4	1.6	8.7	-14.4	-9.9	-17
Total transfer (expenditure basis)	24.0	36.5	22.9	-9.2	-30.0	-17.8	-2.4	-31.0	-32.0	-24
Memorandum item										
Net transfer (financial basis) on 1989 country sample and definitions[e]	36.1	36.9	9.9	-0.2	-10.0	-25.6	-17.3	-19.9	-31.2	-10

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of IMF, OECD, the World Bank and United Nations Secretariat estimates

[a] Definitions: direct investment is net of reinvested earnings (cash flow approach); official credits include use of IMF credit, and interest includes Fund charges; private grants include net flow of gifts from overseas residents (excluding workers' remittances) and grants by non-governmental organizations.

[b] Preliminary estimate; rounded to the nearest half-billion dollars.

[c] Calculated as a residual (including short-term trade financing, normal and unusual outflows ("capital flight"), arrears on interest due, and other flows captured in balance-of-payments data as "errors and omissions" and presumed to be financial flows)

[d] Additions to reserves shown as negative numbers

[e] Major difference being exclusion in estimates made last year of net private grants and data for China, and inclusion of Israel and Singapore

ter, or on a financial basis that excludes reserve changes from financial flows (see box IV.1 on this and other measurement issues).

The change seems to have been caused mainly by two developments that are not easily isolated in the data and are thus contained in the residual item denoted "short-term borrowing and net domestic outflows". On the one hand, 1988 had seen a substantial burst in outflows from developing countries, notably in Latin America, but those diminished substantially in 1989 and in certain cases, notably that of Mexico, became a significant re-flow. On the other hand, arrears on payments to foreign creditors, which rose sharply in 1988, rose again in 1989.

In addition, certain significant trends of earlier years continued in 1989. For example, the net transfer effected through direct foreign investment was again significantly positive. In the past few years, direct investment rose to appreciable levels in China and other Asian developing countries (in this case excluding the four economies discussed previously which have increasingly become a source of direct investment), as well as in Latin America and the Caribbean, the latter in part associated with schemes to swap foreign commercial bank debt into direct investment and other equity claims.

A second important and continuing development is that every year since 1982, the net transfer associated with medium-term private lending to developing countries has become more negative, amounting to a net outflow of about $36 billion last year. Net interest paid rose to $42 billion in 1989, while the net credit flow remained at $6 billion. In contrast, although net interest payments on official credits also reached a new high last year, net lending rose by more, so that for the first time since 1986 there was a positive net

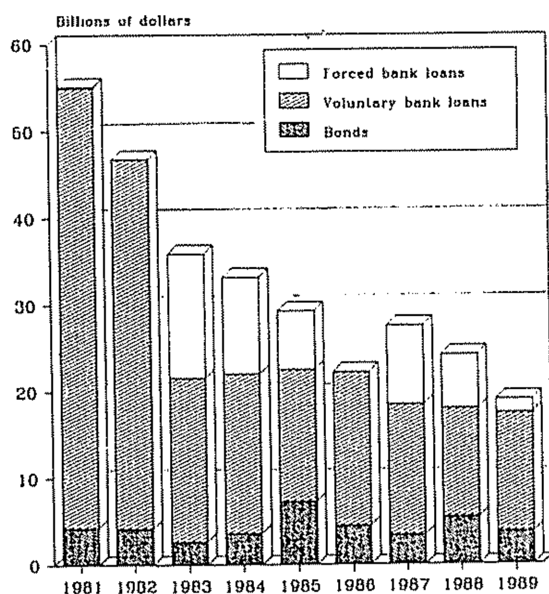
Table IV.3. Foreign debt of the capital-importing developing countries, 1980-1989

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
					Billions of dollars					
Medium-term and long-term debt	439.7	509.9	577.3	670.7	710.9	790.6	891.6	1 003.7	989.4	1 000
Official concessioal	105.2	111.8	120.1	128.4	131.2	151.8	179.2	213.8	222.4	229
Official non-concessional[b]	73.2	91.6	109.2	134.0	146.1	177.6	217.4	261.2	250.9	266
Private	261.3	306.5	348.0	408.2	433.7	461.2	495.0	528.7	516.0	506
Short-term debt	127.4	150.0	164.6	137.4	127.7	127.2	120.9	134.8	134.5	133
Total debt	567.1	659.9	741.9	808.1	838.7	917.8	1 012.5	1 138.4	1 123.9	1 133
Regional breakdown of total:										
Latin America and the Caribbean	242.7	296.5	333.5	361.1	377.3	388.4	409.2	442.4	427.5	424
Africa[c]	109.7	121.1	133.2	144.7	150.8	173.7	201.0	238.8	241.0	253
Four Asian economies[d]	43.7	49.2	55.2	60.5	61.9	67.3	71.6	73.6	69.9	64
Other Asia and Europe	171.0	193.1	220.0	241.8	248.7	288.4	330.6	383.7	385.5	393
					Percentage					
Total as a ratio to GNP[e]	27.0	29.6	34.3	39.3	39.8	42.9	45.8	47.0	40.3	40.0
Total as a ratio to exports[f]	117.8	128.5	152.4	166.9	157.9	176.0	194.9	182.7	155.6	146.5
Memorandum item										
Debt of a larger grouping of capital-importing countries (billions of dollars)[g]	656	755	841	907	939	1 044	1 149	1 296	1 284	1 299

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of IMF, OECD and the World Bank, and national sources.

[a] Estimate.
[b] Including use of IMF credit.
[c] Excluding Libyan Arab Jamahiriya and South Africa.
[d] Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.
[e] Sample of 108 economies.
[f] Sample of 114 economies; exports of goods and services.
[g] World Bank grouping of the developing countries other than high-income oil-exporting countries (principal difference with above total is inclusion of Islamic Republic of Iran, Iraq and certain countries of Western and Eastern Europe classified as "developing" by the World Bank).

Figure IV.5. Gross borrowing on international capital markets by capital-importing developing countries, 1981-89



Source: Data of OECD and the World Bank.

transfer from official credit flows that added to the positive effect of transfers through official grants.

What emerges from these trends is that the role of medium-term private finance in developing countries is winding down, while international official lending is becoming more central. Thus, while developing country debt to the foreign private sector has fallen in the past two years, debt to official creditors, especially on concessional terms, has grown (see table IV.3).

The outlook for international financial flows

Two possible trends can be discerned from recent developments. One is that international private finance will be increasingly tied to investment by enterprises and the other is that international financing of official development projects will be mainly supplied by public sources.

Developing country use of international credit markets has been low in recent years. The restraints have been both on the demand and the supply side. Since the emergence of the international debt crisis in 1982, fewer developing country Governments are deemed creditworthy borrowers. Among those that are, there has been a growing cautiousness about allowing debt-servicing obligations to grow rapidly. Indeed, excluding syndicated bank loans—often called "forced bank loans"—arranged as part of debt restructuring negotiations, developing countries have borrowed less than $20 billion a year on average since 1982 (see figure IV.5).

In the past, almost all developing country borrowing in international capital markets was by Governments or guaranteed by them. There are signs, however, that enterprises from some developing countries may now be able to tap these markets more readily than their Governments. One case in point in 1989 was the private placement of a Euro-bond for a Mexican firm, the first since 1982. State enterprises that are effectively managed may also tap such markets on the strength of their own operations. For example, the Oil and Natural Gas Commission of India borrowed in Japan's public bond market last year without a sovereign guarantee, and other Indian public sector corporations are expected to gain access to that market on a comparable basis.

With the greater internationalization of securities markets, foreign funds are also increasingly moving to the financial markets in developing countries. One widely-used mechanism for indirect investment in foreign equity shares is the American Depository Receipt, which is a United States bank-issued security backed by foreign equity shares. Chilean and Mexican firms have issued these securities and firms from other Latin American countries and the Philippines are reported to be planning such issues in 1990. In addition, mutual funds have burgeoned in recent years, many assisted by the International Finance Corporation of the World Bank, which invest in equities issued in developing country markets. Some of the funds invest in groups of countries; others in individual ones, including Brazil, the Philippines, Taiwan Province of China, Thailand and Turkey. This kind of international investment, as well as direct foreign shareholding, which is increasingly being permitted in the countries with larger domestic financial markets, can be expected to play a greater role in the 1990s.

Foreign financing of enterprises is a more narrowly targeted flow than the balance-of-payments loan of the 1970s that was syndicated among commercial banks. For different reasons, it appears that official development co-operation might also become more focused on specific programmes and projects in contrast to generalized balance-of-payments support. In part, this is reflected in the recent review of structural adjustment lending undertaken in the World Bank. It also seems implied by the politics of aid budgeting in some donor countries. "Aid fatigue" is said to make it difficult in those countries to mobilize resources for generalized official development assistance (ODA) for traditional recipients, but there is strong popular support for assistance to developing countries in the environmental, human resource and other areas that can be effectively targeted.

The outlook for the total volume of ODA flows is hard to assess. The OECD secretariat maintains a medium-term projection of "perhaps 2 per cent" growth annually in real terms from member countries.[9] Much hinges on the continued growth of Japan's aid effort. In 1989 Japan became the largest donor in the world, with aid expenditure of ¥1.4 trillion (approximately $10 billion), and the growth of ODA in its 1990 draft budget was the largest of all major expenditure categories.[10] At the same time, in the United States, formerly the largest source of ODA, Congressional voices have argued for redirecting aid to Eastern Europe; and several other countries are reassessing their aid policies.

The recently concluded renewal of the agreement between the European Economic Community (EEC) and the 68 associated African, Caribbean and Pacific (ACP) countries is also hard to assess. The new agreement, Lomé IV, commits ECU 12 billion ($14.5 billion) for expenditure under several programmes during 1990-1995, more than a 40 per cent increase over the spending under Lomé III. However, more countries have been included as potential beneficiaries.[11] The terms of assistance were improved and new programmes of co-operation were added, notably in the areas of the environment and structural adjustment. The agreement is to be a framework for co-operation for 10 years, with the financial arrangement carried in separate 5-year protocols. It is thus a renewal and enhancement of a long-term commitment of the EEC to the ACP countries, but it was clear during the negotiations that member countries of the EEC differed greatly in their enthusiasm for it, and the agreement did not dispel the apprehensions of the region that their needs might suffer as the attention of Europe turned more to the democratization movements in the East.

The Soviet Union and Eastern Europe have been important sources of aid for several countries, but such support has already been curtailed in many cases and at the moment the future of their development assistance programmes is highly uncertain. On the other hand, ODA from Arab donors may increase as firming world oil prices relax budgetary constraints somewhat. A positive sign is that resource commitments by Arab national and regional development institutions rose in 1989 after having stagnated at a low level for the previous five years (see table A.17). Based on data for the first eight months of the year, total commitments were up more than 30 per cent over the same period of 1988, the major beneficiaries of the increase being African countries.

The prospects for multilateral development assistance improved in 1989 as commitments rose to $35 billion, of which $23 billion were accounted for by the World Bank and its affiliated institutions and $2 billion were commitments for operational activities of the United Nations (see table A.16). In real terms, total commitments rose 16 per cent, led by non-concessional lending; however, they were no higher than in 1985 (see figure IV.6). Resource commitments of the International Monetary Fund jumped more than 150 per cent, reaching $14 billion (see table A.15). The new loans were in support of 23 economic adjustment arrangements, although most of the resources were committed to only three borrowers, namely, Argentina, Mexico and Venezuela.

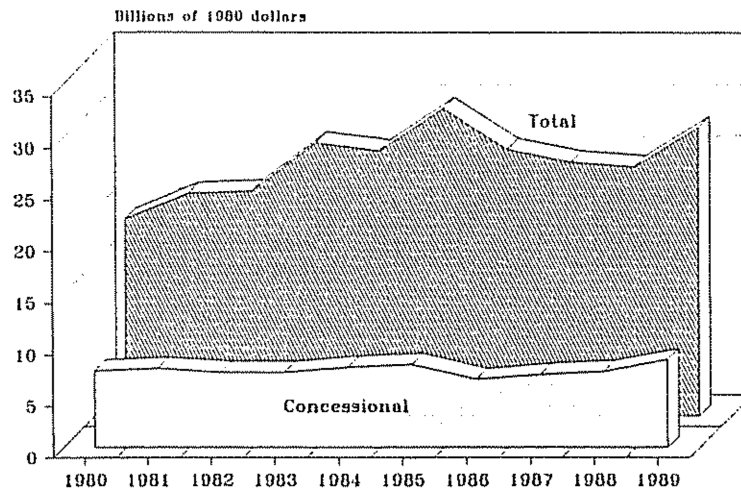
IMF support for economic stabilization and structural ad-

[9] See *Development Co-operation in the 1990s*, report of the Chairman of the Development Assistance Committee (Paris, OECD, December 1989), p. 27

[10] See Ministry of Foreign Affairs of Japan, *Outlook of Japan's Economic Co-operation* (Tokyo, February 1990).

[11] Funds were increased more than 60 per cent for the unique Stabex programme, which seeks to compensate producers for fluctuations in the prices of primary commodity exports to the EEC; but Stabex will still remain a very small programme relative to the instabilities to which the international commodity markets have become accustomed.

Figure IV.6. Multilateral resource commitments for development, 1980-1989



Source: UN/DIESA

justment continued to grow in 1989 for both low-income and middle-income countries, but the growth in commitments was concentrated in non-concessional flows for the generally higher-income countries. This notwithstanding, because of high levels of borrowing from the Fund in the early 1980s, especially by middle-income countries, most windows of the IMF were receiving funds back on a net basis. Its main net disbursements took place through the new, concessional windows, the structural adjustment facility (SAF) and the enhanced structural adjustment facility (ESAF) [12] Overall, developing countries made net repayments to the IMF of $2 billion last year. Adding IMF interest charges, their net transfer of financial resources to the Fund was about $4 billion.

Net resource transfers to developing countries through multilateral development loans rose some $3.5 billion last year, after an annual drop since 1984 had by 1988 almost turned the aggregate net transfer negative [13] The net transfer on multilateral lending did become negative for Latin America in 1987 and 1988, but has since turned positive, owing to the resurgent lending to the region, especially by the Inter-American Development Bank. Its lending capacity had been severely curtailed by the protracted negotiations of the Seventh General Increase in Resources, which were finally completed last year and will enable the Bank to approve $5 billion to $6 billion a year in loans until 1994

Multilateral concessional lending is set for further increases as the international community agreed to the Ninth Replenishment of the International Development Association of the World Bank. The IDA-9 agreement increases resources by $15 billion (plus $2 billion in repayments on earlier loans), 21 per cent more in dollar terms than IDA-8. It is available for spending during the period 1 July 1990 to 30 June 1993. The thrust of IDA lending will be on anti-poverty measures, support for economic policy reforms, and critical environmental issues. Since the requirements for additional concessional funds in the low-income countries of Asia and Africa remain urgent, sub-Saharan Africa's share of IDA-9 resources will be maintained at the 45 to 50 per cent range, depending on the countries' economic performance. The United States was the largest donor, contributing $3.2 billion, Japan was second with $2.8 billion and the Federal Republic of Germany, third, donating $1.6 billion.

Although of smaller size, it is also important to note the agreement reached after 18 months of negotiation for a $566 million replenishment of the International Fund for Agricultural Development (IFAD) for the period 1990 to 1992. The 23 per cent increase in funds renews IFAD's mandate, which targets assistance on an important and sometimes neglected population, namely, small-scale farmers in low-income countries. The agreement marks a shift in what was already a unique arrangement for financing a multilateral institution from funds of OECD and OPEC (country categories I and II). Until now, the beneficiary countries (category III), whose contributions were strictly on a voluntary basis, did not figure significantly among the Fund's contributors. However, the OECD countries have now agreed to match every dollar of category III contributions with $3 of theirs, and thus the beneficiary group has emerged as a donor group.[14]

In yet another important and long-delayed development in multilateral finance, agreement was finally reached in early May 1990 to expand the regular resources of the IMF. The agreement raises Fund quotas by 50 per cent (about $60 bil-

[12] The only other facility with a positive net flow was for compensatory financing, owing primarily to drawings by Algeria and Mexico

[13] The net transfer from lending had fallen from about $8 billion in 1984 to $1 billion in 1988, according to the data of the World Bank Debtor Reporting System (the overall multilateral net transfer to developing countries was in any event larger, as it included the foreign exchange value transferred as part of technical assistance activities, food aid and other multilateral grants)

[14] The total contributions of category III amounted to $64 million, matched by a corresponding $192 million from category I. In accordance with established practice, every dollar of OPEC contribution, which totaled $124 million, was matched by $1.50 from OECD, thereby bringing that total to $310 million

Box IV.2. Implementation of the "Wass Report" recommendations on financial flows to Africa

In February 1988, the United Nations Secretary-General's Advisory Group on Financial Flows for Africa, informally known as the "Wass Commission" after its Chairman, Sir Douglas Wass, published its report on how to improve financial transfers to Africa.[a] It recommended a target increase in financial flows and a set of measures for increasing particular types of flows. On the second anniversary of the report, one can begin to assess the extent to which the proposals were implemented.

The *overall target* was an annual increase in the net financial flow of $5 billion above what was expected to be available in 1986-1987. The target was meant to apply to sub-Saharan Africa excluding Nigeria (and South Africa). According to available data and estimates, and applying *World Economic Survey* methodology as discussed in box IV.1, the annual net financial transfer to the region was more than $1.5 billion higher in 1988-1989 than in 1986-1987. According to OECD, which, as discussed above, applies a different statistical approach and looks only at the transfer from foreign providers of financial resources and technical assistance, the net transfer in 1988 was $3 billion more than the 1986-1987 average (including Nigeria). At constant exchange rates and prices, however, OECD estimated that there was no increase in the net transfer.[b] Using a third measure that includes terms-of-trade effects and applies to Africa as a whole, the United Nations Economic Commission for Africa estimated that there was a net outflow of resources of about $6 billion in 1988 and 1989.[c]

The Wass Commission called for *conversion to grants of all bilateral official development assistance (ODA) claims* on debt-distressed countries in Africa. The proposal derived from United Nations Trade and Development Board resolution 165 (S-IX) in 1978. As at 15 October 1988, the last date at which official information was collected as part of the monitoring of this resolution, $3.3 billion in debt relief or other measures had been taken in favour of sub-Saharan countries, of which all but $315 million dated from October 1986 or before.[d] However, further debt reductions are taking place under new commitments made in 1989 by creditor Governments such as those of Belgium, France, the Federal Republic of Germany and the United States.

The Group recommended *greater debt relief in Paris Club negotiations*, where debts owed to creditor Governments are rescheduled. This was not directly implemented, but the increased legitimacy accorded to debt reduction and interest concessions by the Group may have helped to formulate the new terms for Paris Club debt relief agreed in the 1988 Toronto Summit of seven major industrial countries. By the end of last year, 15 sub-Saharan countries had benefited from the Toronto terms. However, the World Bank has estimated that the cash flow savings in 1989 in sub-Saharan Africa compared to standard reschedulings were only about $50 million. The Bank further estimated that if the Toronto terms were extended to all of low-income Africa and were offered by other official creditors as well as OECD countries, it would reduce annual debt-service obligations by 3.4 per cent of the 1988 level.[e]

Concerning *multilateral debt*, the Group recommended establishing a new facility in the World Bank for refinancing Bank loans on concessional terms for hard-pressed countries. A programme of this sort was adopted in September 1988, using credits from the Bank's concessional lending affiliate, the International Development Association (IDA), and grants from Norway and Sweden. The Group recommended that loans from the Enhanced Structural Adjustment Facility could play a similar role in the IMF, which they may be interpreted as doing.

Recommendations on *commercial bank debt* were addressed to banks and Governments. The former were en-

[a] *Financing Africa's Recovery: Report and Recommendations of the Advisory Group on Financial Flows for Africa* (New York, United Nations, *Africa Recovery*, 1987)

[b] See OECD, *Development Co-operation in the 1990s*, Report of the Chairman of the Development Assistance Committee (Paris, December 1989), p. 219.

[c] United Nations Economic Commission for Africa, *Economic Report on Africa 1990* (Addis Ababa, April 1990), para. 104.

[d] Information supplied by the UNCTAD secretariat, 30 March 1990; *The Least Developed Countries: 1987 Report* (United Nations publication, Sales No. E.87.II D 12), pp. 70-71.

[e] See World Bank, *World Debt Tables 1989-90*, vol. I (Washington, D.C., December 1989), p. 48; and "Debt and Managing Adjustment", report by the UNCTAD secretariat (TD/B/C 3/232), 6 February 1990, paras. 15-19

lion) and sets the date for completion of the next Quota Review at March 1993. This would be the standard length of time from the date that the current Quota Review was originally supposed to have been completed: March 1988. The delay in completing the Quota Review was due to difficult policy matters. One was finding an acceptable formula for reapportioning quotas and voting rights among France, the Federal Republic of Germany, Japan and the United Kingdom. Quotas reflect the economic strength of member countries, and it had become clear that the quota of Japan warranted an increase. In the end, Japan and the Federal Republic of Germany will share second place in the IMF rankings and France and the United Kingdom will share fourth place.

The other difficult policy issue that held up agreement on the quota increase was determining how to treat member countries in deep and protracted arrears to the Fund. Obligations of 11 Fund members totalling almost SDR 3 billion (more than $3.5 billion) were overdue six months or more as at late 1989. Two types of situations had to be addressed. One was when Governments in arrears wished to reactivate their participation in Fund programmes and seek Fund as-

couraged to "take special relief measures ... on a case-by-case basis". Some banks can be said to have responded through charitable swaps (e.g., in the Sudan and Madagascar). The amounts have been small, although banks have been interested in undertaking additional swaps in Africa. The Wass Commission also recommended that bilateral donors allocate funds for the purchase of deeply discounted commercial bank claims. The initial example of such a programme was, however, arranged for Bolivia in 1988. Certain cases have also been arranged in Africa, where bilateral donors participating in such arrangements have preferred discretion, as they would otherwise raise the price of such debt in the secondary market, as happened in the Bolivian case where the price rose from 6 cents on the dollar to 11-12 cents. In addition, a multilateral initiative was agreed last September at the World Bank, when a $100 million IDA facility was created out of World Bank net income to finance commercial bank debt purchases of low-income countries. However, the main recommendation of the Wass Commission concerning bank debt, that an African Development Bank proposal for debt reduction through securitization be put into practice in one or more countries, was not acted upon.

The Wass Commission also called for new financial flows. First, it proposed *expedited disbursements from the end-1987 commitment to co-finance World Bank adjustment programmes*. Of the gross commitments of $6.4 billion (about half of which were additional funds), $5.1 billion were allocated by the end of 1988. However, disbursements had totalled only $0.9 billion. The World Bank noted that "donors need to accelerate these commitments and disbursements ..." [f]

More success can be cited for the requested *speedy implementation of the replenishment of IDA and the African Development Fund*, especially in comparison with the difficulties in the previous replenishment. The ninth replenishment of IDA was agreed last December and should be in place by this June. The sixth replenishment of the African fund is scheduled this year as well.

The Advisory Group also advocated an expansion of ODA, which it suggested should be more fast-disbursing. Indeed, structural adjustment became the watchword of donor assistance programmes. The World Bank now hosts frequent donor meetings for some countries and there has been more co-financing and less aid-tying. However, OECD data indicate almost no increase in the net flow of ODA to sub-Saharan Africa in constant prices and exchange rates.[g] The World Bank staff has estimated that ODA to sub-Saharan Africa should grow 4 per cent a year in real terms in the 1990s. Although less than the rate of growth in the 1980s, even this may not be realized in the 1990s, according to the Bank, unless the share of low-income countries in ODA can be increased.[h]

Finally, the Wass Commission took up the problem of *short-term fluctuations in foreign exchange needs* and recommended that the Compensatory Financing Facility (CFF) of IMF be returned to its original role as a low-conditionality, relatively automatic and quickly available source of funds. This was not adopted as such, but the suggestion that the CFF be expanded to cover additional contingencies was. In August 1988 it became the Compensatory and Contingency Financing Facility (CCFF), wherein loans can now be extended to countries to cover part of the unfavourable deviations in a host of balance-of-payments flows that are beyond the adjusting country's control (including interest rate increases). The contingency mechanism would be triggered once net deviations exceeded a threshold level. However, as at end-1989, no African country has made use of this new Facility.

To a degree, the contingency facility can also be seen as addressing the recommendation that when economic conditions do not improve as anticipated, the repayment period should be lengthened; whereas if recovery is quicker than expected, repayment should be accelerated. CCFF drawings can have a comparable effect on cash flow to lengthening the repayment period, while the symmetry provision of the Facility could call for early repayments under favourable deviations (or it could reduce other Fund disbursements, again having a comparable effect on cash flow).

The recommendation that use of the Facility be subsidized for low income countries was not acted upon, nor was access substantially enlarged pending the Ninth Quota Review as suggested. The Quota Review itself was agreed in May of this year, but still requires implementation.

[f] World Bank, *Annual Report 1989* (Washington, D.C., 1989), p. 44.
[g] From $15 billion in 1986-1987, the net flow rose to $16 billion (for African least developed countries it went from $11.5 billion to $12 billion), according to OECD, *op. cit.*, p. 218.
[h] World Bank, *Sub-Saharan Africa: From Crisis to Sustainable Growth* (Washington, D.C.: The World Bank, November 1989), p. 179.

sistance in adjustment efforts but lacked the resources to become current on Fund obligations. For such cases, the Fund has developed a co-operative approach to the early reduction and elimination of arrears. The IMF Interim Committee at its May meeting extended this approach when it endorsed a proposal whereby a member could earn a "claim toward future financing" based on a sustained economic performance; in other words, the Fund would consider indirectly lending to countries in arrears in certain circumstances.[15]

The Interim Committee also found it necessary, however, to address instances in which members in arrears were "persistently not co-operating with the Fund". Here the Committee called for an amendment to the Articles of Agreement of the Fund by which such members would lose their voting and related rights. The discussions of this matter were difficult, but in the end it was agreed that the quota increase would not come into effect before the effective date of the amendment.

[15] The Committee also concurred with the proposal that the Fund should pledge up to 3 million ounces of gold, if needed, as additional security that borrowings from the ESAF would be repaid (see Communiqué of the Interim Committee of the Board of Governors of the IMF (8 May 1990), para. 8).

For many heavily indebted developing countries, both low-income and middle-income ones, it is now widely recognized that it makes more sense to reduce the debt or the servicing of the debt than to continue to add more loans to a stock of debt that already exceeded a country's debt-servicing capacity. Policies to implement this view with regard to the debt to official creditors of low-income countries began to gather momentum in 1988 with the Toronto Agreement on Paris Club debt and continued with several unilateral initiatives in 1989, particularly pertaining to the debt of African countries (see box IV.2).

Creditor country Governments last year endorsed the proposal of the United States Secretary of the Treasury, Mr. Nicholas Brady, under which the commercial bank debt of heavily indebted middle-income and low-income countries could be reduced voluntarily through negotiations in which "enhancements" would be offered to bank creditors, the cost of which would be underwritten by loans from the IMF, the World Bank and the Government of Japan, as well as from the reserves of debtor countries themselves. The financial markets, which had grown increasingly pessimistic about the debt problem, at first reacted positively. The perception grew that more debt would be moved off the books of the banks, albeit at a discount, and that remaining debt would more likely be serviced fully. Indeed, average prices in the secondary market for the bank debt of middle-income countries rose (see figure IV.7).

However, by the end of the year, the mood of the market again soured. The banks saw a smaller buy-back of debt than expected and concern rose over the servicing of remaining debt as the official financial community seemed to grow tolerant of rising arrears to the banks. The average secondary-market bid on the debt of the 15 debtor countries noted previously fell below one third of face value, while it was less than 10 per cent for sub-Saharan Africa, excluding Nigeria (with the debt of only four countries still in the market, compared to ten in 1987).

The negotiations with the banks were also proving difficult and protracted. In the Mexican case, intensive creditor government involvement was required to bring them to a tentative agreement in July 1989. A long period was then needed to arrange details and "sell" the package to Mexico's 500 creditor banks, final arrangements being completed only in February of this year.[16] No overall framework was set by the Mexican case, however, as subsequent Brady Plan negotiations settled on very different packages for the Philippines, Costa Rica and in March of this year, Venezuela.[17] All the agreements have been quite complicated and assessments of them have varied. However, when all the relevant aspects are taken into account, the benefits estimated are modest and the solution to the developing country debt problem seems once again to have eluded the international community.

The Mexican financial package

Mexico was seeking to cut its net transfer of financial resources abroad from 6 per cent of GDP in recent years to 2 per cent. Mexico's final agreement with its bank creditors did not reach that target. It did, however, contain elements of debt and debt-service reduction and a new money option. The agreement covered about $48 billion of Mexico's debt to commercial banks, and all holders of the debt had to participate in the package or find their claims subordinated to those of banks that did participate.

The financing package gave commercial bank creditors three options. The first was debt reduction wherein old debt would be exchanged for 30-year bonds whose interest rate would float at the changing six-month London inter-bank offered rate (LIBOR) plus a "spread" of 13/16 of 1 percentage point; the dollar value of the bonds received by a creditor bank would be at a discount of 35 per cent of the face value of loans exchanged. The second option was a swap of debt for 30-year fixed interest bonds at par, but paying only 6.25 per cent interest for dollar-denominated loans and comparable rates for other currencies. And finally, there was a "new money" option under which creditors that did not participate in either of the first two options would extend new loans to Mexico over the next four years in an amount equalling 25 per cent of their old loans outstanding; the new money loans would bear market-related interest rates of LIBOR, plus a spread of 13/16 of 1 percentage point.

Principal payments on discount and par bonds were fully collaterized by Mexico's purchase of zero-coupon United States Treasury bonds whose value at maturity will equal the face value of the maturing Mexican bonds.[18] In addition, Mexican interest payments would be partially guaranteed by a fund invested in highly liquid United States dollar assets in an amount equivalent to no less than 18 months of interest. In the event of non-payment of interest by Mexico, payment would be made from the fund until it was exhausted.

Funds for the collateral financing were provided by the IMF, Japan and the World Bank (totalling $5.7 billion) and from Mexico's own reserves ($1.3 billion). As only $5.8 billion of this $7 billion were to be available in time for implementation of the agreement, a bridge loan from commercial banks was negotiated to complete the collateral financing.[19]

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[16] The secondary market responded positively to the completion of this first Brady Plan arrangement, as bids rose from their lows of late last year (see figure IV.8).

[17] After this section of the *Survey* was completed an agreement was also reached between Morocco and its creditor banks.

[18] The Japanese Government arranged a similar, although smaller, issue of comparable bonds to back up the exchange of yen-denominated credits.

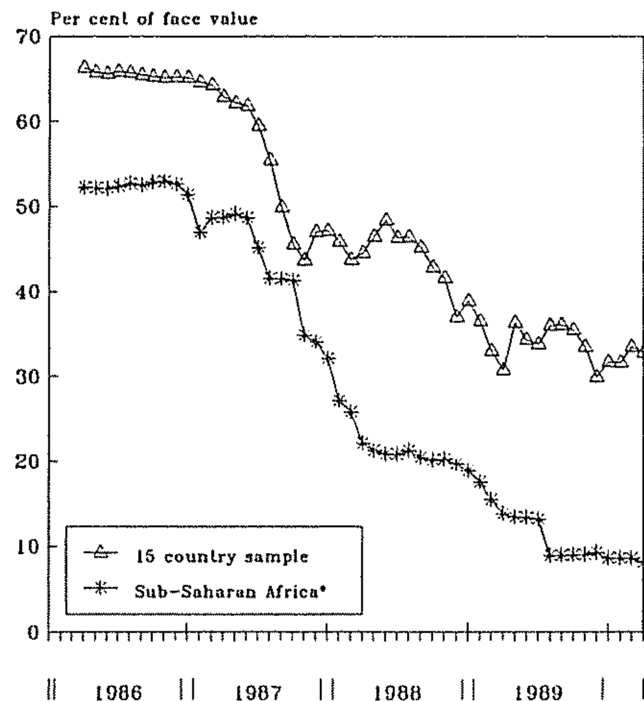
[19] Other important features of the agreement included a "recapture clause", wherein holders of par and discount bonds are entitled to additional payments in case oil prices increase over a certain percentage starting in July 1996. Also, Mexico is allowed to repurchase the discount and par bonds in the secondary market or in direct negotiations with bond holders at any time, provided it is current on interest payments on those bonds. Participating banks are also given access to a debt-equity conversion programme to be reinstated by Mexico in 1990. That programme seeks to swap up to $1 billion per year over three and a half years to finance privatization efforts and investments in infrastructure.

Most assessments of the Mexican agreement praise the breaking of new ground in assessing the debt overhang of middle-income countries, but express concern that after very considerable negotiating effort on all sides, the cash flow gain to Mexico seems rather modest. Mexico had sought a 55 per cent reduction in principal or interest rates but received essentially a 35 per cent reduction instead. Given the large proportion of the debt that was to be covered by the Brady Plan options and the limit to the funds available for setting up the collateral arrangements, the discount could not have been significantly deeper.

The reason is complicated but begins with the fact that in the first half of 1989, Mexican debt was trading in the secondary market at roughly 40 per cent of face value (see figure IV.8), which banks might have taken as an indicator of the cash value of their exposure. If the Mexican scheme had contemplated a straight buy-back, this might have been the starting point for negotiating the buy-back price. What was offered to the banks, however, was a swap into one of two types of 30-year bonds whose principal was guaranteed, but whose interest was not, save for a rolling 18-month period. Since most of the cash flow as seen from 1989 was thus not guaranteed, those bonds could be expected to trade at a discount once they were listed on any international exchange. The amount of that discount, in turn, would depend on how much of the cash flow was not collateralized and without additional resources, Mexico could offer no more than the limited interest guarantee given. The value to banks of participating in the bond-swap options was tied to the expected market value of the bond, i.e., the combined result of the two discounts. If that came to more than 60 per cent, the banks would be taking a steeper cut than they could see themselves taking individually in the secondary market.[20] In short, the size of the discount on the Mexican debt was limited by the size of the pool of funds available to provide collateral.[21]

A steeper discount could have been funded with the same $7.1 billion fund for collateral if more banks had chosen the "new money" alternative. However, banks had built up significant reserves against non-payment of their developing country loans and added substantial amounts to them in the second half of 1989, most reaching levels of 50 to 80 per cent of their Third World loans by year-end. Having reduced reported profits by the addition to reserves, such banks would be hard pressed to explain to their boards of directors making fresh loans to the very same borrowers. Indeed, the consequence for the final form of the Mexican package was that fewer banks chose the new money option than was expected in July when the agreement was first reached. This, in turn, for a while threatened successful completion of the entire exercise.[22]

Figure IV.7. Secondary market bids on bank debt of developing countries, 1986-1990



Source: UN/DIESA, based on data of Salomon Bros.
*Excluding Nigeria.

In the end, banks covering 47 per cent—about $23 billion—of the debt included in the agreement opted for the reduced interest bonds exchanged at par. Servicing these bonds will cost Mexico $1.4 billion in annual interest payments. Of the eligible debt, 41 per cent—almost $20 billion—is to be exchanged for almost $13 billion of discount bonds. Under this option and using the LIBOR in effect as at early 1990 (8.5 per cent)—the discount bonds would require annual interest servicing of about $1.2 billion. Finally, banks holding 12 per cent of the debt chose the new money option. By the end of four years, a total of $1.4 billion in new debt will therefore be contracted and serviced. This will cost Mexico $86 million in annual interest payments, on average, during the four years of the financing package, assuming LIBOR remains unchanged. Moreover, interest must still be paid on the amount of debt that was not exchanged for either type of new bond (almost $6 billion), which amounts to $536 million per year.

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[20] In the actual case, if the bonds trade at a discount of less than 38 per cent, the banks will have received the equivalent of more than 40 cents per dollar of original face value (i.e., a price that is 62 per cent of a price that is 65 per cent of original face value equals a price that is 40 per cent of the original). For an exploration of the relation between bond swaps and cash buy-backs, see Michael P. Dooley, "Self-financed buy-backs and asset exchanges", *IMF Staff Papers*, vol. 35 (December 1988), pp. 714-722.

[21] Indeed, underfunding was one concern expressed in the discussion of the Brady Plan in these pages last year (see *World Economic Survey 1989*..., pp. 75-79).

[22] Mexico and its bank advisory committee were expecting that 80 per cent of the eligible debt would be converted into new bonds. This implied that guarantees were not required for 20 per cent or $9.6 billion worth of debt. As only 12 per cent of the banks chose the new money option, additional resources to cover the guarantees on the extra $3.8 billion had to be arranged.

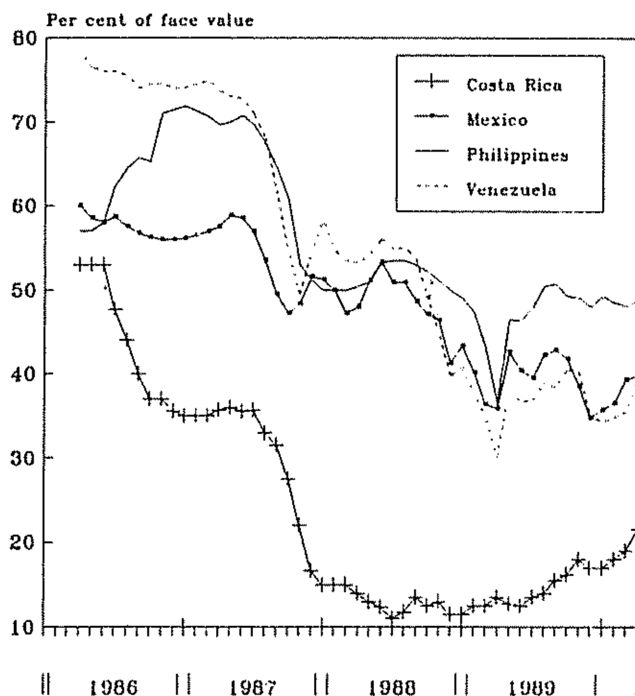
Thus the two bond options, the new money option and the part of the eligible debt that was not exchanged for new bonds, will require approximately $3.2 billion, on average, from Mexico in annual interest payments. This figure compares with an average annual interest bill of $4.5 billion on the initial debt under an assumption that it would otherwise have been rescheduled on standard terms with a grace period on principal payments that exceeded 4 years. Gross savings in interest payments derived from the accord could therefore be estimated at about $1.25 billion per year.[23]

The net savings, however, are smaller because, as noted above, the agreement requires that Mexico provide guarantees for principal repayments and part of the interest bill. The first guarantee was effected through purchase of the 30-year zero-coupon United States Treasury bonds. A total of $35 billion in Mexican bonds needed to be covered in this way. After negotiations with the United States Treasury, an interest rate of 8.05 per cent on these bonds was agreed upon, which meant an outlay of $3.5 billion to purchase the bonds this year. Guarantees for a minimum of 18 months' worth of interest payment on the discount and par bonds required another $3.9 billion. Total resources necessary to enhance the bonds thus amounted to $7.4 billion, although $7.1 billion was the amount finally committed.[24]

Mexico's need to invest in these debt enhancements using both borrowed money and its own reserves carried a cost in terms of servicing the borrowed funds and—in the case of the reserves—in terms of interest earnings forgone. This comes to an annual average of almost $350 million per year during the period.[25] Deducting this from the gross savings of $1.25 billion, the estimated net average annual benefit in terms of interest payments shrink to little over $900 million, which corresponds to only 10 per cent of Mexico's total interest bill in 1988.

There was, however, one further advantage claimed for the agreement for Mexico, namely, that it indirectly served to reschedule most commercial bank principal payments for a long period. Had the previous schedule of principal repayments remained valid, Mexico would have had to transfer $2.8 billion abroad annually, on average, during the four-year period.[26] On the other hand, Mexico would surely have successfully arranged a conventional rescheduling had it chosen to follow that route, which is to say this benefit could have been obtained by other means. Moreover, Mexico has had to sequester $1.4 billion of its reserves, although that was offset by the inflow of new money from the banks of the same magnitude.[27] Consequently, comparing the net expected cash flow under the agreement with the previously scheduled cash flow, Mexico's benefit from the agreement would appear to be $3.4 billion a year for four years, or roughly 2 per cent of Mexico's GDP, well below the savings of 4 per cent that Mexico was aiming at.[28] Comparing the benefits Mexico received under the agreement to what might

Figure IV.8. Secondary market bids on bank debt of Brady-Plan countries, 1986-1990



Source. UN/DIESA, based on data of Salomon bros

[23] Interest rates have decline since the agreement was drafted. The base case considered during negotiations had been LIBOR equal to 10 per cent, under which the gross interest savings would have been $427 million more per year. Indeed, for every percentage point that LIBOR declines, Mexico "loses" about $285 million in annual gross savings of interest payments on this part of the negotiated package, as the difference between the floating international interest rate and the fixed rate of 6.25 per cent diminishes. Likewise, an increase of LIBOR by 1 per cent would raise relative interest benefits by the same amount.

[24] The original commitment was for $7 billion and the difference had to be resolved by a final supplementary negotiation, the result being that Mexico would use $100 million more from its reserves and the initial interest guarantee fund would be reduced, so that by reinvesting the interest earned by the fund the full guarantee amount would be in the fund by the end of 18 months.

[25] Mexico will incur an annual net interest cost on the order of $270 million a year in buying the $3.5 billion of zero-coupon United States Treasury bonds (assuming that the interest rate on loans from official creditors averages about 7.7 per cent). For the funds used as interest collateral, the interest earned by the fund will be approximately the same as the interest paid to the official creditors who supplied some of the funds and the interest forgone on Mexico's own contribution. Expenses and revenues attributable to the interest guarantee fund therefore will cancel out with one exception, which is that the interest earned in the first year has to be added to the fund instead of being paid to Mexico. This comes to over $300 million which, annualized over four years and added to the $270 million, gives the estimate stated in the text.

[26] Based on data of World Bank Debtor Reporting System

[27] Borrowing from official creditors and the commercial bank bridge loan does not represent a net inflow of capital, since these funds cannot be used in the domestic economy as they are sequestered for the guarantees.

[28] Calculated at LIBOR of early 1990 (the interest benefit *per se* in this comparison would be lower than in the base case considered in the text, as making scheduled principal payments would reduce interest due on the diminishing debt outstanding each year).

otherwise have been expected under a conventional rescheduling, the gain in cash flow was less than $1 billion a year.

In sum, although Mexico's 1989 debt agreement provided a measure of relief in net financial transfers abroad, it will be mostly brought about by the restructuring of principal repayments and not by the mild benefit induced by the reduction in interest payments or in debt itself. Although $7 billion of debt was written off in the exchange for discount bonds, debt also increased by about $7 billion: $5.7 billion from official creditors and $1.4 billion from the new money option provided by the banks.

Moreover, a serious consequence of this effort to offer a range of options to creditors is that a majority of Mexico's commercial creditors chose one of the exit routes. Except in a few cases, banks have thereby taken losses and would not soon be likely to offer new money loans as well. Also, Mexico's debt is now less subject to formal debt renegotiation. Borrowings from multilateral institutions are not rescheduled on principle and bonds are not easily restructured. Yet, although major principal payments have been deferred deep into the future, they are in a sense already prepaid through the guarantee scheme. But Mexico's overall interest burden has hardly been lightened and could prove excessive in the future as it has in the past.

All this notwithstanding, private financial flows to Mexico could quickly resume if Mexicans who have moved assets abroad because of uncertainty over domestic policy-making under the debt overhang now bring home their "flight capital". They would be attracted by the relief the package brings to the economy, and the ensuing resurgence of economic growth. Indeed, there were signs that confidence in the Mexican economy grew in 1989 as the debt negotiations progressed. For example, interest rates on domestic Government debt receded significantly after the announcement of the foreign debt package.[29] Private inflows of capital increased in 1989, although it is not possible to isolate the stimulus from increasing confidence and that from very high real domestic interest rates. Moreover, those funds have been volatile in the past and are quick to leave when economic difficulties loom. Indeed, Mexico still faces some difficult adjustments in its trade balance and a resurgence of rapid economic growth is not currently foreseen.

Mexico is thus becoming greatly dependent on multilateral institutions and other official creditors for new financing. There is a risk in using funds originally intended to finance development efforts to cover balance-of-payments difficulties tied to the debt overhang. Part of the $2 billion Mexico will receive from the World Bank to enhance the financing package was deducted from previously approved loans for fertilizer, agriculture and steel in the Mexican economy.[30] It can be asked whether these moneys would have produced greater benefits for Mexico had they supported the investments for which they were originally approved.

The Philippine agreement

Soon after Mexico reached preliminary agreement with its bank creditors in July, the Philippines did the same in August. The Mexican case, however, had not provided a model for the Philippine negotiations. The latter produced an agreement consisting of two options: a new money scheme and a buy-back operation. Banks could also opt not to participate in the accord and in this sense the proposal was less binding on commercial banks than the Mexican agreement. Indeed, the Philippine agreement was negotiated much more quickly and was a far less contentious negotiation than the Mexican case. On the other hand, in both cases it took half a year from preliminary accord to final agreement.

In the end, approximately $1.3 billion in old loans were purchased for cash at a discount of 50 per cent of their face value. This roughly corresponds to the discount offered on the Philippine debt in the secondary market (see figure IV.8). Funds for the buy-back operation largely came from new loans by the IMF, the World Bank and Japan, although the Government also drew $90 million from its own reserves.

The new money option in the Philippine accord took the form of an issue of United States dollar bonds by the Philippine Central Bank bearing a floating interest rate equal to six-month LIBOR, plus a spread of 13/16 of 1 percentage point. The bonds will mature in 15 years and have a grace period of eight years. The Government was aiming to obtain $1 billion under this option, but when the negotiations concluded in late February only about $700 million were provided by over 80 banks.

The net impact of the agreement on the interest obligations of the Philippines was virtually nil. The writing-off of $1.3 billion of debt itself saved over $120 million in annual interest payments (at interest rates in effect in early 1990). But against such savings must be set the expense the country incurs in interest on the funds borrowed for financing the buy-back operation (and the opportunity cost of interest forgone on the reserves used) as well as the interest on new loans. These expenditures amount to over $115 million per year, for a net saving of only $6 million annually.

This notwithstanding, the Philippines gained from the elimination of principal payments on the repurchased debt, and since little principal is to be paid on the new loans in the near future, the annual gain in debt-servicing payments is almost $100 million a year.[31] As in the case of Mexico, the financial benefit of the agreement is thus more analogous to that of a conventional rescheduling than a debt reduction. Indeed, there was virtually no debt reduction: although $1.3 billion of debt were retired, this was mostly offset when the country borrowed $560 million to write the old debt off and issued new bonds of $700 million. Moreover, this agreement—even though the Government raised only 70 per cent of the targeted $1 billion—when added to the Multilateral

29 On the date the draft agreement was announced, 27 July 1989, annual interest rates on the 28-day CETES (Treasury Certificates) dropped by 12 points to 34.6 per cent (by year-end, nominal interest rates had again risen, although real interest rates continued to fall)

30 *World Bank News*, 1 February 1990.

31 Based on pre-existing principal repayment schedules as per World Bank Debtor Reporting System

Assistance Initiative for the Philippines will significantly increase the total size of Philippine debt. The debt-reduction aspect of the Philippine negotiation thus provided little more than what earlier "menu options" of the international debt strategy had provided, namely, an exit vehicle for those commercial banks—generally the smaller ones—that would take a partial loss as the price of not having to participate in further lending.

The Costa Rican agreement

Costa Rica is the third country to reach tentative agreement on debt restructuring under the Brady Plan. This was at the end of October 1989 and the final package was not yet agreed as at late March of this year. None the less, the basic structure of the agreement has been settled. It comprises buy-back and debt conversion operations and rescheduling of interest arrears. No option for new money was included in the agreement.

Banks will be given only two choices: (a) they may tender their loans for cash at a price to be announced by Costa Rica, which is expected to be very close to the secondary market prices;[32] and (b) loans not tendered will be exchanged for bonds at par paying an annual fixed interest rate of 6.25 per cent.

An incentive was built into the agreement for banks to participate in the buy-back option. Those creditors that tender more than 60 per cent of their Costa Rican exposure for buy-back will receive a more attractive bond for their remaining loans outstanding: it will have a 20-year maturity, a grace period of 10 years, and will be backed by a one-year rolling interest guarantee facility similar to the Mexican facility. Creditors that offer less than 60 per cent of the value of their loans will be given a 25-year bond, with 15 years' grace and no guarantee on interest payments for the remainder of their exposure.[33]

In addition, Costa Rica had accumulated about $325 million in interest arrears that have to be settled. Past due interest will be treated as follows: first, much will be extinguished through the buy-back process (in the same proportion as the buy-back of the original debt itself); for the rest, Costa Rica will make a down payment of 20 per cent of the nominal value and the balance will be rescheduled as a 15-year loan, with no grace period and paying the floating interest rate of LIBOR plus a spread of 13/16 of 1 percentage point. Again, those creditors who tender more than 60 per cent of the arrears owed them are set apart from the rest. Interest payments on their loans will have a three-year rolling interest guarantee.

The agreement has the financial support of the IMF, the World Bank and other official creditors who will make available over $250 million for the buy-back and guarantees on interest payments. The two multilateral financial institutions alone are expected to contribute more than $100 million to the financing package. This in itself is one of the remarkable features of the Costa Rican agreement, i.e., the multilateral financial institutions—not to mention the banks—considered Costa Rica eligible for the Brady initiative even though it had substantial interest arrears outstanding. It raised expectations among other debtors that are also in arrears that accumulated past-due interest would not have to be paid before qualifying as candidates for debt negotiations under the Brady Plan.

How much benefit Costa Rica derives from the agreement will depend on the choices creditors make. The Government is seeking to retire about two thirds of the country's commercial debt. With commercial banks holding about $1.5 billion of Costa Rica's long-term debt plus $325 million of arrears and assuming that 67 per cent of it is tendered for cash, the country will be able to cancel $1.2 billion of its debt. This would leave almost $500 million of original debt to be exchanged for fixed interest bonds whose servicing would cost Costa Rica $30 million per year. In addition, the interest arrears that were not repurchased for cash would be rescheduled as discussed above and interest on that would amount to about $8 million a year over the next four years. Set against a hypothetical standard rescheduling with a grace period of four years or more, the buy-back operation and the debt conversion would thus bring Costa Rica a gross saving in interest payments of about $128 million a year over the next four years.

However, as in the preceding cases, net interest savings are less than the gross cuts. Interest on the funds borrowed for the buy-back operation amount to another $15 million per year.[34] Consequently, net savings in interest payments would come to about $114 million per year, compared to a conventional rescheduling. Moreover, the stock of debt would be reduced by over $1 billion, which corresponds to over 21 per cent of Costa Rica's total debt at the end of 1988.

However, what appears to be a significant interest concession by the banks may have been accepted by them mainly because, in fact, Costa Rica was not making its contracted interest payments and was not expected to resume them in the near future. Indeed, in 1987 Costa Rica paid only $37 million in interest on medium-term and long-term bank credits, down from $212 million in 1985.[35] It paid slightly more in 1988 and 1989. Thus, the agreement does little more than

[32] Costa Rica's debt traded at 14-18 cents to the dollar in the secondary market in the second half of 1989 (see figure IV.8) and averaged 16 cents, the price used in the calculations discussed here.

[33] Holders of new bonds are also granted the right to participate in debt-equity swaps. The bonds may be converted into local currency investments up to $20 million annually for a period of five years. The package also includes a recapture clause by which bond holders will be entitled to an increase in the value of their bonds in case Costa Rica's real GDP rises 120 per cent above its level in 1989. Additional payments, however, will not be greater than 4 per cent of the value of bonds plus rescheduled interest payments (see Economic Commission for Latin America and the Caribbean, *Preliminary Overview of the Latin American Economy 1989* (LC/G.1586), 20 December 1989).

[34] Resources borrowed to provide interest guarantees would not be a net cost for the country as the interest the guarantee fund receives would roughly cancel out the interest that Costa Rica would pay to the providers of the funds.

[35] Based on data of World Bank Debtor Reporting System.

recognize the order of magnitude of interest payments that Costa Rica has been able to make in recent years. This is not an achievement to minimize, but it nevertheless would not make a substantial contribution to raising the net financial transfer to Costa Rica. And lastly, the targeted retirement of two thirds of the commercial bank debt (including accumulated arrears) may not even be fully realized.

The Venezuelan agreement

On 20 March 1990, after more than a year of on and off negotiations, Venezuela and its commercial bank creditors agreed to the basic terms of the latest Brady Plan debt package. It is impossible to properly assess that package with the fragmentary information at hand—indeed, the proportion of banks that will take the different Venezuelan options is not yet known. It is appropriate, however, to outline the basic features of the agreement, if only because the riots in Venezuela one year before were among the most dramatic manifestations of the debt crisis and undoubtedly underlined the need for a new departure in international policy on debt, to which the Brady Plan may be seen as a response.

The Venezuelan package, covering about $20 billion of outstanding debt, includes the following major options: (a) Debt reduction, following the Mexican model, through a swap into bonds at a 30 per cent discount, paying interest at LIBOR plus 13/16 of 1 percentage point, combined with guarantees on principal (in the form of zero-coupon United States Treasury bonds) and 14 months of interest, the two underwritten by loans from the IMF, the World Bank, Japan and Spain, as well as by Venezuela's own reserves; (b) A swap at face value, but paying a fixed interest rate of 6.75 per cent, again with guarantees and following the Mexican design; (c) A debt buy-back, as in the Philippine and Costa Rican agreements, with the discount expected to be on the order of 60 per cent; (d) A swap into a new type of bond at face value but paying temporarily reduced interest rates of 5 per cent for two years, 6 per cent in the next two years, 7 per cent in the fifth year and LIBOR plus 7/8 of 1 percentage point for the following 12 years, with the low interest rates collateralized by a 1-year interest guarantee fund; and (e) New money loans (15-year maturity carrying an interest rate of LIBOR, plus 13/16 of 1 percentage point).

Besides the novel option of a temporary interest rate reduction, options (a) and (b) would have stronger recapture clauses than agreed in previous cases. These would be tied to the price of oil after six years; Venezuela would pay the bond-holders additional amounts semi-annually as long as the oil price remained above the threshold of $26 per barrel.[36] Finally, Venezuela agreed as a prelude to the next stage of the negotiations to pay all of its interest arrears to the banks and to assist in this, the Bank for International Settlements is to lend Venezuela $400 million on a short-term basis.

Conclusions

Based on these four debt negotiations, it seems that the current international strategy for restructuring commercial bank debt is thus far not providing debtor countries with enough relief in their net transfer of financial resources to take them out of their debt trap. The bellwether Mexican agreement has not produced an interest-service ratio that is regarded by the international banking community as within limits for normal lending operations. Net debt reduction was too mild for any improvement in the country's debt to GNP ratio. In short, the country is not yet restored to creditworthiness.

The emphasis on debt and debt-service reduction, and the various mechanisms and officially supported enhancements by which it was applied, led most of Mexico's creditor banks to opt for the exit routes. "New money" was the alternative to improved resource transfers through debt reduction, but this was extremely difficult to arrange in needed amounts. In the Philippines, the hope that $1 billion in fresh resources would be contracted turned out to be overly optimistic. The Costa Rican agreement did not include a new money option at all, and the Venezuelan agreement is too preliminary to assess.

In sum, after a year of experience, the Brady Plan does not seem to be the solution so long sought for the debt crisis. It can be argued, though, that if the alternative to the Brady Plan were full servicing of the debt, the Plan would offer considerable long-term benefits. In any case, because debt reduction seems to obviate the possibility of new lending in the short run by the lenders that incur losses, debt reduction has to be quite steep to have a substantial impact on the net transfer of financial resources. As noted in discussing the case of Mexico, the pool of official loans and Mexico's reserves limited its degree of debt reduction. To make debt reduction an effective tool to improve financial resource transfers under the current approach of negotiating voluntary restructurings with banks requires a substantially larger commitment of official resources. Otherwise, debt reduction is a marginal exercise serving mainly to help disaffected creditors exit from the debt renegotiation process. Thus, the Economic Commission for Latin America and the Caribbean (ECLAC) has recently estimated that a tripling of public resources for debt reduction to $90 billion would be required to eliminate the debt overhang with the type of operations used in the Brady Plan.[37]

But a larger commitment of official resources to finance debt reduction would not be a prudent or efficient use of those resources. Although helping banks to accept losses through the various swaps and buy-back schemes is not what is usually meant by "bailing out the banks", these arrangements do serve to transfer at least some risk from private creditors to public agencies that were established by Govern-

36 The entitlements to the supplementary payments are to be in separate certificates from the bonds themselves. and the banks would be able to sell them in the financial markets independently of the bonds

37 In the ECLAC proposal, the paid-in portion, which might be contributed by ten or more Governments, would be only 5 to 10 per cent of the $90 billion total. This was part of a multidimensional proposal to strengthen and amend the Brady Plan by increasing the flexibility of resource use (including more "front-loading" of resource flows) and increasing the clarity and encouragements in international and creditor country policies on debt. One option also considered is establishment of a debt facility based on the Brady Plan (see ECLAC. *Latin America and the Caribbean: Options to Reduce the Debt Burden* (LC/G 1605 (SES 23/5) of 19 March 1990)

ments for very different purposes. What they do best is allocate investable resources to finance balance-of-payments adjustment and long-term development programmes and projects.

Meanwhile, some heavily-indebted countries have turned to unilateral debt-servicing moratoriums when the debt-servicing burden seemed to become oppressive and neither they nor—by and large—their bank creditors have tried to force the issue in the courts or in international negotiating forums. In certain cases, notably those of Bolivia and Costa Rica, the unilateral payments restrictions lessened the resource drain in the short run and in the context of effective domestic adjustment policy paved the way for formal debt-reduction agreements.[38] Of itself, reduction or even elimination of debt servicing does not transform economies. But when domestic impatience with economic stagnation and instability reaches a critical mass and serious economic reforms enter the political agenda, orderly reduction of debt and debt servicing can play a crucial role in supporting the economic transformation process.

Indeed, the time may finally be approaching when the international community could pledge itself to end the developing-country debt crisis instead of just managing it. One reason is the growing recognition of the minor results of the major recent negotiations on debt restructuring. There is increasing disenchantment even among creditors with the interminable sequence of debt negotiations. Even in the case of debtors that have recently obtained debt restructuring agreements which both sides hail as breakthroughs, the betting in financial markets is not on whether they will need to return, but when. Second, the refusal of debtors to service their debts is adding a new pressure to seek a genuine solution and minimize disorder. It might therefore be opportune to try to reach a new high-level intergovernmental understanding on debt which would give expression to the mutual interest of creditors and debtors in restoring debt-servicing capacity and an acceptance of the need to postpone regularizing debt-servicing obligations until there has been progress on adjustment.

Why might creditor Governments come to a negotiating table to discuss reaching such an understanding? Because they begin to believe that the alternative is default—whether or not debtor countries openly proclaimed their debt-servicing intentions—or possibly, political disruption. Debtor-country governments might come because an accepted and conciliatory settlement is better than a conflict with the creditors, and because international backing is essential to mitigate the strains of adjustment and overcome the domestic opposition to it.[39]

The obstacles to an agreement on how to deal with the many different debt problems are many and real. But all sides have learned much in recent years, and realistic options are beginning to seem attainable. What will happen if a co-operative scenario for a negotiated solution does not materialize soon? More muddling through, more financial chaos in debtor countries, more arrears, more stagnation, more political disarray, more wasted opportunities.

The reform effort in Eastern Europe and the Soviet Union

In most years of the 1980s, most of the European centrally planned economies made net outward transfers of financial resources. In some East European countries, these negative transfers followed a period in the 1970s of substantial positive transfers, financed by unsustainable rates of borrowing from international financial markets. As figure IV.9 indicates, the experience of Hungary with respect to both the drop in the aggregate net transfer and the share of investment in output mirrors closely that of the heavily indebted developing countries.[40] But even a country such as Czechoslovakia, which did not build up a large debt burden in hard currency, saw its net transfer turn negative in the 1980s.

The domestic nature and unusually severe dimensions of the crisis in Poland in the late 1970s stand out as well, as the virtual collapse in investment preceded the decline in the net resource transfer. One reason why the net resource transfer remained positive in 1981 when Poland's relations with its commercial bank creditors had already soured was assistance from the Soviet Union. In fact, the net resource outflow of the USSR over the past 20 years mostly reflected policy-directed transfers to other countries, particularly within the CMEA, but also outside. One consequence has been the growth of indebtedness of developing countries to the USSR—albeit generally on concessional terms—which reached $132 billion as at 1 November 1989.[41]

In the 1990s, the Soviet Union will presumably need to

[38] See ECLAC, *Latin America* ..., chap. V.

[39] Some are hurt by adjustment, others by lack of adjustment, but programmes to ameliorate the social impact of adjustment would surely be part of the discussion.

[40] The data in figure IV.9 are not fully comparable with those shown in figures IV.2 and IV.3 for developing countries, since output is measured here in terms of net material product (NMP) whereas GDP is the conventional measure of output in most developing countries (also, investment is measured net of depreciation here and is gross in the developing country statistics). Moreover, major data revisions are being published by the authorities in Eastern Europe and the Soviet Union and so all data in this section should be interpreted as estimates that are subject to revision (see "New thinking about national statistics" in *Economic Survey of Europe in 1989-1990* (United Nations publication, Sales No. E.90.II.E.1), box 3.1). The basic trends and patterns in the data, however, are believed reliable (figure IV.9 excludes Bulgaria, the German Democratic Republic and Romania owing to the unavailability of sufficient data with which to construct estimates at this time).

[41] The credits were concentrated on three developing country members of CMEA, namely, Cuba ($26 billion), Mongolia ($16 billion) and Viet Nam ($15 billion); European member countries of CMEA generally owed smaller amounts, although Poland's debt amounted to $8 billion (all amounts valued at official exchange rate, based on *Izvestia*, 1 March 1990).

devote more of its own resources to domestic development and even to supplement these with resource transfers from abroad. Indeed, for reasons involving Soviet trade policy, as discussed in chapter III, the USSR became a net recipient of financial resources from both the CMEA area and the convertible currency area in 1989 (see tables IV.4 and IV.5). In the convertible currency area, the net transfer came about through extensive foreign borrowing by the Soviet Union and through sales from monetary gold stocks.[42] In the CMEA area, resource transfers are effected in a more complex and, particularly in 1989, a somewhat contentious manner.

Financial resource transfers within the CMEA and the payments mechanism

As defined in the present chapter, a country makes a net financial transfer abroad when its overall balance of trade, broadly construed, is positive, and *vice versa*. Similarly, each of a country's bilateral trade imbalances entails a net bilateral transfer; but if trade with each partner is valued using essentially the same prices, if the terms of the net financial transfers with all trade partners are comparable, and if the size of the overall net transfer is acceptable, a country is not likely to worry about the size of individual bilateral transfers. Positive ones with some countries would be offset by negative ones with others. The difficulty in the CMEA has been that different prices were used for valuing trade with different CME partners,and especially with market economy trade partners, and the terms for settling intra-regional trade imbalances were quite different from the terms for settling external ones.

Almost all trade within the CMEA takes place under a framework of bilateral trade and payment arrangements and their annual supplements (protocols). Although this is a form of barter trade in which exports are exchanged for an equal value of imports, it would be inconvenient to require the value of trade with each partner to balance each year. Instead, whenever a country is a net importer with a particular trade partner, it clears the excess of imports over exports using a single monetary unit called the transferable rouble, held in accounts in the International Bank for Economic Co-operation (IBEC) in Moscow.

Despite the name, a transferable rouble balance will not generally be accepted as payment for imports from another partner, as the latter wants payment in exports under the terms of trade negotiated between them, and the requisite goods have not been available for export. In other words, owing to the incompatibility of trade prices among different partners, each country separately manages each of its bilateral trade balances with each CMEA partner country and has additional arrangements for tourism, interest and other service flows. The intention is that bilateral surpluses would generally be eliminated by offsetting bilateral deficits in later years. But if goods desired by surplus countries are not available for export by deficit countries, accumulated clearing imbalances may become very large. They then need to be converted into inter-state or inter-bank loans or special negotiations may be undertaken to work down the balances.

Countries in which annual bilateral surpluses exceed the annual bilateral deficits within the CMEA build up their total holdings of transferable roubles. These accounts earn interest, but the interest is a claim on the IBEC and not on any particular trading partner until accounts are settled at the end of the year when the interest is divided among trading partners in proportion to the final surpluses and deficits. The net bilateral balances then become part of the planning of the next year's trade agreements; but in fact, agreements are not always adhered to and surplus positions can be hard to turn into desired goods. Thus, as the IBEC is not itself involved in the bilateral trade negotiations, interest earnings and surpluses are illiquid during the year and sometimes rolled forward into future years. The annual intra-CMEA trade deficits are thus paid for with financial assets that effectively have the characteristics of interest-free loans of indeterminate duration.

Countries that run protracted and considerable intra-CMEA trade deficits consequently enjoy a substantial net transfer of financial resources from their partner countries on what seem to be highly concessional terms. This was apparently the case for much of the 1980s for Bulgaria, Czechoslovakia and Poland (see table IV.4).[43] The bulk of the transfer was made by the Soviet Union, but the transfers from the smaller economies of Hungary and Romania had a relatively bigger economic impact for them.[44] In any event, the pattern of transfers within the European CMEA countries changed in the past two years, with the USSR becoming the primary recipient of these resource transfers and the six other countries providing them.

It is not surprising that member countries of CMEA that make such intra-regional transfers have sought to redirect their exports away from their CMEA partners or to change the basis on which the CMEA trade is carried out. Indeed, Hungary decided to revoke all licences for exports denominated in transferable roubles as of 18 January 1990.[45] Hungary and the Soviet Union also recently agreed to place their trade on a convertible currency basis, at least in the limited sense of using imputed world market prices to value the trade and convertible currency accounts to measure *ex post* imbalances. Poland and the Soviet Union agreed in late March to place 15 per cent of a reduced level of trade in 1990 on the

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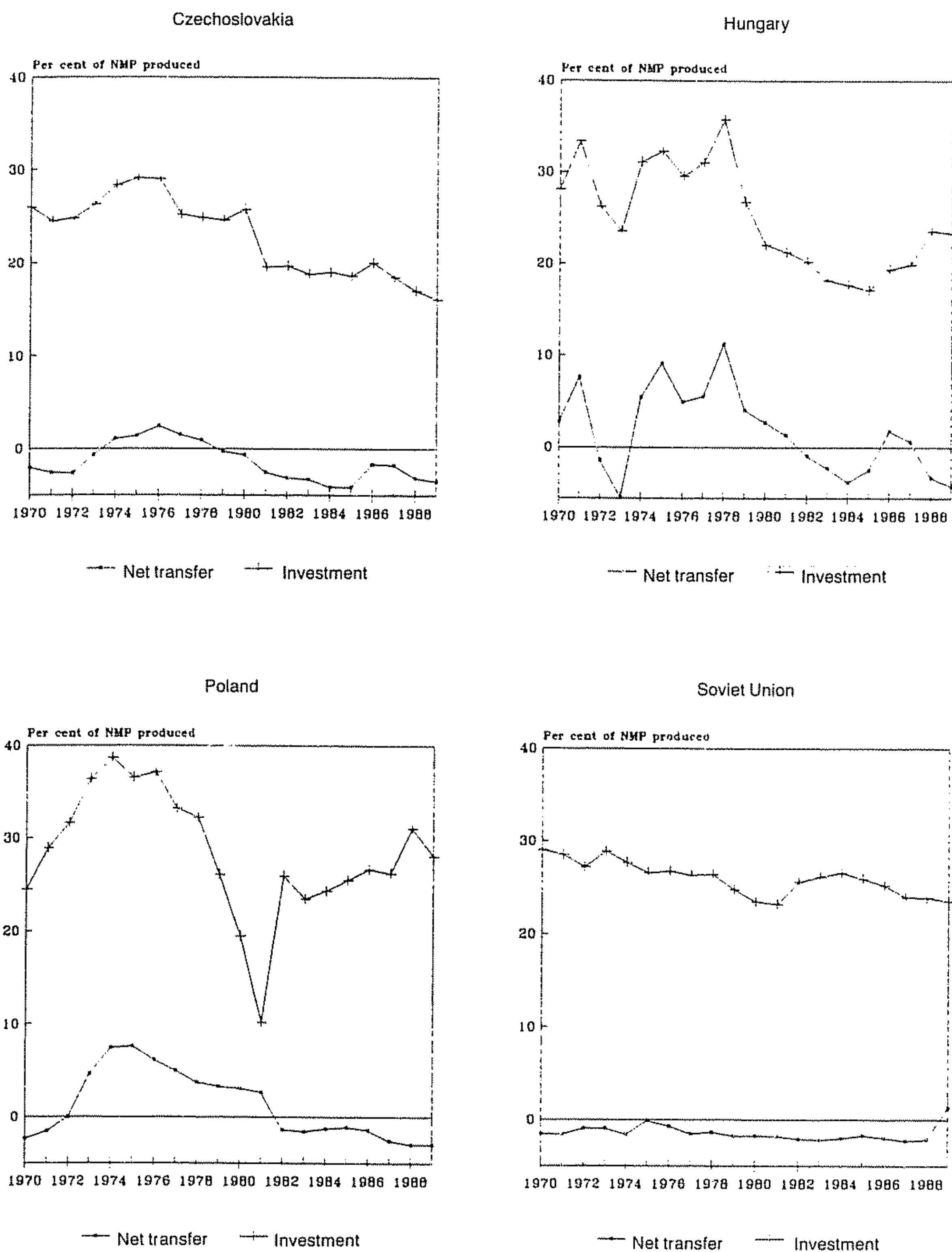
42 See *Economic Survey of Europe* ... section 4.3 (iv)

43 Taking the negative of the trade balance as an indicator of intra-CMEA net financial transfers is at best a very proximate measure, first because of the trade valuation problems discussed in the text, but also because the balance on non-capital services can in certain cases be significant. Although a variety of intra-CMEA flows of non-capital services can be identified—such as transportation (including transit fees for natural gas pipelines), operation of military bases in foreign countries, and tourism—systematic data on the value of such flows are not available.

44 Hungary transferred 1.3 per cent of NMP, on average, from 1980 to 1989 (incompatibilities between prices used for internal and external activity preclude making similar calculations for other countries except Poland, and that only from 1982; its net transfer until 1986 was an inflow that averaged 0.7 per cent of NMP, although thereafter it became an increasingly large net outflow)

45 See *Magyar Hírlap* (Budapest), 19 January 1990, p. 1

Figure IV 9   Net transfer of financial resources of four planned economies, 1970-1989



Source: UN/DIESA, based on national data and ECE estimates.

Table IV.4. Net financial transfer arising from trade among European CMEA countries, 1980-1989[a]

(Billions of transferable roubles)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Bulgaria	0.3	0.6	0.6	0.4	0.3	0.2	--	-0.1	-0.1	-1.6
Czechoslovakia	0.2	0.1	0.3	0.6	0.8	0.7	0.7	0.2	-0.4	0.1
German Democratic Republic	0.2	0.3	0.1	-0.7	-0.7	-0.5	0.1	-0.3	-0.4	-0.8
Hungary	--	-0.4	-0.4	-0.3	-0.5	-0.7	-0.1	-0.2	-0.7	-0.8
Poland	0.8	1.6	0.6	0.5	0.7	0.6	1.0	-0.2	-1.3	-1.7
Romania	-0.1	0.1	-0.2	-0.1	-0.2	-0.3	0.4	--	-0.3	0.5
USSR	-1.8	-3.1	-2.0	-1.6	-1.9	-0.9	-2.6	-0.1	2.4	4.1

Source: Department of International Economic and Social Affairs of the United Nations Secretariat and Economic Commission for Europe

[a] As indicated by negative of balance of merchandise trade with other European CMEA countries (intra-CMEA trade balances do not sum to zero owing to trade valuation differences, asymmetries in the dating of trade flows and the need to estimate flows in certain cases).

[b] Preliminary estimates

Table IV.5.

Net financial transfer of European CMEA countries in convertible currencies, 1980-1989

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
Bulgaria	-1.3	-0.9	-1.0	-0.7	-0.8	-0.1	0.9	0.2	0.9	1.1
Czechoslovakia	--	-0.4	-0.5	-0.8	-1.0	-0.7	-0.4	--	0.1	-0.3
German Democratic Republic	0.4	-1.3	-2.5	-2.1	-1.7	-1.8	-1.4	-1.6	-0.2	-0.4
Hungary	--	-0.4	-0.7	-0.8	-0.9	--	0.5	-0.1	-0.3	--
Poland	0.5	0.4	-0.7	-1.3	-1.8	-1.9	-2.0	-2.4	-2.3	-0.9
Romania	1.6	-0.2	-1.7	-1.6	-2.2	-1.5	-2.0	-2.4	-4.0	-3.7
Eastern Europe	1.1	-2.7	-6.9	-7.3	-8.5	-6.1	-4.5	-6.4	-5.9	-4.2
USSR	-4.7	-0.3	-5.5	-7.3	-7.9	-1.9	-2.6	-9.3	-4.8	1.0
Total,	-3.5	-2.9	-12.3	-14.7	-16.5	-8.1	-7.1	-15.8	-10.6	-3.4
of which:										
Net capital flow[b]	4.0	7.1	-3.1	-7.5	-9.6	-1.5	0.3	-8.6	-3.0	5.8
Net investment income[c]	-7.5	-10.0	-9.2	-7.2	-6.9	-6.6	-7.4	-7.2	-7.6	-9.2

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of the Economic Commission for Europe

[a] Preliminary estimates

[b] Including changes in official reserves and other foreign assets

[c] Including estimated net interest payments of CMEA banks.

same basis. Czechoslovakia and other countries are exploring similar changes, and talks are being held among Czechoslovakia, Hungary and Poland to trade only on a convertible currency basis.

While these steps improve the basis for trade and the entailed resource transfers, they are partial and *ad hoc* measures. As an alternative, a new multilateral clearing institution can be conceived that would gradually move toward complete currency convertibility over a definite time frame while taking account of the need and preference of CMEA Governments to undertake reforms at different rates. The institution—it could be called the Central European Payments Union (CEPU)—would accommodate bilateral trade imbalances by transforming them into multilateral ones and focus policy attention on the overall balance of each member with the institution, and thus on the net resource transfer *vis-à-vis* the group, rather than on the bilateral relations (see box IV.3).

Financial resource transfers with market economies and the international support initiative

Until the transition to currency convertibility is more advanced, the Eastern European economies and the Soviet Union will continue to inhabit simultaneously two financial worlds that operate on different principles and make different demands on participants. While resource allocation and trade in the convertible currency world may be simpler and ultimately more efficient, it is also a demanding and uncer-

Box IV.3. A proposal for a Central European Payments Union

The time may be right to establish a Central European Payments Union (CEPU) as a temporary measure to assist the reforming CMEA countries of Europe in their transition to market-oriented economies with fully convertible currencies.[a] Like the European Payments Union (EPU) set up after World War II, it would receive all inter-member claims for payment for imports. At the end of each accounting period, say a month, the CEPU would clear all claims and the balances would be settled on hard currency terms. At first, the deficit countries would be accorded loans on commercial terms to clear the balance and the surplus countries would receive comparable assets. Over time, an increasing proportion of the imbalances would be settled in hard currency payments themselves until, at the end of the life of the Union, all payments would be made in hard currency, making the union redundant.

The shortage of foreign exchange that precludes member countries from using it to settle their bilateral trade imbalances would be met in two ways. First, only the net balance with the institution would have to be settled, rather than each bilateral imbalance separately. Second, the CEPU would itself lend foreign exchange to members; indeed, for smooth functioning, the credit has to be automatic, although with higher policy conditionality for larger borrowings and ultimately a ceiling on members' net indebtedness to the CEPU. The resources would come from the surplus countries in the CEPU, but also from an initial capital paid in from official reserves of member countries and following the example of the United States contribution to the EPU from the international community.

The capital base could be quite small. In 1989, the absolute sum of bilateral imbalances of trade among the European CMEA countries totalled some $5 billion at official exchange rates, largely on account of the Soviet deficit with the group. Among the countries on the fastest reform track which would be more likely to be the initial members of a CEPU—Czechoslovakia, the German Democratic Republic, Hungary and Poland—the comparable figure was less than $300 million. While the relaxation of bilateral constraints on trade among these countries would lead initially to larger intra-group imbalances, the net amount that would have to be financed by a CEPU of reforming countries would probably not exceed $1 billion a year in the short run under current international economic conditions. If the transition to convertibility were envisaged over a five-year period—with decreasing demand for credit as a steadily rising proportion of the imbalances would be paid in convertible currency—the clearing fund would at most require some $2.5 billion.[b]

Even if these resources were readily mobilized—which might not be the case—the negotiation and operation of a CEPU would not be a simple matter. The history of payments unions underlines the need for shared political interests and commitments to make it work so that participants do not seek ways to manipulate the union.[c] In particular, participants that build up excessive surpluses or deficits with the CEPU must adjust their trade and other economic policies to reduce the imbalances. But a positive attraction to participation can also be built into the Union, as was done in the EPU, when the United States explicitly allowed participants to discriminate against dollar trade through the payments mechanism. The importance of Western European trade to the prospective CEPU members suggests that a similar support could be fostered by the European Communities.

The Federal Republic of Germany might have a major interest in the CEPU, given the prospect of German unification. The German Democratic Republic is the second largest trade partner of most CMEA members. They will continue to need parts, components and maintenance for their current stock of German machinery and equipment and would in all likelihood find it difficult in the short run to place their trade with the eastern part of Germany on a convertible currency basis.

The currency unit of the EEC's European Monetary System—the ECU—might serve as well as the currency unit of a CEPU. The ECU is becoming increasingly attractive as the invoicing currency of Eastern Europe's trade with Western Europe. The ECU is more stable than other currencies, including the dollar and does not depend on any one country's monetary policy. It is widely used in the EEC, with which several Eastern European countries are interested in affiliating. Moreover, experience with the ECU might help CEPU members gradually to manage their foreign exchange régime in tandem with that of the European Monetary System and subject themselves increasingly to its discipline. Such a choice would also invite the EC to assume a major role in financing the CEPU's initial capital and seeing to its success.

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[a] The United Nations Secretariat proposal described here is being published in more extensive form by the Economic Commission for Europe in *Economic Survey of Europe in 1989-1990* (United Nations publication, Sales No. E.90.II.E.1), chap. 3.

[b] It might take as much as a decade to cement in the foundation of the deep and widespread structural reforms that are intended in the prospective member countries of a CEPU, even under favourable domestic and external economic and political circumstances. It could take even longer to encourage their refinement through the self-motivated behaviour of economic agents under central policy guidelines. However, some policy makers, particularly in Czechoslovakia, Hungary and Poland, are more optimistic, hoping to place their mutual trade on a dollar-cash basis within two to three years. As a compromise, perhaps the reforming CMEA countries might commit themselves to reach convertibility over a five-year period.

[c] Once the members agreed on the policy aspects of the Union, the Bank for International Settlements, as a neutral outsider with ample experience in the type of payments-clearing envisaged, might be entrusted with the accounting and supervisory tasks.

tain world that exacts heavy tolls for policy mistakes. The high-debt strategies followed by several Eastern European countries in the 1970s, as in developing countries, led to debt-service difficulties and severely restricted credit in the 1980s. The net financial transfer in convertible currencies turned negative (see table IV.5), and two countries, Poland and Romania, had to reschedule their debt repayments, joined this year by Bulgaria, which borrowed at a rapid rate in recent years.[46] Meanwhile, Hungary has had considerable difficulty procuring financing, and the finances of the German Democratic Republic have depended on the assistance of the Federal Republic of Germany.

The USSR with its large foreign exchange and gold reserves still enjoys relatively unhampered access to capital markets, although creditors will look increasingly for more buoyancy in Soviet exports and a more tranquil political situation, especially if borrowing continues at the accelerated pace of 1989. In this regard, the Soviet Union is like the Eastern European countries: it needs to progress in domestic economic adjustments, which are in any event a high national priority.

Direct investors who take a longer view than commercial bank lenders also look for positive signs of adjustment and stability. They require credible and predictable legal, regulatory, and fiscal arrangements which define property rights and allow profit repatriation at will or within an acceptable time. These arrangements are needed for markets to function; but they will not come into place overnight, least of all while political systems remain in flux.

The economic environment that foreign investors look for is incompatible with mandatory export performance requirements, ownership restrictions, or excessive bureaucratic limitations. Since direct investment is viewed as an important source of western technical, managerial and marketing know-how, as well as capital goods, Governments have already changed some policies to try to meet the concerns of investors. Czechoslovakia, for example, recently upgraded its joint venture legislation. The present joint venture law, however, is still considered unsatisfactory in two respects: it does not automatically give the joint ventures a licence to engage in foreign trade, and it makes repatriation of profits dependent on the hard currency earnings of the venture. A draft revision of the law aims at improvement, and it would also reduce the burden of taxation.

In the wake of liberalization of Hungarian, Polish and Soviet joint venture legislation in late 1988 and early 1989, the number of joint venture agreements rose to unprecedented heights. About 1,300 such enterprises were registered in the Soviet Union as at the end of 1989, although only a small fraction are currently operational. In Hungary, about 700 joint ventures have been set up; Poland has about 400 such entities. The 50 or so joint ventures in Czechoslovakia, the 35 in Bulgaria and 5 in Romania show a similar trend. The total foreign capital invested in the Soviet Union, Hungary and Poland is estimated to have reached about $2.2 billion, the average capital per joint venture being about $1 million.[47] There is a wide variation, however. In the Soviet Union deals worth several hundred million dollars have been made, while for Hungary small joint ventures—from $10 thousand to $100 thousand—are characteristic.

All in all, and taking account of the size of the economies and their investment needs, the financial contribution of direct investment is expected to remain marginal, except in the German Democratic Republic where large investments by companies in the Federal Republic are anticipated. The impact of the investments, however, both directly and through their demonstration effect, can become substantial in all countries. But the total expected private financial flows—whether from direct investment, private lending, or even the cash-flow benefits of debt renegotiations—are not expected to meet the external financing needs for adjustment of the region.

For this reason, the Governments of 24 market economies have developed an initiative for new financial and technical assistance and trade arrangements for Eastern Europe.[48] Financial commitments have been made primarily for Hungary and Poland, although flows to the German Democratic Republic have also picked up.[49] As of March 1990, specific commitments to the first two countries totalled $16.5 billion in direct credits, investment and credit guarantees, grants and technical assistance. Funds are to be provided bilaterally and multilaterally, the latter through EC institutions, the IMF and the World Bank.

The financing envisaged is meant to be in support of adjustment programmes of the sort negotiated with the IMF and the World Bank. Hungary and Poland are already active members of both institutions; Bulgaria and Czechoslovakia are in different stages of applying for membership, and Romania is expected to reactivate its participation.

Finally, a major new multilateral institution is being created for lending to Eastern Europe and the Soviet Union. Demonstrating the ability of the international community to act quickly when a consensus forms around an issue, the European Bank for Reconstruction and Development (EBRD) has taken only six months to go from official proposal at the November 1989 meeting of EC Heads of Government to the signing of the Bank's charter in May 1990 by representatives of the 42 founding countries. Capitalized at

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46 The foreign debt situation in the region was reviewed in *World Economic Survey 1989*, pp. 79-82.

47 *Figyelő* (Budapest), 1 February 1990, p. 13.

48 The Economic Commission for Europe has been monitoring the development of this initiative and has published detailed reviews in *Economic Bulletin for Europe*, vol. 41 (1989), pp. 48-56, and *Economic Survey of Europe* . . , section 4.4. Assistance was not offered to the Soviet Union, nor was any requested, although Soviet analysts have reflected on the forms that assistance for *perestroika* could take (see *Economic Survey of Europe* . . , section 4.4, footnote 88).

49 Perhaps it is a fitting coda to the Marshall Plan for post-war European recovery that DM 6 billion of counterpart funds still held by the Federal Republic of Germany are now being committed to projects in the German Democratic Republic (see *Neues Deutschland* (Berlin), 21 February 1990).

$12 billion, the Bank will lend on both concessional and market terms and mainly for private sector activities, including privatization and joint venture projects, although 40 per cent of its lending will be set aside for infrastructure investments.

Thus, enthusiasm about the reform process in the region has led to generous offers of official financial assistance. The overall net transfer of financial resources of the countries of the region may reverse the trend of the 1980s. But two *caveats* are in order. First, the activity of prospective donors and creditors has been intense in some countries where new Governments are still trying to establish policies and development strategies, but it can be asked whether there is a danger of inundating the region with proposals that are beyond the capacity of the Governments to assess properly. Adjustment experiences in other parts of the world underline how important it is that Governments decide on the most important use of available external resources, which requires working out through the political process an overall strategy and plan for domestic reform that enjoys broad popular support.

The second *caveat* pertains to the limited absorptive capacity of the target countries. The Economic Commission for Europe (ECE) argues that unlike the Marshall Plan for the reconstruction of traditionally market-oriented economies in Western Europe, Eastern Europe's needs for financial assistance are less than its needs for technical assistance, especially in establishing the legal, financial and supervisory institutions of decentralized market economies, what the ECE calls the "infrastructure of market behaviour."[50] The external financial needs of the region will, none the less, be considerable over at least a decade. Most important for the success of the political and economic revolution under way in the region is that unrealistic expectations not be raised and then dashed when the economic transformation proves to be more difficult and protracted than initially foreseen.

Net financial transfers and exchange rate management in developed market economies

In the course of their history, many countries have drawn on foreign capital to finance their investments during industrialization. Mature industrial economies, on the other hand, have tended to generate savings in excess of their domestic investment needs and undertake foreign investments in other parts of the world. Their trade was mostly balanced or in surplus, which meant that their net financial transfers were outward bound or moderately negative. As seen in table IV.6, this has also been the general pattern for most developed market economies in the 1980s.

The striking exceptions are the extremely large net absorption of foreign financial resources by the United States beginning in 1983 and the largely corresponding outflow of resources first from Japan, soon joined by the Federal Republic of Germany. More recently, as the United States net absorption of financial resources receded from its 1987 peak, the United Kingdom also became a significant net absorber of foreign resources.

The large resource inflows of the United States were provided bay Japan and the Federal Republic of Germany, as well as Canada and other developed market economies; but also many developing countries have in the 1980s transferred resources to the United States (see table IV.7). The major oil exporters of Africa and Asia actually reduced their transfers at the time that the United States absorption of external resources accelerated, while the flows from other developing countries grew to exceed those from the Federal Republic of Germany. The different circumstances under which such transfers were made by the rapidly growing Asian exporters of manufactures and the heavily indebted countries were discussed above.

The consequence for the United States economy of almost a decade of external deficit is now beginning to be felt. In 1981 and 1982, the net investment position—the total of United States foreign assets minus the total of foreign claims on the United States—measured about $140 billion. Net investment income in the balance of payments averaged over $30 billion dollars. By the end of last year, foreign claims on the United States exceeded foreign assets by almost $700 billion.[51] Net investment income fell to $1 billion (see table A.11) and will become negative in 1990. The net investment position may reach a negative $1 trillion by the year 2000. If and when the United States eventually reduces its balance of trade in goods and non-factor services to zero, it will still have a substantial deficit in its current account due to net income payments to foreign capital. It will need to run a significant surplus in its trade balance to pay interest and other foreign investment income. It will have to make significant net transfers to its foreign creditors and investors, and hold domestic expenditure below the level of domestic income.

The difficulties of this will depend above all on the time dimension, which is critical to all adjustment problems. It seems reasonable to assume that the United States economy will have no difficulty in securing the financial support for an extended adjustment period, especially so if the countries who supply the bulk of the resources to the United States also prefer a moderate pace of adjustment. In Japan, net foreign investment income has already risen from insignificant amounts in the beginning of the 1980s to over $20 billion in each of the past two years (see table A.10). Sometime this year, Japanese net assets abroad will pass $400 billion. They

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[50] See *Economic Survey of Europe*, section 1.2

[51] Estimate, based on data on the net international investment position and the balance of payments as published in United States Department of Commerce, *Survey of Current Business*

Table IV.6. Net transfer of financial resources of developed market economies, 1980–1989[a]

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Major industrial countries	38.5	2.5	0.8	14.2	52.4	45.0	2.4	23.9	13.8	28.4
Canada	-5.5	-4.2	-12.5	-12.0	-12.9	-9.5	-4.3	-6.1	-7.4	-3.0
France	6.3	5.5	10.6	2.6	-1.9	-2.0	-5.5	0.7	-1.2	-1.9
Germany, Federal Republic of	8.4	-2.3	-12.7	-9.5	-12.7	-19.6	-43.3	-52.2	-56.8	-55.5
Italy	9.5	5.9	2.3	-5.0	-0.9	-0.3	-11.7	-7.2	-4.3	0.5
Japan	10.1	-7.2	-6.5	-19.3	-32.3	-44.0	-78.4	-74.0	-62.7	-37.8
United Kingdom	-12.6	-14.9	-8.6	-4.0	0.9	-4.9	4.5	8.7	29.6	31.1
United States	22.3	19.6	28.1	61.5	112.2	125.3	141.2	153.9	116.5	95.0
Smaller industrial countries	17.7	13.3	8.4	-6.3	-15.7	-16.6	-16.5	-13.6	-11.9	-3.1
Total	56.3	15.7	9.2	8.0	36.7	28.4	-14.0	10.3	1.9	25.3

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

[a] Expenditure definition (negative of balance on goods, services and labour-related transfers, excluding investment income)

[b] Preliminary estimates for some countries

were $292 billion at the end of 1988 and were less than $30 billion at the start of the 1980s.[52]

Most of the capital outflow from Japan has been in the form of securities investment, although direct investment has shot up in the past two years to about one quarter of the total. Two thirds of the flow is directed at other developed market economies, most especially the United States. While the bilateral relationship with the United States remains unique, tied both to the large bilateral trade imbalance between the two countries and the role of the dollar as an international currency, Japanese capital is also diversifying into other markets, especially in Western Europe and some developing countries. Moreover, the Government of Japan has taken on large international responsibilities as an aid donor and an active participant in multilateral finance.

Japan is thus becoming more integrated into and more important to the world economy. Its banks are already the largest in the world in terms of foreign business, most of it transacted in dollars. Indeed, the internationalization of the yen has not yet proceeded very far. For example, although it is the third largest currency held in official foreign exchange reserves, yen holdings account for only about 7 per cent of reserves, after the deutsche mark (about 15 per cent) and the dollar (almost two thirds).[53] As capital-market restrictions continue to be eased in Japan, the international role of the yen may continue to grow as the 1990s evolve. Along with the deutsche mark and the dollar, it is already the major focus of international policy on exchange rate management.

Finance-determined exchange rates

In 1989, the United States purchased $25 billion worth of reserve assets; Japan expended an equivalent amount and the Federal Republic of Germany was also active (see tables A.9 to A.11). These were the financial tracks left by a year of large-scale intervention in the foreign exchange markets by the central banks of these countries in their effort to smooth market-determined exchange rates. At the beginning of the year, observers would have been surprised at the amount of intervention activity that was to follow. But they also did not expect exchange rates themselves to change much.

At the end of 1988, economists in the industrialized countries seemed to believe that the long-sought adjustment in the exchange rates of the major currency countries—specifically, the Federal Republic of Germany, Japan and the United States—had more or less been completed. The real effective exchange rate of the dollar against industrial country trading partners of the United States had fallen on average by one third since 1985; the yen had risen by 35 per cent on a comparable basis and the deutsche mark by almost 15 per cent (see figure IV.10).[54] Heavy official intervention had been necessary in 1987 to prevent a free fall of the dollar, but confidence of the market was restored in 1988 and the United

[52] Data of the Bank of Japan, *Balance of Payments Monthly* (April 1989)

[53] This is based on a standard IMF presentation of the currency composition of reserves, wherein the value of European Currency Units (ECUs) issued against dollars held by central banks of countries participating in the European Monetary System is still counted as dollar holdings. If the ECUs are treated as a separate currency, the dollar share of reserves falls to 55 per cent (the share of EEC currencies as a whole in the latter case is almost one third, compared to 22 per cent in the standard treatment). In either case, the role of the yen remains relatively marginal (see IMF, *Annual Report*, 1989 (Washington, D.C., 1989), p. 55)

[54] There are no uniformly accepted measures of the real effective exchange rate. The IMF alone regularly publishes six indicators, of which the measure shown in figure IV.10 is one. It shows how labour cost per unit of manufacturing in a country compares with that of its industrial country trading partners. A partner's higher inflation or lower growth of productivity would raise its unit labour cost, but a depreciation of its currency would lower it in comparison with home country production. The measure also adjusts for changes in productivity due to business cycle factors (e.g., it would correct for a decline in productivity caused by capacity being idle in a recession) and weights each partner's unit labour cost by its share of the country's trade in manufactures.

Table IV.7. Net resource transfers to the United States, by regions, 1980–1989

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
Canada	-0.3	0.6	6.2	9.3	12.7	13.4	10.5	8.3	7.7	3.8
Japan	9.8	14.9	15.7	23.1	36.1	42.2	52.2	53.5	47.2	42.3
Western Europe	-15.9	-8.1	-1.7	6.4	22.5	32.0	35.6	32.7	19.3	3.2
of which:										
Germany, Federal Republic of	2.5	3.1	5.4	8.4	13.3	16.0	20.1	21.5	18.4	
Latin America and the Caribbean	-1.2	-5.6	5.6	19.1	20.8	17.0	12.5	15.3	9.9	10.4
of which:										
Mexico	-2.6	-5.3	4.3	10.3	8.0	7.7	7.4	8.4	5.6	.
Major oil exporters of Africa and Asia[b]	36.0	25.8	6.7	1.7	5.4	3.3	2.4	21.0	5.6	11.1
Other developing countries	-3.4	-0.8	0.9	9.1	21.3	22.1	32.4	27.9	34.0	34.2
European planned economies	-2.6	-2.9	-2.8	-1.6	-2.0	-1.3	--	-0.1	-1.5	-3.5
Other countries[c]	--	-4.2	-2.6	-5.7	-4.4	-3.4	-4.3	-4.5	-5.6	-6.4
Total	22.3	19.6	28.1	61.4	112.2	125.3	141.2	153.9	116.5	95.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of United States Department of Commerce, *Survey of Current Business*

[a] Preliminary; full country breakdown unavailable at this time

[b] Comprising OPEC member countries, excluding Ecuador and Venezuela.

[c] Including net transactions with international organizations and unallocated amounts

States trade deficit began to narrow, as had the fiscal deficit of the United States Government, which reached 3.2 per cent of GDP in 1988 after having been over 5 per cent in 1985 and 1986.

Market sentiment on exchange rates was not uniform, however. Some argued that the dollar had fallen below its equilibrium level, based on a comparison of prices of specific goods in different countries.[55] Other analysts expected the dollar to fall further, albeit slowly, in order to give further impetus to the correction of trade imbalances and as interest differentials in favour of the dollar narrowed. This applied, for example, to the projections of Project LINK and several other econometric models. The predominant reason for the outlook of relative exchange rate stability, however, was a backward glance at exchange rates. As may be seen in figure IV.10, the dollar and the deutsche mark had returned to the real parities of the beginning of the decade, while the yen seemed to have risen to an appropriate and more or less stable level that would help to bring about a widely sought structural adjustment in Japan's trade.

But these analyses of exchange rates in terms of what economists call "fundamentals" seem to be of declining significance in the foreign exchange markets as the volume of purely financial transactions continues to rise relative to trade-related transactions. In the three years up to the first quarter of 1989, for example, trade-derived foreign exchange transactions in the United States grew by 30 per cent,[56] while total volume in the United States foreign exchange market soared by 120 per cent.[57] As the speculative proportion of the market has risen along with the financial portion, the connection between exchange rates and fundamental trade situations has been eroded by new forces of demand and supply in foreign exchange markets. Indeed, models that attempt to explain the changes in exchange rates using fundamental economic variables perform more poorly when applied to data from the 1980s than when applied to data from the 1970s.[58]

Instead, the foreign exchange market seems to be moved mainly by "news", that is, by new information—financial, trade, policy-related or political—that changes market participants' assessment of the world and by pure "noise" as traders anticipate and react to each other's actions. Thus, while an announcement of a larger or smaller monthly deficit in the United States balance of trade will pertain to the small percentage of transactions that are derived from trade, the direction of change will be news that may move the massive speculative portion of the market. Similarly, changes in interest rate differentials between trading partners tend to have an influence that goes beyond their direct incentive effect on financial flows. And because market participants profit or lose on the basis of the news, considerable effort is made to forecast it. Expected values of the change in the trade deficit

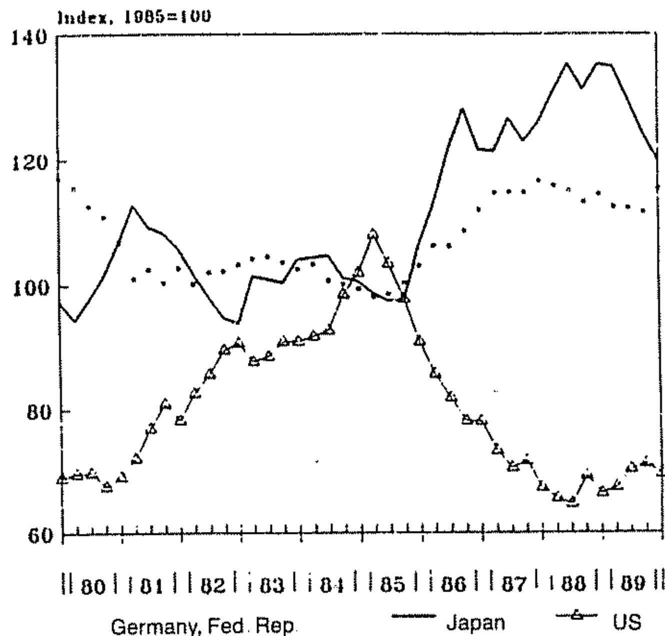
[55] For example, attempts to measure the exchange rate at which a dollar would buy the equivalent amount of goods in the Federal Republic of Germany as in the United States found the rate to over DM 2 per dollar, whereas the actual rate at the end of 1988 was DM 1.8 per dollar (estimates by Goldman Sachs, London, 1989). Critics of such "purchasing power parity" calculations, however, complain that it is very hard to find goods in two countries—even advanced industrial countries—that would be considered equivalent by consumers in the two, given the efforts of manufacturers to create brand identities.

[56] Based on quarterly merchandise imports on a balance-of-payments basis

[57] See Federal Reserve Bank of New York, "Summary results of U.S. foreign exchange market survey", 1989.

[58] See, for example, Michael Goldberg, "Why do the asset market models of exchange rate determination perform so poorly?", New York University (unpublished), 1990

Figure IV.10 Real effective exchange rates of Federal Republic of Germany, Japan and the United States, 1980-1989*



Source: Data of IMF.
* Based on relative normalized unit labour costs

or the interest differential in the future will be the basis for foreign currency trading in the period leading up to the next "event" and can become more important to the foreign exchange market than the actual event itself.

Most of the short-term movement in exchange rates, in other words, appears to be pure noise in the statistical sense of random movements around the underlying levels. Speculative traders hold open positions for only a few hours at a time, not six months. Therefore, the realization that the overvaluation of, say, the pound will correct six months hence is without effect on the movement of the exchange rate since traders expect to close their positions by sundown. Traders are betting against the very short run sentiment of fellow traders. Most importantly, self-fuelling speculative movements appear to be able to raise or lower exchange rates by considerable amounts and for considerable periods, as they move along what analysts have come to call "speculative bubbles."[59]

In this regard, the rise of the dollar in the first half of 1989 can be understood in terms of the speculative market's positive view of the direction of change in trade data, economic growth, inflation and interest rates, and other factors. Indeed, at several times, especially during the first half of the year, the United States Federal Reserve, with support from the Bundesbank and other central banks of the major industrial countries, intervened heavily to weaken the dollar's exchange rate. But at the same time, the Federal Reserve maintained a tight rein on liquidity, so that monetary policy was at odds with the goals of intervention.

There is a general perception that central banks view their primary mandate as maintaining price stability in the domestic economy and often see exchange rate manipulation as a consideration secondary to this. In sending contrary signals, the market apparently believed that the United States authorities were not intent on holding the dollar to its earlier parity. It is now widely accepted that sterilized intervention—not accompanied by corresponding domestic monetary policies—is not an effective tool of sustained exchange rate management. This is largely because the effect of intervention depends, not on the changes in demands for the currencies generated by official sales and purchases, but on the signals which such intervention gives to market participants about the current and future direction of policy.[60] If domestic economic policy is itself providing contrary information, the market may ignore the intervention. The implication is that spending billions of dollars in exchange market intervention is not effective if it is not part and parcel of a consistent and—given the interrelatedness of the major economies—co-ordinated macro-economic policy package.

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59 See Olivier Blanchard and Mark Watson, "Bubbles, rational expectations and financial markets" in Paul Wachtel, ed., *Crises in the Economic and Financial Structure* (Lexington, Mass., Lexington Books, 1982), pp. 295-315. See also Rudiger Dornbusch and Jeffrey Frankel, "The flexible exchange rate system: experience and alternatives", M.I.T. and University of California at Berkeley, November 1987 (unpublished).

60 The argument was made in these pages in *World Economic Survey 1986* (United Nations publication, Sales No. E.86.II.C.1), pp. 66-73. See also Maurice Obstfeld, "The effectiveness of foreign-exchange intervention: recent experience", National Bureau of Economic Research Working Paper No. 2796 (Cambridge, Mass., December 1988).

Chapter V

THE INTERNATIONAL OIL MARKET

Since the oil price collapse of 1986, the world oil market has been witnessing a variety of trends which appear to be coalescing into a new balance between oil demand and supply.

Lower oil prices than those prevailing during the first half of the 1980s and a resumption of economic growth have resulted in a rapid increase in oil demand in the developed market economies and in the developing world.

Investments in petroleum exploration and development have been cut back substantially on a world-wide basis, particularly in high-cost frontier areas. New oil discoveries have been scarce. Similarly, investments in secondary and enhanced oil recovery techniques, which had been so successful in augmenting supplies from existing fields during the period of high oil prices especially in North America, have been reduced and low-productivity, high-cost wells have been abandoned, with consequent loss of output.

The increase in world oil demand since 1986 has been met mostly by a few member countries of OPEC with surplus production capacities and vast petroleum reserves. However, the gap between demand for their oil and their production capacities has been narrowing steadily. Despite the magnitude of their petroleum reserves, there has been little incentive for them either in the price of oil or the security of their markets to maintain or expand their production capacities, especially at a time of acute financial distress and deep economic recession in their economies.

Major oil-consuming countries have been enjoying the benefits of lower oil prices and ready availability of supplies. However, they have been experiencing a large contraction of their domestic petroleum industries. In their view, market forces and free competition would eventually result in a new balance in the world oil market. Calls for dialogue and co-operation have been largely ignored. Meanwhile, because of economic, financial, safety and environmental reasons, the rate of growth of alternative energy sources, especially nuclear power, has been stalled and the hope for new and renewable sources of energy has not materialized. Similarly, energy conservation and efficiency measures have been relaxed.

Energy exploration and development programmes in the oil-importing developing countries have also suffered serious cutbacks, with less direct foreign investments by the transnational oil corporations, fewer loans from the capital markets and lower support by multilateral and bilateral assistance programmes.

With continued economic growth and, hopefully, the revitalization of the economies of Africa and Latin America, oil consumption is expected to continue its upward trend during the current decade.

Because of the long lead times required for energy projects, the dilemma calling for urgent attention of the international community is the expansion of oil production capacities to meet increasing demand in a climate of stability.

As described in this chapter, investment programmes for expanded production capacities have been initiated in joint ventures between a few of the member countries of OPEC and the oil companies. Other member countries of OPEC, which had previously nationalized all oil operations, have recently declared new policies and are examining possible arrangements with the oil companies and capital-exporting developed market economies for the same purpose.

New understandings, dialogue and co-operation between oil consuming and producing countries will be necessary for the security of investments, supplies and markets in this process.

Oil price recovery

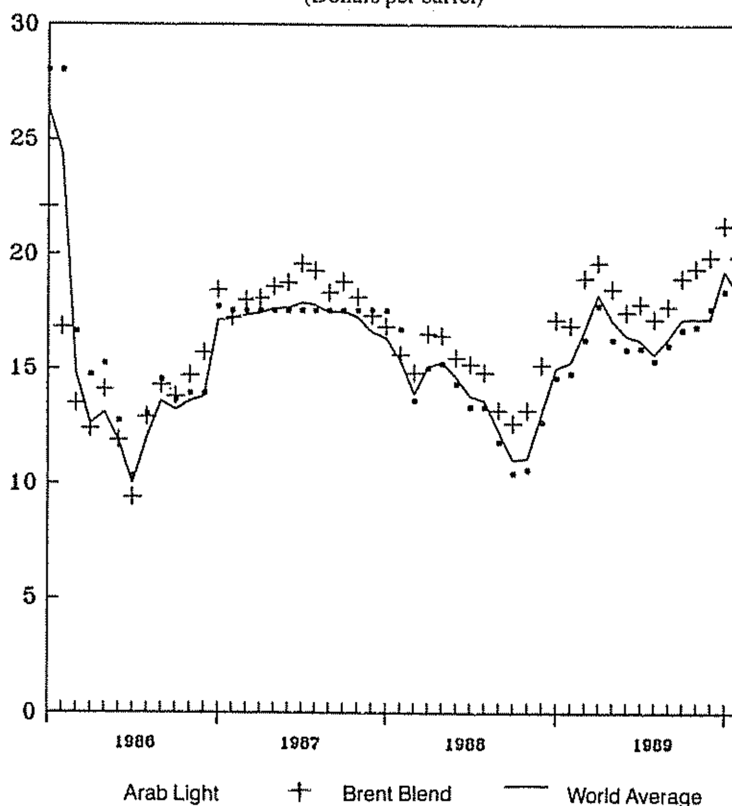
The instability of oil prices and apprehensions of yet another collapse in 1988 were replaced in 1989 by recovery and an upward trend towards the target level of OPEC of $18 per barrel (see figure V.1).

This recovery was brought about at the beginning of 1989 by cutbacks in oil production by the member countries of OPEC. Subsequently, and throughout the year, non-OPEC oil supplies failed to increase as expected because of further declines in output in North America, the North Sea and the Soviet Union, as well as disruptions through a series of accidents involving offshore platforms, pipelines and tankers.

On the demand side, continued economic growth in the developed market economies and in several developing countries resulted in continued increases in oil consumption, including occasional inroads of heavy fuel oil into the electricity generation market.

The combination of growth in oil consumption and overall stagnation in non-OPEC oil production brought about increasing demand for OPEC oil when some of the member countries had already reached the limits of their sustainable production capacities. Other member countries, however, with surplus capacities, acted on their declared policies of

Figure V.1. Crude oil prices
(Dollars per barrel)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on United States Department of Energy, Energy Information Administration, *Weekly Petroleum Status Report*, 1986-1990 issues.

maintaining oil price stability by expanding output above their quotas.

As a result, the average price of OPEC oil, comprising seven crudes, climbed by 19 per cent to $17.51 per barrel in 1989 as compared to $14.71 per barrel in 1988.[1]

This increase in oil prices and the expansion of output resulted in an improvement of $21 billion, or 24.4 per cent, in the value of oil exports of OPEC member countries, which is estimated at about $107 billion in 1989 (see table A.18). Per capita oil export revenues improved to $235 as compared to a low of $184 in 1986 but remain well below the level of $806 in 1980. On the basis of stable oil prices and the expected increase in the demand for OPEC oil, it is estimated that oil export revenues will improve further by $20 billion, reaching a level of $127 billion in 1990.[2]

In the past couple of years, disruptions in oil supplies because of accidents have caused sudden and sizeable increases in the prices of petroleum products in Western Europe and the United States. Coupled with changes in the structure of the petroleum industry, especially with regard to further consolidation and concentration in marketing, these developments have led to public inquiries on pricing practices.[3] For example, after a year-long review of the motor gasoline market in the United Kingdom, the Monopolies and Merger Commission found that a monopoly situation existed, with five major oil companies supplying about two thirds of the gasoline demand through 69 wholesalers. However, the Commission concluded that there were no reasonable grounds for criticizing the way in which integrated companies based their transfer prices on international prices and that neither the absolute level of gasoline prices nor the way they reacted to international price changes had been unreasonable over the period studied. Nevertheless, the Commission observed that continued monitoring of the gasoline market was necessary by matching possible developments, including (a) the emergence of gasoline shortages, perhaps prompted by the recent loss of refining capacity, (b) a further and significant increase in wholesale ownership of retail outlets and (c) a significant reduction in the number of wholesalers or their geographic spread, particularly among the 14 largest wholesalers.[4] Similar inquiries were in progress in the United States.[5]

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[1] "Looking forward to the decade of co-operation", *OPEC Bulletin*, February 1990, p. 6.

[2] "OPEC oil revenues rebound to pre-crash levels", *Petroleum Intelligence Weekly*, 12 February 1990, p. 2.

[3] *World Economic Survey 1989* (United Nations publication, Sales No. E.89.II.C.1), p. 100.

[4] "Oil companies cleared on market collusion", *Petroleum Economist*, March 1990, p. 75.

[5] *A Short-Term Analysis of Heating Fuel Market Behavior*, an interim report to the Senate Governmental Affairs Committee and the House Sub-Committee on Energy and Power, prepared by the United States Energy Information Administration, 31 January, 1990.

Further increase in oil consumption

World oil consumption, excluding Eastern Europe and the Soviet Union, increased on an annual basis by 1.0 million barrels per day, or 2.0 per cent, reaching 51.9 million barrels per day in 1989. This was the highest level since the record consumption of 52.4 million barrels per day in 1979 (see table V.1).

In the developed market economies, oil consumption in 1989 increased by 0.4 million barrels per day or 1.1 per cent. Three quarters of this increase was accounted for by the Pacific region, mainly Japan. Consumption increased by 0.1 million barrels per day in Western Europe, while no change was registered in North America.

Since the collapse of oil prices in 1986, the developed market economies as a whole have increased their oil consumption by 3.0 million barrels per day, or 8.7 per cent. Between 1985 and 1989 oil consumption increased by 1.6 million barrels per day, or 9.1 per cent, in North America, 0.7 million barrels per day, or 5.9 per cent, in Western Europe and 0.7 million barrels per day, or 13.7 per cent, in the Pacific region.

In the developing countries, oil consumption in 1989 increased by 0.6 million barrels per day to a level of 14.5 million barrels per day. Both the annual rate and the absolute increase were higher than in the developed market economies. Between 1985 and 1989 developing countries added 2.1 million barrels per day, or 16.9 per cent, to their annual oil consumption.

For 1990, oil consumption is expected to increase by 0.5 million barrels per day, or 1.3 per cent, in the developed market economies and by an equivalent amount, or 3.4 per cent, in the developing countries. Their combined consumption of 52.9 million barrels per day in 1990 will surpass the previous record of 52.4 million barrels per day in 1979.

This new record, made up of 37.9 and 15.0 million barrels per day for the developed market economies and the developing countries, respectively, would reflect an increase of 4.4 million barrels per day in the latter countries, while oil consumption in the former countries would still be 3.9 million barrels per day below the 1979 level.

During the 1980s there have been significant changes in both the growth rates and the composition of oil demand.

In the developed market economies, much of the overall decrease in oil demand during the period 1980-1985 was due to a drastic fall of 45.3 per cent in heavy fuel oil used mostly for electric power generation (see table V.2). More nuclear power and coal for electricity were used instead. With lower oil prices since 1986, the decline in heavy fuel oil use has been arrested.[6] In addition to price, other factors such as nuclear power shutdowns and weather conditions have affected demand of heavy fuel oil. For example, it has been estimated that by the summer of 1989, the hydropower deficit of the countries of the European Economic Community as a whole had reached the oil equivalent of 300,000 barrels per day and showed few signs of improvement.[7]

Table V.1. World[a] oil demand,[b] 1980-1990

(Million barrels per day)

	1980	1985	1986	1987	1988	1989	1990[c]	1985-1989 change: Quantity	1985-1989 change: Percentage
Developed market economies	38.6	34.4	35.4	36.0	37.0	37.4	37.9	3.0	8.7
North America	19.4	17.5	18.0	18.5	19.1	19.1	19.3	1.6	9.1
Western Europe	13.5	11.8	12.2	12.3	12.4	12.5	12.7	0.7	5.9
Pacific	5.7	5.1	5.2	5.2	5.5	5.8	5.9	0.7	13.7
Developing countries	10.9	12.4	12.8	13.3	13.9	14.5	15.0	2.1	16.9
World total[a]	49.5	46.8	48.2	49.3	50.9	51.9	52.9	5.1	10.9

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Energy Agency, *Monthly Oil Market Reports*, various issues.

a Excluding Eastern Europe and the Soviet Union

b Includes marine bunkers, refinery fuel and non-conventional oils

c Estimate

Demand for aviation fuels has been particularly strong throughout the 1980s, while stagnation in motor gasoline consumption during the first half of the decade has changed to an upward trend since 1986, as has middle distillate fuels, liquefied petroleum gas (LPG) and naphtha.

Unlike the developed market economies, oil demand in the developing countries registered considerable growth in all petroleum products during the first half of the decade (see table V.3). The only exception was in heavy fuel oil, with only a small reduction, which has since been reversed. This reflects the lack of alternative energy sources such as coal and nuclear power in most of the developing countries.

Oil consumption in the developing countries has accelerated further since 1986, especially in the newly industrial-

6 Direct burning of crude oil under boilers for electric power generation is included in "other products" in table V.2.

7 "EEC hydropower output down by 300,000 b/d", *Middle East Economic Survey*, 8 January 1990.

Table V.2. Changes in the composition of oil demand[a] in developed market economies

Product	1980	1985	1987	1980	1985	1987	1980-1985	1985-1987	1980-1987
	Million barrels per day			Percentage share			Percentage change		
LPG/naphtha	4 37	4 31	4 59	11 3	12.5	12.8	-1.4	6.5	5.0
Aviation fuels	1.79	1 98	2.16	4.6	5.8	6.0	10.6	9 1	20.7
Motor gasoline	10 61	10.74	11 37	27 5	31 2	31 6	1.2	5 9	7.2
Middle distillate	9 29	8 84	9.20	24.0	25.7	25 6	-4 8	4.1	-1.0
Heavy fuel oil	8.75	4.79	4.60	22.7	13.9	12.8	-45.3	-4.0	-47.4
Other products	3 84	3 75	4.08	9 9	10.9	11.3	-2.3	8.8	6.3
Total[b]	38.63	34.41	36.00	100.0	100 0	100 0	-10.9	4 6	-6.8

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based, on International Energy Agency, *Oil Market Report,* May 1989, table 1 D.

a Represents consumption measured as deliveries of oil from refineries, plus refinery fuel use and international marine bunkers.

b Totals may not add up because of rounding.

ized countries of South-East Asia but also including other growing economies such as China, India, Pakistan and Thailand. It is generally expected that developing countries may account for about 50 per cent of incremental oil demand in the next few years even on the basis of assumptions of slow economic growth in Africa and Latin America. The revitalization of those economies would consequently result in even bigger increases in oil consumption.

There is considerable uncertainty about the level of oil consumption in Eastern Europe and the Soviet Union in 1989. It is believed, however, that total oil consumption remained stagnant at about 11.7 million barrels per day, with the Soviet Union maintaining its net export position as in previous years.

Table V.3. Changes in the composition of oil demand in developing countries

Product	1980	1985	1987	1980	1985	1987	1980-1985	1985-1987	1980-1987
	Thousand barrels per day			Percentage share			Percentage change		
LPG/naphtha	758	1 264	1 414	6.9	10 2	10 6	66.8	11.9	86.5
Aviation fuels	508	546	606	4.6	4.4	4.5	7.5	11.0	19.3
Motor gasoline	1 941	2 170	2 306	17.7	17.5	17.3	11 8	6.3	18.8
Middle distillate	3 473	4 094	4 428	31 7	33.0	33.2	17.9	8.2	27.5
Heavy fuel oil	3 553	3 345	3 465	32.5	27 0	26.0	-5 9	3.6	-2.5
Other products	712	988	1 116	6.5	8 0	8.4	38.8	13.0	56.7
Total[a]	10 945	12 406	13 334	100.0	100.0	100 0	13 3	7.5	21.8

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Energy Agency, *Oil Market Report,* June 1989, p. 7.

a Totals may not add up because of rounding.

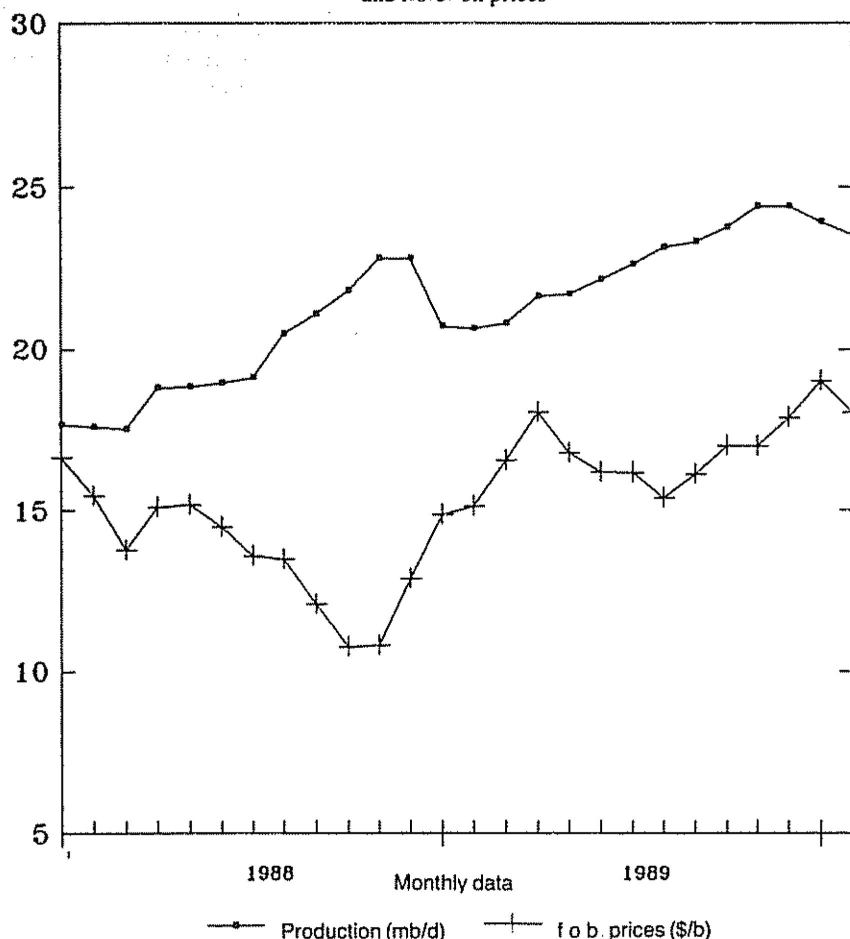
Pronounced production shift to OPEC member countries

The successful meeting of OPEC in November 1988, when unity was restored and new production levels agreed, was followed by cutbacks in oil production of about 3.5 million barrels per day, or 14.5 per cent, during the first quarter of 1989 as compared to the fourth quarter of the previous year. As a result, the rapid decline in oil prices, which had reached their lowest level for the year at $10-$11 per barrel in November 1988, was reversed and by April 1989 they had reached $16-$17 per barrel.

Responding to increasing demand, crude oil production in the member countries of OPEC was on a continuous climb through 1989, as shown in table A.19. Unlike in 1988, persistent production above agreed quotas did not erode the newly found stability in oil prices. In fact, prices on occasion surpassed the target price of $18 per barrel (see figure V.2).

The OPEC oil production quotas, which had been set at 18.5 million barrels per day for the first half of 1989, were increased to 19.5 million barrels per day for the third quarter and 20.5 million barrels per day for the fourth quarter. For the first half of 1990, quotas were increased to 22 million barrels per day, or 19.4 per cent higher than the equivalent period of 1989 (see table V.4).

Figure V.2. OPEC oil production and f.o.b. oil prices



Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on United States Department of Energy, Energy Information Administration, *Weekly Petroleum Status Report*, 1988-1990 issues; and *Petroleum Economist*, March 1989 and March 1990.

Table V.4. OPEC oil production quotas

(Thousand barrels per day)

Country	March 1983	October 1984	Sept. 1986	November 1986	January 1987	July 1987	Jan. 1989	July 1989	October 1989	January 1990
Algeria	725	663	663	669	635	667	695	733	770	827
Ecuador	200	183	183	221	210	221	230	242	254	273
Gabon	150	137	137	160	152	159	166	175	184	197
Indonesia	1 300	1 189	1 189	1 193	1 133	1 190	1 240	1 307	1 374	1 374
Iran (Islamic Republic of)	2 400	2 300	2 300	2 317	2 255	2 369	2 640	2 783	2 926	3 140
Iraq	1 200[a]	1 200[a]	1 200[a]	1 466[a]	1 466[a]	1 540[a]	2 640	2 783	2 926	3 140
Kuwait	1 050	900	900	999	948	996	1 037	1 093	1 149	1 500
Libyan Arab Jamahiriya	1 100	990	990	999	948	996	1 037	1 093	1 149	1 233
Nigeria	1 300	1 300	1 300	1 304	1 238	1 301	1 355	1 428	1 501	1 611
Qatar	300	280	280	300	285	299	312	329	346	371
Saudi Arabia	5 000	4 353	4 353	4 353	4 133	4 343	4 524	4 769	5 014	5 380
United Arab Emirates	1 100	950	950	950	902	948	988	1 041	1 095	1 095[a]
Venezuela	1 675	1 555	1 555	1 574	1 495	1 571	1 636	1 724	1 812	1 945
Total	17 500	16 000	16 000	16 505	15 800	16 600	18 500	19 500	20 500	22 086

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on various OPEC press releases

a Nominal.

At these levels, several of the member countries of OPEC had reached the limits of their sustainable production capacities with the result that, in the case of Indonesia, no increase was set in its quota for 1990. In view of the expectation of still higher demand for OPEC oil, it has been suggested that the management of production through quotas might no longer be necessary in the near future.

Changes in oil production since 1986 seemed to confirm the policy of the member countries of OPEC, which aimed at capturing a higher share of a growing market and reducing the role of non-OPEC oil and alternative sources of energy.

Since 1985, crude oil production in the member countries of OPEC has grown by 37 per cent, or 6.6 million barrels per day. During the same period, there was hardly any increase in oil production either in the countries of Eastern Europe and the Soviet Union or in the oil-importing developing countries; in the non-OPEC oil-exporting developing countries there was an increase of 1.1 million barrels per day, while in the developed market economies oil production dropped by 0.9 million barrels per day, or 6.0 per cent (see table V.5).

Among the member countries of OPEC, the biggest increases were registered in the Middle East, especially in Iraq, Kuwait, Saudi Arabia and the United Arab Emirates. In view of the magnitude of the proved reserves in these countries and announcements of programmes to expand production capacities, much of the incremental demand for OPEC oil is expected to be supplied from the Middle East, with small contributions from Nigeria and Venezuela. Thus, a further concentration of oil supplies is anticipated.

In the non-OPEC oil-exporting developing countries, the rapid expansion of oil output during the first half of the 1980s decelerated significantly in the second half, mainly because of slow-downs in China and Mexico, the biggest producers in this group.

The proved reserves of the non-OPEC oil-exporting developing countries are limited, except in Mexico, and production levels in the medium-term future are not expected to change significantly even though promising discoveries have recently been made in a few countries (e.g., the Syrian Arab Republic and Yemen). More importantly, the rapid growth in domestic oil consumption in many of these countries is expected to result in lower exports.

Table V.5. World crude oil production

(Million barrels per day)

	1970	1980	1985	1986	1987	1988	1989
Developed market economies	11.24	12.57	14.36	14.25	14.20	14.15	13.44
Eastern Europe and the USSR	7.42	12.36	12.24	12.62	12.80	12.85	12.53
Developing countries	26.84	34.48	26.60	29.12	28.76	31.08	33.77
OPEC member countries	23.31	26.72	16.08	18.39	17.59	19.65	22.05
Other oil-exporting countries	2.66	6.66	8.59	8.77	9.25	9.51	9.71
Oil-importing countries	0.87	1.10	1.93	1.96	1.92	1.92	2.01
World total	45.50	59.41	53.20	55.99	55.76	58.08	59.74

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on *Energy Statistics Yearbook, 1982* and *1987* (United Nations publications, Sales Nos E/F.84 X-VII.4 and E/F.89.XVII 10); and crude oil production statistics for 1988 and 1989, *Oil and Gas Journal, 19 March 1990.*

Oil production in the oil-importing developing countries increased by 75 per cent during the first half of the 1980s, reaching a level of 1.9 million barrels per day in 1985, mainly because of sizeable increases in Brazil and India. Since then, however, oil output has stagnated although promising discoveries have been made in Pakistan, Thailand, Turkey, Democratic Yemen and Viet Nam. With very limited proved petroleum reserves and overall cutbacks in oil exploration and development investments, prospects in the oil-importing developing countries are not promising. Increasing oil demand will result in higher oil import bills, which may become more onerous once again with rising oil prices.

In the developed market economies, the most important trend in oil production continued to be the deepening drop in output in the United States, by far the biggest oil consumer in the world (see table V.6). Since 1985, oil production has declined from 9.0 to 7.7 million barrels per day in 1989, the lowest level since 1963. With oil consumption increasing by 1.5 million barrels per day since 1985, net crude oil and petroleum products imports have increased from 4.3 to 7.2 million barrels per day, or by 67 per cent. In 1989, the United States increased its dependence on oil imports to 42 per cent of its oil consumption, the highest level since 1977. With expectations of oil production falling below 7 million barrels per day in 1990, because of an accelerating rate of decline which now includes Alaska as well as all the other oil-producing States, oil imports are expected to increase further with consequent impact on the global oil market.

Similarly, prospects for augmenting production in Canada have become less encouraging, with high-cost frontier discoveries of conventional oil remaining undeveloped, and stagnation in the production of synthetic oil from tar sands because of reduction or elimination of investment subsidies. Without a rise in oil prices to justify the development of these reserves and the expected decline in existing fields, Canada may also become a significant importer of oil.

Table V.6. United States petroleum industry indicators, 1980-1989

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Proved oil reserves (billion barrels)	26.40	29.79	29.79	27.30	27.30	28.00	24.56	25.27	26.50	25.86
Crude oil production (million barrels per day)	8.60	8.57	8.65	8.69	8.88	8.97	8.68	8.35	8.17	7.68
Reserves/production ratio (years)	8.41	9.52	9.43	8.61	8.42	8.55	7.75	8.29	8.89	9.22
Natural gas liquids and other supply[a] (million barrels per day)	1.62	1.66	1.60	1.61	1.68	1.67	1.61	1.66	1.68	1.61
Oil consumption (million barrels per day)	17.06	16.06	15.30	15.23	15.73	15.73	16.28	16.67	17.23	17.23
Net crude oil and petroleum products imports[b] (million barrels per day)	6.37	5.40	4.30	4.31	4.72	4.29	5.44	5.91	6.59	7.19
Net imports as percentage of oil consumption	37.30	33.60	28.10	28.30	30.00	27.30	33.40	35.50	38.20	41.70
Completion of exploration and development wells	69 486	89 234	83 889	75 738	84 983	70 806	38 870	34 927	34 579	30 697

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on United States Department of Energy, Energy Information Administration, *Monthly Energy Review*, various issues; *Oil and Gas Journal*, various issues; and *World Oil*, February 1990, p. 68.

a Includes alcohol and other hydrocarbons.

b Net imports equal imports minus exports.

In the United Kingdom sector of the North Sea, a drop of oil output in 1989 of 0.5 million barrels per day was almost as steep as the decline in the United States. However, the drop in the United Kingdom was due to accidents in offshore pipelines and platforms as well as shutdowns for the installation of safety devices. Further repairs during 1990 will still affect output. With increasing investments and discoveries of small fields, the previously anticipated rate of decline in the sector of the North Sea may be arrested somewhat.

In the Norwegian sector, on the other hand, the opening of new fields resulted in a jump of 0.4 million barrels per day, or 36 per cent.

Oil production in the Soviet Union in 1989 declined by 306,000 barrels per day, or 2.9 per cent, to reach its lowest level since 1980.[8] A variety of factors have contributed to this drop in output, including labour unrest, disruptions in equipment supplies and natural declines in large oilfields. Whether this trend can be arrested or reversed will largely depend on the success of economic reforms, which are reported to have some positive results. For example, in the Tyumen region of western Siberia, which accounts for 60 per cent of the national oil output, newly introduced policies allow oil-producing enterprises to recover between 5 and 20 per cent of the foreign exchange earned above planned oil output. Oil-producing enterprises are also forming closer links with foreign firms, thereby gaining access to technologies and expertise.[9]

New oil supply concerns

In the past, security of oil supply concerns among consumers centred on apprehensions about the political stability and intentions of some oil-exporting developing countries. However, in 1989, only minor supply cutbacks were due to such factors (e.g., Colombia), while major disruptions were caused by accidents involving production platforms in the North Sea, tankers and pipelines (e.g., Alaska and the Soviet Union), refineries (e.g., the United States), and by political instability in Eastern Europe and China.

It is estimated that these supply disruptions caused a loss of about 1 million barrels of oil per day in 1989. The impact on crude oil prices was considerable because they occurred when company stocks, according to estimates of the International Energy Agency, had reached the low level of 65 days of forward consumption in its member countries. However, the impact on prices was cushioned by the steady expansion of crude oil output by some member countries of OPEC (see table A.19). Unusually cold weather in the autumn and the beginning of the 1989/90 winter and a consequent jump in demand for heating redirected the focus of attention to decreasing margins in excess refinery capacities. With practically full utilization of refinery capacities, especially in the United States, accidents had an immediate and dramatic effect on the prices of heating fuels. By the end of December 1989, wholesale prices in the New England, mid-Atlantic and midwest regions of the United States jumped by almost 80 per cent, with crude oil prices following at a level above $20 per barrel, as compared to $12-$14 per barrel during the same period in 1988.

While the risk of similar accidents in the future cannot be

[8] *Petroleum Economist*, March 1990, p. 104.

[9] "Reforming west Siberian oil industry", *Petroleum Economist*, March 1990, p. 78.

forecast, apprehensions are bound to persist primarily because the expansion of oil output in non-OPEC areas during the 1970s and 1980s occurred in increasingly difficult environments (e.g., the North Sea; the Gulf Coast and Alaska in the United States; Siberia in the Soviet Union), often with new and untried technologies. Maintenance of these complex production and transportation facilities may have slackened, especially during the second half of the 1980s, because of lower prices and cash flows for corporations. Also, oil production outside the OPEC area has been at full capacity with only minor exceptions in recent years. Under such circumstances, commercial considerations might outweigh maintenance imperatives.

New directions in structural change of the petroleum industry

Increasing concentration of crude oil resources and production

Before the wave of nationalization in the late 1960s and the 1970s, the international oil industry was characterized by a high degree of integration. It included a small number of transnational oil corporations with operations in exploration and production, transportation, refining and distribution to the final consumers.

With high rates of growth in the world economy and declining oil prices, oil consumption was, until the beginning of the 1970s, increasing at a rate of 7 per cent per annum, doubling every 10 years. Nevertheless, supplies continued to be abundant because of new discoveries in the developing countries, mainly in the member countries of OPEC.

After the complete nationalization of oil companies in six member countries of OPEC (Algeria, Iran (Islamic Republic of), Iraq, Kuwait, Saudi Arabia, Venezuela) and the energy crises of the 1970s, higher oil prices and a marked slow-down in the growth of the world economy resulted in sizeable surplus capacities in oil production, refineries, tankers and distribution outlets which continued to prevail throughout the 1980s.

In crude oil production, surplus capacities were further accentuated by a pronounced shift of investments in exploration and development to non-OPEC areas, especially in the developed market economies of North America, the North Sea and Oceania, as well as to non-OPEC oil-exporting developing countries (e.g., Angola, Colombia, Egypt, Malaysia, Yemen). This led to a drop in the demand for OPEC oil and the introduction of quotas in oil production among its member countries, a practice which has continued since 1983.

While the surplus capacities in OPEC created problems for the management of oil production, they eased the tasks of the national oil companies that were set up to take over the functions of the previously fully integrated private oil companies either independently or in co-operation with the former concession holders under new arrangements providing for a fixed fee in exchange for technical services.

The resumption of growth in the world economy during the second half of the 1980s, the collapse of oil prices in 1986 and the slow-down of non-OPEC oil output and a resulting increase in oil consumption have led to a significant expansion of oil production in the member countries of OPEC.

During the fourth quarter of 1989, OPEC countries were producing at a level of 24 million barrels of oil per day, while their combined capacities were estimated at 25 to 27 million barrels per day. With annual world demand for OPEC oil increasing at about 1 million barrels per day, as experienced since 1986, the gap between production and available capacities could be closed in a few years. However, an expansion of capacities will require heavy investments at a time when practically every member country of OPEC is experiencing financial difficulties. There is also a considerable lead time.

The ability of the member countries of OPEC to increase their oil production capacity, as indicated by the magnitude of their proved reserves, is beyond question, as shown in table V.7. Since 1979, their proved reserves have increased from 436 to 767 billion barrels and their share of the world total has improved from 68 to 77 per cent. Within OPEC, there has been an increasing concentration of reserves towards the Middle East. By 1989, the OPEC countries of this region (Iran (Islamic Republic of), Iraq, Kuwait, Qatar, Saudi Arabia and the United Arab Emirates) accounted for 547.5 billion barrels of proved oil reserves, or 71.3 per cent of the OPEC total and 54.6 per cent of the world total. At the same time, there has been a marked deterioration in both the absolute and the relative position of the developed market economies and the countries of Eastern Europe, with sizeable reductions in proved reserves in the Soviet Union and the United States of America, the two premier producers and consumers of oil in the world.

However, the expansion of capacities in OPEC countries would require access to the modern technologies of international oil companies and the mobilization of financial resources, which might be hampered by uncertainties about future oil prices, the security of future market access and investments.

In an address given before the Royal Institute of International Affairs in January 1990, Sheik Ahmed Zaki Yamani said:

> "The OPEC countries need to establish reliable outlets for their oil, which means co-operating with these companies, since they own most of the downstream assets. ... many important moves have been made in this direction in recent years, either through direct purchases of downstream assets in the consuming areas or by establishing joint ventures with a number of companies. The OPEC producers, however, need also to tap the upstream expertise of the oil companies - for example, in new techniques such as the horizontal drilling - perhaps even get the companies to invest in their countries. The companies for their part need - as they have always done - to secure their

sources of crude supply, particularly at a time when their own sources of crude outside OPEC may not be as plentiful as anticipated. This calls for a new form of relationship between the OPEC producers and the companies, more along the lines of normal commercial contractual obligations than the concessionary agreements of the past."[10]

More downstream integration of oil-exporting developing countries

In recent years, some of the member countries of OPEC have embarked on programmes of downstream integration into refining and marketing operations in major oil-consuming countries in Western Europe and the United States. Kuwait has established such operations in Western Europe on its own, while the Libyan Arab Jamahiriya, Nigeria, Saudi Arabia and Venezuela have preferred joint ventures with private and public sector oil companies in the industrial countries.[11] Recent examples of such ventures include Kuwait's entry into the gasoline market of Thailand with plans to establish at least 200 retail sites in that country and speculations that similar moves may be expected by member countries of OPEC in other developing countries of Asia, as well as in Japan, where oil consumption has been growing at a fast rate.[12]

Similar ventures have been pursued by non-OPEC oil-exporting developing countries such as China, with its first joint venture in refining and marketing in the west coast of the United States of America and by Mexico in Spain.

Table V.7. World proved oil reserves, end 1979-end 1989

	End 1979		End 1989	
	Millions of barrels	Percentage of world	Millions of barrels	Percentage of world
Developed market economies	58 796	9.2	52 700	5.3
Eastern Europe and the USSR	70 000	10.9	60 100	6.0
Developing countries	512 545	79.9	888 771	88.7
OPEC member countries	435 611	67.9	767 100	76.6
Non-OPEC oil-exporting	69 930	10.9	109 429	10.9
Oil-importing	7 004	1.1	12 242	1.2
World[a]	641 341	100.0	1 001 572	100.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on *Oil and Gas Journal*, 24 December 1979 and 25 December 1989.

a Totals may not add up because of rounding.

The motivation for these ventures has been attributed to corporate strategies to assure markets during a period of surplus oil production capacities in the major member countries of OPEC and other oil-exporting developing countries; the existence of surplus downstream facilities in oil- consuming countries also offered opportunities for profitable investments. Such reintegration in the oil industry may also improve market information for national oil companies in exporting countries, and enhance contacts with private and public sector oil companies in the consuming countries, with opportunities for further co-operation.

Despite the above examples of reintegration, the division between firms that are mainly producers and those that are essentially marketers remains. As shown by the integration index in table V.8, all of the national oil companies of the member countries of OPEC listed, as well as Mexico, are net sellers of crude oil.

Changing structures of oil companies

With the exception of only one (i.e., Arco), all the major oil companies of the developed market economies remain net buyers of crude oil. Despite considerable investments and exploration efforts by these companies, mainly in non-OPEC countries, they have generally been unable to improve their position either as producers of crude oil or as holders of petroleum reserves. In fact, most of them have been discovering less but producing more. Consequently, and despite acquisitions through mergers, the proved reserves of seven of the largest oil companies (Royal Dutch/Shell, Exxon, British Petroleum, Chevron, Mobil, Arco and Texaco) are adequate only for 8 to 14 years of production at the 1988 level, as compared to 58 to 216 years for each of the seven largest national oil companies of the oil-exporting developing countries (Iran (Islamic Republic of), Iraq, Kuwait, Mexico, Saudi Arabia, the United Arab Emirates and Venezuela).[13]

[10] Sheikh Ahmed Zaki Yamani, "Oil in the 1990s: the need for international co-operation", address given at the Royal Institute of International Affairs, London, 15 January 1990. *Exclusive*, vol. III, No. 3-4.

[11] *World Economic Survey 1989* (United Nations publication, Sales No. E.89.II.C.1), p. 100.

[12] "Middle East target: Pacific rim oil", *Oil and Gas Journal, 8 January 1990, p. 21.*

[13] "PIW ranks world's top 50 oil companies", *Petroleum Intelligence Weekly, special supplement issue*, 11 December, 1989.

Table V.8. Integration of oil companies, 1988

Company	Country	Liquids output (Thousand barrels per day)		Integration index[a] (Percentage)	
		1987	1988	1987	1988
Saudi Aramco	Saudi Arabia	4 400	5 414	379	369
INOC	Iraq	2 359	2 712	646	743
Pemex	Mexico	2 540	2 506	168	166
NIOC	Iran (Islamic Republic of)	2 298	2 305	374	375
PDV	Venezuela	1 793	2 001	110	124
Exxon	United States	1 835	1 919	47	48
Royal Dutch/Shell	Netherlands/United Kingdom	1 766	1 763	50	49
British Petroleum	United Kingdom	1 425	1 550	68	78
KPC	Kuwait	1 088	1 513	118	164
Sonatrach	Algeria	1 148	1 151	244	244
Texaco	United States	1 056	990	49	65
NNPC	Nigeria	903	986	219	301
Chevron	United States	989	970	39	44
Libyan NOC	Libyan Arab Jamahiriya	875	927	207	220
Pertamina	Indonesia	839	851	114	115
Adnoc	United Arab Emirates	808	820	499	506
Amoco	United States	802	809	76	77
Arco	United States	729	737	114	115
Mobil	United States	709	735	34	34

Source: "PIW ranks world's top 50 oil companies", *Petroleum Intelligence Weekly*, special supplement issue, 11 December 1989.

a Liquids output divided by refining capacity.

Developments in the world economy and the international oil market, especially during the 1980s, have also brought about structural changes among the oil companies. During the period of high oil prices and profits, oil companies, in addition to increasing investments in non-OPEC countries in exploration and production, diversified into other energy areas, including coal, natural gas and non-conventional sources of energy (e.g., oil shale, tar sands, heavy oil, solar energy). In some cases, their diversification extended into non-energy areas altogether. At the same time, new capital was attracted into the oil industry through the creation and strengthening of a great number of independent oil companies with activities particularly in North America and the North Sea.

Outside of OPEC, national oil companies were either established or strengthened in the developed market economies (e.g., Canada, Norway, Spain, United Kingdom), the oil-exporting developing countries (e.g., Angola, Colombia, Egypt, Malaysia, Mexico) and the oil-importing developing countries (e.g., Brazil, India) in order to participate either independently or in joint ventures with private sector oil companies in exploration and production.

Long-established policies excluding private sector oil company participation were revised in several developing countries (e.g., Brazil, China, Colombia, India) with the objective of augmenting oil discoveries to reduce oil import bills or to increase exports.

With declining oil prices since the early 1980s and their collapse in 1986, structural changes in the private sector oil industry have included a wave of mergers and consolidations, as well as geographic and functional concentration of operations. In this process a few major and many independent oil companies have been absorbed.[14,15] Reorganization of the surviving companies has concentrated on the reduction of costs and divestiture of non-energy and non-petroleum operations.

Changes in the comparative position of national economies have also had repercussions in the oil industry. There has been increasing participation of oil companies from Western Europe, Japan, Australia and a few developing countries (e.g., Brazil, Kuwait, Republic of Korea) and a relative decline of the United States oil companies. As indicated in table V.9, between 1984 and 1988, seven Western European companies have gained considerable ground over 13 United States companies in operating cash flow, capital expenditure and capital employed. Western European oil companies have also been active by investing in the United States. In 1988, out of a total foreign investment of $4 billion in the United States petroleum industry, $2.7 billion was from Western Europe.[16]

[14] *World Economic Survey 1989* (United Nations publication, Sales No. E.89.II.C.1), p. 100

[15] "End of big mergers not in sight", *Oil and Gas Journal*, 4 September 1989, p. 36

[16] Ellen M. Herr, "U.S. business enterprises acquired or established by foreign direct investors in 1988", *Survey of Current Business*, May 1989, p. 27

Table V.9. Changes in oil company indicators
(billions of dollars)

		United States companies[a]	Western European companies[b]
Operating cash flow	1984	47	24
	1988	42	30
Capital expenditure	1984	35	19
	1988	30	26
Capital employed	1984	220	108
	1988	208	153

Source: "Oil companies—The rise of the Europeans", *Petroleum Economist*, January 1990, vol LVII, No. 2.

a Amerada Hess, Amoco, Arco, Chevron, Dupont (Conoco), Exxon, Mobil, Occidental, Phillips, Sun, Texaco, Unocal, USA (Texas Oil and Gas, Marathon).

b Agip, BP, Elf, Petrofina, Royal Dutch/Shell, Statoil, Total CFP.

New directions in structural changes

At the beginning of the 1990s, the petroleum industry is poised for more structural changes. These are bound to be influenced by traditional factors connected with trends in petroleum reserves, production and consumption, as well as availability of capital and technologies. However, new trends in political developments, particularly in Eastern Europe and the Soviet Union, and increasing environmental concerns may also be expected to have an impact on further structural changes.

Of immediate concern is the need to expand the production capacities of the member countries of OPEC so that they can supply the increasing demand for oil during the 1990s when non-OPEC production is generally expected either to decrease or to remain flat at best.

Actual OPEC crude oil production in October 1989, at 22.8 million barrels per day, left only 3 million barrels per day to spare from the sustainable capacity of 25.8 million barrels per day (see table V.10). Most of the member countries of OPEC were already producing at a rate near the maximum of their sustainable capacities, with only a few of them (e.g., Iraq, Kuwait, Saudi Arabia) having a combined surplus capacity of 2.5 million barrels per day, or an estimated two years of incremental demand.

Table V.10. Crude oil production capacities of OPEC member countries
(Thousand barrels per day)

Country	Sustainable capacity	Production (October 1989)	Rate of operation (Percentage)
Algeria	700	700	100.0
Ecuador	310	300	96.8
Gabon	230	230	100.0
Indonesia	1 300	1 250	96.2
Iran (Islamic Republic of)	3 000	2 950	98.3
Iraq	3 300	3 000	90.9
Kuwait	2 325	1 905	81.9
Libyan Arab Jamahiriya	1 200	1 100	91.7
Nigeria	1 800	1 600	88.9
Qatar	450	400	88.9
Saudi Arabia	6 825	5 405	79.2
United Arab Emirates	2 200	2 120	96.4
Venezuela	2 200	1 800	81.8
Total	25 840	22 760	88.1

Source: Isotoma Toichi. "*International oil market entering new phase—Is an oil cycle repeating itself?*" *Energy in Japan*, special edition, February 1990

With expectations for increases in demand for OPEC oil and continued stabilization of oil prices, expanded investment programmes for accelerated exploration and development and enhancing of production capacities have already been announced by a number of member countries of OPEC. Significantly, these countries had retained the participation of private sector oil companies in their upstream operations. For example, it has been reported that Nigeria has started a major programme in co-operation with the oil companies aimed at the expansion of sustainable production capacity from 1.8 to 2.4-2.5 million barrels per day by the mid-1990s.[17]

The expansion of production capacity in Nigeria will involve three-dimensional (3-D) seismic surveys, deep onshore and offshore drilling, enhanced recovery techniques, reduction of flared gas, utilization of heavy oil and the development of a natural gas system for the national market and exports to neighbouring countries, as well as liquefied natural gas (LNG) to Western Europe and the United States.

While no aggregate estimate of investment requirements for the Nigerian expansion programme is available, Shell Nigeria's plan alone will involve more than $1 billion per annum for the period 1990-1994. In this connection, it has been reported that for all foreign operators, the big problem for the 1990s lies in the ability of the Nigerian National Petroleum Corporation to fund its majority interest in new investment programmes. In an effort to alleviate its financial problems, Nigeria has divested 20 per cent of its equity interest in a joint venture with Shell involving about half of the country's oil output and 11.8 billion barrels of proved oil reserves for a consideration of $2 billion, which will also reduce that country's commitment to finance new investments.[18]

Similar but less ambitious programmes have been announced in other member countries of OPEC which had also maintained private sector oil company participation, often with new incentives provided in exploration and development agreements (e.g., Algeria, Ecuador, Gabon, Indonesia). However, in view of the magnitude of their proved oil reserves, most of the incremental production capacity during the 1990s is expected from Iran(Islamic Republic of), Iraq, Kuwait, Saudi Arabia and Venezuela, which had nationalized all upstream operations. According to one estimate, out of an increase in total OPEC sustainable production capacity of 6.0 to 9.1 million barrels per day by the year 2000, 5.7 to 8.6 million barrels per day will be due to these five member countries.[19]

For an addition to OPEC sustainable production capacity of about 6.0 million barrels per day by 1995, the Secretary-General of OPEC has estimated investment requirements at $60 billion or $10,000 per barrel a day capacity.[20][21] While average costs for capacity increases may be different among major producers, on this cost assumption, the five member countries of OPEC mentioned above will require a total of $57 billion to $86 billion in order to augment their capacities by 5.7 to 8.6 million barrels per day by the year 2000 (see table V.11).

Table V.11. Investment requirements for additional production capacities by the year 2000

Country	Additional production capacity (Million barrels per day)	Investment requirements (Billions of US dollars)
Iran (Islamic Republic of)	0.5 - 1.0	5.0 - 10.0
Iraq	1.2 - 2.2	12.0 - 22.0
Kuwait	0.5 - 0.9	5.0 - 9.0
Saudi Arabia	2.9 - 3.4	29.0 - 34.0
Venezuela	0.6 - 1.1	6.0 - 11.0
Total	5.7 - 8.6	57.0 - 86.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Isotoma Toichi, "International oil market entering new phase—Is an oil cycle repeating itself?", *Energy in Japan*, special edition, February 1990

Given the lead times for petroleum expansion projects of this nature, arrangements will have to be concluded in the near future if shortages in oil supplies are to be avoided, which could result in yet another energy crisis with sudden and substantial increases in prices. Will the supply of investment capital and the required technologies be available at a time when several OPEC countries are not only short of financial resources but, in some cases, deeply indebted?

[17] "Production in Nigeria", *Oil and Gas Journal*, 26 February 1990, p. 27.

[18] *Ibid.*

[19] Isotoma Toichi, "International oil market entering new phase - Is an oil cycle repeating itself?" *Energy in Japan*, special edition, February 1990

[20] Dr Subroto, Secretary-General of OPEC, "Long-term prospects for oil market stability", *Energy Policy*, October 1989

[21] "Subroto calls for foreign participation in expanding OPEC production capacity", *Middle East Economic Survey*, 5 February 1990, p. A9

Private sector oil companies have on occasion expressed their willingness to enter into new arrangements with the member countries of OPEC for accelerated exploration and development programmes. It was recently reported that Venezuela, in a major policy turnabout, will allow State-owned Petroleos de Venezuela SA to seek international participation in exploration and development in the country for the first time since the nationalization of the petroleum industry in 1976.[22]

Similarly, it has been reported that Iraq has decided to invite foreign oil and engineering companies to develop oilfields already discovered under new agreements to be negotiated. Foreign firms would be expected to provide technology and financing for development drilling and production facilities. In return, the companies would be paid back in crude oil for the cost of development and would be entitled to negotiate for additional volumes of crude oil for a number of years. No equity participation was envisaged.[23,24]

In view of these developments, it appears likely that oil companies will, to a certain extent, reintegrate vertically into their traditional crude oil supply sources, with emphasis on the member countries of OPEC. Oil companies from the developed market economies of North America, Western Europe and Asia and the Pacific may participate in this process.

A new area of similar integration may arise in Eastern Europe, particularly in the Soviet Union, where consultations in the past couple of years appear to be nearing agreements with major oil companies for joint ventures in oil exploration and production.[25]

22 "Newsletter", *Oil and Gas Journal*, 19 February 1990.

23 "Iraq invites wider participation by foreign companies in oilfield development in Iraq", *Middle East Economic Survey*, 12 February 1990, p A10.

24 "Iraqi oil minister explains guidelines for new policy on oilfield development", *Middle East Economic Survey*, 19 February 1990, pp A1-A3.

25 *Wall Street Journal*, 22 February 1990.

Chapter VI

INFLATION STABILIZATION AND ECONOMIC REFORM IN CHINA, EASTERN EUROPE, THE UNION OF SOVIET SOCIALIST REPUBLICS AND VIET NAM: ASPECTS OF THE POLITICAL ECONOMY OF TRANSITION

The emergence or acceleration of open price inflation is one of the most striking features of the ongoing economic reforms in the economies that were formerly managed through highly centralized planning. How to deal with inflation is one of the most important and challenging technical economic tasks facing policy makers bent on managing the transformation of economies that are steered through a complex administrative bureaucracy in to economies in which greater reliance is placed on markets in the allocation of resources. Inflation, however, is only the most obvious sign of the need for comprehensive stabilization policies and economic austerity in the countries concerned. Such policies, in turn, are but one component of a process of comprehensive reform aimed at guiding the transition to a more market-oriented environment.

This chapter discusses the dilemma faced by reformers. It describes the various forms in which imbalances emerge and the empirical evidence on inflation in these economies. It then reviews the process of balancing an economy under central planning and what may go wrong. Key features that determine the core policy issues of the transition phase and how they relate to macro-economic imbalances are discussed and, finally, the experience with reform and inflation, as well as with austerity and stabilization, in selected countries is examined.

Inflation and the dilemma for reformers

The pressure of open inflation in reforming economies has various sources. Three main factors need to be distinguished, as they call for different policy responses. The first is that, as a rule, reforms are launched in an attempt to come to grips with domestic or external imbalances that have accumulated over the years. In several countries, these imbalances have become chronic and policy makers no longer feel able to remedy them through traditional central planning. These imbalances have resulted in economic agents—consumers in the first instance—saving involuntarily or substituting less desirable goods and services for those not available in sufficient quantity. This is essentially a stock phenomenon. Once market adjustments are permitted, even under currently balanced macro-economic policies, many agents will revert to their preferred choices, including dissaving, thereby aggravating short-run imbalances and the pace of inflation.

Closely related to this are the imbalances generated in the process of replacing central planning with an environment in which decisions of economic agents have to be co-ordinated indirectly through macro-economic policy instruments and institutions. There are several reasons for this. One of the most common and predictable is that, at the outset of reform, the policy institutions and instruments in place for indirect economic co-ordination are rather primitive. Policy errors are bound to be made. Furthermore, there is a good deal of uncertainty in output, distribution and trade that policy makers will have to come to grips with. Thus, if central authorities embarking on broad-based economic reform fail to maintain budgetary discipline or if monetary policy fails to rein in the demand for loans, the existing excess demand in the form of the accumulated stock of imbalances will be exacerbated.[1]

Finally, reform based on economic devolution is essentially concerned with putting in place new incentives to motivate economic agents into reacting in a way that policy makers had previously hoped to prescribe chiefly through administrative methods. Replacing the central planning mechanism with indirect economic instruments requires the resetting of relative prices, including interest rates, wage norms and exchange rates. Because marketization cannot effectively proceed without eliminating all but the core subsidies embodied in retail prices, there will be upward pressure on the price level in the short run.

The emergence or acceleration of open inflation at a time of reform often evokes reactions that are diametrically opposed, in part because of its undesirable consequences. Some reformers may wish to avoid the erosion of social welfare levels for ideological and political reasons or to forestall unemployment and a socio-political backlash to open inflation. They will seek to stretch the process of realigning relative prices with underlying scarcities well into the future, thereby debilitating the search for greater efficiency through economic devolution. Others see inflation as the necessary adjustment phase of the transition towards an environment in which there is a clear-cut separation between macro-economic policy and largely autonomous decision-making by economic agents. The macro-economics of a reforming planned economy is more complex than that of a fully-fledged market economy for various reasons. One is inexperience with steering decentralization. Furthermore, at the start of reform, the institutions and policy instruments necessary to ensure indirect economic co-ordination typically are either not available or only partially so. Reformers must come to grips not only with monetary and fiscal matters, but also with income and price issues, given that the existing socialist precepts on income redistribution do not vanish overnight.

[1] There is considerable controversy in the literature about whether the "monetary overhang", that is the stock of imbalances, here in the form of liquid funds, is of recent vintage or essentially generated in the process of the transition toward a reformed economy when macro-economic instruments of control are not yet sufficiently refined to ensure stability. For a lucid description of the two points of view, but with the second one favoured, see Padma Desai, "Perestroika, prices and the ruble problem", *The Harriman Institute Forum*, No. 2 (November 1989)

Forms of inflation

The experience with inflation in reforming countries has been mixed. The wide range of inflationary problems that have arisen need to be tackled in various different ways. It is of some interest to recall the considerable inflation that occurred in these countries during the initial phases of central planning.[2] The elimination of excess demand proved much more difficult than had been anticipated when the central planning mechanism was first introduced.

During the first phase of centrally planned industrialization, rapid shifts in the allocation of resources in favour of investment and the armaments industries took place. To some degree, the planning authorities were aware of the impossibility of adjusting money incomes to the available supply of consumer goods and services, in spite of severe restraints on growth of real wages. The fulfilment of the output and investment plans was therefore bound to give rise to inflationary pressures. The reluctance of central planners to curb investment outlays, in spite of difficulties encountered during plan implementation, reinforced the inflationary effect of the above-mentioned policy choices. But this pressure did not spill over into price adjustments, except marginally.

The reappearance of open inflation in the economies reviewed below has by no means been exceptional. But the experience has varied considerably and has not necessarily been associated with the degree of partial, administrative decentralization pursued since the late 1960s. From official statistics (see table VI.1 and figures VI.1 and VI.2), four groups of countries can be distinguished. Some of the Eastern European countries, the Democratic People's Republic of Korea and Mongolia have by and large adhered to a fixed-price régime of the orthodox central planning model. Any substantial change in prices has been discrete and its impact spread over several years or distributed unequally among various product groups. The second group of countries (including Hungary and Poland) experienced some upward drift in prices, particularly beginning in the mid-1970s, which has been followed more recently by worsening inflationary pressure. The most spectacular open inflation has occurred in Poland with the most recent reforms. Since 1988, the pace of inflation has gained considerable momentum in Hungary also. The third group, encompassing in particular China, the Soviet Union and Viet Nam, kept prices fairly stable for a long time through the orthodox mechanisms of central planning. When the reforms began, however, a sharp upward drift in open inflation became apparent. Finally, some countries (including Bulgaria in 1979-1980 and Romania in 1982-1983) experienced open inflationary pressures even at a time when no reform was envisaged or when it was decided to revert to the traditional mode of controlling inflation.

Table VI.1: Consumer price developments in Eastern Europe and the Soviet Union, 1970-1989

(Previous year = 100)

	1970	1971	1972	1973	1974	1975	1971-1975 total	1976	1977	1978	1979	1980	1976-1980 total	1981	1982	1983	1984	1981-1985 total	1985	1986	1987	1988	1989
Bulgaria[a]	-0.4	-0.1	0.0	0.2	0.5	0.3	0.9	0.3	0.4	1.5	4.5	14.0	20.7	0.4	0.3	1.4	0.7	4.5	1.7	3.5	0.1	-1.3	9.2
Czechoslovakia[b]	1.7	-0.4	-0.4	0.2	0.4	0.6	0.4	0.9	1.4	1.5	3.0	3.4	10.2	0.9	4.7	1.1	0.9	8.9	1.3	0.5	0.1	0.2	1.4
German Democratic Republic	-0.1	0.4	-0.5	-0.6	-0.4	0.0	-1.1	0.0	-0.1	-0.1	0.3	0.4	0.5	0.2	0.0	0.0	0.0	0.3	-0.1	0.0	0.0	0.0	2.0
Hungary	1.3	2.0	2.8	3.3	1.8	3.8	13.7	5.0	3.9	4.6	8.9	9.1	31.5	4.6	6.9	7.3	8.3	34.1	7.0	4.5	8.0	16.5	18.0
Poland[d]	1.2	-0.2	0.0	2.6	6.8	3.0	12.2	4.7	4.9	8.7	6.7	9.1	34.1	24.4	101.5	23.0	15.8	179.1	14.4	17.7	23.5	60.0	244.1
Romania[a]	0.1	0.6	0.0	0.7	1.1	0.2	2.6	0.7	0.5	1.6	2.0	2.1	7.4	2.0	17.0[e]	5.5[e]	0.9[e]	25.0	-0.4[e]	-0.1[e]	0.2[f]	..	..
USSR[a g]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.7	1.4	0.7	1.4	4.2	3.4	0.7	-1.3	0.7	5.5	2.0	2.0	1.0	0.4	2.3

Source: National statistics.

[a] Retail price in the state sector.

[b] Cost of living index for workers and employees.

[c] Including fees and charges of various kinds.

[d] Cost of living index for workers and employees in the socialist sector.

[e] IMF, *International Financial Statistics*.

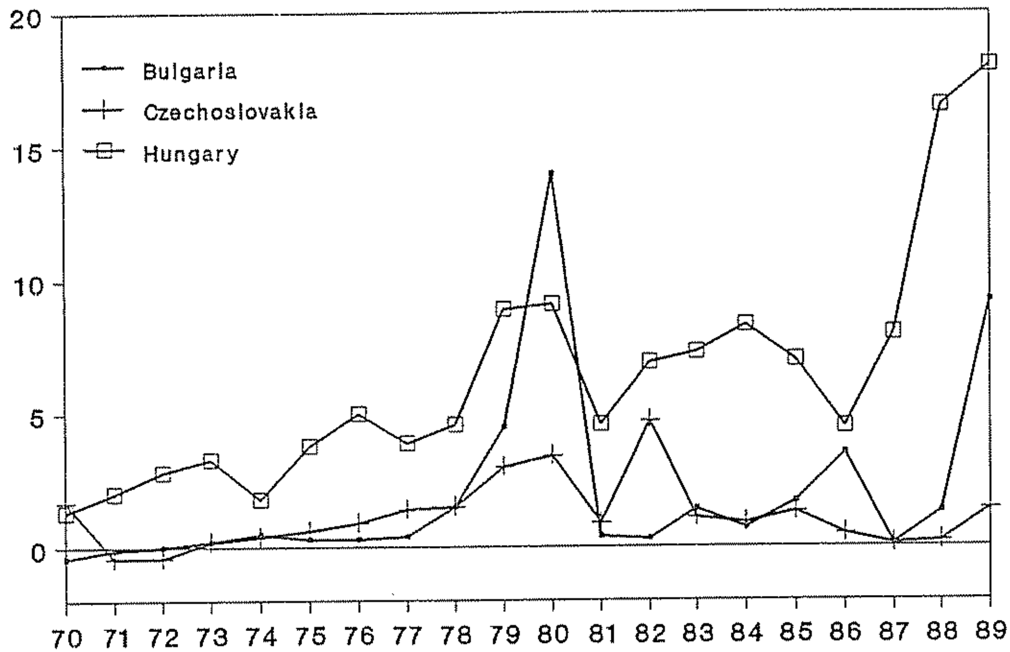
[f] Estimate.

[g] Including public catering; based on rounded index numbers.

[2] For a broad review of the Eastern European experience until the mid-1950s, see "Inflation in centrally planned economies", *World Economic Survey, 1957* (United Nations publication, Sales No. 58.II.C.1), pp. 112-136. For a survey of the literature on inflation in planned economies until about the mid-1960s, see Andrzej Brzeski, "Finance and inflation under central planning", *Osteuropa-Wirtschaft*, No. 3 (1967), pp. 145-158, and No. 4 (1967), pp. 278-297.

Figure VI.1. Eastern Europe: consumer price indices, 1970-1989

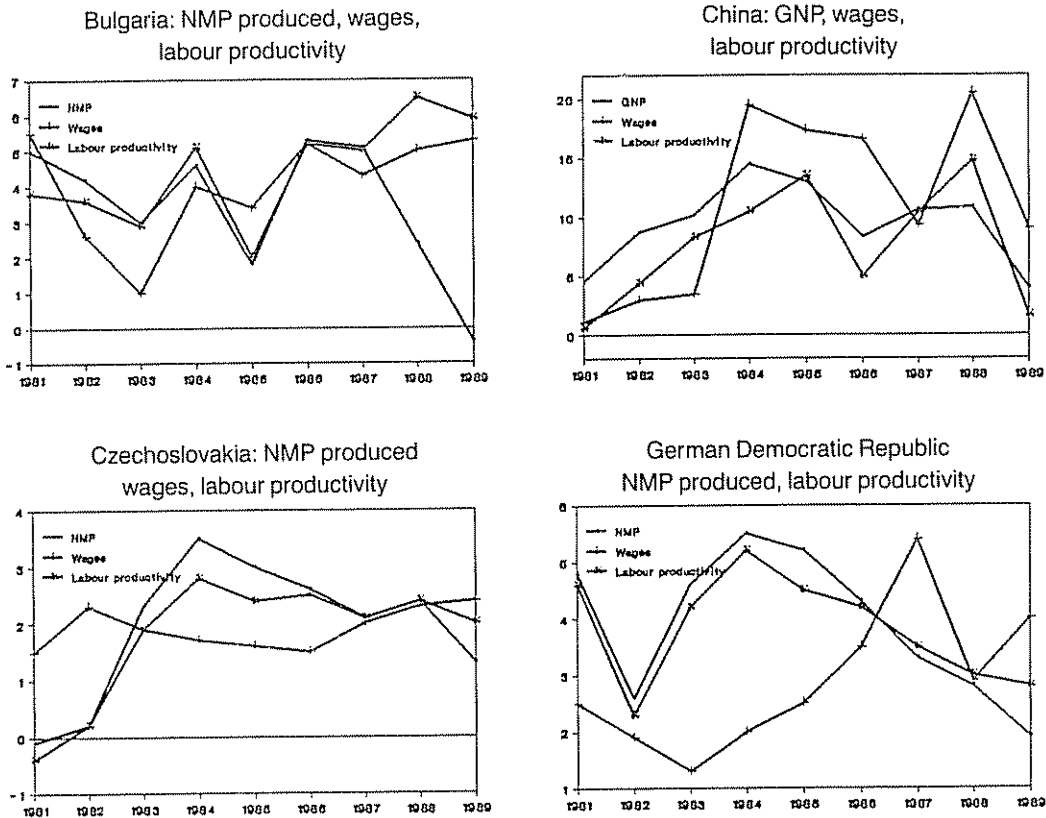
(Annual percentage change)



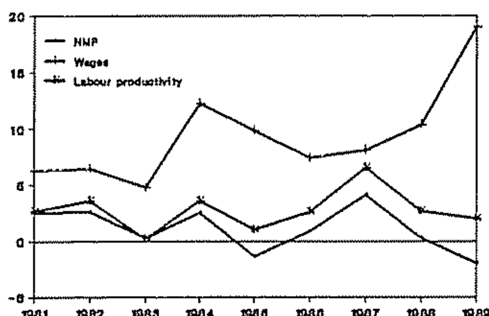
Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on national and international sources

Figure VI.2 China, Eastern Europe and the Soviet Union: indicators of growth, productivity and wages, 1981-1989

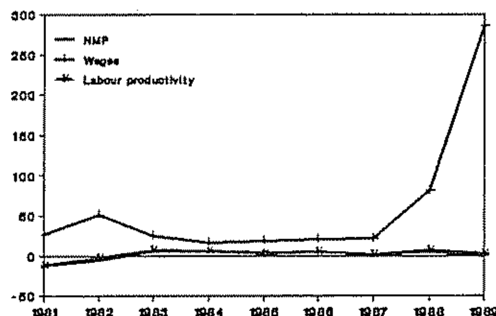
(Annual percentage change)



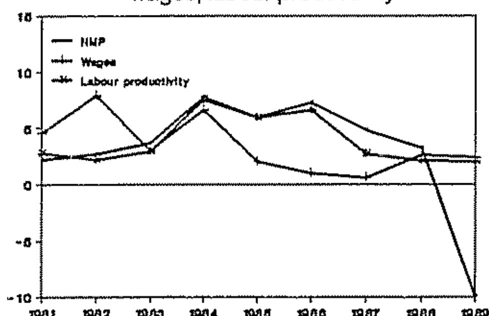
Hungary: NMP produced, wages, labour productivity



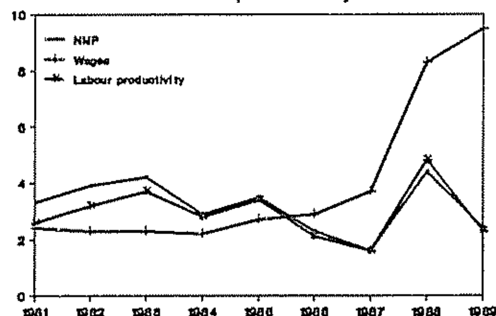
Poland: NMP produced, wages, labour productivity



Romania: NMP produced, wages, labour productivity



USSR: NMP produced, wages, labour productivity



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

Inflationary pressures can take various forms. Open price drift is but one manifestation of the underlying imbalance in a centrally planned economy. Even in countries that ostensibly adhere to rigid control over wholesale and retail prices, there may be an upward drift in prices in various guises. The most obvious is the periodic revision of fiat prices. Another is the price pressure that can be seen in segments of the economy, including the so-called second economy, free peasant markets and handicrafts, that are qualitatively affected by the fixed-price régime because of limits to the extent of open price drift that is socially and politically acceptable. Finally, there may be a hidden rise in prices on a more or less steady basis, which is one aspect of repressed inflation as explained below. The latter phenomenon is crucial to explaining the perceived dangers of inflationary pressures with market-oriented reforms. Whether these various forms of inflation are actually measured in official statistics is a different matter, however.[3]

Hidden inflation is present when the quality, quantity or assortment of the products concerned deteriorates but unit prices remain unchanged. The most prevalent examples are quality deterioration and the substitution of higher-priced goods that differ only nominally from the lower-priced ones formerly available in adequate amounts. Their measurement in price indices is not only methodologically difficult, but is also often ignored. In the consumer sphere, repressed inflation can take various forms, such as outright rationing, involuntary savings, longer queues or forced substitution of higher-priced products.

The impact of hidden inflation is as a rule similar to that of measured open price inflation. The impact of repressed inflation, however, is much more intricate as it changes the fundamental economic behaviour of economic agents. It may induce consumers to choose leisure over work. But this trade-off will usually take the form of changing worker attitudes that result in a marked lowering of average labour productivity. Queuing in particular requires a substantial amount of either work time or leisure time that could be used in a more rewarding activity.

In sum, although there is a broad similarity between the underlying factors that lead to inflationary pressures in planned and market economies, there are also multiple differences that find their origin in the institutional features of these economic models.

[3] The ongoing policy debates in Eastern Europe, Mongolia, the Soviet Union and Viet Nam have unleashed an intense inquiry into the statistical probity of a whole range of official data.

Central planning and imbalances

The considerable inflationary pressure during certain periods of the evolution of central planning is paradoxical, given the concentration of economic power in the hands of central authorities. An first glance, this would preclude obstacles to continual adjustment of demand to the level of supply typically experienced in market economies. After all, central planning, by definition, is meant to reconcile supply of resources with demand.

In theory, if all goods and services were distributed directly by government agencies, no imbalance between demand and supply could arise, although the distribution of aggregate output between consumption and accumulation might entail social tension. Central planning must, however, come to grips with several realities. First of all, consumer goods and labour are not directly allocated. Instead, wages are paid in money and used to purchase goods and services in retail markets that are administratively regulated. If these money flows are not harmonized with the flows of goods and services placed on the market, after allowing for changes in voluntary savings, either because of imperfect planning or unanticipated developments during implementation, they generate imbalances that may be monetized in the short run; they will eventually be monetized, unless the imbalances are fairly quickly reversed through appropriate planning. This duality of flows makes it imperative to supplement physical output plans, through material balances for example, with financial plans to dovetail monetary transactions with the corresponding physical flows. This is critical especially to harmonizing wage, output and allocation plans so as to synchronize disposable incomes with the planned supply of consumer goods and services.

Balance in the consumption goods sector may be disturbed, as it is in market economies, by events that generate inflationary pressure. For example, a rise in the share of investment, net export or government expenditure in aggregate outlays tends to create excess demand over the reduced supply of consumer goods, unless the excess is eliminated by a compensatory rise in voluntary savings or direct taxation. Similarly, a rise in wage and income payments in relation to aggregate income uses will, *ceteris paribus*, exert pressure on consumer prices.

Imbalances are by no means confined to consumer markets, however. Under traditional central planning, interfirm transactions are the subject of direct resource allocation. Therefore, in principle, maladjustments between demand and supply cannot have a direct effect on prices. But excess liquidity in individual enterprises, because of lax bank control, may lead to unplanned inventory formation. This will necessarily affect available supplies, including ultimately supplies of consumer goods. Most important, it may also exacerbate inflationary pressures by raising wages above planned norms. Any such expansion of the wage bill contributes to inflationary pressures. Table VI.2 shows the relation between the growth of real output, nominal wages and average labour productivity. These data show that, even in countries with no open inflation, especially since the mid-1980s, wage payments have tended to exceed gains in output per worker.

If intersectoral transactions are entrusted to individual firms, rather than strictly steered by administrative fiat, central planning must accommodate the reality that the best plan may be derailed and therefore yield imbalances. This feature arises because some economic activities, including agriculture and foreign trade, cannot be planned exactly. Central planning must also attempt to maintain balance in the event of unexpected shortfalls, which in the first instance are inflationary, or unexpected bounty, which is deflationary. This is done through various institutions and mechanisms of controlling and managing the economy. Of course, the plan may have been drafted in such a way that it embodies imbalances by design.[4]

Despite some similarities between the general causes of imbalances in market and planned economies, there are significant differences in the process of inflation, or deflation, and its effects and in the mechanism of adjusting demand and supply. These differences reflect essential dissimilarities in the institutional framework of the two kinds of economies and in specific economic policies and policy instruments adopted by them. In particular, inflationary or deflationary pressures do not necessarily affect actual prices; their impact on prices may simply be latent or the imbalance may get corrected through some means other than price adjustments. These features derive in good measure from the price policies pursued in centrally planned economies, and the way in which these economies engage in international trade and manage consumer incomes.

Among the key elements of the centrally planned economy that ensure price stability are institutional mechanisms that separate real from monetary flows and maintain fiscal buffers between the external sector and the various spheres of the domestic economy; the external sectors are further dichotomized into interactions within the trade and payments régimes of the Council for Mutual Economic Assistance (CMEA) and, primarily, relations with market economies. These mechanisms buttress explicit policies on price stability, in the first instance for planning purposes in the case of wholesale and procurement prices and chiefly for social purposes in the case of consumer prices in all retail outlets.

[4] Thus, during the early phases of central planning, "taut" plans were formulated in an effort to challenge economic agents to "outdo" themselves, even though central authorities realized that the probability of fulfilling such ambitious plans was small

Table VI.2. Annual growth rates of NMP produced, monthly nominal wages[a] and labour productivity[b] in Eastern Europe and the Soviet Union, 1970-1989

(Percentage)

	Bulgaria[c]	Czechoslovakia	German Democratic Republic[d]	Hungary[e]	Poland[f]	Romania[g]	USSR[c]
1971-1975							
NMP	7.9	5.6	5.4	6.2	9.7	11.5	5.7
Wages	3.3	3.5	3.5	6.1	11.9	4.4	3.7
Labour productivity	3.2	3.0	3.3	6.2	9.8	...	3.3
1976-1980							
NMP	6.1	3.7	4.1	2.9	1.2	7.0	4.3
Wages	4.5	2.7	2.8	6.9	9.1	7.0	3.0
Labour productivity	6.1	3.3	3.6	3.7	1.7	6.6	3.2
1981							
NMP	5.0	-0.1	4.8	2.5	-12.0	2.2	3.3
Wages	5.5	1.5	2.5	6.3	27.3[h]	4.6	2.4
Labour productivity	3.8	-0.4	4.6	2.7	-12.2	2.8	2.6
1982							
NMP	4.2	0.2	2.6	2.6	-5.5	2.7	3.9
Wages	2.6	2.3	1.9	6.4	51.3[h]	7.9	2.3
Labour productivity	3.6	0.2	2.3	3.6	-2.5	2.2	3.2
1983							
NMP	3.0	2.3	4.6	0.3	6.0	3.7	4.2
Wages	1.0	1.9	1.3	4.8	24.5[h]	3.0	2.3
Labour productivity	2.9	1.9	4.2	0.2	6.9	2.9	3.7
1984							
NMP	4.6	3.5	5.5	2.5	5.6	7.7	2.9
Wages	4.0	1.7	2.0	12.2	16.3[h]	6.6	2.2
Labour productivity	5.1	2.8	5.2	3.6	5.9	7.5	2.8
1985							
NMP	1.8	3.0	5.2	-1.4	3.4	5.9	3.5
Wages	3.4	1.6	2.5	9.8	18.8[h]	2.0	2.7
Labour productivity	2.0	2.4	4.5	1.0	3.2	5.9	3.4
1981-1985							
NMP	3.8	1.6	4.6	1.3	-0.8	4.5	3.5
Wages	3.3	1.8	2.1	7.9	27.0[h]	4.8	2.4
Labour productivity	3.5	1.3	4.3	2.1	-0.1	4.2	3.0
1986							
NMP	5.3	2.6	4.3	0.9	4.9	7.3	2.3
Wages	5.2	1.5	3.5	7.4	20.4[h]	1.0	2.9
Labour productivity	5.2	2.5	4.2	2.6	4.6	6.6	2.1
1987							
NMP	5.1	2.1	3.3	4.1	1.9	4.8	1.6
Wages	4.3	2.0	5.4	8.1	21.1[h]	0.6	3.7
Labour productivity	5.0	2.1	3.5	6.5	1.9	2.7	1.6
1988							
NMP	2.4	2.4	2.8	0.3	4.9	3.2	4.4
Wages	5.0	2.3	2.9	10.3	81.9[i]	2.6	8.3
Labour productivity	6.5	2.4	3.0	2.7	6.4	2.1	4.8
1989[j]							
NMP	-0.4	1.3	1.9	-2.0	0.0	..	2.4
Wages	5.3	2.4	4.0	19.0	286.0	2.4	9.5
Labour productivity	5.9	2.0	2.8	2.0	2.5	2.0	2.3

Source: National and/or CMEA statistics.

a Remuneration of full-time workers and employees in the socialist sector.

b Net material product per employee in the material sphere.

c Before deduction of taxes.

d In six sectors of the material sphere.

e State sector only; without bonuses and compensation for price rises. Not comparable with previous years.

f Excluding bonuses.

g Total economy; net remuneratino, including bonuses.

h Including compensation for price rises.

i Gross wages.

j Preliminary.

Balancing the economy under central planning

From the beginning of socialist organization in the countries under discussion, it has been accepted as axiomatic that socialism implies the effective control of the economy by society through central planning in pursuit of its objectives. The accepted premise of central planning has been that tools of indirect regulation are not sufficiently reliable in generating rapid growth through industrialization.[5] Resource allocation must hence depend on other signals. This holds good in particular for domestic price policies and the way in which the economy engages in foreign trade.

As a rule, industrial wholesale prices are calculated by the planning centre on the basis of average sectoral production costs without making due allowance for the scarcity of capital, land and foreign exchange. Agricultural procurement prices are set depending upon the organization of agriculture, the specific goals policy makers wish to pursue and the planning centre's influence over free peasant markets. Consumer prices are, as a rule, divorced from wholesale prices by a complex network of subsidies and taxes, which in part reflect government preferences.[6] In addition, prices are generally left unchanged for long periods of time. Each price régime is steered rather autonomously through particular institutional and policy choices.

Monetary policy in such an economy is essentially passive. It is concerned chiefly with issuing loans through the monobanking system for well specified purposes, granted for fixed periods of time, secured by real assets, repayable and centrally regulated or even administered on a planned basis. Money simply facilitates the allocation of resources previously earmarked in physical terms in the plan. Financial assets of households are generally limited to cash, lottery tickets, savings deposits and occasionally government or enterprise bonds; those of firms are as a rule limited to bank deposits. Fiscal policies are subordinated to the general aims of the plan and social precepts on income differentiation, profits and price regulations. Enterprise profits and losses are generally absorbed in the central budget. Managerial and worker incentives seek to overfulfil quantitative production targets, on which bonuses are predicated.

Arbitraging the differences between stable domestic prices and scarcity-related trade prices is as a rule precluded through the foreign trade and payments régimes, which virtually insulate the domestic economy from external influences by means of special instruments and institutions. Organizationally, the nearly absolute separation is accomplished through price equalization by the state monopoly of foreign trade and payments (MFT). Foreign trade organizations (FTOs), which are subordinate to MFT, purchase domestic products for export and sell imports at domestic fiat prices. Differences between domestic and foreign prices expressed in domestic currency are offset through the central budget.

Actual trade events affect the domestic economy through macro-economic changes rather than price fluctuations.[7] Planners attempt to sterilize trade results that diverge from planned magnitudes. Alternatively, they offset trade gains or losses by varying other budgetary outlays or postpone adjustment until the next plan schedules a replenishment of foreign exchange reserves or servicing of foreign debt. This indirect influence is actively mitigated by clearing the bulk of trade through comprehensive bilateral trade and payments agreements with rather autonomous prices, especially in intra-CMEA relations.[8]

Thus, though imbalances in a traditional planned economy may arise for a variety of reasons, they do not necessarily find expression in price movements. Much more important is the macro-economic approach, particularly in view of the comprehensive scope of public finance. About two thirds of the national income is channelled through the budget, which thus co-ordinates output and distribution processes and seeks to maintain financial discipline.

Government outlays are the core determinant of economic activity, if only because the budget wields great control over the level and composition of investments. In addition, there are price subsidies of all kinds, including subsidies for enterprises, foreign transactions and a broad range of consumer goods. Planned economies being socialistic by their avowed precepts engage in considerable social transfers,[9] chiefly in kind but also in money, which together as a rule form a substantial proportion of real incomes. Finally, there are "normal" expenditures for administration, defence and public goods.

As in market economies, a budget surplus in a planned economy contributes positively to aggregate saving. Likewise, a budget deficit implies that the Government's behaviour contributes negatively to saving. If this is not offset by the rest of the economy, there will be excess consumer demand that, given fixed prices, cannot be blotted up and will

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5 Key features of alternative planning models are examined in *World Economic Survey, 1988* (United Nations publication, Sales No. E.88.II.C.1), pp. 93-120.

6 There are, of course, other prices, such as those for handicrafts and free peasant markets, but the three régimes outlined here suffice for the purposes of this chapter.

7 For a perspective, see Colin Lawson, "Exchange rates, tax-subsidy schemes, and the revenue from foreign trade in a centrally planned economy", *Economics of Planning*, No. 1/2 (1988), pp. 72-77, and Thomas A. Wolf, *Foreign Trade in the Centrally Planned Economy* (Chur, Switzerland, Harwood Academic Publishers, 1988), pp. 41-47.

8 This applies generally to trade among full members. There are 10 active members: Bulgaria, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania, the Soviet Union and Viet Nam. Albania is an inactive member. The trade and payments régimes applied even in relations with China until around 1960 and continues to apply to the Democratic People's Republic of Korea. Relations with the Lao People's Democratic Republic and Yugoslavia are usually handled more flexibly.

9 There are also other considerations that tend to allot a greater role to income distribution in some of these economies. Thus, the Central European countries exhibited a strong current of egalitarianism and a deeply ingrained habit of looking to the State as provider before these economies veered towards central planning.

thus result in involuntary savings. Since prices are on the whole prescribed by central fiat, they are not generally affected by these imbalances, however. One may observe some pressure in peasant markets and handicrafts, but even there social restraint ensures that price movements, except for seasonal variations in supply, will generally remain small.

Central planning and imbalances in the reform process

In the most general terms, economic reform is a process aimed at enhancing the way in which resources are allocated so as to satisfy needs, present and future, private and social, better than before. The traditional economic model is altered in several respects, including most notably enterprise behaviour, domestic price policies and the broader issues of safeguarding domestic policy autonomy at all costs and the role of foreign trade. Very often the immediate inducement to reform is flagging output performance due to a slow-down in factor productivity or socio-political tensions resulting from an accumulation of imbalances. The most direct objective is, therefore, to find ways and means of revitalizing the economy primarily on the basis of factor productivity gains.

During the late 1950s and much of the 1960s, the European planned economies made various attempts to bolster factor productivity by instituting a selectively decentralized economic model. Although not quite uniform, these models exhibited certain common transformations of policy instruments and some of the supporting institutions of the highly centralized economic model, but they kept intact the basic precepts of central planning. As such, they focused nearly exclusively on finding a more pragmatic division of administrative and economic duties between the centre and local planning tiers. Changes were sought to activate local decision-making on the basis of cost-benefit analyses and the recognition of market preferences by firms. But, as a rule, administrative central planning was retained, with only some decision-making responsibilities delegated to lower level. Firms could influence plan formulation or implementation, however. In this approach, only minimal reliance was placed on price indicators, as comprehensive price reform continued to be eschewed. Central control confined price flexibility chiefly to the periodic resetting of fiat prices. Somewhat greater importance was placed on utilizing fiscal, credit and income policies to induce enterprises and households to act in accordance with overall plan objectives. But direct control over a number of key economic processes, including most notably foreign trade, remained.

By the early 1970s, the components of the first wave of economic reforms that sought to veer away from overwhelming central planning and gradually to allocate some room for decentralized decision-making were replaced by greater administrative centralization. The resultant modified recentralized models, however, strengthened essential features of the foreign sector reforms first sought in the 1960s. In some countries, this recentralization proceeded with changes in co-ordination mechanisms and institutions, including the administrative regulation of price changes. Though still under political control, frequent price revisions were undertaken or induced to reflect changes in macro-economic policy and the gradual move towards genuine decentralization. The balancing of demand and supply at the micro-economic level was achieved through various informal, chiefly non-price mechanisms, however.

Even though the reform formats embraced from around the mid-1950s through the mid-1980s as variants of the traditional planned economy did not alter the basic precepts of central planning, they complicated the process of macro-economic control in a number of respects. One potentially destabilizing factor was the decentralization of central planning authority in favour of regional or ministerial planning and budgetary centres. This called for another layer of co-ordinating decisions to ensure that they were all reached so as to enhance the policy objectives of the country's leadership.

Perhaps graver problems of co-ordination arose in economic management with the devolution of enterprise decision-making and the weakening of the strict administrative allocation of resources, be it by central, regional, local or ministerial bureaucracies, in favour of horizontal relations among firms. Because some plan targets continued to be assigned, such relations were not always economically warranted, however. Often, firms had to procure inputs, including labour, through means other than centrally prescribed norms. Lax credit control—monetary authorities simply continued to finance enterprises in accordance with the plan regardless of their economic justification—tended to exacerbate imbalances. Because central rewards for output fulfilment were more potent than those for attaining profit, however nominal, and workers pressed for the distribution of retained earnings, there was also an incentive on the part of enterprise management to circumvent wage scales or inflate bonuses.

The above analyses show that, in spite of comprehensive policy control, the centrally planned economies have been exposed to imbalances, which have not always translated into upward price movements. Furthermore, the degree of success in containing such pressures and alleviating them has varied from country to country and from period to period. Often, the outcome has been determined overwhelmingly by the success of balancing, through direct controls as well as draconian credit ceilings, the flow of purchasing power to households against the volume of consumer goods and services placed on markets. Direct controls have certainly been more important than fiscal and monetary policy, operating, for example, through the availability and cost of credit or inducements to save rather than spend. The contribution of the banking system to containing inflation has been passive, owing largely to its dependence on central plans and its paramount task of controlling the underlying monetary flows so as to keep them within planned boundaries. Open price inflation at times erupted in partial markets as a result of the prevalence of differential price controls in unintegrated markets. But otherwise, pressures manifested themselves in various forms of repressed inflation.

Starting conditions for market-oriented reform

The nature and process of the above-mentioned inflationary pressures alter radically once a country embarks on market-oriented reform. Two aspects need to be considered. One concerns the process of transition to the new environment; the other, how to operate optimally within the market-oriented economy, once established. The transition process will usually require that new policies, institutions and policy instruments are established. An integral component of the process is the formulation of an economic policy that ensures some measure of economic stability. How to avoid inflationary pressures or, if they occur, how best to come to grips with them, is an important element.

The central aim of market-oriented reform is to raise factor productivity growth and maintain it at a comparatively high level through decentralization and macro-economic policy co-ordination. This involves curbing, and eventually abolishing, administrative guidance in determining output, resource allocation and income distribution. Entrepreneurial activity is to be co-ordinated through economic links of the market type rather than through vertical chains of administrative command. Supply and demand, and the resultant prices, can guide decisions on outputs and inputs. Profit measures are to reflect a firm's contribution to the economy as a whole and be the basis for rewarding personnel.

Comprehensive economic reforms may lead to inflationary pressures and entail macro- and micro-economic policy dilemmas during the transition period. The most important concern (1) the role of the government budget and fiscal policy, including decentralized administrative organs that have been granted greater fiscal and managerial autonomy; (2) the paramount function of monetary policy in maintaining stability and growth, and indeed its autonomy when conflicts arise with other macro-economic policies; (3) the central place and instrumental role of banks in financing firms on a more commercial basis and mobilizing resources; (4) the commercial decision-making of all economic agents and how to reconcile their interests with those of central managers; (5) the crucial role of MFT in setting commercial policies, opening up the economy to broad foreign competition and bolstering global trade; (6) the forms through which greater micro-economic efficiency is to be achieved and what this entails for the traditional tenets of socialized property; and (7) the rationalizing of all prices to reflect more closely underlying economic scarcities.

Such reform evolves necessarily in the presence of at least two legacies of the orthodox or modified central planning mechanisms. One is the coexistence of features of central planning with indirect co-ordination mechanisms. The other is the absence of firm macro-economic policies, institutions and policy instruments other than those of central planning. Of particular importance is the weak role of money, prices, wages and other indirect co-ordination intruments in the inherited economic model, where that role is taken up by subsidies, payments in kind, material balancing and other non-market instruments.

The demand and supply pressures that potentially disrupt market balances in planned economies are embedded in the behaviour of economic agents that cannot be rectified overnight. For one thing, the entrepreneurial élite in these economies was appointed chiefly because of administrative and political connections rather than managerial ability. Moreover, the spirit of capitalist entrepreneurship simply does not exist. Time is needed to inculcate it into managers. Policy makers need to nurture the transformation process too. Similar constraints arise on the part of households as providers of labour services and as consumers. Having been exposed for many years to relatively low and stable prices for basic goods and services, households are reluctant to part with the implicit subsidies, which places constraints on revamping the role of the government budget. The principle of income differentiation, after having long been frowned upon in response to a pronounced commitment to egalitarianism, is not likely to be readily tolerated by the vast majority of the population. Finally, households may be reluctant to give up full employment and other social welfare guarantees.

Controlling income differentiation through fiscal means, rather than through wage and income norms set by administrative fiat, requires not only more sophisticated fiscal instruments, including value-added tax systems and progressive income taxation in lieu of turnover taxes; its success also depends on the acceptance of such new mechanisms by households. As regards labour and its remuneration, the emphasis at the outset of reform the emphasis necessarily has to be on restraining labour remuneration while raising productivity and instituting larger wage differentials to reflect corresponding differences in productivity levels. Such a *de facto* drop in real wage and income levels will be accepted only if economic agents are confident that short-term hardships will soon give way to rewards according to effort.

During the initial phase of the reform, the stock of excess demand in the form of repressed, and in some cases open, inflation may also have to be dealt with. The policy measures available to come to grips with this overhang need to be examined for their relative merit as soon as circumstances permit so that the effort to bring about changes in economic and administrative structures is not overburdened with the accumulated imbalances.

How best to co-ordinate economic decisions is arguably the core issue of moving towards greater market-orientation without generating imbalances or aggravating those inherited from past mistakes. Whichever replacement co-ordination mechanisms are preferred, they can be established only gradually, although at different rates. This poses the tricky problem of how to guide the process. With rare exceptions, one of the more striking features of reform processes in planned economies has been the rather casual treatment of the co-ordination problem, including most notably of the inflationary pressures present when policy makers embark on reform. Depending on the nature of the pressures, such as inherited imbalances, current macro-economic policies that are not properly co-ordinated or restructuring of relative prices, one element or another of the co-ordination mechanism will require greater emphasis.

Inflation in the reform process is generated mainly by the incoherence or incompleteness of reforms and the fact that they are placed in an institutional environment that is not conducive to indirect economic co-ordination. Macro-economic policies that aggravate imbalances are another contributing factor. There are, furthermore, country-specific circumstances such as the stock of excess demand. In some cases, the devolution of decision-making from the central Government to provincial and local authorities has had important implications for macro-economic policy control and the inflationary process, given the incomplete framework for ensuring "rational" decision-making through central policy.

Any movement towards market orientation calls for comprehensive monetary and fiscal policies to steer the behaviour of individual agents. In addition, income and price policies are needed to realize social priorities. In economies that wish to integrate themselves into the global economy, active foreign exchange and commercial policies also need to be designed. This is by no means a simple agenda, if only because the planned economy, whether traditional or modified, has not been very much concerned about this particular macro-economic infrastructure.

The aim of harnessing private initiative and entrepreneurial spirit is at the core of the more radical reforms currently being implemented. For allocation by a planning organization to be properly overtaken by allocation through the price mechanism, relative prices become key criteria of choice. The price mechanism can perform this function only if there is some reasonable degree of resource mobility and functioning markets, including foreign competition and labour mobility. For the price mechanism to function well, markets must be integrated and made up of a sufficient number of actors to ensure competition not only in domestic wholesale and retail markets, but also in foreign trade and the allocation of foreign exchange. This is not the case in most countries.

Another important component of reform concerns external sectors and hence commercial policy in view of the dependence of these countries on trade and hence the direct feed-through of external disturbances once MFT is relaxed to permit direct trade relations, the hope of raising measurably their export potential on a competitive basis, the need to foster a more competitive environment which is difficult to bring about in small countries, the degree they are intermeshed in the CMEA context and the external payments constraints for some of them. By themselves, these issues present an ambitious agenda for reformers. Except for the CMEA conundrum, examined in chapters III and IV, the issues listed are mostly under the control of policy makers from each country in isolation. But a resolution of the issues for the most indebted planned economies is unthinkable without the co-operation of agents of market economies.

To integrate themselves more closely into the global economy, these economies must come to grips with the dichotomy between CMEA and other markets, including issues of bilateralism, currency inconvertibility, price distortions, fixed trade quotas and other obstacles to ensuring market operations in CMEA. To obtain a more active foreign exchange policy, eliminate market dichotomies and measurably raise trade levels, it is necessary to institute much more coherent trade and foreign exchange policies than those pursued hitherto.

Inflation, stabilization and economic reform in selected countries

To elucidate the connection between inflation and reform, and desirable macro-economic policies to control inflation, the experience of some of the countries that have embarked on or have expressed a keen interest in soon moving towards market-oriented reform are examined below. Three groups can be distinguished: (1) Viet Nam as the only country that has implemented radical policy shifts; (2) Hungary and Poland, where radical policy shifts are currently being sought; and (3) China and the Soviet Union, where reform efforts are being obstructed by palpable inflationary pressures.

Reforming the Vietnamese economy: inflation and stabilization

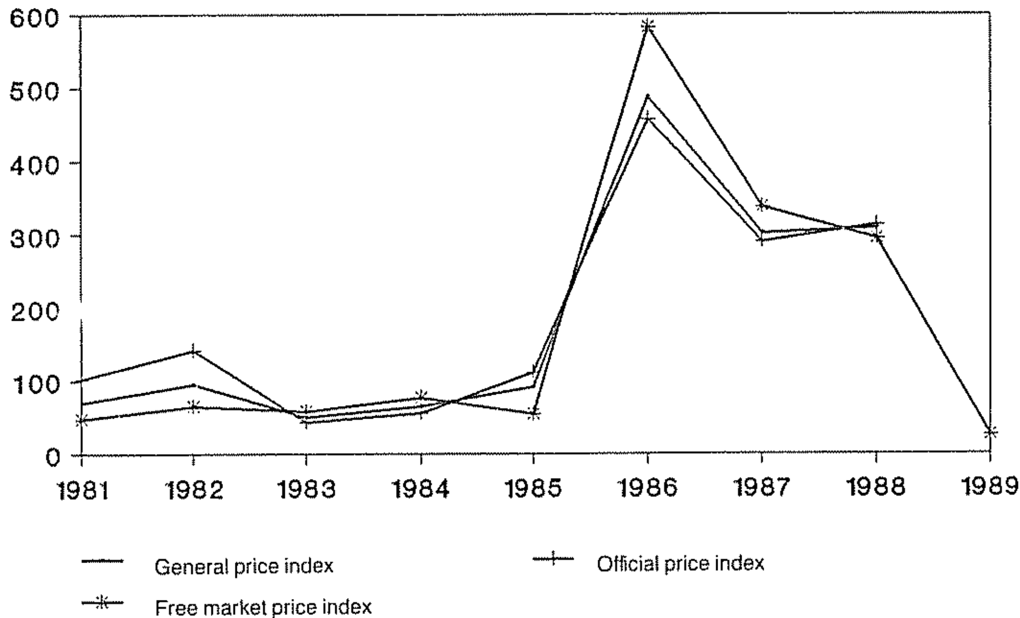
Viet Nam has been enacting economic and managerial reforms since 1979. As a result of decentralization, the reinstitution of private property and the refocusing of state activities on macro-economic policy, the central Government has all but abandoned its direct role in economic activity and has yielded significant ground on core features of central planning. These efforts culminated in early 1989 in draconian changes in economic organization and central policy stances, making Viet Nam arguably the boldest reforming planned economy. Rather than having emerged from within a carefully wrought, internally consistent reform blueprint, these innovations were embraced because of the inability of central authorities to ensure adequate and balanced growth through state ownership, central planning and rigid rules on income differentiation.[10]

The outstanding feature of the recent policy measures was a wrenching stabilization programme. This brought down inflation from a level of 300-500 per cent a year during the period 1986-1988 (see figure VI.3)[11] to a much more moderate pace, of perhaps an annual 80-120 per cent during the first few months of 1989, a decline in prices around mid-year, but a resurgence of inflation later on as control over the money supply tended to be eroded. Prices in 1989 are esti-

[10] For a discussion of the dilemmas, see Suzy Paine, "The limits of planning and the case for economic reform", in *Postwar Vietnam: Dilemmas in Socialist Development*, David Marr and Christine P. White, eds. (Ithaca, New York, Cornell University Press, 1988), pp. 91-94.

[11] All data are approximate as the statistical information of Viet Nam has been in the process of restructuring too.

Figure VI.3. Viet Nam: price indices, 1981-1989
(Annual percentage change)



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

mated to have risen on average by 25 per cent.

Since 1979, Viet Nam has sought to veer away from highly centralized administrative planning. Until the late 1970s, the overriding priority of rapid industrialization claimed resources at the expense of the agricultural and consumer goods sectors. Concurrently, social and health services were greatly expanded. In time, the distortions resulting from this system and the supporting inflationary fiscal and monetary policies, with bank credit financing budget deficits, led to a breakdown of the economic system. This was manifest in the shortage of goods, rising procurement prices and wages and a very unbalanced structure of output with an impoverished agricultural sector, an underdeveloped light manufacturing sector and an overdeveloped heavy industrial sector. Further pressures on resources and the system emanated from protracted military conflicts. These imbalances gradually eroded the central planning system by tacitly encouraging the development of other activities.

Though reform has proceeded with wide oscillations, in part because of the wavering commitment of policy makers, the decade-long experiment has very much weakened central control over resource allocation. Because of worsening shortages, economic agents were forced to resort to parallel markets and production outside the plan. In addition, the lack of success with integrating the southern, largely market-oriented, economy into the centralized system weakened central control. With the share of the state sector in gross output amounting to about 35 per cent from unification through the mid-1980s, Viet Nam has had a much lower concentration of production in the direct control of the State than any other planned economy.

The protracted reform experience since 1979 falls essentially into three periods.[12] The one initiated in 1979 aimed at administrative decentralization. It had three components. Perhaps most important was the attempt to implement the contract system in agriculture, thereby diluting the paramount role of collectivized agriculture essentially to maintaining and upgrading the collective land contracted out to peasant households. The objective was to reverse the disastrous response to the forced collectivization of the Mekong delta by enhancing the role of individual initiative and productivity in both output and reward systems.[13]

The second component focused on placing state enterprises on a self-accounting and self-financing basis, largely through administrative decentralization, and rewarding labour effort in state firms on a piecework basis. Although it was hoped to make profitability a strategic success criterion for the firm, the firm in fact had little leeway in respect either of input and output prices, which remained under central control and set on the basis of the average cost-plus principle, or of production mixes because the firm remained an integral part of the central planning system. This part of the

[12] For a detailed review of the reform process until about mid-1988, see Stefan Vylder and Adam Fforde, *An Economy in Transition* (Stockholm, Swedish International Development Authority, 1988).

[13] See Melanie Beresford, "Issues in economic unification: overcoming the legacy of separation", and Vinh Long Ngo, "Some aspects of cooperativization in the Mekong delta", in *Postwar Vietnam*.

reform was severely undermined by too lax an administration of enterprise finances made possible by accommodating central credit and allocation policies. Retail and input prices for state enterprises were still subsidized, state firms were not financially accountable, there were serious barriers to internal trade and there was no functioning central bank. Prices were occasionally revised, largely to compress subsidies or monetize the in-kind wage component paid in the state sector. But on the whole, subsidies to state firms and price supports, which aggravated fiscal imbalances, remained very important at least until early 1989.

The final component of the 1979 reform was the official recognition of the role of the informal, private sector in such endeavours as agriculture, small-scale industry, retail trade, handicrafts and artisanship. Peasants were allowed to cultivate their own crops and raise livestock for sale in free markets, provided they fulfilled quotas negotiated by their collectives with central authorities. Small merchants and artisans were permitted to become private entrepreneurs. In addition, Viet Nam's economic and administrative structures were decentralized in an effort to widen the power and responsibility of provincial and local authorities.

The new system went into motion gradually, causing more bottle-necks than it was intended to cure. Although there was significant short-term growth during the period 1979-1982 in response to decentralization, the pace subsequently faltered as no measures had been taken to improve supply conditions through increased investment in agriculture or light industry. After 1981, the demand for capital goods and inputs increased significantly again. Growth in state employment resumed and led to rising incomes. Because of competition from the unplanned sector the State had to raise prices and wages. These as well as continued government subsidies raised budget expenditures more rapidly than revenues, leading to growing deficit and inflationary pressures. Private production and foreign trade activities were recentralized during the period 1983-1985. This shift exacerbated supply bottle-necks in inputs and consumer goods. Growth in agriculture also slowed markedly as the initial stimulus of the contract system petered out. Inflation rose from almost 70 per cent in 1981 to 91.6 per cent in 1985. Aggregate growth declined after two years of moderate increases.

These complications and the failure of the reform, except notably in agriculture, induced the leadership to stimulate trade and production through material rewards, while seeking to preserve the authority of the political and planning leadership. This continues to pose a major dilemma, because fostering reforms that encourage economic agents to pursue their own interests, given the inadequate political and state structures in place, may efface central authority.

The second phase of the reform experiment introduced in September 1985 focused on wages, prices and banking. Regarding wages, the Government was aiming at replacing all consumer price subsidies by monetizing payments in kind at a fixed low price, compared with what prevailed in the free market; avoiding a pronounced drop in real wages by lifting nominal wage levels; and raising the real wage level in the state sector as a means of encouraging labour productivity.

As a counterpart to the wage reform, the price reform envisaged the elimination of the dual pricing system,[14] in which transaction prices within the state sector, for both interfirm procurements and retail prices, were well below those in open markets. These price increases were accompanied by compensatory loans to state enterprises and wage increases. But prices remained under central control, set at levels that corresponded to the typical cost-plus averaging of planned economies and kept unchanged at least for the duration of the five-year plan. Greater price flexiblity was possible in free peasant markets, handicrafts and related marginal sectors. Prices, however, would intermittently be reset by the centre to enable state firms to forgo budget subsidies, including those for capital formation. Ongoing state investments were henceforth to be paid for by the user through proper depreciation and capital charges.

Potentially perhaps the most important element revolved around monetary reform. By introducing a new currency and exchanging old dong on a ten-to-one basis only up to a certain limit, the excess having to be kept at the state bank for a substantial period of time, the authorities hoped to rein in consumer demand and re-equilibrate the economy. Although this measure whittled down the existing monetary overhang, the impact on private wealth was blunted because it had been kept chiefly in immovables, gold and foreign exchange. It did destroy the dong assets of state firms, which led to a cash shortage that the Government had to make up simply to ensure viability to firms. This development crippled the partially reformed banking system. But the central bank was still not adequately developed to function effectively as an independent institution to set and enforce monetary policy. The specialized commercial banks were still subject to local political pressure to provide credit to state firms regardless of creditworthiness.

Though this second reform did not envisage a relaxation in the role of the Government in micro-economic affairs, including pricing, the synchronized increase in wages, prices and money supply through currency issue fuelled inflation, a process that was reinforced by substantial budget deficits. The inability of the banking system to enforce credit discipline, because it would interfere with the fulfilment of short-term output targets, also exacerbated inflationary pressures. As a result, the potentially useful price reform became highly dysfunctional soon after its introduction in 1985.

As shown in figure VI.3, inflation soared to unprecedented levels - almost 500 per cent in 1986, compared with 92 per cent in 1985; it abated slightly in 1987 but remained at about the same level in 1988, after the authorities opted for another round of compensated, albeit incompletely,[15] price

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[14] The only exceptions were for "essential" categories, that is, rice, kerosene, medicine, paper, utilities and rent.

[15] With the acceleration of inflation, wages in the state sector were adjusted continuously and the rationing of several basic goods was instituted in 1986. Rice became an important component of wage payments in the face of spiralling inflation. Yet real wages were not maintained as in 1985.

adjustments to narrow the gap between state and free market prices without enforcing fiscal and monetary discipline. This rampant inflation had very severe consequences. It destroyed liquid wealth and eroded real wages. It also interfered with the management of a delicately balanced government budget heavily financed from abroad.[16] Inflation also destroyed the effectiveness of the contract system in agriculture and induced economic agents, including state firms, to explore private channels, where prices were at least keeping pace with inflation. This was perhaps a useful economic alternative. But the fact that it remained outside the plan weakened central management. Because of other controls exerted over supplies to the agricultural sector in exchange for part of the produce, the output of paddy—the key staple—fell drastically. Finally, with the change in inflationary expectations in response to the shift in official pricing policy, hoarding by consumers, traders and producers became rampant. Negative real interest rates, in some years amounting to several hundred per cent, made hoarding even more profitable and exacerbated excess demand. These developments set the stage for the third round of reforms, of which the first positive results have been coming to the fore since mid-1989.

Following the measures enacted during the period 1987-1988 and ratified in early 1989, the course of reform, known as renovation (*doi moi*), has become much clearer. For one thing, policy makers now recognize the need to tackle monetary and fiscal problems to sustain progress with economic reform aimed at the creation of a market-based economic mechanism under macro-economic control. Until recently, the monetary system was rudimentary and there was no independent central authority to implement monetary policy. Although some significant monetary reforms, including the strengthening of the functions of the central bank and the decontrol of the market for gold, were implemented in 1988, interest rate policy was still conducive to inflation and hoarding as real rates remained markedly negative. Furthermore, the specialized banks were still not operating independently, although they were responsive to interest rates and other signals of the central bank. Fiscal policy accommodated inflation through an increasing deficit resulting from higher wages and subsidies funded by foreign and domestic credit. The most important components of the reform programme, apart from strengthening monetary and fiscal policies, envisage further decontrol of prices, reduction of barriers to internal and external trade, promotion of agriculture by increasing the share of private markets, retention of output by individual farmers and acceptance of small private enterprise in the major cities. The decision-making power of state firms has been broadened by the substitution of tax and profit remittances for centrally set quantitative production targets. The foreign trade sector has been further decentralized by increasing the scope for direct participation in trade by local authorities and enterprises.[17] The inflow of foreign capital and technology has been promoted by the establishment of a new foreign investment code.

To attain the goals of *doi moi*, which include ushering in a market-oriented economic mechanism based on autonomy of economic agents, the Government has committed itself to abandoning the day-to-day management of the economy. State firms will be liquidated or restructured, sold off or otherwise contracted out to managers able to make a profit. To date, only smaller firms have been closed down or reorganized, but liquidation or legal bankruptcy has yet to be put into effect. These measures were to be supported by a sharp contraction in the rate of increase in money supply. In fact, zero growth with sizeable real interest rates was the aim in order to discourage wanton borrowing by unprofitable state enterprises. The expansion of the private sector is a priority in the generation of economic growth and employment. The allocation of real and financial resources is to be based on prices determined by supply and demand. Insulation of the domestic economy from the international economy is to be ended by freeing the exchange rate and expanding access to foreign exchange and gold. But this is complicated by the substantial share of trade with CMEA countries that is cleared at transferable rouble prices.

In early 1989, there was an abrupt shift to extremely contractionary macro-economic policies based on high real interest rates, reduced government expenditures and lower real wages. In the monetary sector, the continued restructuring of the banking system was critical to the effective implementation of the new credit and interest rate policies under the guidance of the central bank and the newly formed National Banking Council, which co-ordinates activities of the banking system, and a national committee presided over by the Minister of Finance to co-ordinate fiscal and monetary policy. Nominal interest rates were raised drastically to yield positive real rates. The official exchange rate was devalued to the market rate, which effectively eliminated the need for government export subsidies.

The budget deficit, which was 11 per cent of GDP in 1988, is estimated to have declined only negligibly in 1989, remaining well above the target of 7-8 per cent of GDP for that year. Some price subsidies have been eliminated as a result of the freeing of prices, only part of which is being compensated through wage gains. The growth of wages is being held in check by reducing employment in the state sector and lowering wage differentiation there. Investment and maintenance expenditures rose, however, owing to price increases. The growth of social welfare expenses was checked and a shift was made towards partial privatization of social welfare services. With increased autonomy of micro-economic units, the growth in revenues is undermined as the reform of fiscal revenue generation is still in its early stages.

Since early 1989, prices have been all but decontrolled.[18] Agricultural commodities are now largely sold at market prices; the majority of industrial goods are sold at negotiated prices. To enhance the interaction between domestic and for-

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[16] See Max Spoor, "State finance in the Socialist Republic of Vietnam—the difficult transition from 'state bureaucratic finance' to 'socialist economic accounting'", and Karl H. Englund, "External assistance in the context of Vietnam's development effort", *Postwar Vietnam*. . .

[17] But loss of control over the allocation of foreign exchange forced the central authorities to institute import-licensing and compulsory deposits of export earnings in mid-1989.

[18] As at mid-1989, only those for electricity and transportation were still centrally managed.

eign markets and eliminate major export subsidies, the dong has been drastically devalued to within 10 per cent of the free market value of the dollar, and exchange rate policy is apparently being guided by developments in the free market. Economic decentralization in supplies, marketing, foreign trade and investment for retooling, and even in longer-term capital projects, is to be enhanced through direct interfirm trading and a diversified capital market in conjunction with autonomous commercial banks. Although there are apparently few limitations placed on the acquisition of private property, concerns about income differentiation continue to plague key layers of society. Positive real interest rates are now increasingly used as the primary means of allocating credit, but interest charged to state firms is still subsidized. Otherwise, state firms are held accountable for their financial results and can formulate decisions autonomously. Wages became fully monetized, eliminating subsidies and payments in rice. In agriculture, private production, initially encouraged during the period 1987-1988, is expanding further and in other sectors is being promoted.

The stabilization programme gradually put in place since early 1989 has been yielding some successes in terms of the abatement of inflation to 25 per cent from 308 per cent in 1988, including the price of rice, and confidence on the part of savers in the domestic currency. There has been dishoarding in response to high real interest rates and a change in expectation of inflation and to some extent of consumption patterns. Savings have been successfully mobilized in the financial system with an inflow of over a quarter of a billion dong in the first half of 1989. The supply of consumer goods has also improved with increased imports, especially from neighbouring countries, and dishoarding which relieves upward pressure on the price of non-food items. Since 1985, prices of food grains and foodstuffs relative to prices of agricultural inputs have declined significantly (see figure VI.4); so has the price of non-food consumer goods relative to that of food.

Although real interest rates have reduced the demand for bank loans, subsidies continue to be provided through the budget. The dilemma the Government faces is twofold: it has to gradually restructure or dissolve firms that are unprofitable, avoiding socially debilitating unemployment levels and resolving the philosophical issue of ownership of the means of production; and it has to enforce stabilization without engineering a dysfunctional economic contraction. The high real interest rates of 1989 led to a sharp contraction in economic activity. Beginning in August 1989, these rates have been reduced, but this easing could have been accomplished earlier if the authorities had experimented with the new monetary instruments to ascertain behavioural responses of economic agents in a revamped economic setting. In that respect, the authorities face another problem, namely their comparative lack of familiarity with orthodox macro-economic policy, limited ability to comprehend the new behaviour of economic agents and reluctance to enforce genuine central bank policy, including its policy respect to the central budget. As a result of decentralizing the formal planning hierarchy especially to provincial and district authorities, the central Government essentially lost control over fiscal affairs and the management of foreign exchange.

Though stabilization has had positive gains, they have been bought at a high cost. Aggregate growth slowed to an estimated 3.2 per cent in 1989 from 5.9 per cent in 1988. The contraction has been sharp and indiscriminate in the state sector. But agricultural output improved markedly (some 5 per cent) in response to new incentives and aided by very favourable weather. The lack of a legal framework for private ownership and the uncertain performance of the economy are also inhibiting investment in small-scale private industries, which the Government is hoping will substitute for state investment. Export value grew by some 50 per cent, chiefly with the CMEA area to fulfil contract obligations, and import value increased only by 3.2 per cent. While selected exports to the convertible currency area, such as rice, petroleum and fishery products, increased significantly, the still cumbersome system of foreign trade and the scarcity of credit impeded export growth in that direction.

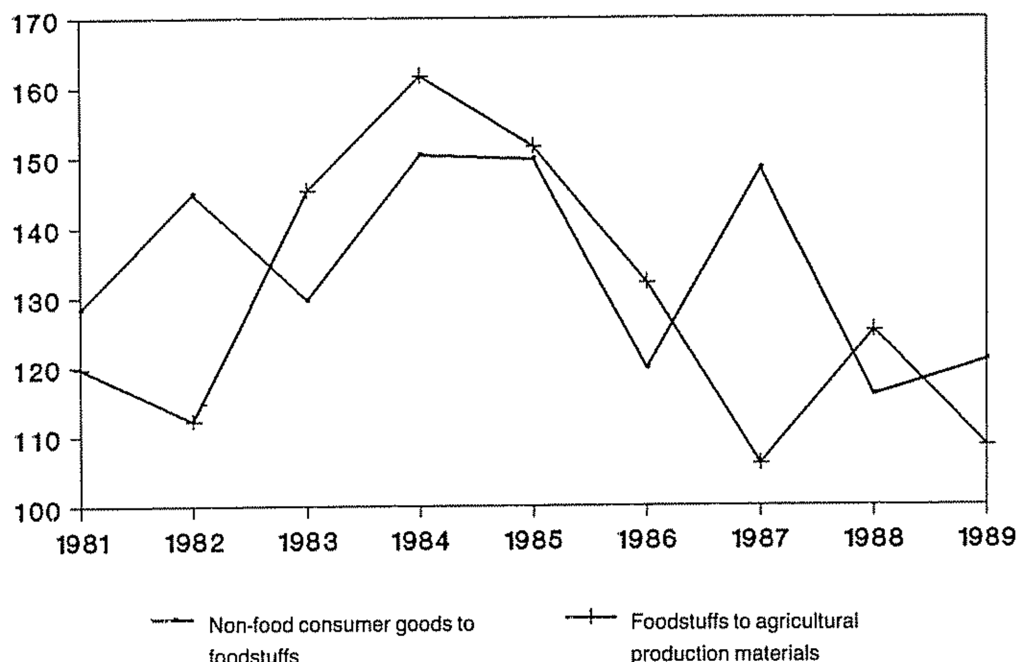
There has been a significant surge in unemployment because of stabilization and renovation, but unemployment benefits are not available on a comprehensive scale. The viability of many state firms that would normally have been justified appears to have been undermined in the process. With high real interest rates and the uncertainty of economic conditions, private investment and employment growth has also been sluggish. Further, the slow-down or decline in government expenditures has adversely affected the delivery of social services, such as medical care and education. State wages, which had been raised at the outset of reform, declined in real terms but wage levels were subsequently raised significantly for workers in state enterprises.

With the moderation of inflation and continued high real interest rates, the exchange rate has appreciated by about 10 per cent since the sharp devaluation at the beginning of 1989. The price of gold has fluctuated with the changes in the rate of inflation and interest rates. The scarcity of credit has resulted in a significant rise in inter-enterprise debt, which has threatened some firms with bankruptcy. Pressure to increase the money supply emerged from the need for cash to procure the rice crop. The response was a loosening of credit in July/August 1989, to the extent of more than doubling the rate of growth of the money supply. This exacerbated inflationary pressures later in the year.

The current situation in Viet Nam underscores the degree of difficulty in carrying out fundamental reform and drastic structural adjustment in a planned economy. After a decade of experimentation, Viet Nam continues to face a daunting string of dilemmas, of which economic stabilization is but one.[19] The duration of the transition has been lengthy, given the decisiveness with which the changes were effected in 1989. The problem of formulating the appropriate macro-economic policies to maintain the requisite restraint on infla-

[19] How these dilemmas affect short-term economic policy is discussed in Van Khai Phan, "On the implementation of the socio-economic plan in the first half of this year and on measures to carry on the plan in the next second half of 1989", report of the Council of Ministers, submitted to the Eight National Assembly at its fifth session.

Figure VI.4. Viet Nam: indices of relative prices, 1981-1989 (1980=100)



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

tion without undermining growth for too long and too deeply is aggravated by the lack of experience with the new economic system and micro-economic responses. The core dilemmas are concerned with how to control inflation while maintaining substantial economic growth in spite of the comprehensive restructuring of state firms, ensuring social equity in spite of the abolition of subsidies, and coming to grips with the external imbalances in rouble and convertible currency relations. Many new economic, legal and social institutions have yet to be established or strengthened before the decentralized economic system can fully function.

The economic sacrifices demanded by the macro-economic policies can breed discontent and create political risks for the Government. The human aspect of the adjustment is made more acute by the already very low income levels. The rapidity of change has also resulted in a backlash within the party against continuing this pace of reform. The situation is exacerbated by the dearth of external assistance, which could ease adjustment. There is also a change in the distribution of income and social welfare benefits, which might result in a disproportionate share of the burden of adjustment being borne by the least powerful group. This may require rethinking the principles of the overall socio-political system. The key source of inflation, the budget deficit, has yet to be tackled, although the Government has cut back sharply on price subsidies.

Inflation, reform and stabilization in Poland

Inflation became one of the most important policy concerns during the period Poland during the period 1989-1990 as the country decisively moved away from central planning. A drastic stabilization programme to control inflation through the "big bang" approach—essentially letting prices freely adjust to demand and supply—came to be viewed as an essential first step in the creation of a market-oriented economy. This abrupt shift in policy stance is facilitated by sizeable financial and other resources from multilateral institutions as well as by aid in various forms, mainly from developed market economies.

In implementing the programme, policy makers face three major sets of issues. First and foremost is the cost, especially in terms of unemployment, structural dislocations and economic recession, that the austerity policies impose. A related question is whether the social fabric will support this burden. Finally, it remains to be seen whether the market-oriented economy that Poland is aiming at can achieve substantial per capita growth and exports to world markets.

There are several factors that may make the hardships of stabilization more bearable than they would otherwise be. One is the decade-long experience with inflation and the erosion of levels of living. Both have made the consumer weary of traditional policies and more resigned to hardship, provided there is a reasonable prospect of a turn-around in economic fortunes in the near future. Another is the change in the Polish political landscape. As a result of the round-table agreement between the communist Government and party then in power and the just barely legitimized opposition, on the one hand, and the gradual constitution of a pluralistic legislature, on the other, an emerging *de facto* social contract has been making severe austerity acceptable. But the popula-

tion is evidently counting on positive growth in levels of living after a fairly brief, but painful, retrenchment. The third factor that favours the programme is the unprecedented amount of external assistance committed in various forms. Market orientation, however, is being pursued at a time when the country faces a crippling external debt burden and major steps need to be taken to correct fiscal deficits.

The current movement provides a radical break with earlier efforts to enact structural change in the economy that began with the socio-political transition of 1956. Among the reforms considered, those envisaged in 1968 sought to bring about "a comprehensive and internally consistent system of planning and management",[20] but in many ways it only aimed at administrative decentralization. This reform was not fully implemented, in part because of the social tensions of 1970 and the subsequent shift in development strategy. As a result, the authorities resorted to partial recentralization in combination with borrowing in capital markets, rapid expansion in East-West economic relations and, beginning in 1973, the introduction of a new system of production units built around the associations of enterprises, complexes and large multi-plant firms in manufacturing. These so-called WOGs (*wielkie organizacje gospodarcze*) were endowed with a substantial degree of managerial and trading autonomy. But the reform left the crucial elements of central planning intact.

The beginning of the monetization of sizeable market imbalances coincided approximately with the launching of the WOG reform.[21] This had two broad goals. One was to redesign the administrative decentralization that had earlier failed and base it on large autonomous firms in manufacturing. The other sought to accelerate the pace of industrial modernization in part through sizeable imports of western technology financed through foreign loans. One of the domestic aims of the WOG reform was to discourage firms from seeking expansion through extensive capital investment and thus to compress investment demand to the absorptive capacity of the economy. There were numerous micro-economic inefficiencies, including inflexible factor markets and firm-specific administrative plan targets, that were not addressed in the reform. In addition, the price structure remained insulated from international trends and firms unresponsive to opportunities abroad. But the WOGs gained some flexibility over their wage fund and could retain a fraction of export earnings.

That reform ended in failure, however, and led to highly unbalanced growth with a loss of macro-economic control. The relative opening up of the Polish economy in the early 1970s coincided with the severe inflation in world markets. The abolition of price equalization for much of traded manufactures allowed first world inflation and, beginning in 1975, the adjustments in CMEA trade prices to be funnelled into the domestic price equation. In spite of the wide range of central controls reintroduced or strengthened in the early 1970s, including control of prices, open inflationary pressure emerged as an endemic problem from 1974 onwards (see figure VI.5). The result was sizeable upward price drifts in the 1980s and near hyperinflation from the second half of 1989 through early 1990.

Open inflation erupted for institutional and policy reasons, of which the following three are important. First, the WOG reform was accompanied by a more liberal trade régime. The authorities were reluctant, or perhaps unable, to change course drastically and realign the domestic economy in response to the sharp shift in terms of trade. As a result, the link between domestic and foreign prices created for selected firms and the inability of planners to reduce budget subsidies for trade continually agitated for upward price revisions. In addition, revised pricing rules for "new" products permitted decentralized firms to raise prices and compete for labour by offering substantial wage hikes. This was facilitated by the reluctance of Polish planners to enforce a firm budget constraint for those autonomous firms. Finally, the Government had made commitments to protect levels of living, which led to ever-rising budget subsidies.[22] These growing imbalances exacerbated price drift and thus fuelled inflation.

The upward price drift was not the most serious task on the policy agenda in the mid-1970s, however. Greater priority was accorded to budgetary and external payments imbalances. Though central authorities sought to regain economic stability by abandoning the reform during the period 1976-1977 through the "economic manoeuvre", inflationary pressures did not subside. At the heart of the economic manoeuvre and its subsequent modifications was the reassertion by the central authorities of direct control over the economy, which was implemented ineffectively and at times with a good deal of inconsistency and outright chaos that confused economic agents. By the end of the 1970s, the only surviving feature of this reform was a higher level of industrial concentration than desired. This recentralization did not, however, succeed in returning to the price stability observed for most of the post-war development.[23]

The Polish crisis at the turn of the decade led to wide-ranging debates and vacillating policy stances. During the period 1980-1981, at least seven reform programmes were examined under the auspices of a Party-Government Commission for Economic Reform. A final draft was approved in July 1981.[24] It envisaged enterprise independence, self-financing and self-management as the three fundamental principles of the reform. But by then the socio-political situation had changed, following the imposition of martial law in December 1981.

[20] For details, see Janusz Zielinski, *Reforms in Polish industry* (London: Oxford University Press, 1973), pp. 14-21.

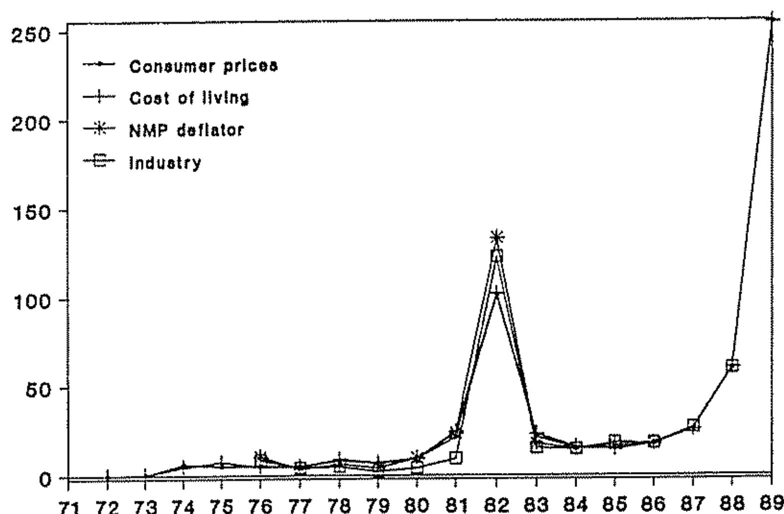
[21] For a diagnosis of macro-economic policies and reforms attempted during the 1970s, see P. T. Wanless, "Economic reform in Poland 1973-1979", *Soviet Studies*, No. 1 (1980), pp. 28-57.

[22] As can be seen in figure VI.5, the cost-of-living index trailed the retail price index as well as the net material product deflator and the wholesale price index until the early 1980s.

[23] For a detailed description of the Polish experience prior to the mid-1950s, see Andrzej Brzeski, "Forced-draft industrialization with unlimited supply of money: Poland, 1945-1964", in *Money and Plan—Financial Aspects of East European Economic Reforms*, Gregory Grossman, ed. (Berkeley and Los Angeles, California, University of California Press, 1968), pp. 17-37.

[24] Ironically, this was confirmed after the introduction of martial law and re-endorsed in July 1986 as the second stage of the reform discussed below.

Figure VI.5. Poland: indicators of inflation, 1971-1989
(Annual percentage change)



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

After the labour unrest of 1980-1981, which led to sizeable increases in wages and price subsidies neither of which could be supported from gains in labour productivity or fiscal revenues, and the imposition of martial law, the authorities sought thorough economic decentralization with a substantial market-led component. The first stage of this reform was launched in 1982. But macro-economic management continued to be much weaker than had been envisaged and the authorities failed to adhere to self-management by withholding control over managerial appointments in the largest 1,500 enterprises (employing some 80 per cent of the labour force). As a result, the influence of self-management bodies on output, pricing and employment decisions was very small. Wage policy was to change drastically and yield a wider span of wage rates, reflecting better underlying differences in productivity. To avoid excessive income dispersion across enterprises, however, minimum wages were guaranteed and indexed, and the wage fund was made subject to progressive taxation.[25]

The balance between supply and demand was to be regained through the "deregulation" of prices and incomes. Prices were to be based on domestic costs and linked to international prices;[26] in setting procurement prices, ensuring adequate incomes for farmers was an additional consideration. Because of the prevailing imbalances, the central allocation of selected means of production was maintained as a transitional measure. Substantial increases in retail and supply prices were to take effect on 1 January 1982, with partial compensation for wage earners, and be followed by the gradual dismantling of central controls.

An important intention of the reform was the replacement of automatic credit-granting to enterprises with discretionary contractual relations based on the central bank's assessment of the firm's creditworthiness. But this element was not fully implemented and over time bank scrutiny fell by the wayside as planners progressively returned to near automatic loans.

In part because of the adverse constraints on external trade and finance and the disarray in micro-economic relations at home, this part of the reform failed to take off as more and more elements were hollowed out by central intervention. Thus, the large wage increases, low output, pervasive shortages and palpable price restraints of 1981 severely eroded enterprise profitability. This required substantial subsidy increases even in 1982, in spite of the sharp price revisions then introduced. Large disparities in profitability among enterprises continued to be partly offset through subsidies negotiated between enterprises and ministries.

The incomplete implementation of the 1981 reform led in 1986 to the introduction of the so-called "second stage". The rights of state enterprises were extended and their autonomy enhanced. Some reform components illustrated the dilemma between requirements of short-term stabilization and the reform programme. To resist the inflationary spiral that

[25] A progressive tax, to be paid from after-tax profits, on wage increments exceeding productivity gains was first to be earmarked for a training fund, though little of it was ever appropriated for that purpose. This opened the door to all kinds of manoeuvring for exemptions through the soft-budget constraint.

[26] During the period 1982-1983, there were three categories of prices: administratively fixed, regulated and free. In 1984, the authorities effectively abolished free prices, which made all prices *de facto* subject to detailed central control.

could be fuelled if profit-making firms were permitted to raise real wages, while other firms had to maintain them and could not shed workers, wages were periodically frozen, the tax on above-norm wage increases was applied to all firms regardless of performance and official and regulated prices on long-term government contracts were made subject to surcharges and rebates set by the Ministry of Finance. Opposition to the measures led to their withdrawal, however

By 1987, the overriding theme of policy-making became regaining balance rather than pursuing reform as such. A Plan for the Consolidation of the National Economy was adopted by the Parliament in January 1989. A number of liberal economic laws have since been passed, remnants of the rationing system for private consumption were abolished and retail price subsidies curtailed in line with overall social policy objectives. There was a commitment to establishing market-clearing prices, despite the pain of adjustment and the uneven distribution of the benefits and costs of such a policy. But this major shift was to be introduced according to alternative scenarios with different horizons, consensus on which appeared to elude policy makers until the current attempt at stabilization. The substantial reduction of mandatory wholesale deliveries and the elimination of rationing by 1990 were proposed. Though these proposals had a liberal bent, it proved very difficult to adhere to the second phase, given the tight balance of payments, the already sizeable inflationary momentum and considerable scepticism on the part of economic agents and policy makers as many of these items had already been included in 1981 reform proposals. The escalation of inflation in conjunction with the unfolding political crisis demanded another solution.

Throughout the recent reforms, inflation continued to manifest itself in all segments of the economy, albeit at a varying pace. Comparing trends in net material product (NMP) deflators and consumer prices (see figure VI.6), the Polish authorities at first tried to protect the consumer through retail price subsidies. But central authorities could not avert an erosion of real incomes, particularly real wages. One important factor in the differential movement of prices was that much of Polish agriculture is private. Price behaviour for foodstuffs in private markets differed markedly from that observed in state retail outlets, owing largely to government subsidies through either procurement policies or outright retail price subventions (see figure VI.7). There has been only a gradual tendency to close the gap.

From 1970 to 1981, state prices rose by a little over 6 per cent a year, but the free market price index quadrupled in the same period. By the late 1970s, however, the Government was no longer able to support such transfers, which had accounted for just under a fifth of budgetary expenditures in the early 1970s, but had reached 24 per cent in 1980,[27] and so raised official foodstuff prices in one fell swoop in 1982. In contrast to the experience of the 1970s, state retail prices in the next decade expanded faster than those observed in open markets, especially for foodstuffs, as state control relented under the dual pressure of shortages in official retail outlets and agitation by suppliers to raise wholesale and procurement prices. This aggravated inflation.

Around the end of 1988, the Government of Poland sharply raised prices for a wide variety of products, ranging from fuel to medicines, driving up the cost of living. It then promised to contain the retail and foodstuff price increases on average to some 20 per cent and 15 per cent, respectively, in 1989.[28] Matters changed dramatically for the worse in the course of the year, however.

The abrupt marketization of the foodstuff sector in August 1989 triggered hyperinflation, although price increases that were much higher than expected had occurred already earlier in the year because the central authorities failed to adhere to their price policy commitments. During the first half of 1989, inflation was on average 8.3 per cent. In July it moved up to around 9.9 per cent. But August was the threshold when retail prices increased by a further 39.5 per cent, a pace that had accelerated rapidly by the end of the year; it reached an annual rate of 900 per cent in December. For the year as a whole, inflation reached 244 per cent. Money incomes during September and October, and probably the rest of the year, grew less than prices,[29] which in some cases reduced demand[30] and improved market balance.

The evidence on price changes suggests that Poland has been an exception to the stereotype of inflation in planned economies. Inflation has been quite open from the early 1970s and markedly pronounced since 1982, with the authorities increasingly admitting their inability to control it. In spite of monetization, there has been repressed inflation as well, in the form of queues, involuntary saving, rapid growth of the second economy and rationing of some products because of lingering controls over prices.

The most conspicuous indicators of internal imbalance rationing of consumer goods, central allocation procedures and physical shortages—improved in 1989 in the wake of more flexible adjustment in demand and supply. Consumer rationing was abolished, after several years, and central allocation was markedly reduced. None the less, substantial constraints remained on alleviating domestic imbalances through imports. In some cases exports have had to be prohibited to avert worsening domestic supply. Large wage increases that could not be spent generated substantial pent-up demand. Restrictions on price increases in the face of pervasive shortages robbed prices of their allocative function. Serious shortages weakened the role of the domestic currency in determining production and distribution. This negatively affected work effort and required substantial incentives to persuade workers to increase their effective working time. The cumulation of these gaps created an excess demand that eventually jelled into market pressures. But excess household liquidity and forced savings have been increasingly

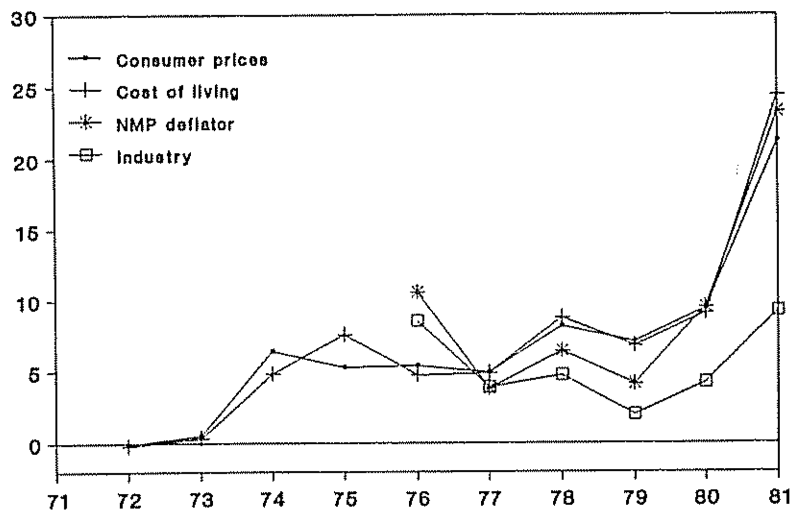
[27] Though there was a slight abatement in the early 1980s, owing in part to substantial price increases, by 1986-1987 another sharp rise in price subsidies relative to budget revenues occurred

[28] *Trybuna Ludu* (Warsaw), 15 December 1988, p. 1

[29] *Figyelő* (Budapest), 30 November 1989, p. 12

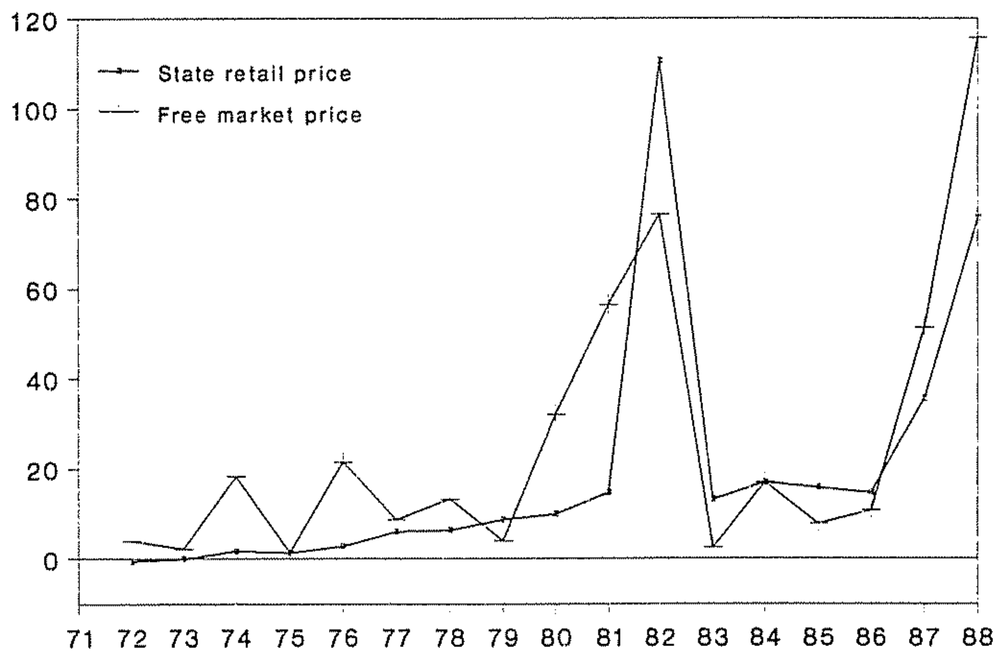
[30] For butter, milk, cheese and quality meat products, for example

Figure VI.6. Poland: indicators of inflation, 1971-1981
(Annual percentage change)



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

Figure VI.7 Poland: divergent retail price movements, 1971-1988
(Annual percentage change)



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

eroded as a result of the rapid pace of inflation in late 1989 and early 1990.

One of the key elements of demand management, at least until 1988, was restraint on consumption through a wage policy. The system of progressive taxation of wages helped to erode the real wage cut brought about by the price increases of 1982 and 1988-1989. Real monthly wages in the socialized sectors rose 41 per cent between 1970 and 1975 and 10 per cent between 1975 and 1980; they fell by 13 per cent between 1980 and 1985 (see figure VI.8). In 1982 alone, the decrease in real wages was 24.9 per cent, none the less far smaller than the January rise in retail prices would have entailed as the authorities had failed to impose wage restraints. From 1982 to 1988, real wages increased by 10 per cent as policy makers failed to correct relative prices and deflate the economy.

Because the deregulation of the banking system remained highly incomplete and the authorities preferred administrative solutions, for institutional and political reasons, macroeconomic policy in Poland could not fully realize its potential in restoring equilibrium. This reform component was treated gingerly, partly in view of the fear of unleashing social instability and the precepts on preserving key elements of socialism, including state property and constraints on income distribution. Perhaps most important was the fear of social unrest, which had previously (in 1970, 1976 and 1980) erupted whenever the authorities raised prices in one fell swoop, a policy measure that subsequently had to be rescinded because of strikes and other expressions of social discontent. Prior to 1990, even milder price revisions had to be alleviated by toning down the announced price increases or by resorting to wage hikes that were much larger than anticipated. In 1970 and 1980, these social tensions caused marked changes in the political and governmental leadership.

It is only with the profound changes in the political make-up of Poland since mid-1989 that the foundation could be laid for a swift transition to greater market orientation. As from 1 January 1990, this effort is being buttressed by a wrenching stabilization programme[31] enacted with the support of multilateral and bilateral donors and creditors. Its principal provisions call for a ceiling to be put on wages and pensions for at least the first half of the year; enforcement of strict financial rules for firms; elimination of budget subsidies for most retail trade and some public transportation;[32] in effect, the bankruptcy of unprofitable firms, regardless of the effect on unemployment; privatization of state assets and encouragement of private property formation from new savings; deregulation of prices and creation of genuine wholesale and retail trading markets; tight monetary policy with positive real interest rates; institution of limited external convertibility of the zloty, after a massive devaluation to roughly the level observed in secondary markets; the restructuring of the fiscal system built around a value-added tax, a personal income tax and a uniform corporate tax; and the emergence of institutions for genuine financial intermediation.

These austerity measures and the institutional changes to encourage private investment and entrepreneurship were prerequisites for a loan agreement with the International Monetary Fund (IMF) signed in late December 1989. Effective implementation of these measures will be a precondition for a three-year programme with the Fund, possibly involving $2 billion in financial support, that may materialize in the second half of 1990. A $1billion stabilization loan to support the current changes has been made available by the developed market economies. In addition, Japan has pledged a $1 billion loan fund to be divided equally between Hungary and Poland to finance imports mainly from Japan.[33] The World Bank has approved its first loan, in the amount of $360 million; the total commitment could soon exceed $2 billion. Further, agreement on loan conditions with the Fund and the World Bank has set the stage for debt renegotiation, which has already occurred in the context of the Paris Club, and possibly debt relief under the Brady Plan. Other aid packages are currently being considered.

Price increases ranging from 25 per cent to 50 per cent a month were expected in the first stage of the programme as a result of firms adjusting to the loss of subsidies. For January 1990 alone, the rate of inflation was expected to be 45-50 per cent, as subsidies for staples and other goods were curtailed,[34] and real incomes were as a result to contract by about 20 per cent. Aggregate output growth was projected to shrink by 2-3 per cent over the year as a whole, owing largely to the anticipated drop of 5 per cent in industrial output. The level of unemployment was expected to rise sharply, but whether this can be contained to the anticipated 300,000 workers, or 1.5 per cent of the work force by the end of 1990, remains to be seen. Estimates by the Fund placed expected unemployment at about three times that level, with nearly 1 million people or 5 per cent of the labour force out of work.[35] On the positive side, inflation should be reduced to a few per cent by mid-1990.[36]

Though the Government of Poland hoped that the stabilization programme would arrest inflation, after a run-up simply to reflect the freeing of prices, and encourage growth by mid-1990, it was doubtful whether hyperinflation could be turned around quickly at a socially acceptable cost. At least during the first month of the austerity programme, inflationary expectations remained very high, which encouraged producers to withhold goods from the market in the expectation that

31 *Trybuna Ludu* (Warsaw), 15 December 1989, pp. 1 and 2.

32 The budget share of all subsidies is to be reduced from 31 per cent in 1989 to 14 per cent in 1990, the latter being appropriated to sustain rents, some public transportation, energy, bread and some dairy products.

33 It has also pledged investment guarantees amounting to $350 million for Poland and $400 million for Hungary. Both measures are expected to act chiefly as seals of approval that may lead to greater interest of Japanese investors in Eastern Europe. The first beneficiary will be a Suzuki automobile plant in Hungary (see *The New York Times*, 10 January 1990, p. A11)

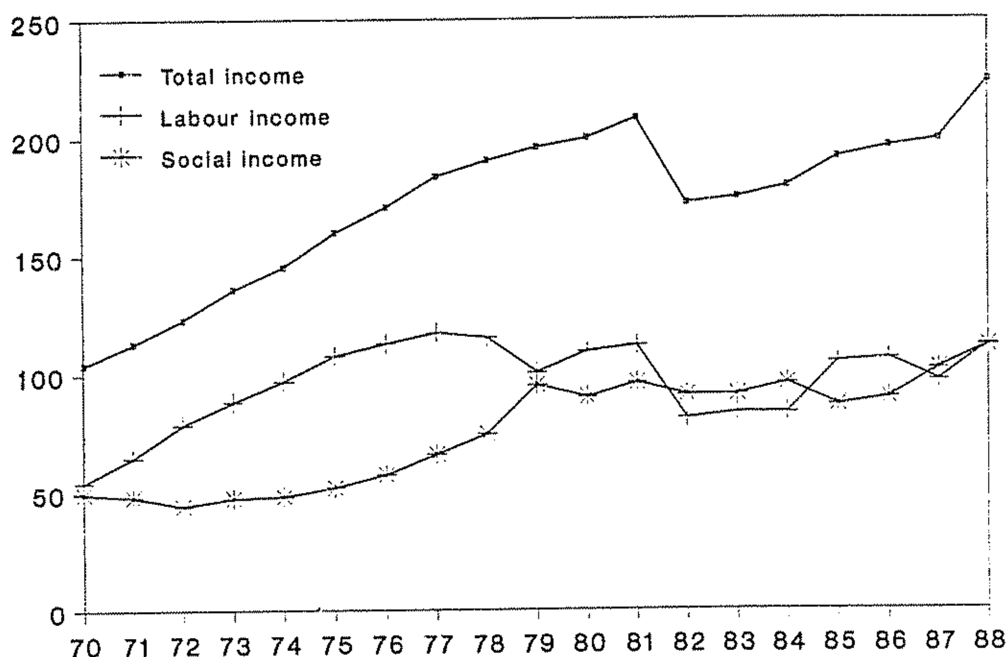
34 Coal, gasoline and other energy prices alone rose five to seven times in early 1990. Subsidies for public transportation were slashed and prices accordingly increased by 250 per cent. Many other staple items of household expenditure in Poland are being tackled.

35 *Rzeczpospolita* (Warsaw), 8 February 1990, p. 2, and *The New York Times*, 6 January 1990, p. A6.

36 The critical adjustment in coal and petroleum prices to the world market level is now forecast to be introduced over several years

Figure VI.8. Poland: growth in real income and its sources, 1970-1988

(Billions of zlotys; 1971 constant prices)



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

they would fetch higher prices later. Similarly, households resorted to hoarding in order to gain on the pace of inflation, resulting in pronounced shortages particularly of such necessities as bread and meat. Furthermore, firms refrained from paying their bills to gain on inflation and avoid having to borrow at high interest rates. Actual inflation in January (78.6 per cent) was about twice the rate anticipated.[37]

In spite of the goodwill of the new Government, the severity and abruptness of the austerity led by mid-January to strikes in key sectors, including mining. Furthermore, enterprises refrained from asking for bank loans[38] and thus created their own liquidity by not paying their bills on time. More worrisome was that firms did not change their supply at all. Industrial activities in the socialized sector during the first quarter contracted by roughly 30 per cent. This unexpectedly large drop, which has begun to raise unemployment,[39] was only partly (perhaps by 5 percentage points) offset by the growing private sector. In trade also, the response remained far below expectations. In January, total exports shrank by 16 per cent (by 22 per cent for convertible currency and by 8.3 per cent for transferable rouble exports), more than the contraction in imports,[40] because many Polish exports are uncompetitive even at the much reduced exchange rate.[41]

The marked confusion, chaos and even panic that occurred during the first weeks of the programme have since given way to less painful responses, if not quite calm and order, on the part of households and enterprise managers. The pace of inflation in February dropped rapidly and by the end of the month price reductions became evident as speculators brought their hoarded goods to market and households adjusted their consumption patterns to the further drop in real incomes. In March, inflation dropped to 5 per cent. The exchange rate has held steady and authorities have not so far had to intervene to stabilize it, partly because of very substantial cut-backs in import levels and the fact that households and firms dishoarded foreign exchange, reportedly $1.5 billion in the first two months of 1990, to make up for income and revenue losses.

37 More informal reports suggest, however, that this measurement was distorted because the statistical authorities have not yet adjusted their techniques to include more fully the behaviour of the rapidly increasing number of new merchants in private and co-operate markets.

38 The prime borrowing rate in January was set at 34 per cent and in February at 20 per cent. Both were deemed too high for most enterprises. At the reduced rate of 10 per cent for March, a sharp increase in loan demand has manifested itself.

39 Unemployment in January reached 56,000. More alarming was that the number of announced job vacancies dropped by 86.2 per cent to about 35,000 (see *Rzeczpospolita* (Warsaw), 8 February 1990, p. 1). These fears were confirmed in February, when unemployment reached 152,190; in mid-March unemployment stood at over 216,500 with even fewer announced vacancies than in January.

40 Imports declined by some 14 per cent, divided about equally between the two currency zones (see *Zycie Gospodarcze* (Warsaw), No. 7 (1990), p. 11).

41 For a commentary, see *Rzeczpospolita* (Warsaw), 8 February 1990, p. 2, and *Zycie Gospodarcze* (Warsaw), No. 7 (1990), p. 11.

Inflation, reform and stabilization in Hungary

Hungary was the first planned economy formally to commit itself to the establishment of a market-oriented economy - the ultimate objective of the New Economic Mechanism (NEM) launched in 1968. Key components were decentralization of decision-making, opening up the economy to global competition and revising the pricing régime. Regarding the latter, comprehensive price controls were replaced by a three-tiered price system encompassing free market, "from-to"[42] and fiat prices. The latter category was to be compressed over time depending upon the circumstances for the vast bulk of traded goods and services. Upward price movements were anticipated in the process. But the core objective was to correct relative prices. The effect of changing relative prices on real incomes was to be cushioned by spreading the changes over time and providing compensation for the resulting losses.

Figure VI.9 shows key indicators of price movements in Hungary. It can be seen that a steady increase in prices has taken place for virtually all kinds of goods and services. The rise in consumer prices, captured by the retail price index and an index of the cost of living (see figure VI.10), remained small until the mid-1970s, largely because the component of centrally controlled consumer goods and services was much larger than that for goods entering agricultural and industrial wholesale transactions (see figure VI.9). Since then, the trends have been reversed with at times very substantial gaps, owing in part to the fact that, until the period 1979-1980, the level of consumer prices was well below that of producer prices, as shown by the GDP deflator and the agricultural and industrial wholesale price indices (see figure VI.9).

The price indices for wholesale and retail networks all indicate substantial inflation since about 1973. These price drifts did not, however, stem from adjusting relative prices in line with underlying economic scarcities, as had been intended. At least during the first phase of NEM, the degree of distortion in the price system hardly eased at all. Between 1968 and 1971, prices increased only moderately because central price-setting was strengthened, in spite of reform intentions, thanks to subsidies.[43] Key policy makers were ambivalent about implementing the steps required to reach the reform goals. They failed to deal with the overcentralized industrial structure, property issues or the creation of a real capital market, all of which were required to support greater market orientation for prices. In these circumstances, the demand for capital and labour rose relentlessly, entailing wage increases unrelated to gains in factor productivity.

During the subsequent period, policy makers focused essentially on modifying wholesale prices more flexibly than retail prices, which gradually aggravated market tensions and thus entailed repressed inflation. This stance could be maintained only for as long as external pressures, which could not find expression in domestic price movements or shifts in allocation policies due to price equalization, remained mild. The impact of global inflation in the early 1970s on Hungary's terms-of-trade was weathered mainly through external borrowing rather than internal adjustment of demand and supply, which permitted proceeding with NEM gradually and, in effect, introducing its key provisions more slowly. The stability inherent in the CMEA trade and payments régimes helped to buttress this stance. But the ominous global and more gradual CMEA developments were a warning, which went unheeded, to reconsider key objectives of NEM, particularly those relating to price determination, the link between internal and external prices and on utilizing effective prices and profitability indicators as key stimuli for micro-economic behaviour.

By the late 1970s, as a result of these and related developments a period of sharply increased inflation, including in retail markets, set in. By 1978-1979, the interrelated domestic and external imbalances had become so substantial that the still worsening terms-of-trade and rapid increase in unit production costs could no longer be centrally managed without cutting into real disposable incomes. But the worsening unit production costs stemmed only in part from Hungary's openness. Growing material intensity and rising domestic costs also contributed to the problem. An attempt was made to alleviate these imbalances through target price adjustments during the period 1979-1985. The aim, as at the outset of NEM, was to help align the level and structure of domestic prices with those of world markets, buffering differential CMEA and world prices through fiscal means. But even this upward price adjustment fell short of what was required to come to grips with macro-economic imbalances.[44]

Since about 1981, special importance has been attached to the external balance, which improved during most, but not all, subsequent years. But this positive result was obtained largely through import constraints, which exacerbated the supply deficit. Periodically (from 1973 to 1978 and from 1985 to 1987), the central authorities could cope with domestic market pressures only by borrowing abroad, however. Inasmuch as these funds were taken mostly on commercial terms, they complicated the management of external accounts. After the anti-inflation policy pursued in 1986, the authorities resumed their unbalanced macro-economic stance and thus added to inflationary pressures, which have since become increasingly monetized.

In many planned economies, inflationary pressures erupt because of increases in wages and monetary transfers without adequate "commodity coverage". Gains in nominal wages in Hungary have been considerable, owing largely to central wage regulation, which does not sufficiently differentiate labour rewards according to output contribution, and the attempt to equalize wage levels at a level higher than planned. The result is potentially inflationary.

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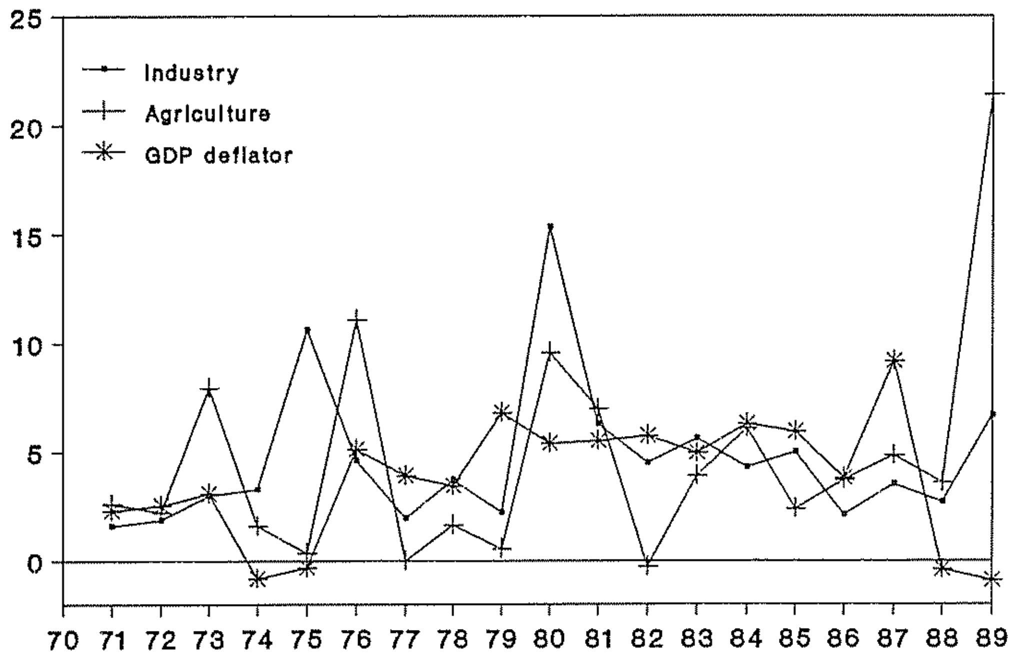
[42] Including prices with a pre-set floor or ceiling or a range within which they could fluctuate

[43] For details, see Béla Csikós-Nagy, *A magyar árpolitika (Budapest, Kossuth Könyvkiadó, 1983)*, p 33

[44] István Hagelmayer, "Inflation and prospects for its reduction", *Acta Oeconomica* (Budapest), No 1/2 (1987), pp 1-15; A Nyilas, "Infláció, fogyasztói árszint", *Statisztikai Szemle* (Budapest), No 4 (1989), pp 341-362

Figure VI.9. Hungary: indicators of wholesale price inflation, 1970-1989

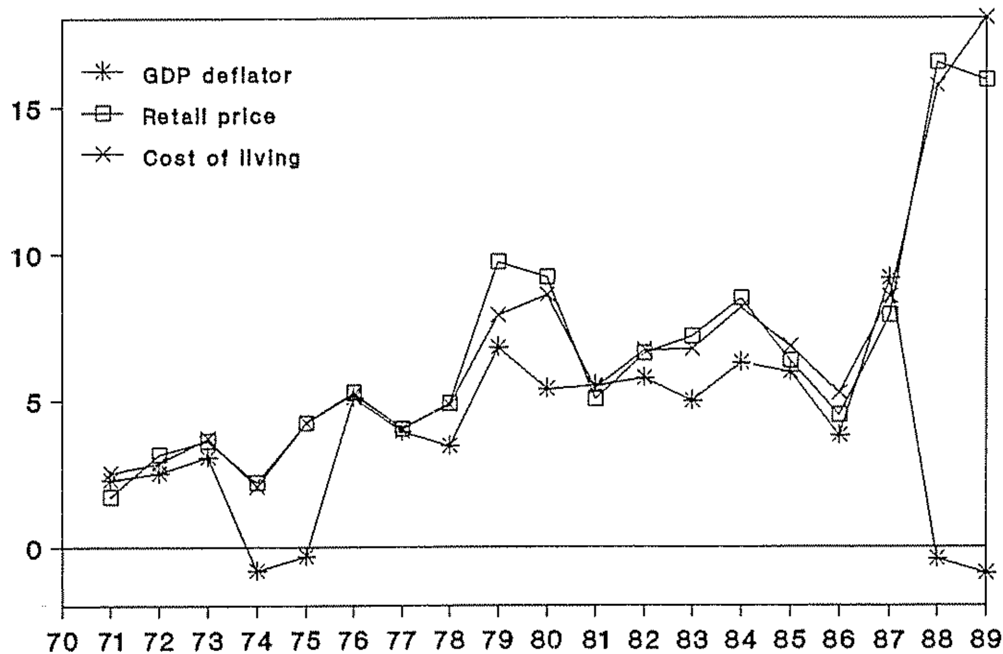
(Annual percentage change)



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

Figure VI.10. Hungary: indicators of consumer price inflation, 1970-1989

(Annual percentage change)



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

Though nominal income gains have been considerable, most have been seriously eroded by open inflation (see figure VI.11). Real wage growth has not kept pace with labour productivity gains. For example, during the period 1970-1988, GDP[45] grew by an average annual 3.6 per cent, but real wages rose by only 1 per cent (as opposed to 2.5 per cent in real incomes, owing to substantial social transfers); but that rate of output was still above the rate of growth in private consumption (2.8 per cent). During the period 1979-1989, aggregate output increased faster than aggregate uses, but consumption (at 3 per cent a year) grew even faster, although real labour income practically stagnated. The rising component was social transfers as other non-wage incomes of workers are minimal. The value of social transfers amounted to 22.6 per cent of real incomes in 1970, jumped to 27.1 per cent in 1975, 32 per cent in 1980 and 37 per cent in 1988 (see figure VI.11). In conjunction with the generalized upward drift in prices, this rising claim on resources not adequately financed through fiscal means[46] suggests that increasing social transfers, broadly defined, have been a major contributor to inflation.

Another important cause of pressure is investment behaviour, in spite of the fact that the absolute level of capital expenditures has been under severe restraint for years. Weak central investment activity could help to abate inflation only by improving the capital-formation process and seeing to it that the restrictive central stance would not be undermined by wanton bank-borrowing. Both features in fact manifested themselves. Yet this contractionary stance neither improved the "quality" of investment nor eased overall investment behaviour. As during the heyday of NEM and its modifications, investment problems have persisted as the efficiency of the capital-formation process failed to improve measurably; not only that, the structure of investment outlays was changed in favour of material- and energy-intensive activities in the late 1970s and early 1980s, rather than improving Hungary's competitive position through factor productivity gains. In addition, micro-economic decision-making was further centralized, and investment-financing ultimately guaranteed by the State took the place of budget-financing. There was little, if any, change in the decision-making about the economic justification of such loans, however.

Finally, efforts to place firms on a self-financing basis and hold them responsible for their decisions did not meet with expectations, in part because of the deteriorating domestic and external economic environment. But also the stance of central decision makers not to allow firms to go bankrupt, lay off workers, otherwise rationalize employment policies and enforce discipline that could cramp the sustainable level of economic activity contributed to *de facto* state tutelage. These presşures were in fact aggravated by deficit-spending from 1968 onwards. Some of the deficit was accommodated by issuing currency. The rest was balanced through loans taken up by crowding out enterprise demand for loans, thereby worsening domestic imbalances.[47]

These and other factors built an inflationary bias into the economy which has been one of the weaknesses of NEM. None the less, NEM has also had several positive effects, including the temporary alleviation of disequilibria. But the disequilibria have persisted and have recently been tackled through, for example, further modifications in pricing policy together with financial stabilization, fiscal reform, reform of the banking system, initiating a stock and capital market and drafting a new law on competition. These changes have come about only in the last two years or so, nearly two decades after the introduction of NEM, and it will take another 5-10 years before they will be fully in place and hence contribute to enhancing market-orientation under the guidance of predictable and credible macro-economic policies.

In spite of many years of price-tinkering, about 20 per cent of prices are still centrally set. Not only that, ostensibly free prices are subject to considerable, largely informal, restrictions[48] as well as government-regulated rules on price formation that have become more complex over the years as NEM has progressed. The continuation of the policy adopted in 1968[49] has permitted the Hungarian authorities to "manage" inflation to within "planned" ranges for all main categories of goods and services.[50] But there is considerable inflationary pressure, as evidence by the upward drift of prices to the range of 15-20 per cent a year during the period 1988-1989.

For some time now there has been a broad consensus among Hungarian policy makers about the necessity of stabilizing the economy and setting the stage for the more complete realization of the goals of NEM; there is, in fact, strong support for moving beyond those goals and establishing a fully-fledged market economy anchored to legally revised property rights; steering it through a pluralistic consensus that might emerge after the parliamentary elections of March and April 1990; and exposing the economy to the discipline of competition.

Though stabilization measures have been debated at great length and some have been agreed upon, if only to come to grips with the external debt (about $21 billion with convertible currency partners), there is not as yet a comprehensive, internally consistent programme in place. Yet Hungary's balance-of-payments situation is precarious, owing in part to the fact that in 1990 the country needs about $3.5 billion to

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45 Because of the stagnant labour force, aggregate output growth may be taken as a proxy for average productivity growth

46 Even though the share of total income redistributed through the central budget remained very high indeed

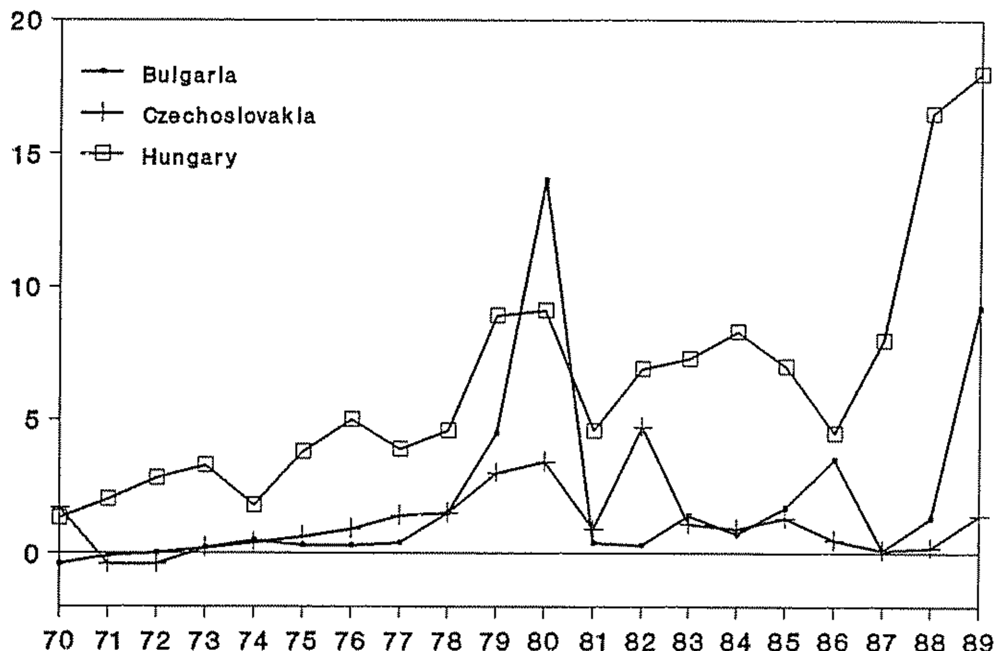
47 G. L. Asztalos, I. Balogh, I. Hagelmayer, M. Polgár and R. Werner, *Infláció és pénzügyek Magyarországon* (Budapest, Közgazdasági és Jogi Könyvkiadó, 1987), pp. 244 and 245.

48 For example, during 1987 and the first quarter of 1988, all intended producer price increases had to be reported to the National Price Board (see F. Vissi, "Infláció és stabilizálás", *Gazdaság* (Budapest), No. 1 (1989), p. 20).

49 For a review of price regulations from 1968 till mid-1988, see Wim Swaan, "Price regulation in Hungary: indirect but comprehensive bureaucratic control", *Comparative Economic Studies*, No. 4 (1989), pp. 10-52.

50 Thus, one can distinguish among five different types of pricing regulations: cost-plus as in the traditional planned economy, value-type in accordance with the labour theory of value, and producer-type, two-level and competitive price since 1980. These price types have never existed in a pure form, however, most having been based on variants of the producer type. For details, see D. Bonifert, "Az árszabályozás hazai hagyományai és nemzetközi tapasztalatai", *Kereskedelmi Szemle* (Budapest), No. 3 (1988), pp. 33-40.

Figure VI.11. Hungary: growth in real per capita income and its components, 1971-1987
(Annual percentage change)



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

service the debt; this amounts to some 10 per cent of GDP. Without refinancing, the ongoing reform efforts would be nipped in the bud. The necessary foreign support could be mustered only through signing a new agreement with IMF, which was seen as support for the country's creditworthiness. For that reason, an agreement with the Fund was worked out and an anti-inflation programme, reflecting in part this agreement, was implemented in January 1990.[51] This aims at cutting budget subsidies for consumer goods and services (including housing), privatizing part of state assets, introducing positive real interest rates, cutting money supply, bolstering creditworthiness, decreasing the trade surplus with CMEA partners, curbing inflation and avoiding a social explosion.

Some of the conditions for obtaining the Fund's "seal of approval" were a further 10 per cent devaluation of the forint enacted in December 1989,[52] drastically cutting the CMEA surplus,[53] slashing price subsidies by 40 billion forint, although social expenditures will increase to ease social tensions; reducing loans to below their 1989 nominal level and encouraging savings through positive real interest rates.[54] This anti-inflation policy is expected to yield in 1990 a rate of inflation of around 20 per cent, on account of the forint devaluation and the sharply reduced price subsidies introduced on 1 January 1990; a lowering of real wages by 2.5 per cent; and an increase in unemployment to 50,000 or 1 per cent of the labour force, but a moderate social safety net will be in place. By creating greater competition, in part through accelerated privatization, the inflationary pressures are expected to be held in check. But one main cause of pressure will be the commitment to abolishing substantial elements of the remaining rigidities of the price system and to linking domestic to world prices.

There is, however, broad agreement among policy makers and economists in Hungary that much more needs to be done to overcome a crippling fiscal deficit and a sizeable domestic

[51] *Népszabadság* (Budapest), 20 December 1989, pp. 1 and 4

[52] There have been at least three further, but smaller (1-2 per cent each), devaluations since then

[53] Hungary has been running a considerable transferable rouble surplus. Because this is inconvertible, policy priority is being placed on cutting it. Inasmuch as the opportunities for raising desirable imports are small, Hungarian exports will have to be reduced, thereby cutting into sustainable activity levels of many manufacturing firms dependent on these markets. The Government has been assisting these sectors in diverting trade to convertible currency markets through the earmarking of various central state funds

[54] A compromise had to be reached on housing subsidies: instead of a 50 per cent rent increase for state-owned apartments there will be only a 35 per cent increase. But the rate of interest on long-term housing loans granted by the National Savings Bank was raised retroactively from 3 per cent to 6 per cent, revoked as unconstitutional late April 1990. Note that the budget in 1989 spent 45 billion forint to support the interest rate differential between the contracted 3 per cent and the going market rate of about 20 per cent

debt,[55] to manage the substantial external debt, to regain a competitive position in world markets, to restructure the economy much more along market-oriented lines and to regain a faster pace of growth that will be sustainable for a number of years.

Reform, stabilization and inflationary pressures in China

The Chinese economy has been undergoing reform now for over a decade. Unlike the reform in most of the European planned economies, the reform in China has from the beginning been phased from sector to sector. Although notable successes have been recorded, the authorities have not yet come to grips with how to ensure macro-economic control as a substitute for central planning, comprehensive price reform has not yet been pursued, and genuine enterprise autonomy in the state sector continues to fall short of the stated intentions of reform.

Upward price pressures have accompanied a decade of fundamental economic reform and rapid growth in China. Though successive increases in prices of a wide variety of products and services have raised the general price level, systemic and policy changes since 1978 have exerted a greater impact on inflation. Decentralization of the economic system has rendered ineffective the traditional system of macro-economic control through the central budget and cash flows through the central bank. Alternative instruments for viable macro-economic management have yet to be developed. At the same time, the traditional incentive structure and lack of financial accountability of state firms have not been sufficiently reformed to generate the desired response to central policy objectives. Further, the priority of rapid economic growth and the shift in emphasis towards consumption growth have strained production capacity and restricted the options available to policy makers to maintain stability.

Between 1952 and 1978, China embraced the traditional planned economy model. There were three primary institutional differences between that model and the orthodox one,[56] with implications for the emergence and control of inflationary pressures. Foremost was the greater decentralization of material allocation since the late 1960s and of access to and use of funds by enterprises since 1971. The power of material allocation devolved upon industrial ministries and their provincial bureaux. Small and medium-sized state firms were placed under the jurisdiction of provincial and lower-level governments. Rapid decentralization in the early 1970s of the production of major intermediate commodities, such as fertilizers, construction material and metals, to more local units created a production and distribution network outside the "unified" system. This resulted in higher than desired investment growth by enterprises, competition for scarce inputs between local and centrally administered firms and alternative channels for material supply through barter. Second, China had a much larger, more decentralized agricultural sector. Rural households kept their savings predominantly in cash, which represented a potential source of demand pressure on consumer goods sold in rural markets. Finally, the immobility of the labour force and its large size moderated upward pressure on wages by restricting the flow of labour into industrial sectors with higher wages. The net consequence was that large portions of the economy functioned outside direct central control and there was greater inconsistency between central targets and local economic decisions.

Memories of the economic and political upheavals associated with the post-war hyperinflation steered the founding leaders of the People's Republic towards a conservative macro-economic stance, which was generally maintained until the latter part of the 1970s. This, as well as resource endowment, facilitated the achievement of overall economic stability until the eve of current economic reform.[57] Years of excess demand prior to reform coincided periodically with major political upheavals or output recessions. On the whole, the requirements of rapid industrialization were met by sacrificing consumption growth and maintaining basic supply at low prices. Consumption growth was restricted in the first half of the 1970s to accommodate the excessively rapid growth of extra-budgetary investment which the central Government was unable to contain.

Instruments to absorb household and enterprise liquidity included the sale of government bonds and campaigns to promote savings deposits at banks. Wage increases were generally kept low. None the less, at times, as during the economic collapse between 1960 and 1962, imports were drastically increased. A small surplus in the central budget was also conscientiously maintained almost every year for three decades prior to 1978 as budget deficits financed by credit from the central bank were recognized as inflationary.[58] Therefore, at the beginning of reforms in 1978 there was no evidence of a monetary overhang.

The development strategy adopted in 1978 envisaged rapid economic growth as well as immediate improvements in consumption. To facilitate attainment of these goals planners pursued far-reaching decentralization of economic decisions. While partial price reform, as discussed later, contributed to the rise of the overall price level, the weakening of direct central control without the establishment of effective

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[55] In 1989, the deficit amounted to 50 billion forint, adding to the national debt of 1,100 billion forint or about 65 per cent of GDP—among the highest in Europe. Domestic debt service alone is estimated to lay claim on roughly 15 per cent of fiscal revenues in 1990. In the context of stabilization efforts, that budget deficit should be reduced to 10 billion forint 1990.

[56] A. Eckstein, *China's Economic Development* (Cambridge, Cambridge University Press, 1977); B. Naughton, "*Saving and investment in China: a macroeconomic analysis*", Ph.D. diss., Yale University, 1986; C. Wong, "Rural industrialization in the People's Republic of China: lessons from the cultural revolution decade", in Joint Economic Committee, Congress of the United States, *China under the Four Modernizations, part one* (Washington, D.C., United States Government Printing Office, 1982), pp. 394-418.

[57] Eckstein, *op. cit.*; R. Portes and A. Santorum, "Money and the consumption goods market in China", *Journal of Comparative Economics*, No. 3 (1987), pp. 354-371; G. Szapary, "Monetary policy and system reform in China", paper prepared for a symposium on monetary policy, financial flows, and reforms in centrally planned economies, Gerzensee, Switzerland, 2-4 March 1989.

[58] Szapary, *op. cit.*

economic incentives and financial accountability in firms led to high investment demand and bonus payments. The resultant increase in aggregate demand was accommodated by an easy monetary policy and expansionary fiscal policy. The decentralization of the monetary and fiscal systems had also seriously weakened the effectiveness of macro-economic control. This was aggravated by poor agricultural performance, even though major procurement price rises were instituted between 1977 and 1979; more moderate increases occurred during the next two years. Part of their impact especially on urban consumers was absorbed by the central budget through higher food subsidies. The centrally set urban wages were adjusted upwards substantially in 1979 and 1980 and bonuses were reinstituted to compensate for a long period of declining real urban wages prior to the reforms.

The decentralization of the fiscal system and the beginning of further devolution of financial power to enterprises fed the rapid growth of extra-budgetary investment. With the incentive to expand tax revenues and retained profit, local governments and enterprises had strong motivation to raise investment in productive capacity. Investment from the central budget in infrastructure also grew substantially between 1978 and 1979. The resultant large budget deficits in 1979 and 1980 of 7 per cent and 5 per cent, respectively, were accommodated by credit from the central bank, thereby significantly accelerating price increases by 1980 (see figure VI.12).

In response to the rising pressures, a period of readjustment and a slow-down of reform was designated for the period 1979-1981 to reduce imbalances and alter the economic structure. The transformation of the output structure entailed a larger share for the agricultural, light industrial and service sectors at the expense of heavy manufacturing. The distribution of output placed much higher priority on raising consumption, which exerted a significant effect on the choice of stabilization policy in the 1980s. The measures embraced were generally effective. By 1981, together with the slow-down in output growth, inflation had declined to 2.4 per cent from 6 per cent a year earlier.

The implementation of a slow-down relied on various measures. The major difference from earlier policy was the choice to preserve consumption growth and reduce central investment. In addition, greater use was made of interest rates and financial instruments to induce savings. To curb the central budget deficit and accommodate continued growth in extrabudgetary investment, which the authorities could not easily curtail, capital investment financed from the central budget was compressed. The remaining deficits were financed by the sale of bonds reimbursing the central bank for loans from the previous year with the proceeds. Liquidity was absorbed by those sales and also by the promotion of bank savings through successive rises in interest rates targeted to exceed actual and expected inflation. The growth of credit to local governments and enterprises was curtailed. The indirect restriction on investment was reinforced by the centre's strong political pressure. On the supply side, the structure of imports was shifted to expand the share of food and other consumer goods and materials for light industry at the expense of machinery imports.

With the end of the interlude of "readjustment" in 1982 a period of accelerated reform began. The macro-economic priorities of continued rapid economic growth and improvement in consumption were retained. However, due to the inability of the centre to effect indirect control over investment expenditures, rapid economic growth was achieved predominantly by "extensive" investment, resulting in recurrent excess demand since 1985. Again, without the incentive and price structures necessary for indirect macro-economic management, increased decentralization of economic decision-making weakened the effectiveness of stabilization policies. Local political pressure against restrictions on credit and the centre's emphasis on rapid economic growth made the tightening of monetary and fiscal policy difficult to sustain for long enough to slow down investment activity.

Decollectivization of agriculture and accelerated rural industrialization had a substantially expansionary effect. The channelling of credit into the development of the rural industrial sector financed the expanding demand for extrabudgetary industrial investment and exacerbated the inherent high rate of non-agricultural investment at the expense of much-needed agricultural investment. The sharp rise in rural incomes since 1984 as a result of dramatic non-agricultural output growth concurrent with rapid urban wage increases fed the growth in consumption. The much more comprehensive devolution of decision-making upon enterprises since 1984 diverted even greater financial and real resources from central control. These emerged as extra-plan production and demand for investment. The tendency of enterprises to be liberal with the distribution of bonus and welfare benefits to workers from retained profits fuelled the growth in urban household demand. Wage increases during the period 1984-1986 far exceeded productivity growth (see figure VI.13).

The intentional increase in imports of consumer goods between 1983 and 1984 alleviated the demand pressure somewhat. But it had to be curtailed because of the resultant external imbalance. The latter also stemmed from the growth in import demand for investment goods, the persistent distortion in relative domestic prices and an overvalued exchange rate. Successive major currency devaluations in 1985 and 1986 directly translated partly into domestic price increases of inputs and consumer goods as there was still pervasive price equalization. There was perhaps some substitution of domestic consumer goods for imported goods, resulting in added upward pressure on domestic demand.[59] The aggressive promotion of export growth since 1984 further directly aggravated demand pressures on domestic resources.

After the initial burst of agricultural output growth in response to decollectivization and price increases, the agricultural sector has been growing slowly since 1985, which has tightened the supply constraint in food and agricultural raw materials. This is a consequence of an extended period of low levels of investment, increasingly scarce inputs and low

[59] *China: Country Economic Memorandum, Macroeconomic Stability and Industrial Growth under Decentralized Socialism*, vol. 1 (Washington, D.C., World Bank, 1989), p. 37.

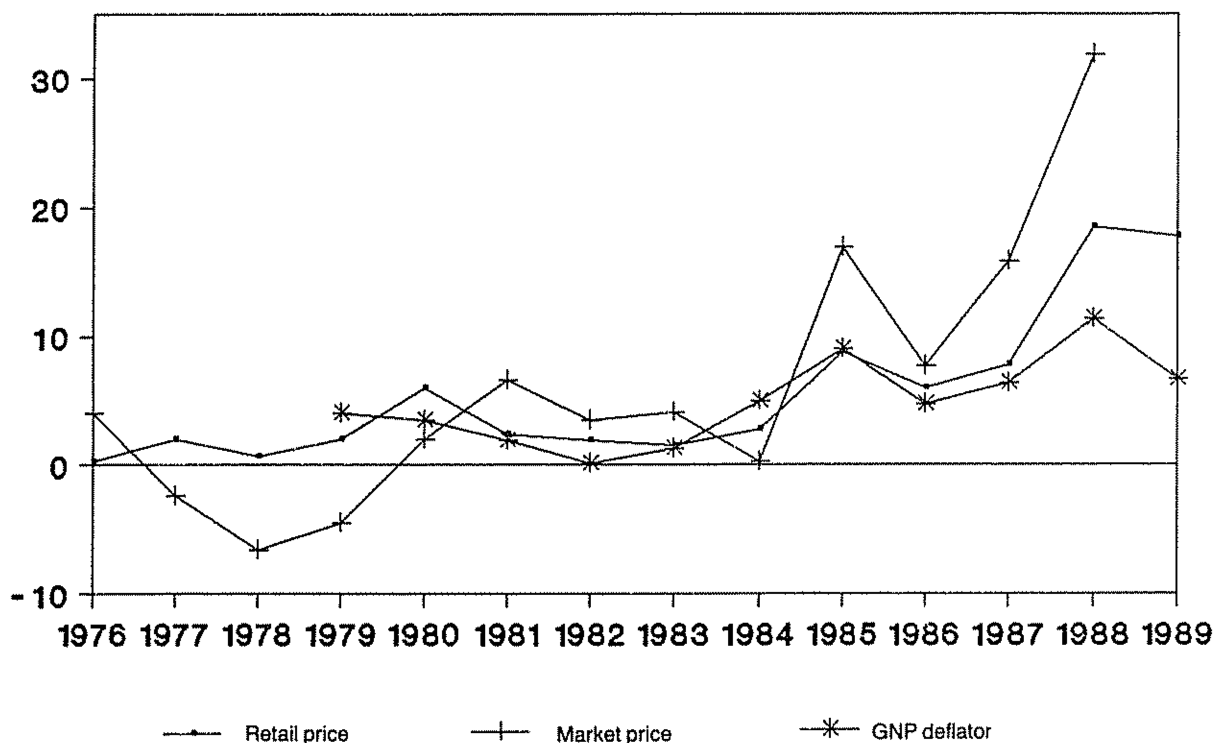
relative prices. The growth in the production of energy and intermediate goods has been seriously hindered by the cutback in central investment in the early 1980s and low prices. Thus, the increase in output in these industries has lagged behind that elsewhere, exacerbating the existing bottle-necks in energy and other industrial inputs.

Given the systemic inconsistencies outlined above, the reforms of the 1980s on balance complicated macro-economic control and exacerbated excess demand. Intentional reduction of wholesale and retail price controls allowed the growing imbalance to be translated into price increases. As a result, by various measures, the rate of inflation in China moved significantly upward after the mid-1980s, as shown in figure VI.12.

The crux of the problem of decontrolling prices in China has been the use of two or more categories of prices for an increasing number of agricultural and industrial goods.[60] A proportion of the output of these goods remains subject to central price controls and production quotas. Producers may sell the remainder direct at generally higher market prices. While decontrolled prices have provided greater production incentives and elicited increased responsiveness in supply, they have also resulted in more rapid price increases owing to the monetization of growing excess demand. Until the most recent round of price decontrol in 1988, centrally controlled prices were adjusted in tandem with market prices, but remained below them.[61] Price reforms in 1988 focused on the decontrol of retail prices of non-staple foods in urban areas.

Figure VI.12. China: measures of inflation, 1976-1989

(Annual percentage change)



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

Substantial excess demand for these goods led to drastic price increases, and the reforms were quickly aborted.

Significant changes in relative prices have resulted from price adjustments and reforms (see figure VI.14). However, relative prices are still not so rational as desired. Especially distorting is that the relative prices of non-staple foods, fuels and utilities are still set well below their market prices. Agricultural prices were adjusted upwards significantly both through increases in government procurement prices and the expansion of free markets. Prices of energy, primary commodities and intermediate goods were also raised in official

[60] K. Ishihara, "Planning and market—China", *The Developing Economies*, No. 4 (1987), pp. 287-309

[61] N. Chen and C. Hou, "China's inflation, 1979-1983: measurement and analysis", *Economic Development and Cultural Change*, No. 4 (1986), pp. 811-836; W. Byrd, "The impact of the two-tier plan/market system in Chinese industry", *Journal of Comparative Economics*, No. 3 (1987), pp. 293-308

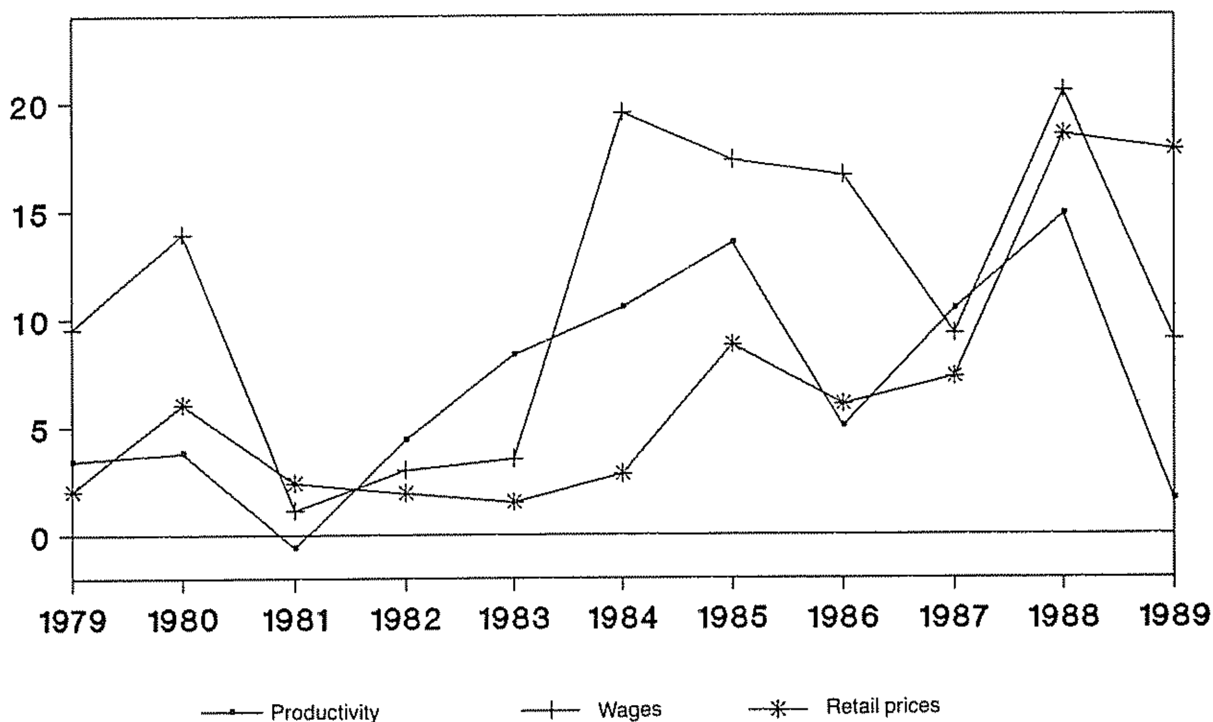
prices as well as in extra-plan prices discussed above. The adjustment of prices for manufactured consumer goods was not uniform. Some were reduced while others were raised, at times in combination with a varying degree of relaxation of central price control. With the inexorable growth of investment, prices of construction materials and other industrial inputs soared. The pressure from rapid growth in income also drove up drastically the wholesale and retail prices of foodstuffs. All these culminated in soaring inflation in 1988, which led to the postponement of any further decontrol of retail prices and the re-stablishment of price ceilings.

An important role in bringing about these imbalances has been played by the monetary and fiscal reforms. As a result of major reform measures in the banking sector implemented between 1979 and 1984 commercial banking functions devolved upon specialized banks and an attempt was made to establish a functioning central bank.[62] Concurrently, the central control of funds for enterprise investment was also shifted from the central budget to bank credits. The major instruments of money supply control available to the central bank are its credit to specialized banks, credit ceilings, reserve requirements and interest rates. The effectiveness of the last two indirect measures is undermined by the lack of accountability of the specialized banks and their branches and the political pressure exerted by local governments on these branches to extend credit to local enterprises. As a result, the most frequently used control has been the imposition of ceilings on the total amount of outstanding bank loans, generally resulting in resource misallocation as state firms tend to be favoured in credit allocation at the expense of private and co-operative sectors.

In the context of this system and the priority of rapid economic growth, there was a general tendency towards a high rate of growth of money supply between 1983 and 1989, with sharp fluctuations reflecting periodic attempts at contraction based on draconian reductions in the money supply (see figure VI.15). The direct effect of expansionary monetary policy on inflation can be observed with a lag of a few months.[63]

Figure VI.13. China: wage, productivity and price changes, 1979-1989

(Annual percentage change)



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

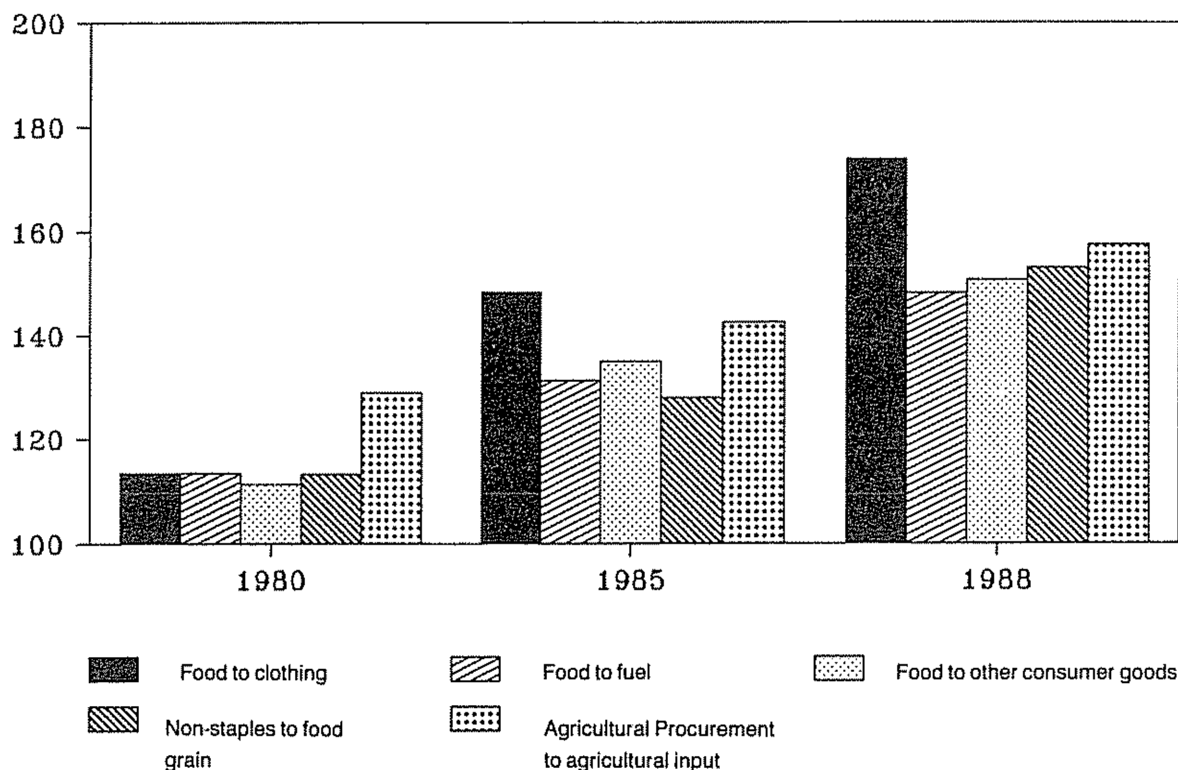
Note: 1989 wage data have been estimated using average wages in all industries

[62] For a broad discussion of financial reforms, see W. Byrd, *China's Financial System: The Changing Role of Banks* (Boulder, Colorado, Westview Press, 1983), and P. Bowles and G. White, "Contradictions in China's financial reforms: the relationship between banks and enterprises". *Cambridge Journal of Economics*, No. 4 (1989), pp. 481-495

[63] Szapary, *op. cit.*; G. Chow, "Money and price level determination in China", *Journal of Comparative Economics*, No. 3 (1987), pp. 319-333

Figure VI.14 China: indices of relative prices, 1980-1988

(1978=100)



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

There was a significant decline in the velocity of money between 1978 and the mid-1980s, reflecting a change in the structure of the demand for money. While the precise reasons for this are not clear, the major factors behind it could have been involuntary savings due to excess demand, the monetization process and a possible change in the structure of savings due to increasing transitory household incomes and in the marginal propensity to save from permanent income.[64] Price reforms in 1988 and the resultant price increases altered the inflationary expectations of consumers while interest rates were not adjusted in tandem. Savings were therefore drawn down drastically for hoarding.

The latest round of stabilization since late 1988 relies on greater utilization of interest rates and recognition of the need to deal with expectations of rising inflation. Interest rates on long-term bank deposits were increased above the rate of inflation and indexed to yield a positive real rate. Interest rates on loans to enterprises and reserve requirements were also raised. More traditional methods, including the compulsory purchase of government bonds out of current wage earnings of urban workers, are also employed. This is reinforced by the postponement of price reform. Nevertheless, the setting of bank credit ceilings is still the primary method employed to restrict investment growth. This has also contracted the supply of working capital as well as of funds for agricultural procurement and has indirectly squeezed bonuses, resulting in slower growth in wages. Therefore, there is persistent pressure to raise the ceiling or to make exceptions.

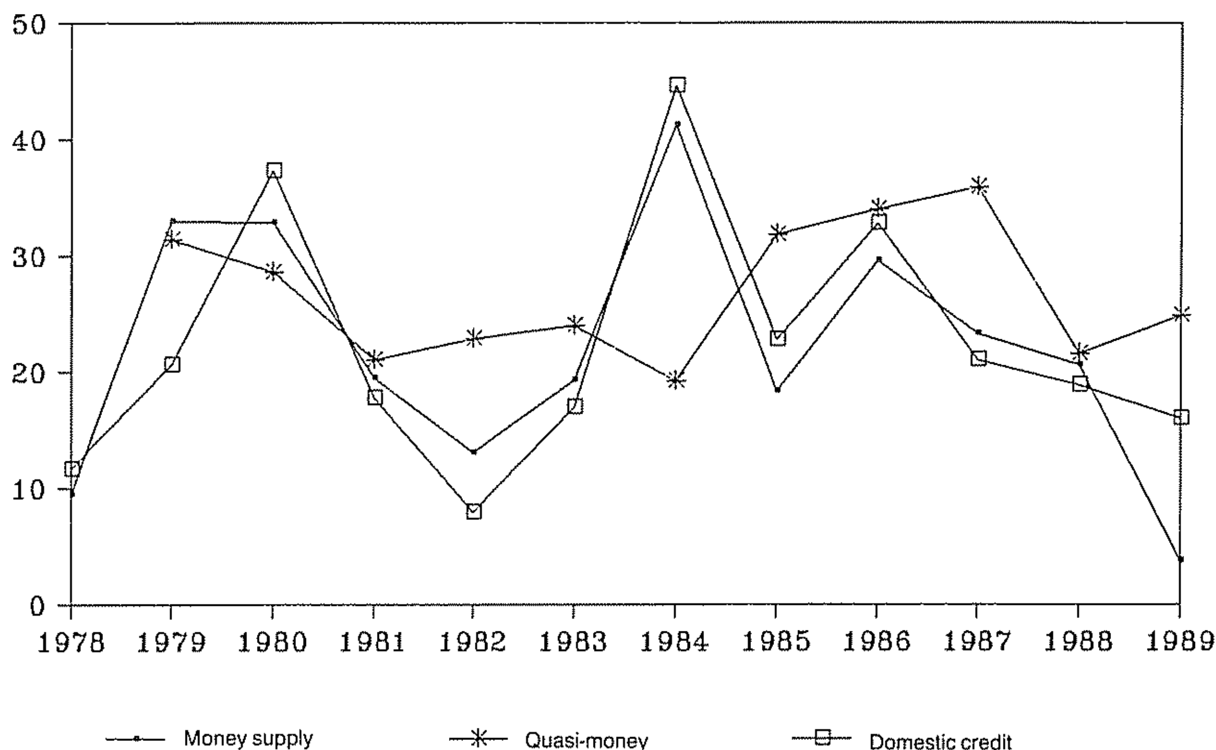
The decentralization of the fiscal system since reform has shifted the share of resources directly controlled by the centre to local governments and firms. The total tax revenues of the central budget as a proportion of gross national product (GNP) declined from 34 per cent in 1978 to under 20 per cent in 1988. There was no commensurate decline in central expenditures. The result has been persistent but, on average, small budget deficits since 1978.[65] In 1979 and 1980 and between 1983 and 1987, the entire deficit or a substantial portion of it was financed by money creation, with inflationary consequences. In contrast, in periods of stabilization, in

[64] Naughton, *op. cit.*; A. Feltenstein and J. Ha, "Measurement of repressed inflation in China: the lack of coordination between monetary policy and price controls" (Washington, D.C., World Bank, 1989); Y. Qian, "Urban and rural household saving in China", *International Monetary Fund Staff Papers*, No. 4 (1988), pp. 592-627; Szapary, *op. cit.*

[65] The largest were in 1979 and 1980, constituting 5.2 per cent and 3.8 per cent, respectively, of GNP. The size of the deficit dropped and remained around 1.5 per cent through the early 1980s and had increased to 2.4 per cent by 1988.

Figure VI.15. China: money supply and credit growth, 1978-1989

(Annual percentage change at end of period)



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

1981-1982 and 1988-1989 for example, deficit-financing relied on the issuance of bonds.

Since reform, the structure of expenditures has shifted in favour of subsidies to urban households and enterprises at the expense of centrally financed investment to control the budget imbalance (see figure VI.16). This has slowed down much-needed infrastructural development as these investments declined from 44 per cent of expenditures in 1978 to 26 per cent in 1988. The rise in the share of consumption subsidies was dominant through 1984 as the Government preserved real consumption of the urban population in the face of price increases. Since 1985, there has been a reversion to greater decontrol of consumer prices and less of a commitment to substantial consumption growth.

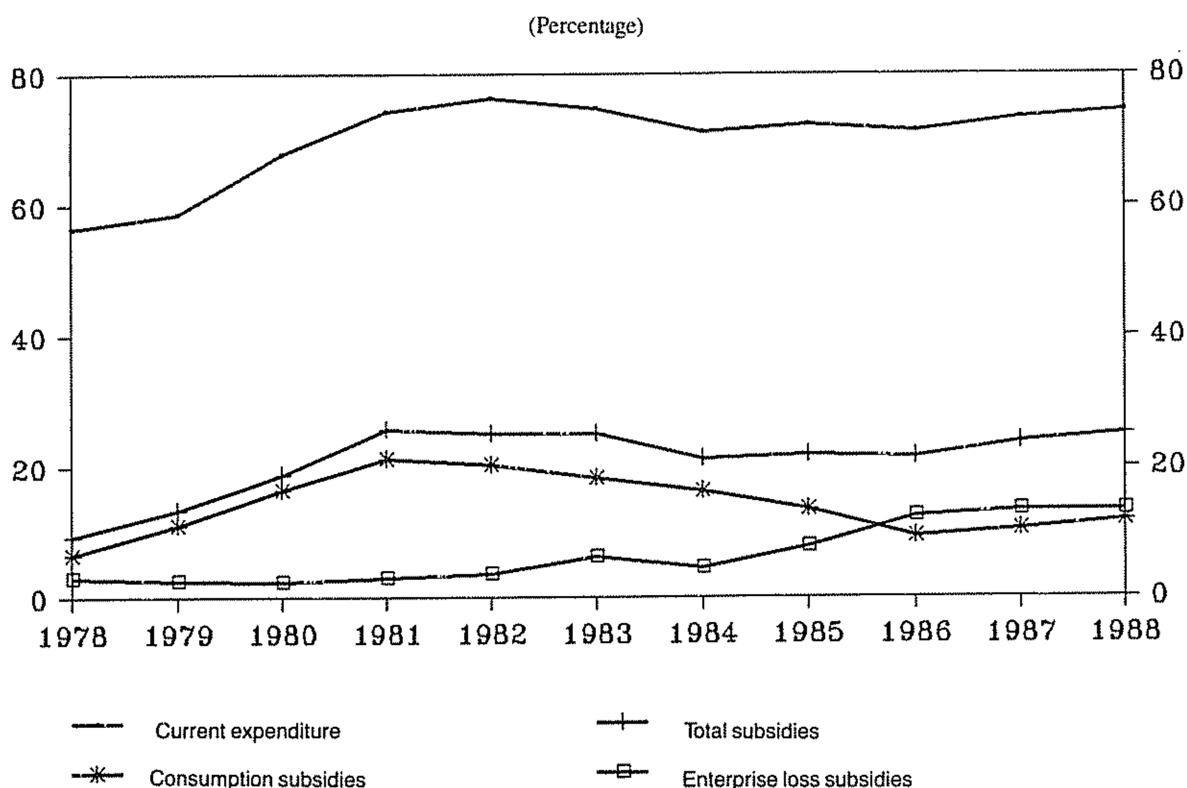
At the same time, the pattern of "extensive" investment financed directly and indirectly by the central budget has persisted among enterprises, as have other management inefficiencies. The financial losses incurred by some enterprises from the price increases since 1985, resulting from the reduction of planning in production and wholesale prices and very rapid growth in demand, necessitated significant increases in the amount of subsidies paid to firms. Thus, in the face of decentralized decision-making and ineffective macro-economic policy, the distributional priorities underlying the new development strategy have benn only partially attained to date. Consumption growth was rapid until the mid-1980s but has slowed significantly since then. At the same time, rapid economic growth was achieved with fewer efficiency gains than had been hoped for and much less price stability than desired.

The current stabilization programme in place since late 1988 is the third major attempt at slowing economic growth and price increases during the last decade. To stem soaring inflation, the 1988 price reforms have been postponed until after the fiscal imbalance has been significantly reduced through contractionary macro-economic policies. However, the economic system in which these policies are being implemented is little changed from that of 1985, so that the problems encountered then can be expected to resurface. That is, expansionary tendencies are generated by a partially decentralized system with distorted price and incentive systems, while the fiscal and monetary institutions necessary for indirect macro-economic management are still undeveloped.

The pace of economic reform has slowed progressively with the indefinite postponement of price reform in late 1988. It came to a virtual standstill with the change in leadership in June 1989. Policy makers equated the need for economic stabilization with increased emphasis on centralization rather than further reform. A return to government monopoly in the distribution and pricing of certain

Figure VI 16. China: composition of government expenditure, 1978-1988

(Percentage)



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

goods, such as agricultural inputs and some durable consumer goods, was considered an important means of controling inflation and improving supply. With the subsequent change in leadership, the shift towards recentralization became more pronounced. This has led to postponement of further reform, particularly in pricing, credit allocation, labour and wage policies, enterprise autonomy, the distribution system and ownership rights.

There is perhaps one major change in the macro-economic priorities that may result in greater resoluteness in slowing down the economy: the importance of controlling inflation is now seen as outweighing the pursuit of rapid economic growth. The distributional effect has been the erosion of real income and consumption growth, with the impact greatest on state employees and pensioners. An integral component of current stabilization policies, however, will have to be a continuation of low consumption growth, particularly if investment growth cannot be effectively controlled.

The contractionary macro-economic policies have so far generated some positive results. Output growth in 1989 declined markedly to 3.9 per cent while inflation had moderated significantly to under 10 per cent by the second half of the year. The retrenchment in investment has been much sharper in terms of central budget outlays for infrastructure and investment in collective and private sectors relative to the state sector. Real urban wages and rural incomes declined. Unemployment has also worsened significantly in both urban and rural areas. As a result of earlier hoarding, higher interest rates and a reduction in real income, consumption growth has declined drastically, the volume of retail sales shrinking by 8 per cent for the year as a whole. Inventory accumulation in the commercial sector has exacerbated the problem of liquidity shortage. Excess demand in intermediate goods as well as in certain foodstuffs, in contrast, has not changed fundamentally.

For 1990, the Government is continuing with moderate aggregate output growth, with priorities still in agriculture and state industries producing energy and key intermediate goods. Money supply and credit growth are targeted to be maintained at the 1989 levels, but are scheduled to be much higher during the first half of the year to avert a recession. The latest focus of macro policy is on the trade-off between stabilization and economic growth, which may influence the monetary stance later in 1990. Income and employment policies will be loosened to stem the continued decline in real urban income. The promised increases in wages, even for redundant urban workers, and pensions will continue to propel excess demand, whose eradication will therefore be more difficult than it would otherwise have been.

Inflationary pressures and perestroika in the Soviet Union

Whether inflation could occur in the Soviet Union and, if it has ocurred, to what extent, are two questions that have been discussed for decades. The first question raises a more philosophical range of issues; the second focuses primarily on more practical matters. For many years, it was argued that inflation did not exist as macro-economic management through detailed central planning was held to succeed in maintaining balance, if not instantaneously at least through subsequent planning periods. This position was buttressed by statistical measurements, mostly of an *ad hoc* nature, underlining the stability of wholesale and retail prices over the long haul.

From time to time, these fixed administrative prices were revised, some being lowered and others raised, but a pronounced upward trend was rarely discernible either from official statistical releases or more academic research in the Soviet Union.[66] Both stances have been heavily criticized in the western literature about Soviet economic development almost from the beginning of central planning in the late 1920s. Since *glasnost* and *perestroika*, very probing questions about inflation have been raised also in the Soviet Union by academic researchers, government officials and the public at large.[67]

Unfortunately, there is as yet no consensus on the precise measure of inflation in the Soviet Union, when it was most intense, and the chief institutional and policy mechanisms by which it was driven, controlled or suppressed. But there is by now ample evidence, although not so far uniformly endorsed, to refute earlier claims about the avowed success with stabilization under orthodox central planning.

Obtaining reliable quantitative indicators and cogent explanations of causalities are by no means tasks resolved by consulting official statistical releases. For one thing, there is still no official retail price index.[68] Moreover, implicit deflators, such as are embodied in official aggregate output indicators or the national accounts, have come under sharp criticism from Soviet observers. There is now broad agreement that official measures have not quite come up to par. The least controversy exists about the fact that greater attention ought to be paid to measuring qualitative changes in products and distinguishing more rigorously between genuine improvements and purely nominal ones that in fact conceal price hikes. There is greater controversy over other methodological features of empirical measurements whose treatment (for example, the insertion of new products in statistical series) leaves much to be desired. Furthermore, there is growing recognition that in "shortage" economies, such as the Soviet one, no measure of inflation; short of it being built up from detailed micro-economic observations about prices and many other indicators that influence economic behaviour, can adequately reflect imbalances in the economy.[69]

Owing in part to the unsatisfactory nature of official measurements[70] and the growing public concern about inflation, various Soviet organs and private researchers have begun to release their own estimates, which vary considerably.[71] Estimates for 1989, for example, range from the near-official 2 per cent to over 10 per cent.[72] The more optimistic estimates are usually prepared on the basis of official statistical releases. This presumes that reliable consumer price indices can be computed from a stable pattern of consumption, irrespective of the palpable structural shifts in consumer behaviour and sizeable changes in the quality and availability of goods and services—a strong assumption given the bulging imbalances since *perestroika*. The higher estimates take into account changes in a wider pattern of consumer prices, reflecting the more rapidly escalating prices for new products and in co-operative markets, as well as changes in the pattern of consumption and in the quality of goods and services being sampled. Though official measures of open price inflation in 1989 came to about 2 per cent, imputations of price movements that would have been required to equilibrate markets have yielded an offical inclusive rate of 7.5 per cent.[73]

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66 For a perceptive note on the reason for this. see Anders Aslund, *Gorbachev's struggle for economic reforms* (London. Pinter. 1989). pp 3-8

67 For two recent Soviet analyses of inflation under central planning and beyond, see Yury Yakovets. "Inflyatsionnaya volna: prichiny, sledstvia. protivodeystvie". *Voprosy ekonomiki* (Moscow), No. 9 (1989), pp 26-33, and Ruslan Grinberg, "Inflyatsia v sotsialisticheskikh stranakh: zakonomernosti i osobennosti", *Voprosy ekonomiki* (Moscow), No 9 (1989), pp. 67-76. Similarly critical questions have been re-examined in the western literature For two recent inquiries with useful references, see Vladimir G Treml, "Perestroika and Soviet statistics", *Soviet Economy*. No 1 (1988), pp 65-94; and "Dr Vanous's 'Dark side of glasnost' revisited". *Comparative Economic Studies*. No. 4 (1989), pp 95-109.

68 In November 1989, the Supreme Soviet instructed the State Committee for Statistics in conjunction with the State Committee on Prices to devise during the first quarter of 1990 a system for calculating reliable price and inflation indices (see *Pravda* (Moscow), 29 November 1989. pp. 1 and 3)

69 This issue is intertwined with the modelling and simulation of economies in fundamentally chronic disequilibrium For a recent review of the many issues involved, see Christopher Davis and Wojciech Charemza, "Introduction to models of disequilibrium and shortage in centrally planned economies", in *Models of Disequilibrium and Shortage in Centrally Planned Economies*. Christopher Davis and Wojciech Charemza, eds (London and New York, Chapman and Hall. 1989), pp 3-25

70 Price statistics are now considered to be one of the least reliable statistical measures collected, compiled and disseminated by the official statistical authorities, especially *Goskomstat* or the State Committee on Statistics (see *Ekonomicheskie nauki* (Moscow), No. 6 (1989), pp 64-72). For a broader assessment of problems with Soviet statistics, see G N Zoteev. "O printsipakh perestroiki statistiki natsionalnogo dokhoda SSSR", *E G Yasin. "Perestroika i statistika". and "Krugly stol redaktsii". Ekonomika i matematicheskie metody* (Moscow), No 5 (1989)

71 Many important indicators are presented in the Soviet press rather carelessly, thereby further complicating independent assessment For example, the increase in money in circulation for the first three quarters of 1989 relative to the corresponding period of the preceding year was reported at 17 per cent in one authoritative source (*Ekonomicheskaya Gazeta* (Moscow), No 44 (1989). p 18). but at 33 per cent in another source (*Literaturnaya gazeta* (Moscow), No 48 (1989). p 1)

72 The latter is from M Panova and Y Yakutin, "Mery chrezvychainye. no neobkhodimye". *Ekonomicheskaya gazeta* (Moscow), No 47 (1989), p 9

73 See V.I. Kirichenko, 'Trudnye shagi ekonomiki", *Pravitel'stvenny vestnik* (Moscow). No 4 (1990), p 3 Such an official measure was unheard of even as recently as a year ago

Whatever the precise magnitude of inflation may in the end turn out to have been, there is at this stage little dispute that, during the past 20 years or so, the growth in the Soviet population's monetary income has been sharply eroded through inflation of one kind or another Likewise, there is now broad agreement that the intensity of inflation has fluctuated over time, partly related to Soviet domestic and trade performances but also to macro-economic policy stances It is worth stressing, though, that fiat price revisions, as in 1967 and 1982 (see figures VI.2 and VI.17), appear to be the key contributor to the upward price drift The core missing factor in these measures, given the fixed-price régime in most years, is the degree of repressed inflation, which has manifested itself in all the forms discussed earlier But there has also been monetized inflation that has not so far been adequately measured. Both have markedly undermined the purchasing power of the rouble and hence jolted the confidence of the population in the Soviet currency In addition, there have been more intricate repercussions on the trade-off between leisure and effective work effort.

Except for Albania, the Democratic People's Republic of Korea and Mongolia, the Soviet economy was arguably the most orthodox planned economy at the outset of *perestroika*. Certainly, various modifications to the traditional planning system had earlier been envisaged and partly pursued.[74] Although especially the so-called Kosygin reform of 1965—the archetype of administrative decentralization—aimed at devolving greater autonomy upon enterprises, whose activities would be geared to the profit motive as well as by other parameters, and lower-level planning organs, it was generally highly conservative as far as price reform was concerned. It sought to recentralize the mechanism of price-setting, after the devolution upon the regional planning offices, and to introduce price revisions [75] Letting prices reflect market forces and linking them with external trade prices were not even considered at the time. At best, the authorities aimed at resetting fiat prices so that they would better reflect average input costs for the branch as a whole. Retail prices for food and light manufactures were reset in late 1966 and new wholesale prices were introduced in July 1967. But soon thereafter, recentralization occurred because of disenchantment with the reform.

More recent attempts to restructure the Soviet economy include the industrial reorganization introduced in 1973 and the effort of mid-1979 to revive key elements of the 1965 reforms. Neither envisaged a loosening of the price régime, although changes were introduced at one point or another. Especially the 1979 reform and its emphasis on profit as a central performance criterion of enterprise autonomy gave rise to concern about prices. But both were half-hearted attempts at streamlining the output structure and failed to make major changes in the official role of prices in micro-economic decision-making.

Inasmuch as profit depends on input and output prices, and for a firm the former were more difficult to control than the latter, a favoured way of concealing price increases tacitly encouraged with the 1979 reform was the introduction of ostensibly new products at higher prices. Because the implementation of price revisions and price-setting regulations favoured "new" products, the general level of retail prices was affected by enterprise behaviour Though measurement remained inadequate, the retail price index by 1980 was perhaps four points above the level observed in either 1970 or 1975; a similar increase occurred in the next five years (see figure VI.2).[76] Price increases since then have been around 2-3 per cent a year. As noted, however, these data continue to be contested in the professional literature. But there is no dispute about the fact that essential consumer goods and services continue to be heavily subsidized from the central budget.[77] In 1988, this amounted to 91.5 billion roubles or the equivalent of 20 per cent of budget expenditure. These subsidies are contributing to substantial budget deficits, of the order of 90 billion roubles or 10 per cent of GDP in 1989 alone,[78] and to a rising national debt.[79]

As a result, when the Soviet leadership decided to embark on *perestroika* in 1986 and subsequently to pursue radical reform with determination, its starting conditions were by and large the institutions and instruments of central planning in physical detail. These had been compounded by lax monetary and fiscal policies, including the legacy of unbalanced growth since the mid-1970s

Soviet imbalances exemplify the three types of imbalances discussed in the first section of this chapter. Policy makers have now to come to grips with a substantial monetary overhang inherited from undisciplined economic policies pursued especially since the 1970s. This inherited imbalance has since been augmented by major errors in formulating and implementing macro-economic policies, some of which could have been avoided.[80] One such decision has been the anti-alcohol campaign launched in 1985, which forcefully reduced output in part through the wanton destruction of the

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[74] For a broad review of Soviet reform attempts and their results, see Ed A Hewett, *Reforming the Soviet Economy—Equality versus Efficiency* (Washington, DC, The Brookings Institution, 1988), especially pp 221-302

[75] For details, see Gertrude E Schroeder, "The 1966-67 industrial price reform: a study in complications", *Soviet Studies*, No 4 (1969), pp 462-477

[76] V.K Senchagov, "Anatomia tseny", *Kommunist* (Moscow), No 16 (1989), pp 12-27

[77] The redistributive role of the budget has increased enormously It accounted for 55 per cent of national income utilized in 1970 but 74 per cent in 1987 (Yakovets, *op. cit.*, p. 32).

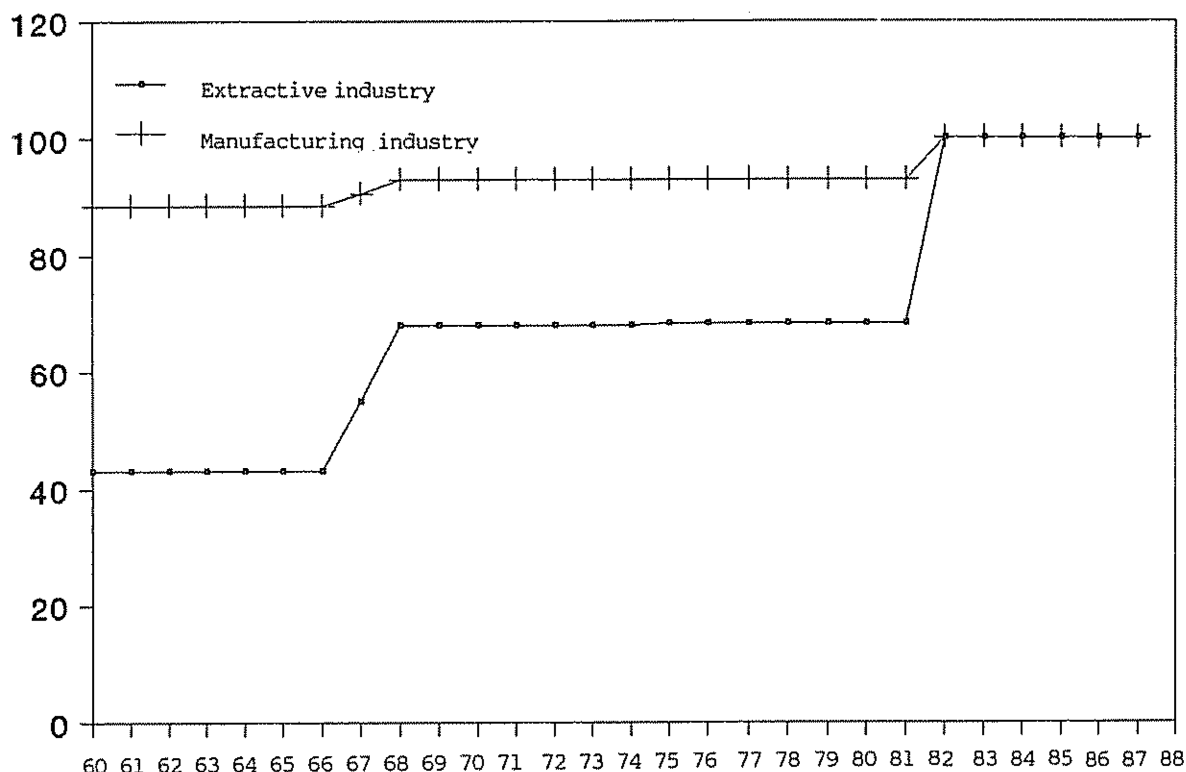
[78] It is to be slashed to 60 billion roubles in 1990

[79] Earlier, a deficit of roughly 100 billion roubles or 11 per cent of GDP had been expected (Y. Borozdin, "Ekonomicheskaya reforma i tovarno-denezhnye otnoshenia", *Voprosy ekonomiki* (Moscow), No 9 (1989), p. 17). The domestic debt because of borrowing in the Soviet Union was reported to be 400 billion roubles in 1989 (S. Dzarasov, "Reforma i rubl", *Planovoe khozyaistvo* (Moscow), No. 12 (1989), p. 27). But there has been growing concern about the proper definition of national debt.

[80] The precise size of the overhang is a matter of dispute. It encompasses part (perhaps 150 billion roubles) of the population's savings deposits; part of the holdings of enterprises that can be turned into cash, perhaps through surreptious transactions with co-operatives; and "hot money" in the second economy. This involves billions of roubles but there is no agreement on precisely how many Combined, however, the overhang amounts to at least the annual value of retail trade (400 billion roubles in 1989)

Figure VI 17. USSR: implicit wholesale price index, 1960-1988

(1982 = 100)



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

capital stock in vineyards and distilleries. Because of this cut-back, the government budget lost a substantial amount of revenue, estimated at around 40 billion roubles, for which no substitute was found. Moreover, moonshining took a major leap forward, thereby diverting a substantial amount of fiscal revenues to the second economy and leading to an increase in the amount of "hot money". Furthermore, this development could proceed only by laying claim to substantial foreign currency resources to finance imports. Many Soviet economists now feel that these resources could have been better allocated to procuring durable consumer goods or foodstuffs in great demand.

Inexperience with steering an economy in transition, let alone a more market-oriented economy, has resulted in macro-economic policies that are not capable of maintaining current balance, far less correcting imbalances inherited from past mismanagement. Furthermore, little progress has been made with rectifying distorted relative prices. If anything, the disarray in relative wholesale and retail prices has been compounded by the rational reaction of decentralized units to an irrational economic situation.

The characterization of current Soviet reform as one that aims at market relations is not really warranted as yet.[81] Soviet decision makers appear to envision essentially maintaining a considerable degree of central policy control, including control through planning channels.[82] But they want micro-economic tasks to be discharged by decentralized units that are not completely free to decide upon input and output profiles, that cannot choose sources of supply of primary and intermediate inputs and how best to dispose of final products, and that have little control over price formation. At the same time, the aim of policy is to integrate the Soviet economy more fully into the global economic framework without, however, automatically linking domestic with external prices as this might undermine the desired degree of domestic pricing and policy autonomy.

Pursuing decentralization in the absence of a competitive environment and efficient and flexible prices, including ex-

[81] For a discussion of the ambivalence on this issue, see A. Bachurin, "Kakoy rynok nam nuzhen", *Planovoe khozyaistvo* (Moscow), No. 1 (1990), pp. 42-51.

[82] Even with the most recent reformulation of the ultimate objectives of the reform policies, it is not very clear whether full marketization, for example in Poland or Viet Nam, is being envisaged for the near term. But the policy debate in the Soviet Union has been changing rapidly these past months.

change rates, supported by a fully operative network of intermediating financial institutions and adequate instruments can be risky and counterproductive. The experience with *perestroika* to date has amply underlined these dangers, if only because the partial loosening up of the enterprise decision-making sphere enacted in early 1988 resulted in inexpensive goods and services becoming scarce and prices going up. Given the constraints on enterprise behaviour and the highly monopolistic nature of economic structures, including very limited import competition, this is precisely the kind of profit-maximization response from micro-economic units that should have been anticipated: firms with any degree of freedom at all utilized the decentralization opportunity to move into high-profit activities and to pass on profit increases to workers as wages, rather than envisage the more arduous task of boosting factor productivity and output. This stance was actually supported by inadequate monetary and fiscal policies. The latter owe much to persistent government deficits partly financed by issuing money.

Perhaps most blatant has been the lack of financial discipline of the nominally decentralized banks. Because of easy money available to them from the central bank, firms have not at all been restrained in keeping with economic rationality, the desired outcome of macro-economic policy or the intrinsic input-output constellation of the firm in question. Until recent stabilization measures, the issuing of money was not actively discouraged. In 1989, it was expected that money in circulation would exceed the supply of goods and services by 18 billion roubles, representing about 5 per cent of the value of retail trade. An effort is being made to compress this addition to an already substantial monetary overhang to about 10 billion roubles in 1990.[83] This substantial increase in the money supply is one of the endemic sources of pressure exacerbating market imbalances.

After nearly five years of *perestroika* with growing imbalances, the Soviet leadership now appears determined to tackle at the source of the crises that are choking the Soviet economy in general and the consumer in particular. Certainly, the Government earlier tried to implement measures to curb inflation and stabilize the economic situation to some degree, but made no sizeable impact. There is now broad agreement that something bold needs to be done soon. But what precisely should be done, and how quickly stabilization should be pursued as a necessary prelude to making headway with genuine decentralization are key issues of the ongoing reform dialogue that figure prominently on the policy agenda.

With a rapidly worsening economic situation in 1989, especially in key consumer markets, there was little alternative but to seek substantial stabilization. In late 1989, Deputy Prime Minister Leonid Abalkin submitted a proposal to complement *perestroika*. It included a fairly detailed stabilization programme until the end of 1990 as a foundation for moving swiftly ahead with reform. The post-stabilization part of the programme consists of three stages: the start-up of genuine reform during 1991-1992, the comprehensive introduction of the new system during the following three years and the full realization of the programme and making it completely operational during the second half of the 1990s.

The stabilization package had three components. First, it envisaged a deficit-reduction programme, a tight-money policy, a far-reaching effort to improve the supply of consumer goods and services and a range of measures to gradually reduce the monetary overhang. The second component would be provided by cementing in the legislative bases for new economic measures by adopting laws and regulations on the banking system, economic stabilization through macro-economic policy and anti-monopoly measures. The final set of measures aimed at re-establishing social stability, including regaining grass-roots support for and belief in the Government's ability to cope with the prevailing crises.

Part and parcel of the stabilization effort would be the elimination of loss-making firms in the course of 1990 by transferring assets. This could take virtually any form other than outright privatization. The forms envisaged included leasing, management contracts and conversion into co-operatives or joint-stock companies. This was intended as a prerequisite for launching new wholesale prices in 1990 and genuine wholesale trading, as opposed to the overwhelming use of state orders.[84]

This moderately ambitious programme could have helped to rectify the most egregious imbalances in the Soviet economy, but it failed to elicit the support of parliamentary organs, which were unusually disputatious. Only a much less radical set of measures was approved, aimed at protecting real incomes, state enterprises and spreading the adjustment of relative prices over a longer period of time. In its resolution of 20 November 1989,[85] the Supreme Soviet adopted a package of anti-inflationary measures that included temporary suspension of some paragraphs of the USSR law relating to setting contract prices for basic foodstuffs and certain non-food goods in wide use as well as foreign trade in consumer goods and basic raw materials for their production. At the same time, the Government implemented some measures to prevent the removal of cheap products in great demand from production and a hidden increase in prices for "new products",[86] both aimed at stabilizing consumer markets. Furthermore, the programme seeks to spread stabilization over a multi-year period, and the Government has drawn up lists of essential products whose prices cannot be changed at the present time. Moreover, measures are being discussed to compensate some strata of the population for the erosion of fixed incomes. Finally, bold measures were taken to bolster production and destocking of consumer goods, including goods from the military sector, and increase the sale of houses and apartments.

[83] *Sotsialisticheskaya industria* (Moscow), 11 November 1989, p. 2

[84] For more details on the role of state orders as intended by *perestroika* and as actually practised, see *World Economic Survey, 1988* (United Nations publication, Sales No. E.88.II.C.1), pp. 109-117; and *World Economic Survey, 1989* (United Nations publication, Sales No. E.89.II.C.1), pp. 21-25.

[85] Reproduced in *Pravda* (Moscow), 29 November 1989, pp. 1 and 3

[86] As from 1 January 1990, prices of other "new" consumer products can be augmented at most by 30 per cent

At the same time, the Congress of People's Deputies decided that the Government should accelerate the implementation of radical reform, set in train measures for financial recovery, stabilize money circulation and satisfy consumer demand during the period 1990-1992. Also during that period new methods of macro-economic management should be devised. In addition, the role of commercial lending should be enhanced and guided by monetary policy. Furthermore, during 1990, draft laws on ownership, including ownership of land, on the autonomy of republics and regions (*oblast*), on the banking sector, on regulating investment activity, on employment and on related reform matters should be finalized. The Congress also authorized the Government to initiate measures to stabilize the prices of essential consumer goods and protect real incomes of special groups in 1990.

In sum, there has been a broad debate on how to reform the Soviet economy since the inception of *glasnost*, especially with the constitution of new parliamentary organs since 1987. There is now a mainstream view that genuine economic reform with balanced macro-economic policies will take at least a decade. Such reform may be constructed in two phases, during which an interconnected system of pragmatic measures will need to be instituted to improve the efficiency of the Soviet economy and ensure its integration in the world economy. The preparatory stage of urgent economic stabilization measures, which will take at least until 1992, should get the economy out of the doldrums. The conditions necessary for changing relative prices to reflect underlying scarcities should be put in place by enacting measures to counter the monetary overhang, largely by increasing the supply of goods and services and widening the range of assets that households and firms can hold. Price reform is now planned to be carried out gradually, starting with wholesale and procurement prices from 1991 onwards; retail prices are to be dealt with later.

Before this genuine reform can be fully addressed, however, it will be necessary to resolve the food problem, the budget deficit and the worsening situation in consumer markets, and indeed to ensure more balanced economic development through stringent fiscal and monetary policies. Further integration in global trade should be pursued to facilitate the necessary structural change in the Soviet economy which may, in time, yield increased exports of manufactures. Greater efficiency in imported capital goods may mean that consumer goods can be imported to supply domestic markets. To this end, new regulations giving firms greater autonomy in foreign currency matters are to be introduced in 1991.

Conclusions

This analysis of the origin and propagation of inflation in reforming planned economies, has demonstrated that there are essentially three broad factors that need to be distinguished: inherited imbalances, inadequate macro-economic policy co-ordination during the transition phase and the need to reset relative prices so that they reflect underlying scarcities. These factors are the key determinants of excess demand spilling over into price pressures and "monetizing" itself when market adjustments are permitted. To minimize the adverse effects of pursuing radical economic reform, the policy response to each of these factors should be custom-made.

Inherited imbalances need to be tackled through means other than the fine-tuning of economic instruments. Their compression or elimination requires extraordinary measures, such as confiscatory monetary reform, the creation of new financial assets for private agents, the sale of additionally earmarked goods and services, the mobilization of foreign exchange at or near its shadow cost for filling gaps in domestic retail markets, the sale of state-owned or social property or other steps that help to mop up excess liquidity in circulation.

In contrast, rectifying current macro-economic imbalances should be the objective of putting in place proper monetary and fiscal policies, including the institutional and instrumental infrastructure through which such policies can be implemented in an orderly way. Inasmuch as these mechanisms in planned economies are underdeveloped, it will be necessary during the transition to experiment with new policies and their institutions and instruments in order to fine-tune the macro-economics of the transition and eventually of the market-oriented economy. Under some circumstances, it may be necessary to adopt comparatively tight macro-economic policies, if only to avoid an inflationary spiral.

The evidence on the methodology of reform and stabilization as well as the examination of the experience with inflation shows how important the connection between reform and open inflation is. The latter is an inevitable consequence of policies that aim at adjusting relative prices in line with underlying relative costs. To the degree that this is the statistical result of a once-and-for-all correction of relative prices, especially the upward adjustment of prices for key consumer goods and services, the rise in prices is not necessarily alarming. Without reliable guides on trade-offs to micro-economic choice, market orientation will remain elusive or dysfunctional. Policy makers should primarily be concerned with mitigating the adverse income effects, particularly for the poorest layers of society, of such inflation and ensuring that competition proceeds with minimal abuses. This may call for revised aggregate price and income policies in support of a social safety net for those strata of society most adversely affected by price shifts. This is required simply to cushion against severe losses in real income levels as prices of essential goods and services, traditionally subsidized under central planning, are bound to rise disproportionately.

The monetization of imbalances accumulated at the time of physical planning (so-called repressed inflation) compounded by persistent imbalances during the transition from traditional planning to a more market-oriented mode of decision-making are worrisome. They not only erode purchasing power and wealth, but also undermine key features of stability in socialist economies. Rather than revert to administrative decision-making, the concern at the policy level about inflation should be addressed through proper macro-economic policy measures.

As a result, questions about the consistency of system reform and the compression of inflation, the design of reforms and unexpected domestic and external events that exacerbate inflation, the sequencing of reform measures and the steady fine-tuning of macro-economic policy stances have to be further explored. Although a fully dovetailed programme cannot be designed *ab initio*, reform blueprints so far have only inadequately sought to come to grips with these interrelated technical features. Fine-tuning of policy during the implementation process could be geared towards tackling those issues so that they do not detract attention from the main purpose of the reform.

Chapter VII

EXTERNAL ECONOMIC FACTORS AND SOCIAL CONDITIONS IN DEVELOPING COUNTRIES

The economic and social progress that took place in the 1970s came to a halt in many developing countries during the 1980s. In others, particularly in South and East Asia, economic growth accelerated, the relative number of the absolute poor decreased and social indicators showed solid improvements.

The reasons for the change in trends, and particularly for the diversity of situations, have been analysed extensively in a number of studies and reports of the United Nations system, international institutions, individual Governments and academic institutes. In previous issues of the *World Economic Survey*, national and international causes of the variations in the rate of economic growth in different groups of countries have been analysed.[1] In many countries rigid economic and social structures inhibited rapid adaptation to the changed environment of the late 1970s and early 1980s. In a large number of countries, the magnitude of the shocks—escalation of interest rates and a major drop in the prices of commodity exports—overwhelmed adjustment programmes. In others, the difficulties stemmed mostly from the inability to expand agricultural—in particular food—production. Finally, in several countries, prolonged armed conflicts adversely affected economic activities and diverted a considerable amount of resources from development.

The link between changes in gross domestic product or national income and social indicators is tenuous, particularly in the short-term. Institutional changes, targeted policies for certain social services or to improve nutrition, and measures to make income distribution less unequal can have a much greater impact on social welfare and social progress than an acceleration in output expansion. Yet, two propositions remain valid. First, in the medium- to long-term, improvements in social conditions require a growing economy. Secondly, in developing countries with rigid economic structures and no mechanisms to buffer large segments of the population from an abrupt worsening of the economic situation, the impact of an adverse shock to the economy can be very painful. In the 1980s, natural disasters such as droughts and floods further strained the capacity of several economies.

The terms of trade during the 1980s worsened for primary commodity exporters. This had a direct effect on real resource availability. Moreover, in many countries net credit flows dwindled considerably and, for some, became negative. The persistence of high real interest rates during the 1980s also adversely affected borrowers.

The changed international economic environment made the need for adjustment inescapable. The objectives of adjustment are to restore the balance-of-payments position, and especially to change economic structures so as to regain growth momentum, but its short-term effects can be very harsh. Yet, adjustment cannot be avoided when general economic conditions have changed and weakened a country's economic position. The alternative is a further weakening. The challenge is to design policies to restore sustained growth without having to pay a high social cost.

Declining per capita incomes during the 1980s

About two thirds of the developing countries experienced a decrease in their per capita income in the period 1980-1989. In more than half of these countries, the decline was more than 10 per cent, and in two out of five it exceeded 20 per cent (see table VII.1).[2] The magnitude of the decline and the number of countries affected by it are without precedent in the post-war period. The consequences of falling incomes have often been devastating: standards of living have deteriorated; nutritional conditions have worsened; revenues from excise taxes and direct taxes have been negatively affected, limiting the scope of Governments for compensatory measures; and investments have fallen, thus reducing the potential for growth in the medium- to long-term.

Less than one fifth (16 out of 84) of the developing countries experienced growth in per capita income of 1 per cent or more. The population of those countries represents roughly two thirds of the population of developing countries. Indeed, populous countries, such as China, India and Pakistan, achieved per capita income increases exceeding 20 per cent between 1980 and 1989. In all three countries, per capita income growth was faster in the 1980s than in previous decades.

In the case of the energy-exporting countries, which are mostly in the group that experienced a per capita income loss exceeding 35 per cent, two factors were responsible for the major declines in income: in the first half of the 1980s, export volumes declined as the oil demand of industrial countries declined; in the second half, international oil prices plummeted. Actually, the changes in per capita income of individual countries were neither smooth nor simultaneous.

[1] See, for example, *World Economic Survey 1986* (United Nations publication, Sales No. E.86.II.C.1), chap. II (section on diversity of experience in developing countries); *World Economic Survey, 1987* (United Nations publication, Sales No. E.87.II.C.1), chap. VIII (The fast-growing developing countries of the 1980s); *World Economic Survey, 1988* (United Nations publication. Sales No. E.88.II.C.1), chap. VIII (Growth and adjustment in small and medium-sized developing countries during the 1980s); and *World Economic Survey, 1989* (United Nations publication, Sales No. E.89.II.C.1), chaps. II (section on developing countries: the growing dichotomy) and VIII (Economic adjustment and the net transfer of resources from developing countries).

[2] The table is based on a sample of 84 developing countries. Most of the developing countries which are not in the sample are small, low-income countries. The available data for the latter, although incomplete, suggest that in the large majority of them per capita income also declined considerably in the 1980-1989 period.

Table VII.1. Real per capita income, 1980-1989[a]

Decline				Increase			
(1) More than 35%	(2) 20 - 35%	(3) 10 - 20%	(4) Less than 10%	(5) Less than 10%	(6) 10 - 20%	(7) 20 - 35%	(8) More than 35%
			Net energy importers				
El Salvador	*Argentina*[b]	Central African Rep	Burkina Faso[c]	Bangladesh	Gambia	India	China
Ivory Coast	Chad	*Costa Rica*	*Comoros*	*Brazil*[c]	Nepal	Malta	Cyprus
Liberia	Guatemala	Ethiopia	*Malawi*	*Burundi*		Pakistan	Hong Kong
Madagascar	Haiti	*Ghana*	Rwanda	*Chile*		Sri Lanka	Rep. of Korea
Nicaragua	*Honduras*	*Kenya*	Yugoslavia[c]	Colombia		Turkey	Singapore
Sudan	*Mozambique*	Lesotho	Zimbabwe	Dominican Rep [c]			Thailand
Togo	*Niger*	*Mali*		Israel			
Zambia	*United Rep of Tanzania*	*Mauritania*		*Morocco*			
		Panama		Paraguay[c]			
	Uganda	*Philippines*		*Senegal*			
	Sierra Leone						
	Somalia						
	Uruguay						
	Zaire						
			Net energy exporters				
Bolivia	Algeria	*Mexico*	Cameroon	Indonesia	Oman		
Gabon	Angola		Egypt		Malaysia		
Iraq	*Congo*		Syrian Arab Rep				
Kuwait	*Ecuador*		Tunisia				
Libyan Arab Jamahiriya	Iran						
Nigeria							
Peru							
Qatar							
Saudi Arabia							
United Arab Emirates							
Venezuela							

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from ECLAC, IMF, UNCTAD, and the World Bank

[a] Per capita income corresponds to per capita GDP adjusted for changes in terms of trade and net factor payments. The sample consists of 84 developing countries or areas for which data are available. Those represent 94.4 per cent of the total population in the developing countries in 1985. For columns (1) through (8), the respective percentages of the total sample population are 6.9, 5.8, 7.9, 3.7, 9.4, 5.8, 27.1 and 33.5 per cent

[b] Those countries classified as severely indebted, according to World Bank, *World Debt Tables, 1989-90*, are italicized.

[c] Not significantly different from 0

For many countries, particularly oil importers, the decline in per capita income was more acute in the early 1980s, while for oil exporters, the decline was more abrupt in the second half of the decade.

In countries with rising per capita income, social conditions generally improved in the 1980s. In most of them, substantial gains were achieved in agricultural production, suggesting that both rural and urban populations benefited. The share of the absolute poor in total population, moreover, diminished considerably in those countries. In countries with declining per capita income, on the other hand, living standards worsened, and the progress observed in social indicators in the previous decade slowed down considerably or was reversed. The number of people living in absolute poverty rose substantially, and it became more difficult to increase social expenditures to compensate for falling incomes.[3] None the less, despite smaller fiscal budgets, some Governments redirected expenditures to increase the protection of vulnerable population groups.[4]

The debt problem compounded the difficulties of many countries with stagnant or falling per capita income. As shown in table VII.1, among energy importers, falling per capita incomes were in most cases accompanied by severe external indebtedness in the 1980s. Several countries started to transfer financial resources abroad, as discussed in chapter IV.

In sub-Saharan Africa, declining per capita incomes have been accompanied by a relentless fall in per capita food production. Only in a few countries did food production growth match population increases, as shown in chapter IX.

The crisis has been of an urban nature in Latin America: a major slowdown in manufacturing production was accompanied by increasing urban unemployment, and a substantial

[3] See United Nations, "International co-operation for the eradication of poverty in developing countries", (A/44/467), Table 1.

[4] For example, Botswana, Costa Rica, Chile and Zimbabwe. See United Nations Development Programme, *Human Development Report, 1990* (Oxford, Oxford University Press, 1990)

fall in real wages was experienced in the public sector.[5] Per capita food production in the region was generally maintained at previous levels, but the rate of increase in manufacturing value-added slowed from 6 per cent in the 1970s to only 1 per cent in the 1980s.[6]

Transmission channels and impact of external factors on the social situation

The relationship between a changed international economic environment and internal conditions depends on several factors. The structure of the economy and government policies play a major role. The perception of policy makers and private economic agents about whether external changes are of a permanent or a transitory nature is also important. The belief that problems are only transitory can lead to inaction or delayed actions, which may become very costly in the future.

Typically, before the 1980s, a fall in export prices resulted in domestic adjustment accompanied by compensatory financing. The length and intensity of adjustment depended on initial conditions, the policies adopted and the point in time at which export prices began to recover. The process was usually accompanied by a slowdown in growth—in a few cases contraction—and some fall in investments. Initially, a reduction in imports as a consequence of falling terms of trade affected manufacturing output. Investments comprising imported machinery and equipment were also adversely affected.

The 1980s fall in national income, usually larger than output (see table VII.2), had pervasive effects that reduced opportunities for social progress. It diminished the room for manoeuvre on the fiscal front as revenues from direct taxes and excise taxes fell. This problem has been compounded as a result of the ways in which trade changes have also affected government revenues. This is because a fall in export earnings reduces export taxes, which often represent a large share of fiscal revenues. A decline in imports has similar effects, as import tariffs also constitute a significant portion of government revenues. Another factor leading to fiscal strains was the rise in international interest rates.

The resource constraint is only one of the factors determining whether basic social programmes are slashed more than proportionately as a share of total budgetary cutbacks. Given the fungibility of governments expenditures, decisions regarding the level of social services are determined by policy considerations, as well as by the budget constraint. As shown in table VII.3, Governments throughout the developing world have in most cases sought to preserve social expenditures at existing per capita levels and, if necessary, to reallocate resources from other functional areas.

The data cover only the period 1980-1985. Therefore, they do not reflect the deterioration that took place in many countries in the period 1986-1989. Even so, some of the findings are disturbing (see table VII.3) In sub-Saharan Africa, the low levels of expenditure per student in primary education remained stagnant, while per capita expenditure in health declined by about 10 per cent between 1980 and 1985. In Latin America and the Caribbean there was a corresponding fall of 10 per cent and 5 per cent, respectively, during the same period.

The strain in fiscal resources and foreign exchange also had an impact on other programmes. Subsidies, particularly food subsidies, were adversely affected in some countries. Housing programmes and other social investments were reduced. Foreign exchange restrictions often led to a decrease in imports of school materials, medicines and, in several cases, even food, despite increasing demands.

The immediate impact of these changes on social indicators such as school enrolment, literacy rates, infant mortal-

Table VII.2 Growth of output and per capita income, 1981-1989

(1980 = 100)

	Population (millions)	Per capita gross domestic product		Per capita income[a]	
	1985	*1980*	*1989*	*1980*	*1989*
Developing countries	3655	100	112	100	107
(Excluding China)	(2595)	(100)	(98)	(100)	(93)
Africa	523	100	80	100	70
Latin America	405	100	90	100	85
Mediterranean	74	100	114	100	113
South and East Asia	2546	100	158	100	153
West Asia	108	100	64	100	39

Source: Department of International Economic and Social Affairs of the United Nations Secretariat

[a] Per capita gross domestic product adjusted for changes in terms of trade and net factor payments

[5] For example, the decline in real wages in the central Government between 1980 and 1989 exceeded 25 per cent in countries such as Bolivia, Guatemala, Mexico, Peru and Venezuela.

[6] See United Nations Economic Commission for Latin America and the Caribbean, "Preliminary overview of the Latin American economy, 1989" (LC/G 1536)

Table VII.3. Government public expenditure in primary education and health care, 1980 and 1985[a]

Country groups developing countries	Primary education per student, as percentage of GDP per capita		Primary education per student, in 1980 dollars		Health per capita, as percentage of GDP per capita		Health per capita, in 1980 dollars	
	1980	1985	1980	1985	1980	1985	1980	1985
North Africa	12	13	169	183	1.3	1.4	10	13
Sub-Saharan Africa	17	18	64	64	1.8	1.7	9	8
South Asia	8	11	21	33	0.9	1.2	3	5
East Asian newly industrialized economies	10	14	197	374	0.3	0.3	8	11
Other East Asia	8	9	69	95	1.1	1.1	5	6
West Asia	14	8	378	208	2.5	3.1	118	156
Mediterranean	7	6	91	83	5.5	4.3	175	141
Western Hemisphere	9	9	190	171	1.9	2.0	39	37
Total	10	11	97	94	1.1	1.2	7	7

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on UNESCO, IMF and the World Bank.

[a] Country group averages are weighted by population.

ity, life expectancy and calorie consumption is rather tenuous, with the exception of the last variable, whose variations have a direct link to per capita income and food subsidies or other food aid policies of Governments. In most countries, even in many that have experienced a considerable fall in per capita income, school enrolment and literacy rates have increased, infant mortality has been reduced and life expectancy has risen. However, there has been a slowdown in the gains achieved in such indicators during the previous decade, and even retrogression in some cases (see table VII.4).

As can be seen from the trends in several social indicators, Asia appears to have experienced gains in all of the social indicators examined. In Latin America, on the other hand, infant mortality rates rose marginally and net school enrolments stagnated in the second half of the decade. The trends in Africa are also disturbing, as net school enrolment decreased in 1987 when compared to 1980, and by mid-decade the daily calorie supply as a percentage of requirements remained at the same inadequate level of 1980.

The improvements in social indicators in the 1980s, when they occurred, were partly the consequence of past policies, including investments in schools and sanitation, literacy campaigns and health education. If the social infrastructure starts to erode and special programmes are cut, social indicators may not reflect a deterioration for several years because of the time lags involved. Similarly, although the number of teachers, nurses,paramedics and doctors hired for government programmes has rarely been reduced, their pay has been slashed in a large number of countries. The issue then is whether teachers and nurses, faced with a fall in real wages of the order of 20 - 30 per cent, which has been typical in many countries, can provide the same quality of service as before.

Secondly, some of the continuing progress in certain social indicators was due to the fact that certain improvements occurred independently of falls in income. For instance, improvements in literacy and education, leading to new understanding of health care, sanitation, school attendance and the like, often began during the years when incomes were rising but, because accumulated or acquired knowledge is not lost when incomes fall, the effects continued in times of recession and were relatively independent of income level. Such has been the case, for example, with the returns on female literacy, consisting of reduced child mortality, improved household nutrition and lower school dropout rates.

Thirdly, technological advances in inexpensive treatments for diarrhoeal dehydration and the expansion of immunization programmes in many poor countries have made possible large improvements in mortality indicators, as has foreign aid in food grants during times of famine. However, changes in social indicators at the country level often hide considerable disparities between groups, with some of the most vulnerable segments of the population often being especially hard hit. In some localities there have been major setbacks in social conditions, including significant increases in infant morbidity and mortality.

As discussed, the effect of dwindling revenues and the outward transfer of resources on public sector wages has been more directly evident in severely indebted countries. Faced with severe budgetary constraints, Governments in such countries opted for wage restraint: delaying wage increases in inflationary settings or even reducing wages in a few cases, rather than effecting a massive retrenchment. There have also been indirect effects, which extend to the private sector wage bill. Given the leadership role that the public sector exercises in wage determination in developing countries, in particular through statutory minimum wage setting, average private sector wages also fell significantly in most of the countries concerned. These aspects of public sector and private formal sector wages and employment are discussed at length further on.

It can be expected that in a climate of falling wages, the functional income distribution will shift. This was particularly so in the case of heavily indebted countries. The need of Governments or the private sector to increase outward trans-

fers and increase their operating surplus has contributed to growing functional inequality. The shift in the 1980s in net resource transfers in most of the heavily indebted countries, for example, necessitated heavy domestic borrowing in national financial markets (the placement of government securities with financial intermediaries), which raised real interest rates and expanded the share of financial profits in the economy. The share of operating surplus in the factor payments of heavily indebted countries was often due to economic agents placing their profits or savings in short-term, high-yielding financial instruments tied to Governments' servicing requirements on their twin domestic and external debts. As a result, as shown in table VII.5, wages fell and operating surplus increased more in a sample of heavily indebted countries than for the sample as a whole. By 1985, the operating surplus in the sample of heavily indebted Latin American countries ranged from 39 to 68 per cent of GDP, with a mean of 52 per cent. The shift in net resource transfers during the 1980s appears to have contributed to a shift in the functional distribution of income away from labour towards owners of capital and savers [7]

Table VII.4. Trends in Social Indicators, 1970-1987[a]

Regions	Social indicators							
	1970	1980	1985	1987	1970	1980	1985	1987
	Infant mortality rate (deaths per thousand live births)				Under-5 mortality rate (deaths per thousand live births)			
Africa	140.3	118.3	108.6	102.8	236.6	198.4	181.3	168.4
Asia	97.1	74.3	65.0	58.0	149.6	112.0	98.1	80.1
Latin America	80.0	59.2	51.2	51.4	116.2	84.1	72.5	69.1
	Life expectancy at birth				*Literacy rate*[b]			
Africa	44.8	48.9	51.0	53.1	26.4	34.3	46.1	46.2
Asia	54.7	59.5	61.7	64.2	43.0	55.6	60.7	63.8
Latin America	60.5	64.3	66.1	67.0	71.5	78.1	81.2	84.1
	Net school enrolment[c]				*Daily calorie supply as percentage of requirements*			
Africa	48.6	55.0	57.2	54.4	93.2	97.3	97.3	
Asia	67.5	81.7	79.0	87.9	99.4	109.2	114.1	
Latin America	78.7	79.2	83.2	83.2	102.6	106.9	108.3	

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on United Nations, *World Population Prospects, 1988*, Population Studies, No. 106; UNESCO, *Statistical Yearbook, 1989* (Paris, 1989); UNESCO, "Basic education and literacy (mimeo, 1990); UNICEF, *The State of the World's Children, 1989 and 1990* (Oxford, Oxford University Press, 1989 and 1990); FAO, *FAO Production Yearbook, 1988*, vol. 42 (Rome, 1989); and other sources

[a] Unweighted average of national data

[b] Denotes rates of literacy among both sexes, aged 15+ (in percentages).

[c] The net enrolment is a ratio indicating the proportion of primary school students enrolled in classes corresponding to their age group

Table VII.5. Real growth in factor payments[a]

(1980 = 100)

Sample	1980	1985	Change per earner[b]
Heavily indebted Latin American countries (8)			
Wages	100	88	74
Operating surplus	100	104	92
All developing countries (34)			
Wages	100	108	95
Operating surplus	100	103	91

Source. Department of International Economic and Social Affairs of the United Nations Secretariat, based on *National Accounts Statistics: Main Aggregates and Detailed Tables, 1986* (United Nations publication, Sales No. E 89 XVII 7), parts I and II

[a] Unweighted averages for a sample of eight Latin American countries, forming part of a total of 34 developing countries for which data were available. Figures adjusted to constant 1980 United States dollars

[b] Adjusted factor payment figures for 1985 per income earner, based on a rate of labour force growth of 13.6 per cent for Latin America and 12.8 per cent for all developing countries during 1980-1985. See ILO, *World Labour Report, 1989*, vol. 4 (Geneva, 1989), table A.1.

7 The data on functional income distribution, while indicating that wage earners have lost in absolute and relative terms, does not necessarily suggest that the rich as a group became richer. The operating surplus in the period grew far less than population, indicating that both groups were worse off in absolute terms. (It must be noted, however, that income accruing to owners of capital in national accounts might underestimate actual income received by this group as the return on flight capital is not generally captured in such accounts)

The fall in urban wages and shifts in rural poverty

Countries adjusting to severe external shocks generally experienced a substantial fall in urban wages and incomes. Real wage rates declined over the total urban economy of most African and Latin American countries, and fell more in countries formerly characterized by a combination of high wage premiums in the formal sector and growing urban unemployment levels.[8] From all appearances, in fact, wage reduction has been the primary vehicle for reducing domestic absorption utilized by countries that need to allocate part of their national income to servicing their external debt. The immediate impact of such income policies on social indicators such as mortality, nutrition and literacy rates, however, has been small. This was partly because reduced real government wages did not fall on the most vulnerable groups. Typically, between 1 and 5 per cent of the labour force in the bottom three deciles of the income distribution were employed in 1985 in the government and parastatal sectors of severely indebted countries.[9]

The decisions affecting wages in the public sector in the past decade have generally been influenced by the severe budgetary constraints and countervailing pressures from various interests—public sector employees maintaining or increasing their real wages, members of the non-public sector labour force obtaining public sector jobs and other claimants on public expenditure. In the resulting trade-offs, a tacit agreement would seem to have been reached with public sector workers, by which lay offs would be avoided so long as wages were allowed to erode, usually by delaying wage increases in inflationary settings. This accommodation has suited many Governments sensitive to the political effects of retrenchment, as in cases where a rise in unemployment has generally been viewed by the population as the result of government-imposed austerity measures. At the same time, Governments have generally allowed public sector employment to continue expanding at rates comparable to the overall growth of the urban labour force, thus helping to keep unemployment and underemployment from reaching even higher levels. As indicated below, however, budgetary limits severely reduced this absorptive capacity in some countries during the second half of the 1980s.

In Latin American countries, the government wage bill declined from 32 per cent of central government expenditure in 1980 to 30 per cent in 1986, while interest payment obligations rose as a share of government expenditure from 7.7 per cent in 1980 to 27.3 per cent in 1986.[10] In sub-Saharan Africa, the wage bill remained at 28 per cent of total government expenditure in 1980 and 1985, although declines in trade-related revenues forced many Governments during the second half of the decade to contain public service employment growth with freezes on hiring and lay-offs of temporary staff.[11] It should be noted that in both regions real central government expenditures fell considerably in per capita terms in the period 1980-1986.

Declines in real wages helped offset the drain of employment expansion on the government wage bill. As shown in table VII.6, employment levels in the public sector of a sample of seven heavily indebted Latin American countries was 32 per cent higher in 1987 than in 1980, while total labour earnings were 10 per cent lower, and average wages were 32 per cent lower. In sub-Saharan Africa, the increase in the number of public employees was 8 per cent and the decrease in average pay was 30 per cent for the years 1980 and 1985.[12] The net effect of such trends on income distribution has not been all negative in the sense that high unemployment levels were mitigated by continued labour absorption practices and opposition to retrenchments, and because the fall in public wages reduced the differentials between the formal and informal sectors of the economy. However, these achievements have had a severe cost for long-serving public sector workers, who have experienced a substantial erosion of their living standards.

Statutory minimum wages and public sector pay scales have traditionally had an indicative effect on wage and salary setting in the private sector.[13] This effect, however, became less significant in the 1980s in countries with sharp cuts in real public sector wages and salaries. Although average wages and salaries also fell in the private sector, table VII.6 shows that they generally declined less than in the public sector. However, in adjusting to the external shocks and reduced consumption demand in the domestic economy, private firms in both Africa and Latin America moved quickly to shed redundant workers, with retrenchment levels reaching especially high levels in circumstances where wages proved rigid downward. During 1983-1984, for example, when imports were reduced by 40 per cent, firms in Latin America laid off 6 per cent of their workers, thus contributing directly to the rise in unemployment and poverty that occurred in the crisis years. This resulted in a more unequal distribution of the income loss than occurred in the public sector labour force.

As a consequence of this one-time sharp reduction in the number of workers employed in the private formal sector, by 1985, 8 per cent less of the urban labour force was employed

[8] See, for example, G. Rodgers, ed., *Trends in Urban Poverty and Labour Market Access* (Geneva, ILO, 1988); ILO, *World Labour Report, 1989*, vol. 4, (Geneva, 1989); various studies from the ILO World Employment Programme Working Paper Series; and J. P. Lachaud, "L'Analyse du marché du travail urbain en Afrique" (Geneva, 1987) Institut international d'études sociales.

[9] In Peru, for example, the figure was 3.5 per cent; in Côte d'Ivoire, 1.6 per cent. See, P. Glewwe and D. de Tray, "The poor in Latin America during adjustment: a case study of Peru", LSMS Working Paper, No. 56 (World Bank, July 1989); and P. Glewwe and D. de Tray, "The poor during adjustment: a case study of Côte d'Ivoire", LSMS Working Paper No. 47 (World Bank, April 1988).

[10] See IMF, *Government Finance Statistics Yearbook, 1988* (Washington, D.C., 1988).

[11] Freezes on hirings were adopted in Benin, the Gambia, Mauritania, Sierra Leone, Somalia and the United Republic of Tanzania. Lay-offs of temporary staff took place in the Congo, Côte d'Ivoire, Ghana, Nigeria, Rwanda and Somalia.

[12] It should be pointed out, however, that the decline in real wages in sub-Saharan Africa pre-dates the economic downturn which occurred after 1980.

[13] The prominence of this role is particularly evident in many African countries where the public sector is responsible for 50 per cent or more of total wage employment.

Table VII.6. Employment and labour earnings by segment, for Latin America and Africa

(1980 = 100)

Segment	Latin America[a] 1985	Latin America[a] 1987	Sub-Saharan Africa 1985
Public sector			
Number of workers	124	132	108
Average labour earnings	79	68	70
Total labour earnings	99	90	76
Private sector			
Number of workers	98	103	84
Average labour earnings	93	85	.
Total labour earnings	91	88	.
Informal sector			
Number of workers	141	156	138
Average labour earnings	67	59	
Total labour earnings	95	92	.
Agriculture			
Number of workers	116	113	
Average labour earnings	79	77	..
Total labour earnings	91	87	.
Minimum wage	85	86	80

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on PREALC, *Evolution of the labour market during 1980-1987* (Santiago, 1988); ILO, *African Employment Report. 1988* (Addis Ababa, 1989); and other sources

[a] Based on official data for Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico and Venezuela.

in private firms than in 1980.[14] Moreover, during the moderate economic upturn of the second half of the decade, which enabled firms to increase the use of their existing plant capacity, Latin American companies showed little sign of restoring previous job levels.[15] By 1987, in fact, employment levels were only 3.3 per cent above the 1980 levels for large firms of Latin America.[16] Similarly, in sub-Saharan Africa declines in labour costs have not been sufficient to reverse a trend of declining wage employment in the private sector, as shown in table VII.6, the reason being the continuing deceleration of economic growth in the region.

The stagnation of recruitment opportunities in the formal sector of Africa and Latin America has contributed to high unemployment rates among youth, particularly young women and secondary school graduates. As a result of this, many young people have become increasingly discouraged about their prospects for occupational advancement and upward social mobility in technical, bureaucratic and professional careers.[17] This is particularly a problem in much of Africa, where unemployment among young people averages about three times the already high overall unemployment rate, and where policies guaranteeing employment in the public sector to secondary school and university graduates have in many cases had to be abandoned.[18]

There has also been evidence that many young persons wish to emigrate, particularly those who are more dynamic and have a university education. To the extent that many of them were successful in finding opportunities abroad, countries lost valuable human resources at a time when they could least afford to.

Because of retrenchments, lower wages and reduced opportunities for employment in the modern sector, the supply of labour in the informal sector rose rapidly during the 1980s. The data are particularly weak in this respect,[19] but from table VII.6 it appears that—the sector being supply-driven—labour absorption was greater than for the urban economy as a whole and earnings per worker fell more than in the formal sector. In times of rapid inflation, however, the self-employed were generally able to adjust their market-determined prices upwards continuously with inflation more effectively than could workers whose incomes were administered. In some instances, moreover, there is encouraging, fragmentary evidence that new opportunities have emerged

[14] PREALC, *Ajuste y Deuda Social: un Enfoque Estructural* (Santiago, 1987).

[15] See ILO, *World Labour Report*, 1989 ..., table 1.9

[16] PREALC, *Evolution of the Labour Market during 1980-87* (Santiago, 1988)

[17] See, for example, D. Ghai and C. Hewitt de Alcantara, "The crisis of the 1980s in Africa, Latin America and the Caribbean: economic impact, social change and political implications", UNRISD Discussion Paper No. 7 (Geneva, July 1989); and G. Rama, "Latin American youth between development and crisis", *CEPAL Review*, No. 29 (August 1986), pp. 17-39

[18] Automatic hiring of school graduates has been discontinued in Benin, the Central African Republic, the Congo, Guinea, Mali, Rwanda, Somalia and the Sudan. See ILO, *World Labour Report, 1989* ..., p. 49

[19] Estimates of informal sector employment are typically based on *ad hoc* surveys and, to obtain an idea of the overall magnitude, on residual calculations

for substituting informal for formal production of simple, everyday consumer goods.[20]

Reduced subsidies on wage goods such as kerosene and urban transport, expanded excise taxes and increased charges for schooling and health care, have reduced the consumption capacity of low-income urban groups. In particular, many of the urban poor in Africa and Latin America have been negatively affected by increases in food staple prices relative to the general index. This has been a particular problem in African cities, where food price increases have been fueled by the impact of growing costs and reduced availability of food imports due to currency devaluation or quantitative controls under conditions of limited foreign exchange. The reduction or abolishment of subsidies and price controls on basic food staples in many African and Latin American cities has further reduced urban consumption wages. Hoarding and speculative practices, encouraged by rising inflation, have also increased real food prices. With food accounting for 60 per cent or more of the household budgets of urban low-income groups, such food price increases further squeeze the capacity of these households to pay for shelter, clothing and other necessities. The fact that under-consumption of food and malnutrition have grown in urban areas of Africa and Latin America, in the latter region often despite an adequate supply of food, makes it clear that food insecurity is as much a matter of inadequate effective demand as it is of supply.

In general, compared with urban wages and self-employment earnings, incomes in the rural areas of sub-Saharan Africa appear to have fallen less. Subsistence production helped cushion the spread effect of the economic crisis for much of the rural population. In many cases, however, other shocks, such as the drought of 1983-1985 and civil strife between ethnic groups, impoverished many rural households and turned others into refugees. Also, where per capita agricultural output fell sharply, many producers saw their incomes decline. In some cases, moreover, the rural poor in sub-Saharan Africa may have suffered more than their incomes suggest. For instance, it is normal for such groups to rely on personal savings, remittances and, if need be, on borrowing from relatives, kin or village support systems to help smooth consumption and buffer their standard of living from income fluctuations caused by the ups and downs of seasonality. Mutual support arrangements and networks, however, have come under growing stress as family kinship and village groups become less able to help one another, and especially to help their poorest members. Given the deterioration in urban wages and the high unemployment that has occurred, remittances from urban kin often diminished also and became more sporadic. Rising inflation, furthermore, in many instances decimated the savings of rural households that obtain the bulk of their annual income in one instalment at harvest time and hold a relatively high proportion of their assets in cash form between payments in order to smooth consumption.

Offsetting these falls in incomes, however, was the fact that many small farmers have benefited from higher prices and improved internal terms of trade with their countries' urban sector (see table VII.7). On the whole, as a result, rural incomes generally stagnated while urban incomes fell.[21] In the United Republic of Tanzania, for example, real farm incomes are estimated to have risen slightly during 1980-1984, while urban wages declined by 50 per cent.[22] In Côte d'Ivoire, urban wages fell while rural incomes stagnated, with the ratio of urban to rural wages dropping from 3.5 to 1 in 1980 to about 2 to 1.[23] In some countries, as a result, out-migration from rural areas declined and some degree of reverse migration occurred. In Nigeria, for instance, a 24 per cent increase in the rural labour force took place in the mid-1980s as a result of retrenched urban workers returning to the farms of their kin, and because out-migration declined as word about the lack of work in urban areas spread throughout rural communities.[24] Similarly, in Ghana three fifths of all internal migrants in the country during 1982-1987 are reported to have been migrants leaving Accra and returning to the rural areas.[25]

In Latin America, as a whole, the gap between rural and urban incomes—like income differentials within the rural sector itself—generally remained very wide. Rural-urban inequality was reduced somewhat in a few countries such as Costa Rica and Venezuela, where landownership is not so concentrated.[26] However, income differentials between urban and rural areas generally remained much larger than in sub-Saharan Africa—8.6 to 1 in Brazil and 6.3 to 1 in Mexico.[27] As shown in table VII.7, moreover, domestic terms of trade between agriculture and industry experienced a shift against agriculture in the 1980s. Thus, despite increased agricultural output and productivity, real wages in agriculture in 1987 were 23 per cent below their 1980 levels (see table VII.6), and demand for labour declined as a result of labour-saving technologies adopted in the sector during the 1970s.[28] The combination of reduced wages and less demand for agri-

[20] See ILO, *World Labour Report, 1989* ...

[21] See V. Jamal and J. Weeks, "The vanishing rural-urban gap in sub-Saharan Africa", *International Labour Review*, vol. 123, No. 3 (1988).

[22] L. Demery and T. Addison, "Food insecurity and adjustment policies in sub-Saharan Africa: A review of the evidence", *Development Policy Review*, vol. 5, No. 2 (June 1987), p. 181.

[23] L. Demery and T. Addison, "The alleviation of poverty under structural adjustment", (Washington, D.C., World Bank, 1987), p. 12.

[24] D. Lal and H. Myint, "The political economy of poverty, equity and growth: Indonesia and Nigeria" (Unpublished World Bank report, Sept. 1988), pp. 215-220.

[25] See United States House of Representatives "Structural adjustment in Africa: insights from the experiences of Ghana and Senegal" (Washington, D.C., March 1989), p. 8.

[26] O. Altimir, "Poverty, income distribution and child welfare in Latin America: a comparison of pre- and post-recession data", *World Development*, vol. 12, No. 3 (March 1984), p. 280.

[27] A. Maddison and others, "The political economy of poverty, equity and growth in Brazil and Mexico" (Unpublished consultant report, World Bank, July 1989), p. 75.

[28] See A. de Janvray, E. Saffulet and L. Wilcox, "Rural labour in Latin America", World Employment Programme Research Working Paper WEP 10-6 WP 79 (Geneva, 1986).

Table VII.7. Domestic terms of trade between agriculture and industry, 1980-1987[a]

Region (sample size)	1980	1981	1982	1983	1984	1985	1986	1987
Sub-Saharan Africa (30)	100	103	113	113	112	112	117	123
Latin America (14)	100	97	93	96	90	89	102	94

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on World Bank, *World Tables, 1988-89*

[a] Terms of trade are unweighted and calculated using agriculture and industry sectoral GDP deflators as proxies of producer prices.

cultural labour has induced many landless workers to settle in towns and secondary cities, where they are engaged in seasonal and temporary work in both the urban and agricultural sectors.[29]

In sum, with earnings in the rural areas of Latin America and Africa falling for some groups and stagnating or increasing for others, the available evidence suggests that greater segmentation and differention of rural incomes is the main trend in the rural sectors of those two regions. For the hard-core poor, any fall in income or consumption is a matter of grave concern since they have so little to spare. At the same time, it is evident that the income position of urban workers, in relative terms, deteriorated more than that of other socio-economic groups. In other words, urban workers more than any other group bore the brunt of the economic crisis of the 1980s. Taken together, the net effect of the changes in the urban and rural sectors has been a downward equalization of incomes.

Conclusions

Living conditions in Africa and Latin America declined persistently in the 1980s, in contrast to the progress achieved in much of the Asian region. Poverty likewise increased in Africa and Latin America, while declining in Asia. Reversing those trends in the two negatively affected regions will be a major challenge during the present decade.

Adverse terms of trade and increasing resource outflows have reduced the level of domestic resources available to improve the situation in sub-Saharan Africa and Latin America. Wage earners sacrificed the most in making available the surplus needed to make payments on the external debt. Of all social groups, in fact, urban wage earners and the self-employed in the informal sector were hit the hardest by the economic crisis, in relative terms. Education as a correlate of income became less manifestly evident as a result. Indeed, well-educated youth lost hope of gaining access to good careers and upward mobility and, instead, were disproportionately represented among the unemployed. The under-utilization of this human capital represents a loss for future growth and stability.

The situation of the non-urban poor has been more ambiguous. In the rural areas of sub-Saharan Africa, for example, some groups benefited as producer prices increased, thus somewhat redressing the traditional inequity between rural and urban areas. Others, particularly those in areas where food production stagnated or fell, found it increasingly difficult to elude the damages inflicted on them by the prolonged crisis, as systems of mutual assistance became frayed. The rising cost of wage goods, in particular food, further squeezed the consumption of the poor who were not self-sufficient in food production. Government-targeted transfers helped, but were generally more effective in middle-income countries with pockets of poverty; in low-income countries where at least half the population was in dire need, they were clearly insufficient.

Social indicators generally performed better than incomes during the past decade, but some stalled and others reversed direction in Africa and Latin America. As stores of human capital built up in the past depreciate and go unreplaced, the future could be marked by a further erosion in the social and economic conditions represented by those indicators.

In circumstances where living conditions have declined visibly for most of the population, Governments have been criticized by their citizens for trying to meet their external obligations at the cost of allowing the domestic social situation to erode. Likewise, as the distance between the rich and the rest of the population widened, instances of ostentatious consumption made possible by wealth held in foreign accounts became a contentious issue, fostering further discontent and tension among social groups.

With poverty and, in some cases, income distribution both worsening in countries negatively affected by conditions in the international economy, the task of Governments has become enormous. Poverty is a major concern, bearing on much, if not most, of the population in countries with low living standards. Meeting the basic human needs of the poor is a concrete, specific objective that can be attained with economic growth, appropriate government interventions and foreign assistance. Under present conditions, however, with a return to economic development and long-term development in part dependent on a stronger human resource base, the lack of attention to adding to human as well as other capital during the past decade is likely to defer the day when

[29] See ILO, "Temporary labour in Latin America" (Geneva, 1986).

poverty can be alleviated and social well-being improved through sustained economic growth.

More stable terms of trade and a meaningful increase in net financial transfers are also essential if developing countries are to achieve sustained economic growth. Should those external factors deteriorate any further, social conditions are bound to decline. The problems of high interest rates, external debt and trade in primary commodities thus remain issues of central importance on the international agenda.

Chapter VIII

SOME FACTORS UNDERLYING THE PROLONGED EXPANSION OF THE MAJOR DEVELOPED MARKET ECONOMIES

Despite instability in financial markets and large trade imbalances, the developed market economies have been experiencing a prolonged expansion of output centred on the relatively strong performance of the major countries of the group. In terms of economic activity and inflation, the period since the 1981-1982 recession compares well with the preceding decade, if not with the 1960s. The eight years of recovery, accompanied by moderate inflation and declining unemployment, though delayed in Western Europe, have encouraged the belief that these countries are now on a track where, barring domestic or external shocks, they can look forward to continuing moderate expansion interrupted by no more than, at worst, moderate cyclical downturns. If so, the world economy could be more stable and dynamic in the 1990s than it was in the 1980s.

The present chapter identifies several reasons for the prolonged expansion, focusing on the performance of the seven largest market economies, namely, Canada, France, the Federal Republic of Germany, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland and the United States of America. In asking whether the reasons for their expansion are likely to remain valid for the near future, the chapter aims to shed some light on the solidity of the grounds for the present optimism.

The expansion has so far fallen roughly into two phases (see table VIII.1). In the first phase, from 1983 to 1985, there was vigorous economic growth in North America while the performance of Western European countries—with the exception of the United Kingdom—was weak. In the second phase, from 1986 to 1989, the pace slowed somewhat in North America, while it picked up in Western Europe. Japan maintained a more even rate of expansion through both phases, though as in Western Europe, its initial recovery lagged behind that of North America.

While policies, institutional conditions and the course of economic events have all accounted for the prolonged expansion, it is of particular interest to disentangle the influence of each from the others. Never an easy thing to do, this is especially hard for the 1980s because of the sea change in approaches to economic policy that took place around the turn of the decade.

The abatement of inflation

One change in policy priorities that has stamped the 1980s was the decision by key industrial countries not to tolerate any longer the high inflation rates of the late 1970s. This set in motion the worst recession of the post-War era and provoked the crisis in low-income commodity-exporting countries and heavily-indebted countries from which they still suffer. But it did correct the inflationary difficulties of the developed market economies and set the stage for their new growth path.

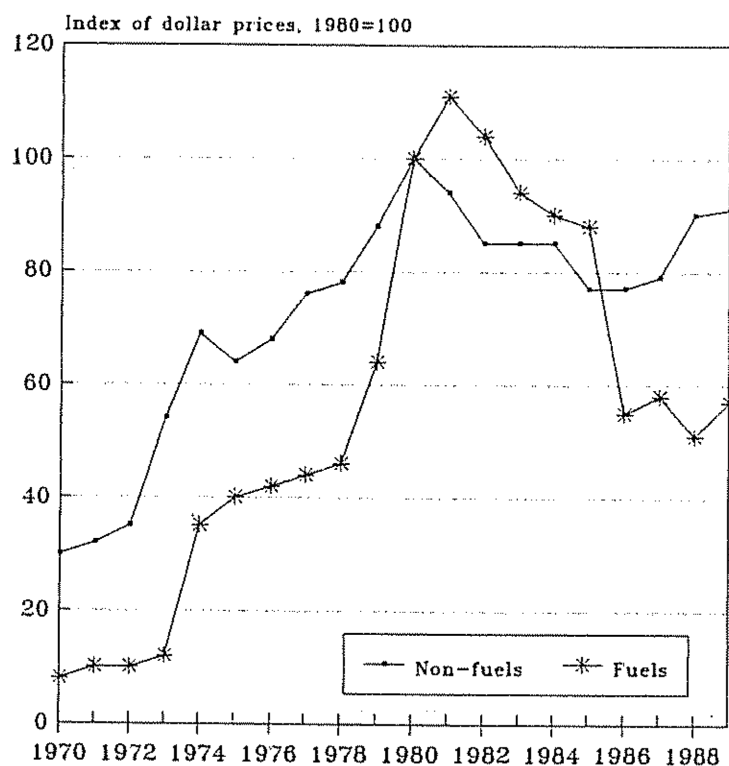
Indeed, without the abatement of price inflation, it is doubtful whether the long post-1982 recovery would have taken place. The accelerating pace of price increases in the late 1970s generated widespread concern that inflation was slipping out of control. It threatened to exacerbate tensions among income groups, to distort prices, to shorten time horizons and, more generally, to undermine confidence in the stability of the economic environment within which the planning of production and investment occurs. However, price increases moderated in the early 1980s and, although a few still express dissatisfaction with price performance, as long as inflation is kept at the rates of recent years, it is not seen to pose a threat to economic growth.

Since the recession of 1982, overall price increases as measured by the GDP deflator have fallen to an annual rate which—for the seven countries as a whole—has remained continuously below 5 per cent (see table A.3). Individual countries have accommodated themselves to somewhat different rates. Over the past several years, these have fluctuated within the range of 3 to 5 per cent in the United States and Canada, 3.5 to 7 per cent in the United Kingdom, zero to 3 per cent in the Federal Republic of Germany, and zero to 2 per cent in Japan. In France and Italy—partly because of their linkage with price trends in the Federal Republic of Germany through the European Monetary System—rates of inflation have progressively fallen in the 1980s until they averaged some 3 and 6 per cent, respectively, over the last three years. While countries have thus differed in their acceptance of inflation, all have recorded lengthy gains in output without—at least until very recently—experiencing any significant acceleration in prices.

There are three main reasons why countries have been able to lower the rate of inflation in the post-1982 years. These are the effectiveness of monetary policy, the weakness of oil and other commodity prices and changes that have affected wage-setting behaviour.

It was monetary policy that stopped the accelerating inflation of the late 1970s and early 1980s. In the United States, monetary policy was redirected towards firm control of the money supply, allowing interest rates to rise sharply and output and employment to fall. With a similarly restrictive monetary policy being pursued in other countries—and generally backed up by fiscal restraint—recession became general. The success of this policy was that it broke inflationary expectations. With unemployment and bankruptcies rising steeply, few doubted the serious intent of the monetary authorities to bring down the rate of inflation. Having gained such credibility, monetary policy has served effectively throughout the post-1982 recovery to dampen any threatened revival of high inflationary expectations. Thus, the substantial easing of monetary policy in later years did not provoke any recrudescence of inflationary expectations, while it supported the continuation of growth that took place after 1986.

Figure VIII.1 Commodity import prices of developed market economies, 1970-1989



Source. Department of International Economic and Social Affairs of the United Nations Secretariat

Note. Non-fuel index is proxied by world index of commodity export prices, excluding crude oil

Table VIII.1 Growth of real GDP of seven major market economies, 1961-1989

(Average annual percentage change)

	1961-1973	1974-1979	1980-1982	1983-1985	1986-1989
Canada	5 4	4 2	0.6	4.8	3.8
France	5 4	2 8	1.8	1.3	2.8
Germany, Federal Republic of	4 4	2 3	0.3	2.1	3 0
Italy	5 3	3 7	1.8	2.3	3.2
Japan	9 6	3 6	3.7	4 3	4 3
United Kingdom	3 2	1 5	-0.6	3 1	3.7
United States	4 0	2 4	-0 1	4 9	3 5
Group of Seven	5 5	2 8	1 1	3 9	3 6

Source: Data of OECD (includes United Nations estimates for 1989)

Note: The periods 1961-1973, 1974-1979 and the period beginning in 1980 are divided at downturns in standardized international economic cycles, as per OECD, *Historical Statistics, 1960-1987* (Paris, 1989) The period beginning in 1983 marks the first part of the recovery phase of the present cycle, while the period beginning in 1986 is the most recent phase. The average growth rate for the group is the weighted average of individual country growth rates. For purposes of the present chapter the weighting scheme of OECD is followed, namely, 1987 GDP at 1987 exchange rates

The task of preventing the revival of inflation was considerably eased by the weakness in oil and other commodity markets (see figure VIII. 1). As adjustments to the high oil prices of the late 1970s took place both in global consumption and in global production, the pricing policy of the OPEC countries was abandoned and oil prices declined dramatically in the middle of the decade. Prices of industrial materials also fell back sharply, at least until 1987. Among the principal reasons were substantial additions to productive capacity at the end of the 1970s, the slow recovery of industrial production in Western Europe—the principal importing area—and competition from technologically new substitutes. Thus, with commodity and energy still accounting for a significant proportion of national expenditure, a fall in their prices provided a downward pressure on the general price level.

For individual countries, the picture has been complicated by the fluctuations in their exchange rates. In the first half of the 1980s when the dollar was appreciating, Western European countries and Japan were faced with rising domestic prices for imports, which intensified their reluctance to relax the restrictive macro-economic policies that they had adopted. Conversely, in the second half of the decade, dollar depreciation served to lessen their concerns about stimulating domestic demand. The effects on price levels of the wide swings in currency values, however, have been asymmetrical as dollar depreciation has not exerted any sizeable upward pressure on domestic prices in the United States. This seems mainly explained by the smaller size of the foreign trade sector in the United States compared with most other countries. But even in sectors in which imports are a large share of consumption (or 100 per cent, such as video cassette recorders), there seems to have been an unusual degree of stickiness in the United States prices. Exporters of such goods to the United States appear to have preferred to "price to market", holding dollar prices as stable as they can for reasons of long-run competitive strategy and letting profit margins absorb the exchange rate fluctuation.[1]

The third major set of factors dampening price inflation in the 1980s includes those affecting wage setting. In the 1970s, a significant force sustaining inflation was the tendency for wages to rise not only in response to price increases, but also in anticipation of them. This was exacerbated by the long-term slow-down in productivity growth that began in the early 1970s (see box VIII.1). In the 1960s, wage earners had become accustomed to wage settlements that entailed substantial gains in real wages, and they continued to expect such gains in the 1970s although these could no longer be paid for out of the much diminished productivity growth. For the countries heavily dependent on foreign trade, the sharply worsened terms of trade following from increases in commodity prices cut into real income and aggravated the problem. The result was substantial pressure for higher nominal wages which—in an accommodating monetary environment—was effective, making for a lack of responsiveness of real wages to slowing productivity growth. Indeed, labour markets came to be characterized as rigid.

The origins of the rigidities in labour markets were complex. Stemming from the earlier post-War concern with full employment, a high social value had been placed throughout the preceding decades on protection of the job security and earnings of workers. This led to an accumulation of labour legislation, collective bargaining arrangements and labour management practices which, whatever their other benefits, together introduced numerous rigidities into the functioning of labour markets and into wage determination. The focus was on protection of the employed worker and not on the labour force as a whole. This contributed to the stagflationary phenomenon—most acutely evident in the late 1970s—of wages increasing concurrently with rising unemployment.[2] It posed a dilemma for macro-economic policies since many came to fear that, despite the presence of unemployment and underutilized capacity, the pursuit of expansionary policies would not evoke greater output but would be largely dissipated in higher wages and prices.

In the years since 1982, there has been a considerable moderation in the upward trend of wages. Nominal wage rates have generally advanced at a much slower pace and, in contrast to the 1970s when real earnings outstripped the gains in labour productivity in some countries, the growth of real earnings in all of the larger countries has fallen short of productivity growth (see table VIII.2).

Behind the change in wage behaviour lies a number of factors. The sharply higher unemployment engendered by the severe recession of 1981-1982 substantially altered the negotiating balance between employers and employees, and the inability of managements to pass on price increases in the face of weak demand added to the resistance to wage demands. The openness of markets, the consequent competition from imports and the option of "outsourcing" production to countries with lower wage costs were other

1 Indeed, there is evidence that profits on export to the United States rose to abnormally high levels in the period of the strong dollar and were returning to more normal levels. On this and other controversies, see Peter Hooper and Catherine Mann, "Exchange rate pass-through in the 1980s: the case of U.S. imports of manufactures" and "Comments and discussion", *Brookings Papers on Economic Activity*, No. 1 (1989) pp. 297-337 and Paul Krugman, *Exchange Rate Instability* (Cambridge, Mass., MIT Press, 1989).

2 For some commentators, wage rigidity does much to explain the higher levels of unemployment that prevailed during the 1980s in Western European countries compared with the United States. This view draws support from neo-classical theory which argues that if non-cyclical unemployment exceeds a modest amount of frictional unemployment, it must be caused by the overpricing of labour relative to other productive factors. The reality, however, is more complex. Unemployment in the Federal Republic of Germany, for example, has been continuously higher than in the United States, but there is evidence that wages are not more rigid. A comparison of wage behaviour in the Federal Republic of Germany and the United States during the first half of the 1980s found that real wages responded similarly to changes in unemployment in both countries while nominal wages responded more weakly to price increases in the Federal Republic of Germany than in the United States. Part of the reason for the higher unemployment probably lay in a lower level of aggregate demand relative to productive capacity. However, to complicate matters further, it should also be noted that flexibility in wages among employed workers can also coexist with the presence of other labour market rigidities—such as occupational or geographical immobilities—that can give rise to unemployment (see Linda A. Bell, "Wage rigidity in West Germany: a comparison with U.S. experience", Federal Reserve Bank of New York, *Quarterly Review* (autumn 1986), pp. 11-21; also, for a discussion of the causes of unemployment in the 1980s, see *World Economic Survey 1987* (United Nations publication, Sales No. E.87.II.C.1), chap. VII).

Box VIII.1. Revival in productivity growth?

One general concern about the performance of the developed market economies in both the 1970s and the 1980s has been the slow-down in the growth of productivity. Output can be increased by the application of more labour or capital to production; but what is more important for the growth of output in the long run is the effect of technical progress on the productivity of these factors. If there is a slow-down in the growth of total factor productivity—measured as that part of the increase in output that cannot be explained by the application of more labour or capital—it means that improvement in levels of living will also slow down.

The deceleration in the growth of productivity since the early 1970s has been sharp. The increase in total factor productivity in the seven major market economies as a group fell to an annual rate of 0.8 per cent in their business sectors during the period 1974-1979. From 1961 to 1973 it had averaged 3.2 per cent. From 1980 to 1988, it recovered only modestly, averaging 1.0 per cent per annum (see table).

The deceleration in the 1970s was particularly severe in the continental European countries and Japan where very high rates of growth in productivity had been achieved in the 1950s and 1960s. The very high rates arose from the recovery of these countries from war damage and—probably much more important—by the catching up of their technology with the level already attained in the United States. By contrast, the growth of productivity in the United States—the country at the technological frontier—was no greater in the 1950s and 1960s than it had been in earlier decades.[a]

But even given the narrowing technological gap, what is striking about the decline is that it beset all the industrial countries—including the United States—and that it began to do so around the same time. Several studies have been carried out to quantify the effects of relevant factors on the slow-down in measured productivity growth.[b] Some of the factors, such as the costs of pollution control or a deterioration in educational and skill levels or obsolete managerial styles,[c] have been specific to particular countries; and not all factors are easily measurable for inclusion in quantified analysis. Two causes, however, can be identified which appear to have affected most, if not all, countries. One relates to a slowing down in the rate of capital accumulation. The other derives from the effect on capacity utilization of large shifts in relative prices in certain key markets and of shortfalls in aggregate demand induced by policies to counter inflation.

For many economists, the slower rate of growth of the capital stock during the 1970s and early 1980s—which was evident in most of the larger industrial countries—appears a

Total factor productivity of seven major market economies, 1961-1988[a]

(Average annual rate of growth)

Canada	2.0	0.7	0.3
France	3.9	1.7	1.5
Germany, Federal Republic of	2.7	2.0	0.7
Italy	4.6	2.2	1.0
Japan	6.4	1.8	1.8
United Kingdom	2.2	0.5	1.9
United States	1.6	-0.4	0.4
Group of Seven	3.2	0.8	1.0

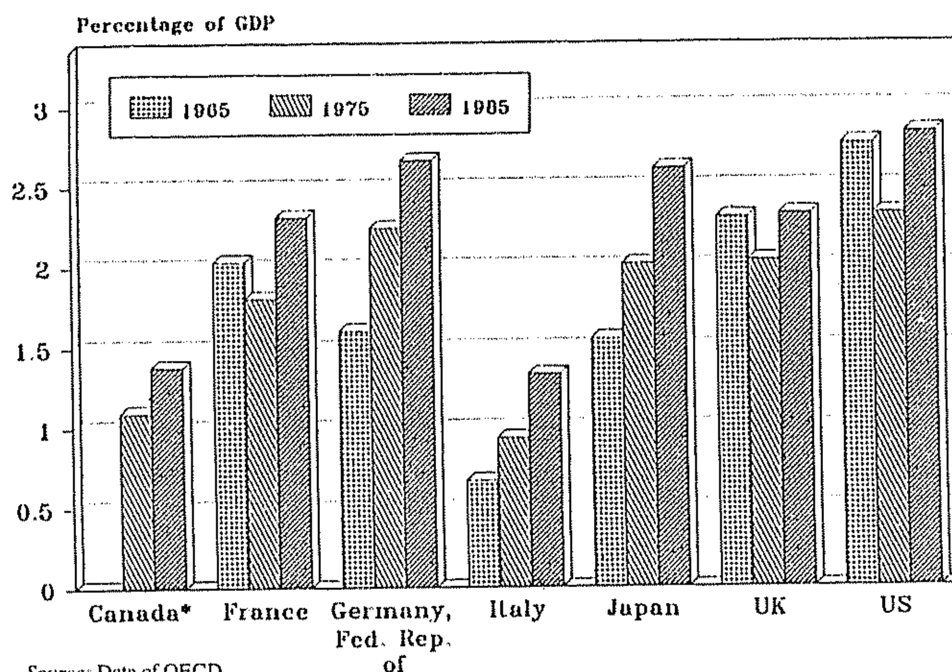
Source: OECD, *Economic Outlook*, No. 46 (December 1989), table 39.

[a] Defined as a weighted average of the growth of productivity of labour and capital in the business sector (weights in each period are shares in output of labour and capital). Total for group is the average of individual country data, weighted by 1987 GDP at 1987 exchange rates.

significant reason for lower productivity growth. Not all productivity improvements are embodied in new plant and equipment, but the possibilities for technical innovation through improvements in skills or other means are sooner or later exhausted without complementary investments. Moreover, if the capital stock had been heavily used on a sustained basis, it would have stimulated the search for ways to increase output through innovation and investment. But with idle capacity and low investment rates, this feedback effect on innovation was lost.

This ties in with the effect of relative price movements and changes in macro-economic conditions on growth of productivity. One consequence of higher energy prices in the 1970s and early 1980s was to render some of the capital stock uneconomic to operate. And the resort by industrial countries in the 1980s to tight monetary policies left rates of capacity utilization below normal trends which also had adverse implications for productivity. Although sharing in the tight monetary policy approach, the United States was different. Owing to its fiscal policy stimulus, it experienced strongly rising domestic demand in the earlier 1980s. But because the exchange rate was overvalued, capacity in manufacturing industry was still underutilized by the mid-1980s. In other words, the combination of severe instability in particular markets and macro-economic conditions stamped much of the 1970s and 1980s with periods of capacity underutilization, which depressed productivity.

Expenditure on research and development of seven major market econmies, 1965-1985



Source: Data of OECD
*Data for 1965 not available

There are certain signs that productivity growth in the 1990s might be stronger than it has been since the 1970s slow-down. First, as the table shows, the trend in the United Kingdom and the United States in the 1980s was already an improvement over the 1970s. Secondly, some of the measured productivity growth slow-down seems related to a shift in the composition of output towards services, which usually shows a low growth of productivity, itself possibly in part a measurement problem. When one looks at the growth of total factor productivity in, say, manufacturing alone, the 1980s recovery is stronger than the table shows for the United Kingdom and the United States and rises rather than stagnates in Japan.[d] On the other hand, the relationships shown in the table for overall productivity are not reversed for the other countries when the focus is restricted to manufacturing.

More directly encouraging signs that apply to all the seven countries are the recent pick-up in private non-residential fixed investment (see table VIII.6) and generally higher spending on research and development in the 1980s compared to the 1970s (see figure). The critical condition for turning research results into productivity enhancements through investment is the promise of significant and stable economic growth. Barring a derailing of growth through macro-economic difficulties in handling unforeseen shocks and disturbances, that promise should be realized.

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[a] The annual rate of increase in value added per hour of work was 2.6 per cent, which was the same as the average rate between 1913 and 1950. See Angus Maddison, *Phases of Capitalist Development* (Oxford, Oxford University Press, 1982)

[b] See, in particular, Edward F. Denison, *Accounting for Slower Economic Growth: the United States in the 1970's* (Washington, D.C., Brookings Institution, 1979 and later updates) and J. W. Kendrick, "International comparisons of recent productivity trends", in *Contemporary Economic Problems*, W. Fethner, ed., (Washington, D.C., American Enterprise Institute, 1981)

[c] In the case of the United States, see Michael Dertouzos, Richard Lester, Robert Solow and others, *Made in America: Regaining the Productive Edge*, Report of the MIT Commission on Industrial Productivity (Cambridge, Mass., MIT Press, 1989)

[d] From 1980 to 1985, total factor productivity was estimated to have risen 1.9 per cent a year in United Kingdom manufacturing, against 1 per cent overall; similarly, in the United States the two growth rates were 2.5 per cent versus zero change, and in Japan it was 4.5 per cent versus 2.0 (see A. Steven Englander and Axel Mittelstädt, "Total factor productivity: macroeconomic and structural aspects of the slow-down", *OECD Economic Studies*, No. 10 (spring 1988), p. 20).

Table VIII.2. Real labour cost and productivity in the business sector of seven major market economies, 1974-1988

(Average annual percentage change)

	Real labour cost per employee		Productivity of labour	
	1974-1979	1980-1988	1974-1979	1980-1988
Canada	1.3	1.2	1.5	1.5
France	3.5	1.2	3.0	2.4
Germany, Federal Republic of	2.8	1.7	3.4	1.9
Italy	3.1	0.5	3.0	1.6
Japan	4.0	2.6	3.2	3.1
United Kingdom	1.2	1.2	1.5	2.6
United States	0.1	0.3	0.0	0.9
Group of Seven	2.5	1.5	1.7	1.8

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

Note: Real labour cost is defined as compensation per employee in the business sector deflated by the GDP implicit price deflator (as a proxy for prices in the "business sector"); productivity is defined as output per person employed in the business sector. Total for group is the average for each country, weighted by 1987 GDP at *1987 exchange rates*.

factors. The increase in the number of women and part-time workers in the employed labour force has probably also played some role.[3] So, too, have shifts in demand away from the older "sunset" industries—where labour has generally been more highly organized—to the service industries and the "high tech" industries.

There have also been several governmental initiatives. These have mainly focused on training and retraining schemes or relocation schemes intended to improve the match between the demand for and the supply of skills. Some Governments—e.g., France, the United Kingdom and the United States—have also sought to make wages more flexible by encouraging various experimental schemes to make profits part of the wage package. Legislative action directly affecting wage bargaining, however, has been very limited. The legislation of the United Kingdom concerning trade union elections and strike action has been the exception, and most legislation has been restricted to such specific matters as minimum wage rates.[4]

The combined effect of these changes has been to lessen the degree to which an expansion of aggregate demand in the presence of appreciable unemployment and capacity under-utilization would be dissipated in higher prices and wages. In the mid-1980s, for example, it was quite widely believed among economists that if the rate of unemployment in the United States fell below 6 per cent, the economy would be faced with an acceleration in the rate of inflation; but though unemployment began to slip below that level in late 1987 and averaged only 5.2 per cent in 1989, the 1989 pick-up in inflation was mild.

How durable is the low inflation environment?

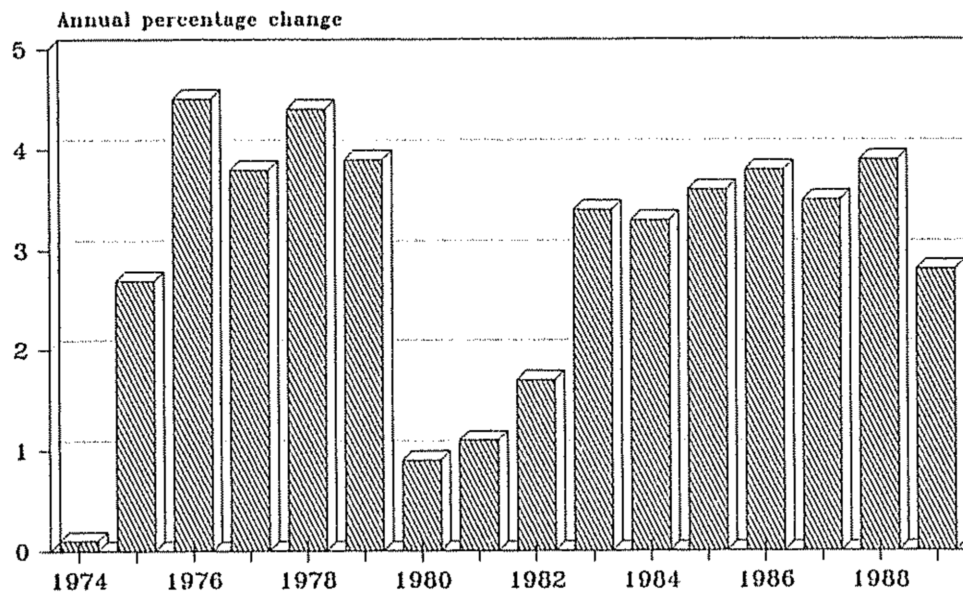
For primary commodities in general, the prospects are that prices will remain relatively stable in the medium term. But with present rates of growth in energy consumption and with the limits of productive capacity already being reached in production, transportation, transformation and distribution, energy prices are expected to come under increasing upward pressure (see chap. V). On the other hand, the conditions surrounding demand and supply in the food markets appear unlikely to change so sharply as to destabilize prices. Shortages could certainly develop in markets for specific raw materials because of lengthy lags in the response of productive capacity to increases in demand but sharp rises in their prices would by themselves have quite limited effects on the general price level. It is not possible to be as sanguine about exchange rates, however. While exchange rates may well not repeat the very wide swing that they performed in the 1980s, the possibility remains—as discussed in another section - of large destabilizing movements.

Apart from possible shocks from commodity—especially energy—or foreign exchange markets, the course of prices will depend heavily on the future performance of wages. If the present signs of a recovery in the growth of productivity, as noted in box VIII.1, are more than transient, larger non-inflationary increases in real wages would become possible,

[3] Part-time employment has grown as a share of total employment in the 1980s in each of the major industrial countries except Italy, where it remains about 5 per cent; in the others, it ranges from 12 per cent in France to 22 per cent in the United Kingdom. Female participation in the labour force has also grown in the 1980s, reaching 50 to 60 per cent of the female population in recent years, although growth in the 1980s was marginal compared to the rapid growth in the 1970s. (Japan was an exception, as its rate was almost unchanged since 1970.) For additional details, see *World Economic Survey 1989* (United Nations publication, Sales No. E 89 II C.1), pp. 15-19 and 191-201.

[4] See ILO, *World Labour Report 1989* (Geneva: ILO, 1989), pp. 12-15 and OECD, *Economies in Transition: Structural Adjustment in OECD Countries* (Paris, 1989), chap. 2

Figure VIII.2 Growth of real private consumption expenditure of seven major market economies as a group, 1974-1989



Source: Data of OECD

easing the tensions that surround wage determination. On the other hand, the welcome trend towards lower unemployment levels means a return to tighter labour markets which could intensify wage pressures. On this score, the crucial determinant of the inflationary environment of the 1990s may well be whether changes in institutional and other conditions in labour markets over the 1980s have much enhanced the degree of wage flexibility so that wage pressures respond relatively quickly to demand constraints when imposed by monetary authorities.

The buoyancy of household spending

It is common in economic analysis to look to changes in investment, trade, the government's budgetary situation and monetary conditions to explain macro-economic cycles and medium-term growth trends. But in the Group of Seven industrial countries in the 1980s a special focus is needed on household expenditures. Household spending on consumer goods and services has done much to set the pace of the post-1982 expansion. For the seven larger developed market economies as a group, the rise in private consumption expenditure has been both more stable and longer sustained than in the last major cyclical recovery in the 1970s (see figure VIII.2). Among individual countries, this has most certainly been true of the United States. In the Federal Republic of Germany and Japan, however, the pace of growth in consumption expenditure during the earlier years of the post-1982 recovery was less than what they had experienced in the post-1975 revival.

Household spending has been buoyant for several reasons. An important one has been the widespread shift in fiscal policy towards lower rates of tax on private incomes. In the United States it was in response to the substantial tax cuts introduced by the Economic Recovery Act of 1981 that consumption expenditure assumed its leading role in propelling the economy out of the 1981-1982 recession. In other countries, tax cuts have been mostly concentrated in the second half of the decade. In the Federal Republic of Germany and particularly in Japan,[5] reductions in income taxes were effected in 1987 and 1988, helping to sustain the overall buoyancy in consumption expenditure at a time when it was slackening somewhat in the United States.

Consumption expenditure also benefited from the weakness in world food prices, and more especially, from the sharp decline in energy prices in mid-decade. These raised real incomes, especially in Canada and the United States where the oil price decline was passed through to consumers in lower gasoline prices.[6] But besides changes in tax policies and in relative prices, consumer spending has also been buoyed up through most of the 1980s by what seems to have

[5] Japan's fiscal reform in 1988 was the most significant since 1950 (see *OECD Economic Surveys: Japan* (Paris, 1989), chap. III).

[6] In other countries, the price windfall was mainly captured by Governments in higher tax revenues (see *World Economic Survey 1989*, pp. 95-96).

Table VIII.3 Net household saving of seven major market economies, 1974-1989

(Percentage of disposable household income)

	1974-1979	1980-1982	1983-1985	1986	1987	1988	1989[a]
Canada	12.2	15.7	14.5	11.3	9.7	9.4	10.7
France[b]	19.4	17.6	14.8	13.2	11.5	12.4	12.3
Germay, Federal Republic of	13.3	13.0	11.2	12.2	12.3	12.6	12.5
Italy[b]	29.4	26.9	25.4	23.7	22.1	22.7	22.5
Japan	21.7	17.6	16.1	16.4	15.1	15.2	16.8
United Kingdom[b]	11.5	12.9	10.3	7.5	6.2	4.4	4.2
United States	8.0	7.3	5.4	4.2	3.3	4.3	5.4
Group of Seven[c]	1 4.	13.1	11.2	10.3	9.3	9.8	10.6

Source: Data of OED, *Economic Outlook*, No. 46 (December 1989).

[a] OECD estimates.

[b] Gross saving.

[c] Weighted average of the saving shares of each country, weights being 1987 GDP at 1987 exchange rates.

been a widespread decline in the share of current income that households save.[7]

The decline in household saving

After the end of the 1970s, rates of household saving in the larger, developed market economies began to decline irregularly, and from 1982 until the past year or so they mostly fell quite steadily (see table VIII.3). The United States saving decline had begun earlier and by 1981, inadequate personal saving had already been identified as a problem.[8] The 1981 United States tax reform was in part a policy response in that it reduced taxation of non-wage income and offered a series of direct saving incentives. Despite these and other inducements such as unusually high real interest rates, the United States saving rate continued to fall, as it did elsewhere. It appeared that these encouragements were being overwhelmed by other developments.

Several hypotheses have been offered to explain the phenomenon. One was that during the period of increasing inflation, households had to increase their monetary savings if they wanted to maintain a given real value of cash balances held for precautionary reasons. As inflation slowed, this need was reduced and saving could fall. However, this appears to have been at best a partial influence, as rates of household saving as a proportion of income have fallen in some countries below the levels of earlier decades when inflation was relatively low.

It has also been thought that demographic changes may have exerted some influence. One factor in a number of countries has been the relatively high rate of family formation taking place since the late 1970s, as the "baby boom" generation of the earlier post-War years reached adulthood. This generated a strong demand for housing and buoyant expenditure on related consumer durables. Another factor working in the same direction in its effect on aggregate household saving is the increasing share of the elderly in the total population. Since people tend to borrow most in the stage of the life cycle when they are in young families, and to save little in their retirement years, these trends at both ends of the adult population spectrum tended to reduce overall household saving.

However, when the young families were themselves children, they were a dependent population that had to be supported from the incomes of the economically active population. As may be seen in table VIII.4, there has been a substantial decline in the youth dependency ratio in each of the seven countries from the 1970s to the 1980s, and this would tend to raise the average household saving rate. On the other hand, the elderly are also a dependent population, if less directly on their own families than in generations past and more through reliance on social security and other forms of income transfers. But while the ratio of the elderly dependent population has been growing, it has not yet grown as fast as the youth dependency ratio has been falling. In short, the net effect of demographic changes on saving is ambigu-

[7] Household saving is conventionally defined as the deferment of consumption expenditure. But the definition of consumption may be overly broad. For example, purchase of a house is considered investment, while purchase of an automobile, which, like a house yields services over a period of years, is considered consumption. If purchases of durables are reclassified as investment, not only do overall savings appear higher, but the drop in savings rates in the 1980s appears smaller; in particular, the 30 per cent decline in the United States household savings rate from the 1974-1979 period to the post-1983 period becomes instead a drop of 10 per cent (based on data and estimates of Andrew Dean, Martine Durand, John Fallon and Peter Hoeller, "Saving trends and behaviour in OECD countries", *OECD Working Papers*, No. 67 (June 1989), table A3).

[8] See, for example, Donald Cox, "The decline in personal saving", Federal Reserve Bank of New York, *Quarterly Review* (spring 1981), pp. 25-32

Table VIII.4. Population dependency ratios of seven major market economies, 1965-1995[a]

(Per cent of population of working age)

		1965	1975	1985	1995
Canada	Aged 0-14	56.6	40.7	31.6	29.7
	Aged 65+	13.0	13.1	15.3	18.0
	Total	69.6	53.8	46.9	47.7
France	Aged 0-14	41.1	38.2	32.2	30.6
	Aged 65+	19.4	21.5	19.7	22.2
	Total	60.5	59.7	51.9	52.8
Germany, Federal Republic of	Aged 0-14	34.4	33.5	22.4	22.8
	Aged 65+	18.2	22.6	21.1	23.5
	Total	52.6	56.1	43.5	46.3
Italy	Aged 0-14	37.0	38.0	28.9	23.8
	Aged 65+	15.2	18.9	18.8	22.6
	Total	52.2	56.9	47.7	46.4
Japan	Aged 0-14	38.2	35.8	31.6	25.2
	Aged 65+	9.2	11.6	15.1	19.9
	Total	47.4	47.4	46.7	45.1
United Kingdom	Aged 0-14	35.9	37.2	29.3	29.9
	Aged 65+	18.5	22.2	23.0	23.9
	Total	54.4	59.4	52.3	53.8
United States	Aged 0-14	50.8	39.1	32.7	32.2
	Aged 65+	15.8	16.3	18.0	19.5
	Total	66.6	55.4	50.7	51.7

Source: Department of International Economic and Social Affairs of the United Nations Secretariat.

[a] Estimates to 1985; medium-variant projections for 1995.

ous a priori and while there is some econometric evidence that changes in the structure of the population have thus far tended to raise saving rates, the question does not yet seem to be fully resolved.

Moreover, even though public and private pensions have become more generous, working people—especially in Europe and Japan—appear increasingly to have foreseen longer periods of retirement and therefore have raised their saving rate during their working years.[9] One result is that already the elderly account for an increasing proportion of interest income of households. In the United States, in particular, evidence from income tax returns is that individuals over 65 years of age received 53 per cent of interest income paid to households in 1985, compared to 45 per cent a decade earlier. Indeed, the very success of households in thus building up their interest earning assets may be one reason personal saving did not increase in the United States in the early 1980s when interest rates rose to high real levels. That is, the higher interest income received by the elderly was seen by them as in the nature of a windfall that could be spent, as there was no strong incentive to add it to their savings, especially as inflation seemed to have been brought under control.[10]

Apart from these influences, one large economic change at work over the past decade has been the strong rise in wealth relative to income. House prices and land values have generally been rising faster than income, and prices of equity shares rose remarkably in the 1980s from their long-depressed levels in the 1970s. Also, with interest rates generally lower than at the outset of the 1980s, bond prices rose. The effect of this gain in wealth has been to encourage households to increase their spending out of current income or, in other words, to reduce their rates of saving.

Households whose saving turned negative—whose expenditures exceeded their income—generally did not liquidate their assets, but borrowed more. In this, they have been aided in the 1980s by the deregulation of financial markets, which increased competition in lending to consumers and abetted the development of new financial instruments. The United States has been a centre of this innovation; e.g., home-equity lines of credit—revolving credit accounts granted on the collateral of equity held in a house—rose from nothing at the start of the decade to $75 billion at the end of 1988.[11] Apart from enjoying certain tax advantages, these loans tended to be based on the value of the home in a period of rapidly rising house prices rather than on the borrower's earnings. Households also began to be able to borrow without any explicit security at all, as in the case of credit card purchases, an innovation that has spread across the globe.

Indeed, although the ratio of consumer debt to income has long been higher in the United States than elsewhere, over the last two decades the ratios in several countries have begun to approximate those in the United States. After a sharp rise in consumer borrowing in the United Kingdom during the 1980s, its ratio is now close to that of the United States. In Japan and the Federal Republic of Germany, there was a strong tendency towards convergence with the United States during the recovery of the 1970s period as consumer borrowing rose vigorously. Significantly, in both countries, the pace of growth in real consumption expenditure during that period was distinctly more than what they experienced during the early years of the post-1982 recovery. The tendency towards convergence weakened in the first years of the 1980s, but it may again be emerging at the present time.[12]

Yet a further perspective on personal saving and expenditure may be had by looking at household wealth and debt together in the form of the net worth of households. The ratio of aggregate net worth of households to their income had fallen in the late 1960s or early 1970s in Canada, Japan, the United Kingdom and the United States but it was rebuilt in the rest of the 1970s.[13] By the 1980s, households apparently felt wealthier and thus able to maintain more buoyant consumption spending.

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9 See Barry Bosworth, "International differences in saving" (The Brookings Institution, unpublished), prepared for presentation to the annual meetings of the American Economics Association, Atlanta, 28 December 1989.

10 See Eytan Sheshinksi and Vito Tanzi, "An explanation of the behaviour of personal savings in the United States in recent years", National Bureau of Economic Research, *Working Paper Series*, No. 3040 (July 1989).

11 By comparison, $135 billion to $190 billion in traditional home-equity loans were outstanding at the end of 1988, although the markets for these two instruments were largely separate, with lower-income households making greater use of the traditional loans (see Glenn Canner, Charles Luckett and Thomas Durkin, "Home equity lending", *Federal Reserve Bulletin* (May 1989), pp. 333-344).

12 Dorothy B. Christelow, "Converging household debt ratios of four industrial countries", Federal Reserve Bank of New York, *Quarterly Review* (winter 1987/88), pp. 35-47.

13 The cycle did not occur in the Federal Republic of Germany. Data on France and Italy were unavailable (as per Fallon and Hoeller . chart H).

Table VIII.5. Growth of financial wealth of households in the United States, 1974-1987

(Average annual percentage change)

		1974-1979	1980-1982	1983-1987	Level in 1987 (billions of dollars)
Financial wealth					11 169
	Nominal increase	10.5	10.4	8.1	
	Additions	5.3	4.4	4.6	
	Real increase[a]	1.8	0.4	4.6	
Debt					2 935
	Nominal increase	10.9	7.6	11.6	
	Additions	11.6	7.6	11.9	
	Real increase[a]	2.2	-2.1	8.0	
Net financial wealth					8 235
	Nominal increase	10.4	11.3	7.0	
	Additions	2.9	3.3	2.1	
	Real increase[a]	1.7	1.2	3.5	

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of OECD, *Financial Accounts of OECD Countries*, 1988, No. 2, (Paris, 1989)

[a] Nominal increase deflated by the change in the consumer price index

Moreover, the process of the rebuilding of wealth may have worked in a way that was especially likely to stimulate spending, at least this is what the case of the United States, shown in table VIII.5, seems to suggest. United States households added an average 5 per cent a year to their wealth in the 1970s period depicted in the table, but saw their real wealth actually rise less than 2 per cent a year because of the high rate of inflation. In the current expansion, in contrast, a somewhat smaller rate of addition to household wealth has produced an equal increase in real wealth; that is, the inflation rate was offset by the capital gain on the nominal value of the stock of household financial assets

It was noted above that financial innovations served to encourage higher levels of consumer borrowing. But United States households also had other reasons to use greater amounts of debt to finance their purchases. In the high-inflation 1970s, borrowing that raised the nominal debt by 11 per cent a year on average nevertheless raised the real stock of debt by only 2 per cent a year. Indeed, when the rate of borrowing slowed in the recessionary early 1980s, the high inflation rate reduced the real stock of indebtedness. In the current expansion, households appear to have returned to a rate of borrowing that raises their indebtedness at an equivalent rate to that of the 1970s, but now it produces a much larger increase in the real debt level. None the less, because the stock of assets is so much larger than the stock of debt, and is still growing, even with the real level of debt rising 8 per cent a year, the real net financial position of households grows twice as fast as it did in the 1970s.

Consumption and saving in the 1990s

The wealth, demographic and policy changes of the 1980s that altered savings and consumption patterns are themselves likely to undergo changes in the 1990s. The demographic picture is already changing in that the overall dependency ratio is projected to start rising in the 1990s in the four European countries and Japan, as the growth of the aging population exceeds that of the population of children. In Canada and the United States, in contrast, the overall dependency ratio is not expected to rise before the second decade of the next century.[14]

The growth of household wealth and, tied to that, consumer debt are also expected to moderate. Of particular importance are house prices since houses generally form an important part of total assets. In some countries—as, for example, the United Kingdom and the United States—the long rise in house prices appears to have broken and in future years, house prices may move more closely in step with incomes or even decline in relation to them.[15] Pressures on the housing market created by the "baby boom" generation are likely to pass away in the 1990s, and new patterns of social behaviour such as the increase in numbers of single adult households may also stabilize. In Japan, where there is a large unsatisfied demand for housing, demand is not likely to abate but the run up in land and housing prices may essentially be over. Indeed, some believe land prices are vulnerable to a collapse not unlike that in the stock market, where prices of equity shares have fallen by about 25 per cent in the first three months of the year.

[14] Secretariat projections, as published in *World Population Prospects 1988* (United Nations publication, Sales No. E.88.XIII.7), from which the data in table VIII.4 are an extract. For savings and budgetary implications for the twenty-first century, see Peter S. Heller, "Aging, savings, and pensions in the Group of Seven countries", *IMF Working Paper* (WP/89/13), 31 January 1989

[15] In the United Kingdom, house prices have risen from about three times average earnings in 1980 to about five times in 1988. For new buyers, mortgage payments accordingly take a larger bite out of earnings; this has been putting a brake on demand from first time buyers. In the United States, the demographically driven demand for housing is projected to fall over the next 20 years and, based on the historical relationship between housing demand and house prices, the real price of houses is estimated to decline by 3 per cent per annum (see N. Gregory Mankiw and David N. West, "The baby boom, the baby bust, and the housing market", National Bureau of Economic Research, *Working Paper Series*, No. 2794 (December 1988))

As the growth of household wealth slows, consumers and their creditors may become more cautious in the rate of expansion of consumer borrowing. It is already a frequently expressed concern in the United States that, since the rate of increase in consumer instalment debt has outstripped that of incomes, households may find a rising burden in servicing the debt. Also, in a weak housing market, the security provided lenders of home-equity loans is reduced. This would not only put a brake on further borrowing but could cause hardship among poorer households in the event of a recession which curtailed incomes and employment. Although this may be a real enough possibility for some overborrowed households, it is not likely to be a widespread phenomenon. Over the 1980s, partly as a result of the intensification of competition in the financial sector, the repayment period for consumer debt has been considerably stretched out and interest rates have also been reduced. At least in part for these reasons, the debt-servicing burden as a percentage of personal disposable income in the United States was about the same in 1987 (17 per cent) as in 1982. Moreover, a disproportionate share of the debt is owed by higher income groups and the burden of debt-service payments in relation to incomes does not vary much among the different groups.[16] In any event, some restraint on borrowing has been introduced in the United States by the phased elimination of the deductibility from taxable income of interest payments on consumer debt other than mortgages and home-equity loans.

Together with the demographic changes, these circumstances mean that households are less likely to buoy up consumer spending with increased borrowing and are more likely to restore their rates of saving to something like their former levels. The net effect of the various trends on each country seems likely to lead to higher rates of household saving in the United States and possibly lower rates in the Federal Republic of Germany and Japan. In themselves, these developments point to a slower growth of consumer demand in the 1990s in the United States relative to the 1980s and possibly a more rapid one in the other countries.

The rebound of fixed, non-residential investment

Private fixed investment in machinery, equipment and non-residential structures is well known for its volatile behaviour. Its contribution to the growth of aggregate demand varies widely from year to year, usually turning negative when general economic activity weakens. However, in the years since the 1982 recession, fixed investment of the seven larger developed market economies as a group—though still volatile—has yet to turn negative and has grown in most years by substantial amounts (see figure VIII.3).

As with consumption expenditure, the overall performance has been smoothed out by differences among countries in the phasing and strength of their recoveries. Investment spending in the United States rose with particular vigour in the boom years of 1983 to 1985. But it fell back temporarily in late 1986 and early 1987 before regaining its upward momentum. Investment in Japan did not resume its growth until 1984 and it accelerated substantially only from 1987 onward. Among the Western European countries—with the exception of the United Kingdom—the pattern was much the same, though the rate of increase in investment remained distinctly weak. The United Kingdom, like the United States, experienced a vigorous growth in investment during both the earlier and later years of the decade (see table VIII.6).

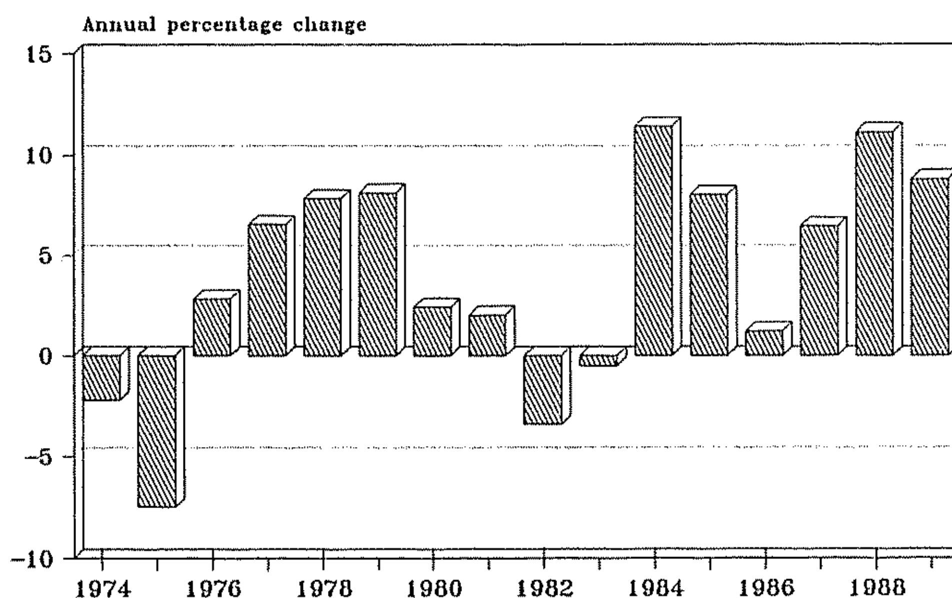
The main determinant of business fixed investment is profit expectations over the life of the investment, and so the task for analysts of investment behaviour is to decipher the elements that shape these expectations. One is the trend in sales as seen against installed production capacity. Thus, as capacity utilization in manufacturing industry and services began to rise during the 1980s, investment in new capacity for expanded sales appeared increasingly attractive. In those countries where consumption expenditure grew more slowly during the first half of the decade, the rising demand for exports was a partial substitute in some instances. This was important for Japanese investment during the early years of the recovery because of its close trade links with the United States. It was less influential in the continental European countries where exports are more closely geared to intra-European trade; but the prospect of the unified EEC market after 1992 began to stimulate investment by the second half of the 1980s.

In the competitive environment that has prevailed both within and across borders, technological advances have raised the prospective profitability of investment in new machinery and equipment (or raised the probability of losses from not investing in an era of more rapid obsolescence). Much of the struggle among firms to maintain or increase market share has taken the form of innovations in products or processes. Areas of particular emphasis have included improvements in the quality of products or services and the introduction of processes allowing the more rapid adjustment of production and distribution to changing consumer demands. In the United States and the EEC countries, a significant motivation for investment—particularly in the earlier years of the decade—was the rationalization and modernization of plant and equipment in long-established industries; this was spurred on by the loss of market shares to lower cost or higher quality imports. Among the EEC countries, the structure of increased real unit labour costs with which they emerged from the 1970s was also an incentive to investment in labour-saving equipment.

The prospective profitability of investment was also raised by the diminished pressure of wage increases on unit labour

[16] Robert Avery, Gregory Elliehausen and Arthur Kennickell, "Changes in consumer installment debt: evidence from the 1983 and 1986 surveys of consumer finances", *Federal Reserve Bulletin* (October 1987), pp. 761-778.

Figure VIII.3 Growth of real private gross non-residential fixed investment of seven major market economies, 1974-1989



Source: Data of OECD.

Table VIII.6. Growth of real private gross non-residential fixed investment of seven major market economies, 1974-1989

(Annual percentage change)

	1974-1979	1980-1982	1983-1985	1986	1987	1988	1989[a]
Canada	6.8	5.0	1.3	4.1	11.1	18.9	10.1
France	-0.3	0.5	-0.7	5.0	4.8	10.4	6.7
Germany, Federal Republic of	1.9	-1.6	3.7	4.3	4.2	7.3	11.2
Italy	1.0	-2.4	1.9	3.1	11.3	7.3	7.6
Japan	1.0	5.2	8.9	5.8	8.0	16.0	18.0
United Kingdom	3.0	-0.8	8.9	0.6	14.2	19.3	7.0
United States	3.5	-2.0	7.3	-3.3	3.9	8.4	4.1
Group of Seven[b]	2.4	0.3	6.2	1.2	6.4	11.1	8.8

Source: Data of OECD, *Economic Outlook*, No. 46 (December 1989).

[a] OECD estimates

[b] Weighted average of the investment growth rates of each country, weights being 1987 GDP at 1987 exchange rates.

costs. Indeed, as labour productivity began to rise faster than the real cost of labour (see again, table VIII.2), unit labour costs fell. In addition, after-tax profits have gained from reductions in the rate of corporate income tax. Of particular importance in the case of the United States was the increase in depreciation allowances introduced in 1981 by the Accelerated Cost Recovery System. But while these cost and tax changes improved profit expectations, their role in encouraging new investment was probably subsidiary.

The influence of another element on the supply side—the cost of capital—appears uncertain. Major determinants of the cost of capital are interest rates and the cost of raising equity funds. Real long-term interest rates reached very high levels during the early years of the post-1982 recovery; in the United States they averaged almost 8 per cent from 1983 to 1985 when investment was increasing with particular vigour. In the later years of the 1980s real long-term interest rates have generally fallen and—at least until the 1987 stock mar-

ket crash—the cost of raising equity capital also fell. Thus, while investment may have received some stimulus from the falling cost of funds in the late 1980s, investment first became strong when the cost of funds was still quite high.

This does not mean, however, that the cost of capital failed to influence investment decisions. One recent study, for instance, found appreciable differences among four of the larger countries in the cost of capital; and it noted that the share of fixed investment in GNP has been lower in those countries where the cost of capital has been higher.[17] The study estimated that the after-tax cost of funds to corporations in the Federal Republic of Germany and Japan was as low as 2 per cent compared with some 5 to 6 per cent in the United Kingdom and the United States. However, as the study pointed out, differences among countries in the tax treatment of profits could offset these differences in costs. What finally matters for investment decisions is the pre-tax rate of profit that has to be earned in order to cover the after-tax cost of funds. However, when allowance is made for different tax provisions, the generalization that the cost of capital is higher in the United Kingdom and the United States still appears valid. What also emerges is that the advantage of the Federal Republic of Germany and Japan is greater, the longer the lifetime of the investment project. In projects with a short lifetime, the cost of funds is less important, and in the United States the higher depreciation allowance can be sufficient to offset the disadvantage of the higher cost of funds. Thus, though investment rose more vigorously in the United Kingdom and the United States during much of the 1980s because of demand, the structure of higher capital costs probably biased its composition away from relatively long-term projects.

Will the rate of investment be maintained?

It would be very interesting if we could measure the effect of the various factors listed in raising the expected rate of profit from investment. But expected profits are in their nature unobservable in economic data, although ex post profits are available, as are data on the value of the capital stock. The ratio of the two time series gives a measure of the average rate of return on capital.[18] As thus measured, the rate of return had recovered from levels of the early 1980s and surpassed the average of the 1970s period in six of the seven countries (see table VIII.7). The exception, Japan, was nevertheless enjoying annual rates of return of 21 per cent or more. If these average profit rates are more or less maintained in the 1990s, the prospect for investment will continue to be strong.

Other influences are also at work that may serve to strengthen investment demand. A positive stimulus on European investment is being generated by the 1992 economic integration programme of the European Economic Community. The successful conclusion of the Uruguay Round of trade negotiations and an end to the protectionist drift could have similar, if more limited and diffused, effects. Further, with higher levels of spending on research and development (see again, box VIII.1), there may be fresh technological advances to accelerate the rate of investment. It has been suggested, moreover, that as Japan and the EEC countries join the United States at the frontier of technological progress, the pace at which the frontier is pushed back could accelerate.[19] Certainly, as the internationalization of corporations continues to spread and as more corporations develop cross-border relations with their counterparts elsewhere in order to gain access to or to develop new technologies, these will be disseminated and applied more quickly.

It was noted in the preceding section that the locus of dynamic consumer spending may be shifting to Europe and Japan from the United States. The demand stimulus to investment spending might thus also be concentrated in these countries. But if there is more progress in reducing the United States fiscal deficit, the easing of pressure in the credit markets may reduce real United States interest rates and further encourage investment in that country, particularly to increase capacity to export to the more dynamic markets abroad.

Table VIII.7 Rates of return in the business sector of seven major market economies, 1974-1989

(Profit income as a per cent of capital stock[a])

	1974-1979	1980-1986	1987[b]	1987[b]	1989[b]
Canada	16.1	17.4	19.4	20.4	20.5
France	17.9	16.1	17.5	18.0	18.3
Germany, Federal Republic of	17.1	16.3	17.5	18.9	18.3
Italy	19.6	20.9	23.3	23.4	23.0
Japan	23.2	21.6	21.9	22.0	20.7
United Kingdom	11.2	11.7	13.2	13.5	13.8
United States	20.3	19.7	22.6	23.3	23.3
Group of seven	19.6	19.0	20.8	21.3	21.1

Source: OECD, *Economic Outlook*, No. 46 (December 1989), table 50.

[a] Profits are derived from national accounts data as value added in production at factor cost minus compensation of employees (and thus profits exclude gains or losses from price changes, but include some labour income since all the income of self-employed people is included); capital stock is defined as the cumulation of the assets included in private gross non-residential fixed investment minus retirements (and thus inventories are excluded), evaluated on the basis of replacement cost.

[b] Estimated for some countries by OECD.

The international transmission mechanism

The maintenance of a largely open system of international trade and the more recent emergence of a liberalized international capital market have played a critical role in the sustained post-1982 recovery of the countries under review

[17] See Robert N. McCauley and Steven A. Zimmer, "Explaining international differences in the cost of capital", Federal Reserve Bank of New York, *Quarterly Review* (summer 1989), pp. 7-28.

[18] The convention is to measure profits from operations (i.e., from value added by enterprises) so the measure excludes capital gains or losses from trading assets or from revaluations of inventories.

[19] See Angus Maddison, *Phases of Capitalist Development* (Oxford, Oxford University Press, 1982).

here. This is not to deny that strong protectionist pressures were felt in the countries or that there were fears about unrestricted capital flows. But for the most part, trade and financial flows were open and served as efficient mechanisms for transmitting aggregate demand impulses internationally.[20]

The stimulus of rising export demand shifted strongly among the larger developed market economies between the earlier and the later years of the recovery. It was the upsurge in domestic demand in the United States during the 1983 to 1985 period which, together with the strongly appreciating dollar, pulled up exports from the other countries and imparted some momentum to the growth of their domestic output. In the larger of these countries, relatively high saving propensities and lagging domestic investment were tending to depress domestic economic activity on the one hand, and on the other, concern about inflation and the high priority given to containing public expenditure and budget deficits deterred the authorities from pursuing expansionary measures. Thus, in the 1983-1985 upswing, the rate of increase in total demand in the United States outpaced the growth of total output, while in all the other countries except Italy and the United Kingdom, the reverse occurred (see figure VIII.4).

One consequence for the United States, however, was a sharply rising trade deficit as both exporting and import-competing industries suffered from the overvalued dollar and—directly or indirectly—from the relatively weak expansion in foreign markets. While the deficit was easily financed by the inflow of capital from the countries with a surplus of saving, it intensified domestic protectionist pressures and generated fresh trade tensions among the main trading partners. The slow growth in income, especially in the European countries where it was accompanied by high unemployment rates, also fed protectionist pressures in those countries.

Meanwhile, the untenable nature of the very large trade surpluses in the Federal Republic of Germany and Japan and of the comparable trade deficit in the United States came to be recognized, and steps were co-ordinated internationally to adjust policies. These began with the Plaza Accord in September 1985 to encourage the realignment of the dollar and they were supported later by domestic macro-economic measures in the leading countries; the latter were designed to reduce the large but opposite saving-investment imbalances while preserving the growth of economic activity. The outcome was a virtually complete reversal in the 1986-1989 years of the relation between domestic demand and output that was observed in the 1983-1985 period. As can be seen in figure VIII.4, total domestic demand in the later period grew more slowly than output in the United States while it exceeded output growth in the Federal Republic of Germany and Japan—the chief actors of the co-ordinated policy—as well as in the other four countries.[21] It then became the turn of domestic economic activity in the United States to be stimulated by an expanding volume of exports.[22]

The manufacturing sector in these countries seems to have been particularly sensitive to the shift in demand growth and the drop in the overvalued dollar. Thus, whereas the United States was effectively being priced out of its export markets as the dollar rose in the first part of the 1980s recovery, its manufactured exports grew sharply after the dollar declined; that is, not only was the 15 per cent average rate of growth of the volume of manufactured exports during the period 1986-1989 a credible performance in itself, but it came at a time when the United States export markets for manufactures were growing at little more than half that rate (see table VIII.8).

Table VIII.8. Growth of manufactured exports and of export markets of seven major market economies, 1983-1989[a]

(Average annual percentage change in volume)

	Market	Export	Market	Export
Canada	15 7	14 0	7 5	4 5
France	5 4	2.9	7.5	4 2
Germany, Federal Republic of	5 9	6 2	8.0	5 6
Italy	4 3	6 1	7 2	6.4
Japan	7 3	9 6	6 8	2 2
United Kingdom	5 3	5.3	6.9	5 8
United States	6 0	1 1	8 2	14.7
Group of Seven	6 6	5 9	7 5	6 4

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of OECD, *Economic Outlook*, various issues

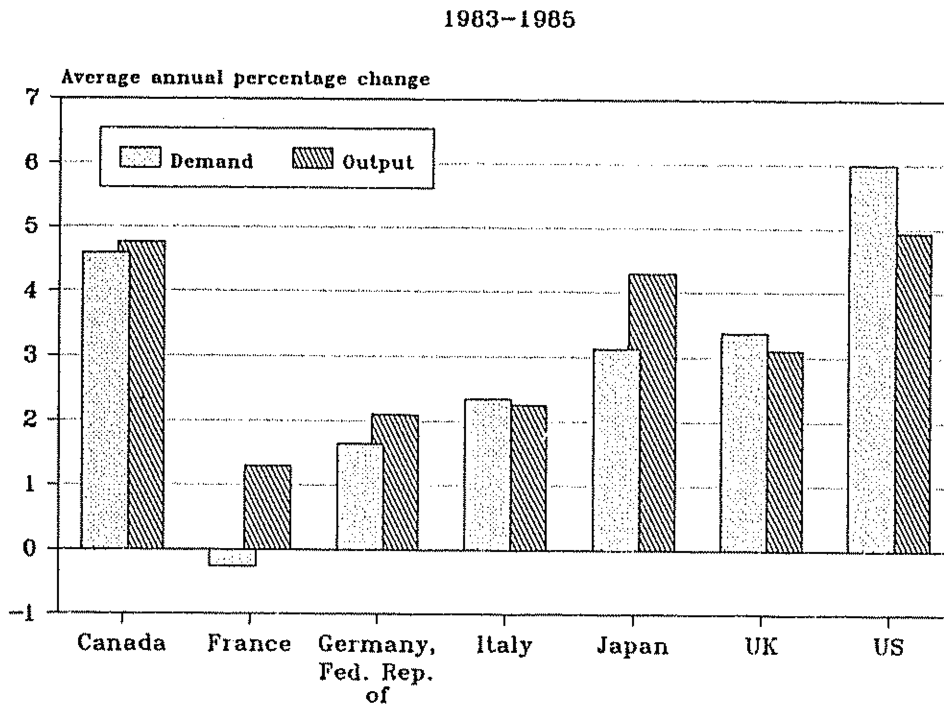
[a] Market growth is defined as a weighted average of the growth of manufactured imports in each exporting country's national or regional markets, the weights being the share of manufacturing trade flow in1981 for years up to 1986 and 1985 for years thereafter

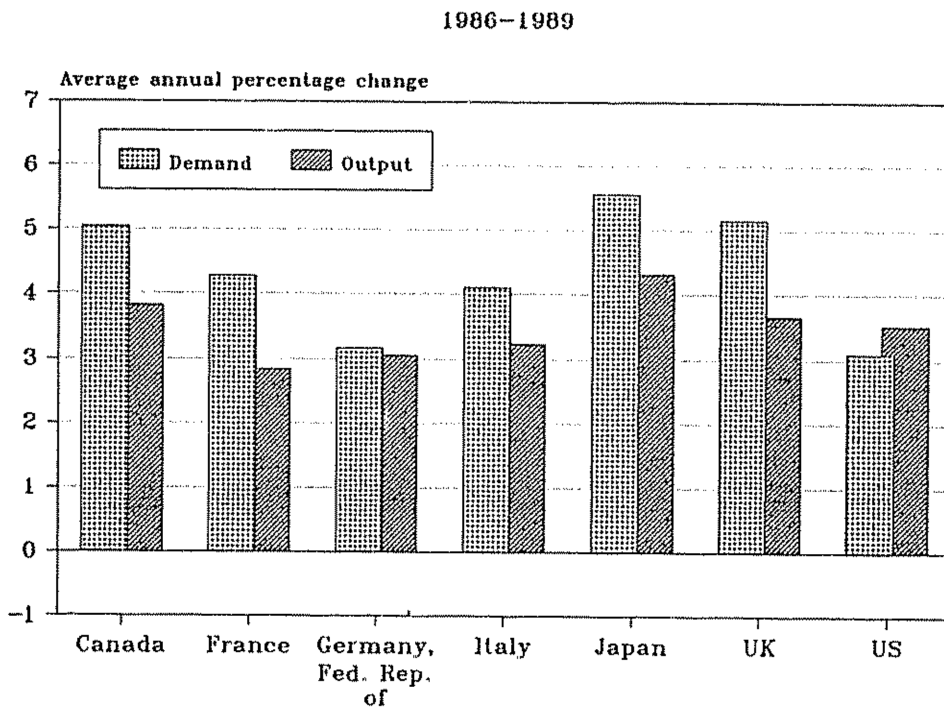
[20] Many protectionist actions were taken, particularly in the increased use of anti-dumping and countervailing duties and in the more frequent resort to retaliatory threats or unilateral measures against alleged protectionist activities. None the less, the economies remained open overall, as reflected in the upward trend of import-penetration ratios for manufactures. In the United States, the ratio of imports to apparent consumption rose from about 9 per cent in 1980 to 13 per cent in 1988 and in the EEC countries from about 10 per cent to 13 per cent. Only in Japan was the increase in penetration slight, rising from 5.5 per cent to 6 per cent, according to data compiled by the United Nations Conference on Trade and Development (see *Trade and Development Report 1989* (United Nations publication, Sales No. E.89.II.D 1), chart 4). In the service sector, too, there has been a growing interpenetration of markets, as in the tourist and distribution industries, but especially in finance. With the deregulation of national capital markets, the dismantling of exchange controls and the liberalization of establishment rules for foreign financial institutions, the conditions were laid for the great upsurge in international capital transactions that has marked the 1980s

[21] In Italy and the United Kingdom, where the growth of demand already exceeded the growth of output in 1983-1985, the degree by which demand grew faster than output increased in 1986-1989 (i.e., from a 4 per cent to a 27 per cent excess in Italy and from an 8 per cent to a 41 per cent excess in the United Kingdom). In both cases, the sharp increase in demand seems to have been generated independently of the co-ordination exercise

[22] In 1987 the growth rate in United States real GNP accounted for by the increase in real exports of goods and services alone was 1.4 per cent. Total real GNP rose by 3.7 per cent. In 1988, exports accounted for 2.1 per cent while total real GNP rose by 4.4 per cent. In 1989, the estimated contribution of exports was 1.4 per cent and the growth of GNP was 3 per cent. See OECD, *Economic Outlook* (December 1989), table 26.V

Figure VIII.4 Growth of aggregate demand and output of seven major market economies, 1983-1989





Source: Data of OECD

By the same token, the higher yen exchange rate in the 1986-1989 period appears to have been a major reason for the sharp slow-down in the growth of Japanese manufactured exports both in absolute terms and relative to the growth of its markets. In Europe, once the delayed recovery began, the high degree of interconnectedness of the economies of the EEC countries translated into more rapid growth of their markets for manufactured exports. However, with the deutsche mark and the currencies linked to it through the European Monetary System rising against the dollar, export growth to the non-EEC area was held back.

Instability in foreign exchange markets

If the period after 1986 thus appeared to be placing the major market economies on a path of adjustment, it is a slow one and one that requires continuing United States dependence on foreign capital inflows and the consequent rapid rise in the external indebtedness of the United States. Despite dramatic and positive changes in the performance of real exports and imports, the United States deficit in the balance of payments on current account, though it contracted in 1988 and 1989, has remained large and is not expected to shrink rapidly. This is primarily for two reasons. First, since United States merchandise exports are only some 70 per cent of imports, their growth has to be at a considerably higher rate in order to outweigh the growth of imports if the merchandise trade gap is to be narrowed substantially. Secondly, with the continuous net inflow of capital to finance the current account deficit each year, investment income payments abroad keep increasing.

Were investors to curtail sharply their inflow of funds, the shortfalls of both domestic savings and foreign exchange earnings would have to be covered by large-scale official inflows—as happened in 1987[23]—or by a sharp fall of the dollar exchange rate and rise in interest rates, which might set in motion serious trade and financial disruptions.[24] So far, the world's demand for dollar assets has not abated; but since the dollar is the principal reserve currency of the world, the possibility that the demand for dollars might slacken renders exchange rates vulnerable to severe instability.

The United States current account deficit has recently been about 2.5 per cent of gross national product, while net indebtedness stood at 11 per cent in 1988. According to one slow-adjustment scenario, if the United States current account deficit net of investment income payments—that is, the net transfer of financial resources to the United States—continued at its 1988 level, it could eventually stabilize at about 3.25 per cent of gross national product, and it would raise net indebtedness to 32 per cent of GNP by the year 2000.[25] But even these rates would not be exceptional in themselves. Other developed market economies have run current account deficits of 3 per cent or more of GNP for several years and have carried levels of debt in excess of 40 per cent of GNP without provoking a crisis of confidence.

Moreover, unlike the United States, which borrows from foreign investors through the sale of dollar-denominated assets, other countries borrow in foreign currency. Foreign investors are aware that borrowing countries could encounter a liquidity problem in servicing their external debt and they lend only if the policies pursued in these countries seem to make such risk acceptably small. In the case of United States debt, however, the risk that foreign investors face is not illiquidity; it is the foreign exchange risk that they carry in holding dollar assets. In a sense, United States external borrowing is thus less subject to the direct scrutiny and discipline of capital markets and more linked to expectations about the dollar exchange rate. So long as the differential between United States and foreign interest rates more than offsets any loss expected from a deterioration in the exchange rate, it remains worthwhile for foreign investors to purchase dollar-denominated assets. This seemingly gives the United States a greater measure of latitude in its domestic policies. However, this may be more appearance than reality since assessment of the effectiveness of domestic policies in containing the current account deficit within sustainable limits should go far towards moulding exchange rate expectations.

The sheer size of the United States economy is another important factor. For the United States to finance a current account deficit of 3 per cent of gross national product and also continue its current rate of external lending and investment, foreign investors have to be willing to add very large amounts of dollar-dominated assets to their portfolios. According to estimates by OECD, the private sector outside the United States absorbed about $23.5 billion a year in dollar-denominated assets from 1975 to 1982. This swelled in the current recovery period, reaching a peak of $96.5 billion in 1985. In 1987, they took only $8.4 billion and, as noted above, the dollar was extremely weak that year. Foreign demand for dollar assets can thus be quite volatile and the ability of the United States economy to sustain a large payments deficit clearly hinges on the size of the foreign demand for dollar assets. In 1988 and 1989, that demand was sufficient to absorb the full supply and indeed the strength of the dollar implied that even more dollar assets would have been taken had they been available. At the present time, foreign portfolios are growing and the dollar share of those portfolios appears to be increasing (especially in early 1990 as far as Japanese investors are concerned). The dollar share, however, will stop growing at some point as investors cannot but be aware that the larger the share, the greater the exposure to the exchange rate risk. Thereafter, the growth of the foreign demand for dollar assets would grow no faster than the growth of the portfolios themselves, which OECD estimates to be in the order of 10 per cent a year.[26]

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[23] See *World Economic Survey 1988* (United Nations publication, Sales No. E.88.II.C.1), box IV.3.

[24] The classic statement of this scenario is Stephen Marris, *Deficits and the Dollar: the World Economy at Risk* (Washington, D.C., Institute for International Economics, December 1985).

[25] See Federal Reserve Bank of New York, *Seventy-fourth Annual Report* (April 1989), p. 32.

[26] See OECD, *Economic Outlook*, No. 46 (December 1989), table 17.

But exchange rate expectations are notoriously variable and often inexplicable. The point was amply demonstrated by the dollar's weakness in 1987. The most common reason given at the time was growing scepticism about the political determination to reduce the United States fiscal deficit. But it appeared to be more a matter of a subjective shift in sentiment and attitudes among market participants than a change in objective conditions. Though there was no decisive change in political intent in 1988, the dollar again strengthened. What this suggests is that the dollar exchange rate will remain highly vulnerable to shifts in expectations so long as the duration of the current account deficit appears so open ended.

Confidence has been bolstered since the 1985 Plaza Accord by the co-operation of central banks both in the management of interest rate changes and in their intervention in foreign exchange markets. This has smoothed changes in exchange rates and has ensured fairly orderly adjustments, at least thus far. But for confidence to be maintained, market analysts will look to see progress in correcting the underlying United States saving-investment imbalance, especially in the light of the new opportunity to reduce the Government deficit as part of the "peace dividend".

Volatility of stock markets

Concern about other financial conditions has also been expressed, such as bank failures arising from regulatory changes or the rising level of corporate indebtedness in the United States (see box VIII.2). Sudden plunges in prices of the equity shares traded on stock markets have long been feared as a possible source of financial panic and economic disruption. New life has been breathed into the fear by the severity of recent price declines on Japanese and United States stock markets. It has been magnified, too, by concern that with the liberalization of international capital flows and the technological advances in communications, tremors in one market can be transmitted to other markets throughout the world almost instantly. The dark picture can be drawn of a stock market collapse in one leading country that could have repercussions not only on stock markets abroad but also on real economic activity both at home and abroad; the linkages run between stock markets, from stock markets to domestic economies, and through international trade to the economies of other countries.

But with the technical improvements of recent years in communications, it is easy to be overimpressed by the extent to which national stock markets have become more closely linked. Certainly, the technical changes and—more important—the dismantling of exchange controls on capital movements, along with the deregulation of national financial markets, have extended these links. National markets have been opened to trading by foreign brokerage houses; and there is a continuing trend towards diversification of investment portfolios to include the equity stock of several countries. Macro-economic imbalances between domestic saving and investment have also enlarged cross-border flows in the 1980s. Still, in relation to the size of domestic equity markets, foreign participation remains modest, and the notion that cross-border activity could by itself transmit a sharp price decline from one market to markets elsewhere appears an unsubstantiated fear. Indeed, there is no evidence that the degree of sympathy in price movements among national markets has increased since the globalization of markets took place. Even in the crash of October 1987, there was little evidence that cross-border transactions were the transmitter of price declines. What brought about the concurrent movements was the loss of confidence experienced by investors elsewhere in response to the unsettling news of the United States stock market's collapse.[27] They responded much more calmly to the subsequent decline in October 1989, largely because they had learned from the earlier experience that a large fall need not spell disaster. The relative quiet in the world's markets in the first quarter of 1990, as the Tokyo stock market was undergoing a very major correction in the prices of what most analysts believe were highly overvalued shares, is another case in point.

From an aggregate demand viewpoint, the importance of the volatility in stock markets rests mainly on its effects on private consumption. It was earlier noted that the large rise in the price of equity stock in the years after 1982 probably had an effect in stimulating household consumption expenditure; and sharp drops could be expected to do the opposite. The extent to which equity holdings figure in the wealth of households varies considerably among countries, but in all major market economies, the dominant components are not equity stock but real estate, bonds and liquid assets. Still, econometric investigations of the "wealth effect" on consumption expenditure find a significant response to fluctuations in equity prices. Thus, many expected that the stock market collapse of 19 October 1987 would—especially in the United States—appreciably reduce domestic consumption expenditure and—through external linkages—adversely affect output elsewhere. However, real private consumption expenditure in the United States decelerated sharply only in the last quarter of 1987; in subsequent quarters throughout 1988 and into 1989, consumption expenditure resumed its growth, if somewhat less vigorously than in the early recovery years. The most plausible explanation for the apparently negligible wealth effect is that households did not regard the speculative rise in equity prices during 1987 (which the fall did no more than cancel out) as a permanent gain in wealth. As such, it appears that the response of households to a fall in equity prices depends upon the general economic situation within which it takes place and the public's perception of the nature of the fall.

The present concern with stock price behaviour was first sparked by the 1987 crash of the United States stock exchanges. Since the end of the Second World War, there have been three occasions on which prices fell by more than 3.5 per cent in a single day, and all three occasions have occurred within the past three years. These large price declines can be regarded as "corrections" made to bring equity prices back

[27] For a fuller discussion of these points, see Thom B. Thurston and Barry Herman, "Some recent issues and evidence in the behaviour of world equity markets", Department of International Economic and Social Affairs of the United Nations Secretariat, *Working Paper Series*, No. 12 (August 1989).

Box VIII.2. The rising level of corporate indebtedness in the United States

A frequently expressed fear of recent years—especially in the United States—has been over the rising levels of corporate indebtedness relative to income. The belief is that the increased debt burden is likely to make real economic activity more vulnerable to events that adversely affect the credit standing of borrowers.

Most of the increase in indebtedness in the United States can be traced to the wave of corporate mergers and acquisitions that took place during the decade. The debt has been incurred by corporations or individuals to acquire equity in other corporations, leading to a net substitution of debt for equity at the national level. There were comparable waves of corporate restructuring and realignment in the late 1950s and early 1960s, in the 1920s and in the early 1900s. How far they are beneficial is a matter of much controversy. Proponents argue that they stir up lethargic managements, strip corporations of unprofitable or extraneous activities and enhance efficiency. The managements of highly leveraged corporations can indeed be under more external pressure to adhere in their decisions to the criterion of profitability than managements subject only to the weak discipline of annual shareholders meetings. On the other hand, critics point to the preoccupation of managements with launching or defending themselves from financial takeovers rather than with the business of managing their corporations efficiently and devoting enough attention to long-run product and process development. The high yield bond market (the "junk" bond market) has been an innovative means through which numerous acquisitions have been financed and it has been in this market that growing doubt about the wisdom of more recent takeover bids has been expressed.

In evaluating whether the resulting increase in the stock of corporate debt has threatened corporate solvency in general, the relevant comparison is with changes in the total value of assets. When the assets of non-financial corporations are measured in the standard way at "book value", what emerges is that the ratio of debt to assets has risen in the 1980s in the United States, while it has remained stable or fallen in Canada, the Federal Republic of Germany, Japan and the United Kingdom (see table).

Book value, however, is generally a significant understatement of the actual value of corporate assets. There is no simple way to measure in practice what the full value of an enterprise is, including, for example, its value as a going concern with an established company name and reputation. One solution is to say that the implicit financial market assessment should be used to estimate the value of the assets of a firm; that is, by the balance-sheet identity, the total value of assets equals total liabilities plus the value of equity, and the latter can be measured at market value. By that measure, as the table shows, the debt-to-asset ratio has remained stable in the United States while in the other countries it has fallen. This implies that corporations, despite the increase in their total outstanding debt, are no more prone to the risk of insol-

Ratio of gross debt to total assets of the corporate sector in major market economies, 1970-1987

	1970	1975	1980	1985	1986	1987
	Assets at book value					
Canada	0.54	0.61	0.59	0.58	0.57	0.57
Germany, Federal Republic	0.65	0.65	0.66[a]	0.63	0.62	0.60[a]
Japan	0.85	0.85	0.84	0.81	0.81	
United Kingdom	0.53	0.54	0.53	0.53	0.53	
United States	0.49	0.45	0.44	0.48	0.50	0.51
	Assets at market value					
Canada	0.50	0.58	0.54	0.47	0.45	0.45
Germany Federal Republic of	0.72	0.76	0.81	0.71	0.70	0.77
Japan	0.86	0.83	0.84	0.73[a]	0.63	0.59
United Kingdom	0.51	0.64	0.63	0.52	0.48	0.48
United States	0.45	0.52	0.50	0.50	0.49	0.51

Source: Bank for International Settlements, *Fifty-ninth Annual Report* (June 1989), pp. 84-85.

[a] Break in the series.

into line with their fundamental values, and there are several theories about speculative activity to explain why the corrections were delayed and cumulated instead of being made in small increments on a daily basis. In addition, part of the blame has been laid at the door of "programme trading", an arbitrage technique that is dependent on the execution of large-scale transactions without delay, which was made feasible by the computerization of markets. After the crash of 19 October 1987 when the United States stock market fell by 23 per cent, several new trading rules were introduced in an effort to brake future declines, the most important being the "circuit breakers", which suspend trading if prices drop beyond stated limits. The collapse of 13 October 1989, when prices fell 7 per cent in two hours, was not as severe, but it is still an open question whether the price volatility of the past two and a half years will be dampened down by recent measures.

To the degree that the market is intrinsically volatile, it will be important that its immediate effects be isolated. It could otherwise threaten the stability of the financial system. The recent cases when prompt action by monetary authorities made liquid funds readily available to temper the losses in asset values illustrate what is needed. However, when used this way, control of the money supply is not available as a tool to curtail inflation.

The greatest danger arising from volatile drops in equity prices is that they could directly diminish business or house-

vency today than they have been during the past 10 to 15 years.[a] The possibility of a liquidity crisis, however, is another matter.

It is sometimes noted, by way of reassurance for those concerned about rising corporate indebtedness in the United States, that the ratio of debt to assets is considerably higher in Japan and the Federal Republic of Germany. This does not mean, however, that the risks of default are higher in these countries. As between the Federal Republic of Germany and Japan on the one hand, and Canada, the United Kingdom and the United States on the other, the differences in leverage appear to derive largely from institutional characteristics and, to some extent, from government policies. In the former countries, financial relations between the investors and the corporations are often closer; in the Federal Republic of Germany, for example, the banks that lend to corporations may also be shareholders in the corporations. In addition, lending is concentrated in the hands of fewer creditors in those countries and Governments participate more in underwriting loans to the private sector. The general effect of these features is to lessen the default risk because lenders will endeavour and be well placed—to keep them solvent.[b]

However, this does not dismiss all the fears that arise from the increasing indebtedness of the corporate sector. Indeed, the burden of servicing United States corporate debt has increased in relation to corporate earnings.[c] Thus, while insolvency may seem no greater a risk than before, it appears that there is now a greater danger of corporations facing severe liquidity problems in the event of a sizeable fall in earnings. During the depths of the 1981-1982 recession, interest payments amounted to some 24 per cent of the cash flow of non-financial corporations, while by 1989 when earnings were much more buoyant—they absorbed some 31 per cent. For the most heavily leveraged corporations, default could be the inescapable consequence of a large downturn in earnings. One simulation exercise suggested that, if the 1981-1982 recession were to repeat itself, the rate of bankruptcies would rise to twice the current levels.[d] It should be remembered, however, that the 1981-1982 recession was particularly severe and was accompanied by exceptionally high interest rates. Rates of bankruptcy rose, moreover, since the last recession but have fallen since 1987, and in 1989 when interest rates rose and economic activity slowed, the number of United States business failures declined by the largest amount since 1978.[e]

Under the usual variations in economic parameters, most corporations should thus be able to operate without distress. But the vulnerability of large, heavily leveraged corporations and the exposure of their bank creditors, in particular, pose a serious risk. An anti-inflationary monetary policy that erred overmuch on the side of restriction could precipitate a wave of bankruptcies that might seriously undermine the financial sector and general business confidence. There is a strong need to avoid having to undertake new rescue efforts in the United States financial sector. Although the full cost to the United States Government of resolving the crisis in the savings and loan sector is disputed, common estimates exceed $300 billion. Financial institutions need to strengthen their balance sheets, especially those with substantial holdings of junk bonds, but this takes time. Meanwhile, the rise in corporate indebtedness restricts the room for manoeuvre open to the monetary authorities to contain inflation.

[a] In the case of Japan, where average share prices plummeted about 25 per cent in the first quarter of 1990, the unusually low ratio of gross debt to total assets of corporations would be expected to return to more usual levels.

[b] This also tends to reduce the risk premium incorporated in the interest paid by corporations on their loans and helps to lower the cost of capital in these countries.

[c] There is a discrepancy between the stability of the debt-to-assets ratio when assets are measured at market value and the increase in the debt-servicing burden. It arises because equity prices have been used to indicate the market value of assets and equity prices have risen relative to corporate earnings.

[d] Ben S. Bernanke and John Y. Campbell, "Is there a corporate debt crisis?", *Brookings Papers on Economic Activity*, No. 1 (1988), pp. 83-125.

[e] Data of Dun and Bradstreet Corporation, New York, March 1990.

hold confidence. In times of great uncertainty, a fall in stock market prices could be read as a harbinger of recession, causing enterprises and households to rein in their spending as a precautionary measure. In more buoyant and confident times, both enterprises and households may be more disposed to view stock market gyrations with detached scepticism.

The role of policy

Ten years ago, policy makers looked back on the economic turmoil of the 1970s and made major reassessments of the role of policy and the scope for the public management of developed market economies. This led several economies, including the largest ones, to adopt a new and more-or-less common strategy for policy in the 1980s. That strategy can be summarized as initial strict control of aggregate demand (except in the United States), primacy of monetary policy for economic management, building confidence in policy intentions by avoiding the "stop-go" approach of earlier times, and emphasis on "supply-side" reforms to increase the flexibility of production and exchange and raise the profitability of investment (albeit at the expense of reducing labour's real income growth). As the discussion in this chapter sought to

show, the strategy achieved much of its intended purpose in that, after a sharp recession, inflation was brought down to acceptable levels and an economic recovery was set in motion that has continued to the present day. But the ambition of the strategy went further, namely, to so alter the structure of the economies as to make them more flexible and competitive, less prone to inflationary pressures and less vulnerable to economic shocks. On these dimensions, the evidence is not yet in.

One unmitigated success of the 1980s strategy has been the relative stability of prices. This owed much to the tight monetary policies adopted at the outset. They broke the prevailing inflationary expectations and, through sharply increasing unemployment, altered the negotiating balance in wage settlements. Monetary policy gained a credibility that preserved its effectiveness in later years. However, the task of preserving price stability was much eased throughout the recovery years by the weakness of primary commodity prices and in particular by the fall in energy prices.

Divergences in fiscal policy among the leading countries have played a fortuitous role in stimulating and sustaining the post-1982 recovery. In Japan and Western European countries, high priority was given to the reduction of budget deficits; it was believed that, along with a tight monetary policy, this would restore business confidence and set off an investment-induced expansion.[28] Actually, the initial stimulus to their recovery came from the export sector as it responded to rising economic activity in North America. While sharing the aim of reducing the relative size of government in national expenditure, policy makers in the United States were more influenced by the view that lower income taxes would encourage greater work and effort. The large tax cuts, however, were not accompanied by reductions in public spending, and in the recessionary conditions then prevailing, their effect was to raise private consumption expenditure and set off a strong upswing in economic activity.

By mid-decade, however, the imbalances that were part and parcel of the new policies had reached alarming dimensions. There was a great deal of concern in the United States and in other countries about the excessive United States fiscal deficit, while concern was also widespread about the unsustainable pattern of exchange rates and international payments imbalances, especially among the Federal Republic of Germany, Japan and the United States. The payments problem also raised the spectre that intensifying protectionist pressures could undermine an already weakened multilateral trading system.

A new element was therefore added to the policy strategy of the major economies, namely, to co-ordinate their macro-economic policy in order to eliminate inconsistencies and promote convergence of policy aims. This took the form, on the one hand, of formal summit meetings and meetings of finance ministers and central bank governors and, on the other hand, of close informal discussions and joint intervention in foreign exchange markets. In the United States, meanwhile, the political stalemate that allowed the budget deficit to soar past $200 billion in 1985 was also addressed through the Balanced Budget and Emergency Deficit Control Act of 1985 (the Gramm-Rudman-Hollings bill), which mandated across-the-board budget cuts according to a formula whenever a properly legislated budget at a specified maximum deficit could not be adopted.

The upshot was that fiscal policy in the United States edged towards a reduced budget deficit in the second half of the 1980s, while the Federal Republic of Germany and Japan relaxed their tight fiscal policies somewhat. Larger changes were seen in monetary policy, as the money supply grew more rapidly and interest rates fell in all three countries in 1986, helping to support economic growth which was beginning to slacken. At the same time, the size of the change in interest rates differed among the countries so that the inflation-adjusted interest rate in the United States fell relative to that in the Federal Republic of Germany and Japan. This reduced the incentive to hold dollar assets and thereby lowered the demand for dollars and the dollar exchange rate.[29]

The effect of the policy measures and subsequent amendments agreed at meetings at the Louvre and in Venice in 1987, coupled with the unexpected terms-of-trade gain from the sharp drop in oil prices in 1986, helped steer economic growth along the desired low inflation path. Although the absolute size of the internal and external imbalances were being corrected very slowly, they came to be seen as less threatening since GDP was rising steadily. Confidence in the revised policy strategy was high, especially as various potential disasters were successfully averted, including the sharp drop in the private financing of the United States payments deficit which threatened the collapse of the dollar in 1987 and the plummet of stock prices in markets around the world in the same year.

Policy-making in the 1980s, however, may be judged as less than a complete success. The collapse of Japanese stock prices this year is seen by some as a belated result of an unwarranted tripling of stock prices from 1985 to the end of 1989 that—like the soaring real estate market in Japan—suggested there was an excess of liquidity in the economy over several years. In any event, Japanese interest rates have now been raised significantly[30] and are forecast to rise further under the current outlook. Aggregate demand, however, may not continue as strong as believed before the crash; that is, it cannot be taken for granted that the sudden stock market correction will not slow down the Japanese expansion. Policy makers will perforce be feeling their way in setting macro-economic policy in this new environment.

The decade also ends with limits to the ability of the

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[28] Budget deficits had risen to substantial levels as a percentage of gross national product, and confidence in the effectiveness of fiscal policy as an expansionary instrument had ebbed. It was believed that fiscal expansion, though it might temporarily raise output, would sooner or later be dissipated in higher prices and wages. Further, borrowing to finance budget deficits would "crowd out" private investment.

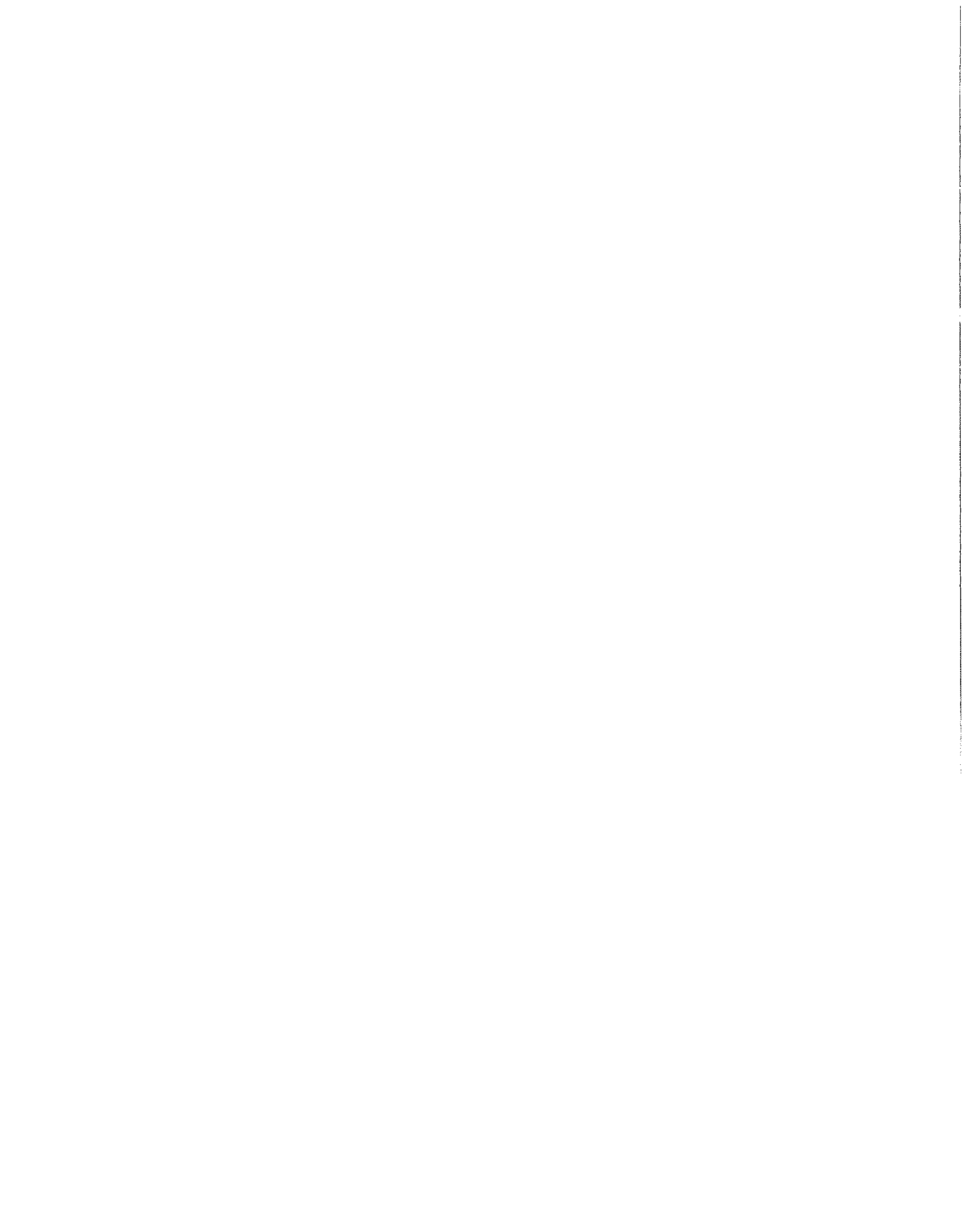
[29] On the meaning and measurement of such real interest rates and their relationship to exchange rates in the major market economies, see *World Economic Survey 1989*..., chap. VII

[30] For example, by March, various short-term interest rates were two-thirds to three quarters higher than a year earlier

United States to tighten monetary policy while prices are starting to rise more rapidly. The restriction is tied to a certain fragility of the United States financial system discussed above. But to say there is less scope for United States monetary policy is not to say that it is impotent, especially if, unlike in the 1980s, it does not have to work against an excessive fiscal impulse. In other words, fiscal policy might be used in tandem with monetary policy to contain inflationary pressures, as through appropriate timing of peace-dividend deficit reductions. What is of some concern, however, is that United States inflation seems to be gathering steam while economic growth is still relatively slow.

During the 1980s, the Federal Republic of Germany was the anti-inflationary anchor of Europe. Now, however, the plan for monetary and economic unification with the German Democratic Republic will restrict the ability to set monetary conditions during a transition period that surely will last several years. As it is, inflation is forecast to rise to levels that would have been unacceptable a few years ago, although it is forecast to be accompanied by relatively strong growth of output (see chap. II).

The new decade begins with expectations of moderate overall economic growth and increasing rates of inflation. But inflation is rising from a low starting point and the commitment of the Governments of the major economies to contain it is as strong as ever. Moreover, if the structural changes sought in the 1980s for labour markets have succeeded in making wages more flexible, if the growth of productivity is poised for an increase, if the household saving rate rises in the United States and falls in the surplus countries, if confidence in the long-run growth of demand sustains investment rates, if the tightening world energy markets are successfully managed to avoid any sudden discontinuities in prices and if wealth holders around the world continue to allocate a large part of their incomes to dollar assets, then the potency of macro-economic policy might not have to be fully tested.



Chapter IX

SPECIAL ISSUES

A. SOCIO-ECONOMIC ATTAINMENT OF WOMEN

In the preceding issues of the *World Economic Survey*, for 1988 and 1989[1] broad indicators on the socio-economic attainment of women were presented, with particular attention to the participation of women in economic activity. The present analysis discusses income distribution, education, health, nutrition and fertility.[2] Emphasis is placed on examining progress made in the access of women to the development process and to advances in technology and medical science.

A different aspect of the socio-economic attainments of women concerns their participation in political affairs.[3] Around the world, women are participating more actively in public life, as voters, administrators and members of government. This section includes a survey of the political role of women around the world, with special emphasis on the radical changes in Eastern Europe.

Income distribution

The starting point for an analysis of income distribution is usually the national accounts. However, it is not possible to determine from the national accounts the paid, let alone the unpaid, contribution of women, nor the degree of equality in the distribution of income and benefits or the distribution of property and wealth between men and women. The statistics currently published are generally not disaggregated by gender, and the present concepts and definitions of production omit the contribution of women to economic activity.[4]

National accounts statistics usually treat the household as a single economic unit, whereas many of the inequalities confronting women arise from their treatment within the household. Parents tend to provide more opportunities for education to boys in the expectation that they will provide economic support for them in their old age. The investment that the family makes in boys is being paid for, partly, by girls both in the short term by their present household labour and in the long term by the consequences of their lack of education.

Some household surveys in which the economic activities of individual family members are assessed provide an indication of the inter-family division of responsibilites and benefits by gender. They also make it possible to make rough estimates of the value of non-compensated economic activity. However, it is difficult to translate such results into a measure of income distribution by gender.

The difficulties of assessing women's contribution to and rewards from economic activity are especially great in developing countries. However, labour force statistics reveal many important aspects of women's economic roles: their participation rates, their status as employers and own account workers, employees or unpaid family workers.

Table IX.1 shows the share of females in the work force. There is a higher percentage of women in all categories of employment in the developed than in developing countries, which reflects the fact that their participation falls within the market economy and is thus better measured.[5] A notable feature of the table is that in each region the female share of unpaid family workers is higher than the female share of the other categories. Unpaid women family workers are often a major part of the work force in agriculture and make a major contribution to production. However, as much of this work is in subsistence agriculture, where production does not enter the monetary economy, it goes unnoticed in national accounts. In some countries, however, attempts have been made to measure the value of women's output in subsistence agriculture. This raises women's contribution to family income considerably. In Nepalese villages, for example, the female contribution to household money income was reported as 22 per cent, but when account was taken of the value of their subsistence agricultural output, their full economic contribution increased to 53 per cent of total household income.[6]

Including estimates for the value of subsistence agriculture production in national accounts does not cover fully the value of female labour. Many other activities undertaken by women go unaccounted: food processing for household consumption, health care, education and housework.

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1 *World Economic Survey 1988* (United Nations publication, Sales No. E 88 II C 1) and *World Economic Survey 1989* (United Nations publication, Sales No. E 89.II.C.1). For a full discussion of the role of women in development, see also *1989 World Survey on the Role of Women in Development* (United Nations publication, Sales No. E 89 IV 2).

2 The data for this analysis came largely from the United Nations Women's Indicators and Statistics Data Base for Microcomputers (WISTAT), prepared by the Statistical Office of the United Nations Secretariat in co-operation with UNICEF, ILO, FAO, UNESCO, WHO, and the Inter-Parliamentary Union. Information on WISTAT may be obtained from the Office of the Director, Statistical Office

3 The Commission on the Status of Women, at its 1987 session, selected *inter alia* the issues of equality in political participation and decision-making, under the priority theme "Equality". This decision was subsequently endorsed by the Economic and Social Council in its resolution 1987/24 of 26 May 1987. As part of its preparations for consideration of the priority theme, the Division for the Advancement of Women of the Centre for Social Development and Humanitarian Affairs assembled data on the incidence of women in decision-making positions world-wide. (See Commission on the Status of Women document "Equality: Equality in political participation and decision-making: report of the Secretary-General" (E/CN 6/1990/2))

4 For further details, see "Development of guidelines on national accounts for women's contribution to development" (E/CN 3/1989/12)

5 See *World Economic Survey, 1989*, pp 195-196

6 *Engendering Adjustment for the 1990s. Report of a Commonwealth Expert Group on Women and Structural Adjustment* (London, Commonwealth Secretariat, 1989), p 36

In developing countries, there are substantial differences between women's labour force participation rates in urban as opposed to rural areas. Statistics on urban/rural differences in developing countries are very sparse, however. Some are shown in table IX.2. In four sub-Saharan African countries, the rate of formal economic activity among rural women was greater than among urban women, in Latin America and the European countries the reverse was the case, while in Asia the picture was less consistent. In the countries with low rates of formal labour force participation—Afghanistan, Bangladesh and Pakistan—urban women had a higher rate of economic activity than rural women and in the other countries, with the exception of the Philippines, they had a lower rate.

Access by a woman to paid economic activity does not mean access to an income equal to that of a man. Women tend to be employed in less productive, lower paid sectors such as subsistence agriculture, personal services and labour-intensive manufacturing. Furthermore, both rural and urban women frequently find employment in small, family owned businesses, often as unpaid family workers.

Women are on an average paid less than men for similar work. Table IX.3 gives figures for male and female hourly remuneration rates in the formal non-agricultural sector for those countries for which there are data. In every case, women were paid less than men.

It is increasingly recognized that in many developing countries women who work in the informal sector provide the main economic support for themselves and their families. For many families, women's income from informal sector activities is indispensable for survival. This situation is seldom adequately realized by policy-makers, who continue to focus on the needs of organized male workers and on ways to provide employment for men considered to be the main bread-winners.[7]

Receiving a market income not only integrates a woman more closely into the economy but also increases her independence as an economic agent. Her independent income is of direct relevance to her socio-economic attainment, as paid remuneration itself frequently determines the distribution of benefits within the family. In areas where formal female labour force participation is low, such as in South Asia, the distribution of food and work responsibilities within the household tends to be more unfavourable to women than in areas where they are able to obtain an independent income.

In the developed market economies, there is a closer and more transparent relationship between a woman's participation in economic activity and the income she derives from it. Legislation has sought to ban earnings differentials based on gender and to remove restrictions on women's economic independence. Reforms continue: the United Kingdom of Great Britain and Northern Ireland, in 1990, ceased treating a married woman's income for tax purposes as that of her husband.[8]

In developed countries, data on labour force participation, and, where available, on the inter-family distribution of benefits are more reliable and provide some indication of present trends. Smaller families, more flexible working hours, and improving child care facilities, have meant that women in developed countries increasingly continue to work after becoming mothers. In the United States of America, for example, in 1987 the civilian labour force participation rate for women between the ages of 25 and 54 who had children under three years was 55 per cent, more than double the rate in 1967.

The relative number of households where the male is the sole income earner has fallen. In Canada, for instance, the percentage of husband-wife families in which the husband was the sole income earner halved in a decade—from 34.7 per cent in 1971 to 16.4 per cent in 1982.[9] In 1984, it was calculated that over one third of total family income in husband-wife families came from the wife.[10]

Thus, women's participation in economic activity seems to be increasing. At the same time, many obstacles still confront single mothers with small children, who often make up the majority of the poor. They need child care assistance and help in obtaining employment or appropriate training so as to prevent the increasing "feminization" of poverty in developed countries.

In Eastern Europe, formal mechanisms to assure women's equality in the work force have been in place for a considerable time. However, the high rates of economic activity among women in these countries were not accompanied by a more equitable sharing of domestic duties, including that of queuing for food and other consumer goods, with the result that women's full-time paid employment was added to their already considerable domestic work-load. Also, women's access to high-level decision-making positions in the economy was constrained by the extent to which they were under-represented in high-level positions in the party, which dominated both political and economic activity.

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[7] The United Nations International Research and Training Institute for the Advancement of Women (INSTRAW), with the co-operation of the Statistical Office of the United Nations Secretariat has been working to develop methodologies and guidelines to improve the measurement of women's informal activities. For a review and analysis of new methods and data to overcome present limitations, see *Methods of Measuring Women's Participation and Production in the Informal Sector: Technical Report* Series F, No. 46 (United Nations publication, forthcoming), and Economic Commission for Africa, INSTRAW and the Statistical Office, "Handbook on compilation of statistics on women in the informal sector in industry, trade and services" working draft, March 1990.

[8] For details of the arrangements, see "Economic progress report" No 206, February 1990 (London, Her Majesty's Treasury).

[9] *Women in Canada: A Statistical Portrait* (Ottawa, Statistics Canada, March 1985), p.75.

[10] *Women in the Workplace: Selected Data* (Ottawa, Statistics Canada, March 1987), table F-1, p.74

Table IX.1. Females in the different employment categories, latest available year

(Percentage)

	Economically active[a]	Employers and own account workers	Employees	Unpaid family workers
Developing countries[b]	29.0	22.2	25.8	55.5
Africa[c]	35.7	29.1	14.7	46.3
Asia[d]	27.1	22.2	25.7	59.8
Latin America and the Caribbean[d]	26.3	18.3	27.8	29.8
Developed marked countries	38.1	27.7	40.5	78.5

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Women's Indicators and Statistics Data Base for Microcomputers (WISTAT)

[a] The sample size for the total economically active population is greater than that for the different categories of the labour force

[b] Excluding China.

[c] Based upon 13 countries

[d] Based upon 22 countries.

Table IX.2. Rates of economic activity among urban and rural women in selected countries: 1980 census round

(Percentage)

	Rates of economic activity	
	Urban	Rural
Developing countries		
Africa		
Cameroon	30.4	54.4
Cote d'Ivoire	20.3	47.1
Malawi	25.5	64.8
Mozambique	48.0	91.8
Asia and Pacific		
Afghanistan	7.9	6.3
Bangladesh	5.8	4.3
India	12.8	35.2
Islamic Republic of Iran	10.2	16.5
Nepal	31.2	46.1
Pakistan	4.1	2.8
Philippines	32.6	16.7
Republic of Korea	30.4	52.5
Sri Lanka	23.9	26.6
Vanuatu	51.4	84.2
Latin America		
Argentina	28.6	16.7
Brazil	34.4	18.7
Ecuador	26.7	12.2
Developed market economies		
Austria	42.8	41.9
Canada	53.9	44.4
Denmark	50.4	46.7
Finland	52.4	43.0
France	42.6	33.9
Greece	23.6	28.2
Japan	45.2	52.0
Sweden	51.8	38.9
Eastern Europe		
Bulgaria	63.8	56.2
Hungary	53.2	46.6
Poland	54.1	65.6

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Women's Indicators and Statistics Data Base for Microcomputers (WISTAT)

Education

Equal educational opportunities are essential for all socio-economic attainments of women. At present, enrolment rates for women are generally lower than for men. Reaching equal proportions thus requires a faster expansion of female than of male enrolment, a decision to invest specifically in the education of women.

In the developed countries, in 1975 equality at the primary and secondary levels of education had been achieved. By 1987, equality had been achieved also in the third level (see table IX.4). During this period, the potential number of students rose very slowly—the number of children between 15 and 19 years of age increased by 1.1 per cent between 1970 and 1985—and as a result of the fast increase in enrolment, the gross enrolment rate for both males and females in the third level rose from 28 per cent in 1975 to 34 per cent in 1987.

In the developing countries the potential school population for all levels of education rose rapidly—the population of those aged between 5 and 19 rose by 35 per cent between 1970 and 1985.

By 1975, progress towards equality had been made at the primary level where 44 girls attend school for every 56 boys. In Latin America, equality in enrolment had been virtually achieved. At the secondary level, girls were 38 per cent of enrolment in the developing countries. By 1987, they were 40 per cent. At the third level, the disparities between male and female enrolment were greater. In 1975, there were 32 female students to 68 male ones and in 1987 there were 37 to 63. The number of those enrolled more than doubled, but female enrolment rose even faster.

The different regions—Africa, Asia and Latin America—all show a move to more equality in education and these overall regional figures point to a general trend across countries. For instance, of the group of 97 developed and developing countries for which data for secondary education were available for 1970 and 1980, only 11 countries showed a trend towards greater inequality between those two years.[11]

Virtually universal enrolment for primary education has been achieved in Latin America and in many Asian countries, but not in Africa, where gross enrolment at the first level was only 76 per cent in 1987—84 per cent for boys and 68 per cent for girls. At the secondary level, gross enrolment ratios in developing countries in 1987 varied from about 25 per cent in Africa to 55 per cent in Latin America.

Enrolment ratios do not measure the quality of education or whether there is any difference between the quality of the education delivered to boys and girls. However, the disparity between the education of girls and boys was recently brought out by the World Conference on Education for All: Meeting Basic Learning Needs, held in Thailand in March 1990.[12] Table IX.5 gives some idea of the effects of the disparity. It shows figures for rates of illiteracy among those between 15 and 24 years of age. In the developed countries, the rates of illiteracy in this age group are normally less than 1 per cent. In each developing country grouping, the figures are based upon very limited numbers of countries, but they show considerable illiteracy among young adults who were recently of school-age—on average, 25 per cent among males and 40 per cent among females. In Latin America, rates of illiteracy were the lowest of the developing country regions, and about equal for males and females. The significant difference was to be found between urban areas (about 5 per cent) and rural areas (over 26per cent). In other groups of developing countries, rates of illiteracy were considerably higher among women than among men.

Another measure of bias in an educational system is the percentage of students who actually complete a particular level of education. When there is pressure within the family for a student to drop out, either because of the financial burden or because of a need for extra assistance in economic or domestic activities, or simply because further education is not considered worth while, it is usually the female students who are "chosen" to discontinue their studies.

The effect of this is illustrated in table IX.6, which gives the percentages, in the 1970 and 1980 census rounds, of males and females aged between 20 and 24 years who had entered the secondary level of education or higher, and the ratio of male to female enrolment. The figures thus reflect the actual educational attainments of men and women who completed their studies fairly recently. The regional figures are aggregates of a limited number of countries. This is especially the case for Africa.

The census figures show that in the developing countries a greater proportion of young people aged between 20 and 24 had entered secondary school in 1980 than in 1970: nearly 38 per cent of men (24 per cent in 1970) and 26 per cent of women (13 per cent in 1970). In all regions, women were less disadvantaged than in 1970. In Latin America and the developed countries, the ratios of men and women who had entered secondary school were approximately equal. China had a comparatively high percentage of young people who had entered secondary school. A group of fast-growing exporters of manufactures in Asia had the most equal ratio of men to women who had entered secondary studies, which confirms the general impression that modernization and rapid economic growth are linked to an educated female population.

There is a correlation between women's educational at-

[11] The calculation was:
(f1980/m1980)/(f1970/m1970).
Where f1980 was the number of female students in a particular country in 1980 and m1980 the number of male students. A result of less than 1.0 indicated a trend away from improving access

[12] United Nations Children's Fund, "World Conference on education for all: Meeting Basic Learning Needs, Jomtien, Thailand, 5-9 March 1990". (E/ICEF/1990/L.14)

Table IX.3. Wage differentials in non-agricultural activities

Country or area	Women's wages as percentage of men's		
	1970	1980	1986/87
Developed regions			
Australia	74[a]	86[a]	87
Belgium		69	74
Czechoslovakia		68	68
Denmark	74	84	82
France[b]	87	87	89[c]
Germany, Fed. Rep. of	69	72	73
Iceland, unskilled wage earners	78	86	90
Japan, employees		54	52
Luxembourg		65	65
Netherlands		78	77
ew Zealand		77	79
Switzerland	63	68	67
United Kingdom	60	70	70[c]
Africa			
Egypt	61	64	
Kenya, employees		80	76
Swaziland, unskilled wage earners[a]		69	73
United Rep. of Tanzania, employees		85	92
Asia-Pacific			
Cyprus		54	59
Hong Kong[d]		76	74
Jordan, employees		83	79[c]
Republic of Korea		44	50
Singapore[e]		63	69[c]
Sri Lanka		92	75

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Women's Indicators and Statistics Data Base for Microcomputers (WISTAT).

[a] Including agriculture, hunting, forestry and fishing

[b] Based on hourly wage rate rather than on actual earnings

[c] 1983/84

[d] Based on daily wage rate rather than on actual earnings

[e] Including agriculture, fishing and sea transport.

Table IX.4. Indices for pupils enrolled at different education levels; percentage of females in total enrolment, and gross enrolment

(1975 = 100; percentages in parenthesis)

	1975		1980		1987	
Developing countries						
Total enrolled	100	(48.6)	116	(50.2)	132	(51.5)
1st level	100	(92.8)	111	(94.8)	119	(99.1)
2nd level	100	(31.0)	131	(35.3)	166	(40.1)
3rd level	100	(4.6)	140	(5.7)	216	(7.4)
Females enrolled	100	(41.9)	117	(43.8)	135	(45.6)
1st level	100	(82.9)	112	(85.3)	122	(90.9)
2nd level	100	(24.2)	136	(28.5)	176	(33.2)
3rd level	100	(3.0)	149	(4.0)	249	(5.6)
Percentage of females in enrolment	42		42		43	
1st level	44		44		45	
2nd level	38		39		40	
3rd level	32		34		37	
Developed countries						
Total enrolled	100	(73.7)	98	(73.5)	100	(77.3)
1st level	100	(101.0)	96	(101.4)	95	(101.8)
2nd level	100	(84.6)	98	(84.4)	100	(91.3)
3rd level	100	(28.4)	109	(30.3)	118	(34.1)
Females enrolled	100	(72.6)	100	(73.5)	102	(77.1)
1st level	100	(100.9)	96	(101.1)	95	(101.3)
2nd level	100	(84.4)	100	(85.8)	101	(91.6)
3rd level	100	(25.4)	118	(29.4)	134	(33.9)
Percentage of females in enrolment	48		49		49	
1st level	49		49		49	
2nd level	49		50		50	
3rd level	44		48		50	

Table IX.4. *(continued)*

	1975		1980		1987	
Africa						
Total enrolled	100	(33.3)	152	(42.4)	186	(44.5)
1st level	100	(64.9)	147	(79.5)	169	(76.0)
2nd level	100	(15.0)	175	(23.0)	264	(31.4)
3rd level	100	(2.5)	170	(3.5)	252	(4.3)
Females enrolled	100	(27.0)	159	(35.5)	199	(37.8)
1st level	100	(54.4)	154	(69.2)	183	(68.2)
2nd level	100	(10.4)	187	(16.9)	290	(23.2)
3rd level	100	(1.3)	178	(1.9)	283	(2.5)
Percentage of females in enrolment	39		41		42	
1st level	41		43		44	
2nd level	33		35		37	
3rd level	25		27		29	
Asia						
Total enrolled	100	(50.9)	112	(50.8)	124	(51.7)
1st level	100	(98.5)	106	(96.7)	110	(104.3)
2nd level	100	(34.9)	126	(37.9)	156	(42.0)
3rd level	100	(4.7)	135	(5.6)	203	(7.3)
Females enrolled	100	(43.7)	112	(43.8)	126	(45.3)
1st level	100	(87.8)	106	(86.4)	113	(95.3)
2nd level	100	(27.3)	129	(30.5)	163	(34.6)
3rd level	100	(2.8)	144	(3.6)	245	(5.2)
Percentage of females in enrolment	42		42		42	
1st level	43		43		44	
2nd level	38		39		40	
3rd level	29		31		35	
Latin America						
Total enrolled	100	(58.7)	120	(63.6)	139	(67.4)
1st level	100	(97.0)	115	(104.8)	127	(107.8)
2nd level	100	(36.6)	139	(44.9)	180	(53.7)
3rd level	100	(11.7)	133	(13.5)	188	(16.9)
Females enrolled	100	(57.2)	121	(62.5)	141	(66.5)
1st level	100	(95.5)	115	(103.3)	126	(105.5)
2nd level	100	(35.7)	144	(45.4)	191	(55.6)
3rd level	100	(9.9)	138	(11.7)	205	(15.7)
Percentage of females in enrolment	48		49		49	
1st level	49		49		48	
2nd level	48		50		51	
3rd level	42		43		46	

Source: United Nations Educational Scientific and Cultural Organization, *Statistical Yearbook 1989*, tables 2.4, 2.6 and 2.10

Table IX.5. Comparison of rates of illiteracy among those aged 15-24, by gender and by urban and rural areas: 1980 census round

(Percentages)

	Total[a]	Urban	Rural
Developing countries (excluding China)			
Male	25.7	9.7	27.4
Female	40.3	13.4	37.9
Africa			
Male	31.8	15.7	39.6
Female	57.4	37.9	66.7
Latin America			
Male	11.9	5.6	26.3
Female	11.9	6.1	26.2
Asia			
Male	28.5	12.8	26.6
Female	45.9	18.6	37.7
China			
Male	4.8	1.5	5.4
Female	17.9	4.0	20.5

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Women's Indicators and Statistics Data Base for Microcomputers (WISTAT)

[a] The size of the sample for total illiteracy rates was greater than that for the urban and rural areas

tainments and fertility reduction, child survival and nutrition. These consequences are, quite apart from considerations of equity, a powerful justification for investment in women's education at these levels.

At the third level of education, more specific and higher advanced skills are imparted. Several factors work to improve women's enrolment in growing countries: economic growth makes it possible to afford third level educational facilities and to break down old customs and practices; Governments move towards greater equality in education, and the labour market calls for more educated women.

There are no criteria for how extensive third-level education should be. In the developed countries the ratios of enrolment vary considerably: for example, in 1986, the gross enrolment ratio for men and women at the third level was 22.3 per cent in the United Kingdom, 32.9 per cent in Norway and 58.2 per cent in Canada.[13] Moreover, third level education in statistics of the United Nations Educational, Scientific and Cultural Organization (UNESCO) is divided into "universities and equivalent institutes" and "other third level institutes", such as teacher training colleges or institutes conferring a professional qualification. While female enrolment at "other institutes" is often higher than male enrolment, female university enrolment very rarely equals male university enrolment.

Enrolment ratios for females in science and technology are particularly low. Women's entry into these fields is restricted by the factors that militate against them at all stages of education. Drop-out rates among girls are high and deficiencies in their earlier education deprive many girls of the necessary mathematics and science training. In addition, there is a lack of female scientists who could serve as role models for girls wishing to pursue studies in science and technology. In some African countries, however, even though the economic crisis has reduced funding for research and cut academic salaries, the percentage of female students in architecture and design, building engineering, engineering, science and veterinary medicine is rising.[14]

Health

Women have a dual role in health care. First, they have distinct and significant health needs related in part to their reproductive function during pregnancy and childbirth; and secondly, they are the informal providers of health care in the family and form the majority of professional health workers in the community. It is women who are expected to be health educators; to teach sound health practices to future generations; to create a home environment that is conducive to health (from clean water to nutritious food); to assume the major role in family planning; to ensure that children are immunized and cared for during the crucial years and to take them to the formal health care services when necessary; and to care for the elderly.

Variations in life expectancy at birth among regions and countries are considerable. Africa has the highest mortality levels, with a life expectancy at birth of only 52 years for females and 48 for males in 1980-1985 and 54 years for females and 50 for men in 1985-1990 (see table IX.7).

South Asia also has relatively high mortality. Life expectancy at birth in Bangladesh, Bhutan and Nepal was estimated to be lower for women than for men in 1985-1990 and equal in India and Pakistan.

Latin America and the Caribbean have the second highest level of female life expectancy among the world regions: 68.8 years in 1985-1990 compared to 77.2 in the developed countries.

Complications associated with childbirth are among the five leading causes of death for women aged between 15 and 44. It is impossible to measure accurately the number of women who die as a result of pregnancy, since most maternal deaths go unregistered in areas where the problem is most acute. A rough estimate is that about 500,000 women die annually as a result of complications during pregnancy (see table IX.8). Most of them are poor, live in remote areas, and their deaths are accorded little importance within the community. About 99 per cent of the world's maternal deaths occur in developing countries. Of live births, 14 per cent take place in developed countries but only 1 percent of maternal deaths occur there. Over half the total of maternal deaths occur in Asia, nearly one third million each year. Three quarters of these deaths occur in India, Pakistan and Bangladesh. Most of the remaining deaths (150,000 a year) occur in Africa.

Maternal mortality rates, which measure the risk of dying from a given pregnancy, are highest in Africa where they are estimated at 640 per 100,000 live births. The risk of dying from maternal causes is somewhat lower in urban areas, though rates of over 500 per 100,000 live births have been reported in several cities.[15]

In many developing countries, the high risks associated with child-bearing have a dominant effect on overall female life expectancy. In some rural areas of South Asia, of every two deaths of women of reproductive age one will be pregnancy related.[16] In general, for a woman living in the poorer parts of the world, where early death is already a common event, maternal mortality augments the risk of dying by at least one third, and in some remote rural areas by as much as 85 per cent.

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[13] United Nations Educational Scientific and Cultural Organization, *Statistical Yearbook 1989*, table 3-2.

[14] See Economic Commission for Africa, "Report on strategies for improving women's access to education and training in science and technology in Africa" (E/ECA/ATRCW/RCIWD 4/5), pp 19-20.

[15] Erica Royston and Sue Armstrong, eds., *Preventing maternal mortality* (Geneva, World Health Organization, 1989), pp 31-32.

[16] *Ibid.*, p 36

Table IX.6. Young people, aged 20-24, who had entered the second level of education or post-secondary studies, 1970 and 1980

(Percentage)

	1970		1980		Male/female ratio in 1970	Male/female ratio in 1980
	Male	Female	Male	Female		
Developing countries or areas	24 0	13 2	37 6	26 1	183	138
Africa	26 2	10.4	29 1	15 5	252	187
Asia	22.6	9 1	37 7	23 5	250	160
Hong Kong, Republic of Korea, Singapore and Thailand	39 7	26 4	55 3[a]	47.0[a]	150	118[a]
South Asia	20 7	6 8	36 5	18 9	306	193
Latin America and the Caribbean	28 9	25 9	38 4	38 3	112	100
China	..	..	73 1	51 7	..	
Developed market economies	80 6	80 2	92 3	91.9	101	100
Europe	60 4	54 1	78 9	76 0	112	104
North America	88 8	89 6	97 8	98 3	99	100
Eastern Europe	67 4	64 4	80 6	80 9	105	100
USSR	87 6	89 4	..	.	98	..

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Women's Indicators and Statistics Data Base for Microcomputers (WISTAT).

[a] Hong Kong, Republic of Korea and Thailand only.

Table IX.7. Life expectancy at birth, by region

Regions	1975-1980	1980-1985	1985-1990
World			
Both	58 1	59 6	61 5
Male	56 9	58 2	60 0
Female	59 4	61 1	63 0
Developed			
Both	71 7	72 3	73 4
Male	67 9	68 5	69 8
Female	75 6	76 3	77 2
Developing			
Both	55 8	57 6	59 7
Male	55 1	56 6	58 6
Female	56 7	58 7	61 0
Africa			
Both	48 1	49 9	51 9
Male	46 5	48 3	50 3
Female	49 7	51 5	53 6
Asia[a]			
Both	57 5	59 3	61 7
Male	57 1	58 6	60 9
Female	57 9	60 0	62 6
South Asia			
Both	52 0	54 4	56 9
Male	52 4	54 5	56 9
Female	51 6	54 4	57 0
Latin America			
Both	62 8	64 5	66 0
Male	60 4	61 9	63 4
Female	65 3	67 2	68 8

Source: World Population Prospects, 1988 (United Nations publication, Sales No E 88 XIII 7)

[a] Including China and Japan

Table IX.8. Maternal Mortality

(Estimates, latest available year)

Region	Maternal mortality rate (per 100,000 live births)	Maternal deaths (thousands)
World	390	500
Developed countries	30	6
Developing countries	450	494
Africa	640	150
Asia	420	308
South Asia	650	230
Latin America	270	34
Oceania	..	2

Source: Maternal Mortality Rates: A tabulation of available information, 2nd ed (Geneva, World Health Organization, 1986), p 3

Nutrition

Poor nutrition weakens maternal health, and reduces working capacity. Improving women's nutritional status should, then, improve women's health and increase productivity in both household and economic activities.

Anaemia is a condition in which there is a reduction of the concentration of haemoglobin in the bloodstream to a level below the norm. This deficiency of red blood cells is more likely to affect women in the reproductive age: their routine blood loss during childbirth and menstruation causes them to need three times more iron than men. Nutritional anaemia is one of the major causes of death among women in developing countries, and affects both psychological and physical health. It increases susceptibility to diseases, lowers resistance to fatigue and reduces working capacity. Moreover, it affects women with especial severity during pregnancy when they are already vulnerable to stress. It is estimated that at least half of non-pregnant women and two thirds of pregnant women in developing countries are anaemic,[17] compared with 14 per cent in developed countries[18] (see figure IX.1). In Africa, three of every five pregnant women and two of every five non-pregnant women are anaemic. In South Asia, two of every three pregnant women and over half the non-pregnant women are anaemic.

Hardships imposed by poor nutrition, water shortages, inadequate food entitlements, and absence of effective social security systems all combine to undermine women's health and cause anaemia as well as other debilitating diseases. Lack of specific nutrients also have an especially harmful effect upon women. For instance, lack of calcium and vitamin D, may cause deformities of the pelvic bones resulting in difficulties during childbirth.

Many studies relating women's work-load to child health indicate the effects of the former on women's own health. A heavy work-load for women tends to produce a poorer diet, not only for their children and other members of their families, but also for the women themselves.

The hours of work necessary for women to fulfil their functions is one of the most important factors affecting their health and general well-being. When time spent on work outside the household is added to that spent on household activities insufficient time is left for the rest required for good health. Studies from many different countries in all regions indicate that women work longer hours than men.[19]

Fertility and family planning

The total fertility rate is defined as the average number of children that would be born to a group of women in the childbearing ages if they are not depleted by mortality. The total fertility rate in developed countries has been declining, from 2.03 in 1975-1980 to slightly below 2 in 1980-1985 (see table IX.9). Fertility decline is now well established in most of the developing world, although fertility levels and trends vary markedly.

Summarizing the distribution of developing countries across the stages of fertility transition, 27 countries with a combined population of 288 million are still at the pre-transitional stage, characterized by high and stable or rising fertility.[20] Most of those countries are in sub-Saharan Africa. While 48 per cent of the population of sub-Saharan Africa lives in the countries where the average fertility is pre-transitional, that proportion drops to 26 per cent in Northern Af-

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[17] Erica Royston, "The prevalence of nutritional anaemia in women in developing countries: a crucial review of available information", *World Health Statistics Quarterly*, vol 35, No 2 (1982), pp 52-91

[18] E. Demaeyer and M Adiels-Tegman, "The prevalence of anaemia in the world", *World Health Statistics Quarterly*, vol 38, No 3 (1985), pp 302-316

[19] J. Leslie, M Lycetter and M Buvinic, *Weathering Economic Crises: the Crucial Role of Women in Health* (Washington, D C. International Centre for Research on Women, 1986)

[20] *World Population Monitoring, 1989* (United Nations publication, Sales No E 89 XIII 12), p 118

Table IX.9. Total fertility rate

(Per woman)

Region	1975-1980	1980-1985	1985-1990
World	3.84	3.61	3.44
Developed	2.03	1.93	1.90
Developing	4.54	4.19	3.92
Africa	6.52	6.37	6.23
Asia[a]	4.06	3.72	3.45
South Asia	5.27	5.14	4.72
Latin America	4.38	3.98	3.61

Source. *World Population Prospects, 1988* (United Nations publication, Sales No. E.88.XIII.7).
[a] Including China and Japan

rica, 1 per cent in South Asia, and zero in Eastern Asia and Latin America.

In Africa, the total fertility rate remained in the range of 6.5 to 6.4 children per women from 1975-1980 to 1980-1985. The small decline is mostly attributable to the downward fertility trends in the Northern African region. In the rest of Africa, with only a few exceptions (Cape Verde, Mauritius, Réunion) most countries show no sign of notable fertility decline.[21] Fertility is expected to continue to fall in Asia, from 4.1 in 1975-1980 to 3.4 per cent in 1985-1990 and to 3.0 in 1995-2000. In Eastern Asia there has been a steep and continuous decline in fertility. For most of Latin America and the Caribbean, fertility during the last two decades declined notably. The total fertility rate in Latin America and the Caribbean was 4.0 in 1980-1985 and was estimated to fall to 3.6 for 1985-1990.

The poor maternal health in many countries is a compound of two factors—high fertility and the high health risks for a pregnant woman. The international debate on the determinants of fertility decline centres on the relative importance of the level of socio-economic development, the cultural setting and government population policy. However, it has also been established that there are a number of behavioural and biological factors which, in all countries, increase the risk of a women developing complications which, if appropriate help is not available, could take her life. Her nutritional and health status prior to pregnancy, her age, and the number of prior pregnancies have been found to be particularly important.

Although the age of marriage and first pregnancy is rising in many developing countries, there are still many in which 50 per cent of first births are to women under 19 years. Births to women who are not fully mature can permanently injure their health: the maternal mortality rate in the under 19 age group is up to three times that in the 20-24 year age-group. In rapidly expanding urban areas, adolescents in developing countries are beginning to experience the same problems as adolescents in industrialized countries, such as increased numbers of out-of-wedlock pregnancies and abortions, and an increased incidence of sexually transmitted diseases with high risk of subsequent infertility. At the other extreme, when children are born to women over 35 years of age there is also a high risk of infant and maternal mortality and morbidity.

Family planning services and information can improve maternal and child health by helping women to time and space their pregnancies. About three fourths of maternal deaths are direct obstetrical deaths, resulting from haemorrhage, severe infection, obstructed labour, toxaemia and complications from abortion. In addition, when the mother dies, the chances of her young children surviving diminish sharply. Moreover, it is estimated that 8 million women each year experience non-fatal pregnancy-related complications, including permanent disability and chronic health problems. The risk of death from each of these causes, in turn, reflects several underlying factors. First, the absence of family planning and prenatal care that could preclude or minimize the emergence of problems such as abortion, sepsis and obstructed labour; second, the lack of trained personnel to treat adequately problems such as haemorrhage and septicaemia in the home or local health clinic; and third, the speed with which childbirth-related emergencies, such as haemorrhage, can develop. However, about half of the maternal deaths and much of maternal morbidity in developing countries could be eliminated within a decade through relatively low-cost measures.[22]

Induced abortion is probably the most widely used method of limiting the number of children. Both induced and spontaneous abortions are widespread. Many women are so desperate to end unwanted pregnancies that they seek illicit and dangerous abortions. Up to 200,000 women a year die as a result of illegal abortions and the health of many more is permanently damaged.[23]

One of the most effective health interventions for the prevention of maternal mortality and morbidity is pre-natal

[21] *Ibid.*, p.123

[22] Barbara Herz and A.R. Measham, *The Safe Motherhood Initiative: Proposals for Action*, World Bank Discussion Papers, No. 9, (Washington, D.C., 1987)

[23] *Women, Health and Development*, WHO Offset Publication, No.90, (Geneva, World Health Organization, 1985), p.8. The proportion of maternal deaths due to illegal abortion is approximately 20 per cent in Bangladesh, 29 per cent in Ethiopia, 64 per cent in Chile and 86 per cent in Romania (*Safe Motherhood Initiative Newsletter* No. 1, November 1989-December 1990 (Geneva, World Health Organization), p. 7

care, particularly where the general health status of women is very poor. In addition, an essential element of maternal care is that every women should have the assistance of a trained person during labour, whether birth takes place at home or in hospital. In the early 1980s, while practically all births in developed countries were attended by a qualified midwife or doctor, only 64 per cent of births in Latin America, 49 per cent in Asia (even taking into account the 98 per cent figure for China), and only 34 per cent in Africa were attended by trained persons.[24] Intensive efforts are required in the training and deployment of midwives to achieve the objective of giving every woman in labour the chance of skilled attendance. The upgrading of existing traditional birth attendants and their incorporation into the national health system has been widely considered as the most practical response to the problem.

Health education, both in schools and the community, can do much. The danger of very early marriage and adolescent pregnancy should be stressed in lessons on reproductive health. Other appropriate subjects are the advantages of spacing pregnancies and the reasons that pre-natal care is necessary.

The recognition that improvements in the health and social status of women provide the key to their equitable and effective participation in overall socio-economic development is being translated into action at the international level. In particular, Governments, agencies, non-governmental organizations and other groups and individuals decided to co-ordinate efforts to reduce the number of women suffering and dying as a result of pregnancy and childbearing. This led to the Safe Motherhood Initiative Conference, held in February 1987 at Nairobi, sponsored by the World Bank, the World Health Organization (WHO) and the United Nations Fund for Population Activities. The target set was to reduce maternal deaths by at least half by the year 2000. The Initiative aims at enhancing the quality and safety of girls' and women's lives through the adoption of a combination of health and non-health strategies. It places special emphasis on the need for better and more widely available maternal health services, the extension of family planning facilities and effective measures to improve the status of women.

Activity within the Initiative takes many forms: increasing awareness of the dimensions of the problem and the need for action; strengthening maternal health services; training health workers and others; facilitating educational and economic opportunities for women; and, research, particularly operational research.

Urbanization

In 1990, it is estimated that about 43 per cent of the world's population live in urban areas.[25] In the developed regions and Latin America, between 70 and 80 per cent of the population live in urban areas. In Asia, including China, about 30 per cent of the population live in urban areas and in Africa some 33 per cent.

Urban areas offer advantages for women that, normally, cannot be as readily found in rural areas: opportunities for employment in manufacturing and service industries, hospitals and universities, and a more modern society in which those traditional values operating against women are less powerful.

But urbanization in the developing countries has also been a rapid process, resulting in the unplanned growth of squatter settlements around established urban centres. As a result, the differences between established middle class neighbourhoods and burgeoning squatter settlements are frequently very great. In Karachi, for instance, rates of infant mortality in the middle class area of the city were low and the disease pattern was similar to that in an industrialized country; but infant mortality rates in the squatter settlements were as high as 95 to 145 per thousand live births and there was a high incidence of malaria, gastroenteritis, diarrhoeal diseases and infectious diseases.[26] The crude birth rates in the middle class areas were less than half of those in the squatter settlements.

Many of the statistics relating to urban areas come from the 1980 census round. These do not, therefore, fully capture the effect of the economic recession and the debt crisis of the 1980s. Spiralling inflation, reductions in government services, and diminished employment opportunities have reduced urban living standards in many developing countries.

The rapid growth of urban areas has made it difficult for housing, clean water, sewerage, transportation, and health and educational facilities to keep pace with needs,[27] but such services are still more readily available in urban than in rural areas.

Housing facilities have a major impact on the ability of women to perform their domestic functions and to care for children. They are generally inferior in rural areas. Table IX.10, which is based on partial data and cannot be used for inter-regional comparisons, shows that in Africa, Latin America and Asia the percentage of dwellings without piped water, toilet facilities or electricity is considerably higher in the rural than in the urban areas.

How conditions in rural and urban areas are translated into health conditions and fertility rates is seen in table IX.11 which is based on interviews with women aged between 40 and 49 years, at the end of their child-bearing years. Rates of fertility were lower in urban than in rural areas and were lowest in the urban areas of the most urbanized region—Latin America. However, fewer children survived in rural

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24 Royston and Armstrong, *op. cit.*, pp 166-167

25 See *World Economic Survey, 1989*, table S III 5, pp 223-226

26 "Population growth and policies in mega-cities: Karachi" (ST/ESA/SER R/77), p 3

27 For detailed discussions of the problems of mega-cities, see the series "Population growth and policies in mega-cities" (ST/ESA/SER R-) produced by the Population Division of the Department of International Economic and Social Affairs of the United Nations Secretariat

areas in all three regions: whereas 90 per cent of the children born to the women interviewed in the urban areas had survived at the time of the interview, the comparable figure for the rural areas was 81 per cent. The net result was that the number of children surviving was more equal between rural and urban areas than the number of children actually born.

The process of urbanization will continue. It has the potential to improve work opportunities and living standards for women. However, it is a process in which government has to provide adequate infrastructure and services, and land for urban growth. In the Republic of Korea, it has also been the Government's policy since around 1970 to develop the country's rural areas to reduce rural out-migration and to strengthen the country's social fabric. The Government promoted the New Village Movement as an integrated community development movement. Efforts were made to raise rural incomes, partly through the establishment of rural industries.[28]

Women, democratization and political participation

Participation was a major theme of the United Nations Decade for Women: Equality, Development and Peace, 1976-1985. During the Decade, the Convention on the Elimination of All Forms of Discrimination against Women was adopted in 1979, and it entered into force in 1981.[29] As of March 1990, there were 101 states parties to the Convention.

It is now increasingly realized that expanding the effectiveness of women's participation will, as stated in the Convention, benefit the "development of a country, the welfare of the world and the cause of peace".[30] Women are, however, still severely underrepresented in the decision-making categories of the labour force.[31]

Participation by women in political, economic and social activity cannot be compartmentalized. Voters and legislators set the national agenda and determine matters related to women's economic activity.

1989 was a year of profound political change. Many of the political institutions that had been established in Eastern Europe in the aftermath of the Second World War were drastically revised. The societies emerging in the aftermath of the events of 1989 are attempting to create multi-party parliamentary democracies where political rights will be fully respected.

While the events in Europe were perhaps the most dramatic of 1989, in many other parts of the world democracies were becoming more firmly entrenched and the prime importance of human rights was more widely acknowledged. The full role of women in these events, and the effect that they will have on women can only be assessed a few years from now. However, greater democratization opens up new possibilities for all members of society, but particularly for women, to play a more effective role in national decision-making as voters and legislators.

The issues of interest to women in the political process cover a wide range. They include matters of interest to them as politically aware members of society, such as foreign policy, national security and defence, environmental issues or economic policy. They also include matters of clear interest to them as women, such as equality in economic activity, the provision of maternal delivery and family planning services and legal protection against abuse or discrimination; and issues of interest to them as mothers, such as the provision of child care facilities, more flexible working arrangements that will enable them to fulfil their roles as mothers and members of the labour force, and protection for single-parent families.

Women's concerns and views could have a major impact on national decision makers and on election results, especially as women make up the majority of the voting age population in most countries. In the analysis of election results, differences have been noted in male and female voting patterns.[32] Similarly, many differences between male and female perceptions have been brought out in political polls and surveys. One such survey, in Sweden, suggested that women are more concerned about street violence and the risk of war.[33]

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[28] "Population growth and policies in mega-cities: Seoul" (ST/ESA/SER.R.64), p. 23.

[29] For the full text of the Convention, see *Human Rights: A Compilation of International Instruments* (United Nations publication, Sales No. E.88.XIV.1), pp. 112-125.

[30] Preamble to the Convention on the Elimination of All Forms of Discrimination against Women. *Ibid.* p. 113.

[31] In the latest year for which data were available, only 3.2 per cent of the female labour force in the world was in the category "administrative and managerial workers", whereas 4.5 per cent of men were in this category. See *World Economic Survey, 1988* pp. 153-154.

[32] For instance, in the 1984 presidential election in the United States, exit polls suggested that 63 per cent of men and 56 per cent of women voted for the winning Republican candidate. (*The Economist*, 10 November 1984, p. 20). The importance attached to disaggregating voting intentions by gender attests to the importance of female voting patterns.

[33] See *Living Conditions, report No.58, Inequality in Sweden, Trends and Current Situation* (Stockholm, Statistics Sweden, 1988). In 1984/85 20.5 per cent of the women questioned, as opposed to 4.1 per cent of the men questioned, had decided during the previous year not to go out at night for fear of being assaulted, robbed or otherwise molested (p. 248). Single mothers were especially concerned about violence. As regards the family economy, women, and especially single mothers, were far more concerned than men or parents of larger families or people living alone (p. 249). Women were slightly more concerned about becoming unemployed than were men, but a really sharp difference could be seen in the number of women who were concerned over the world situation. Whereas only 63.3 per cent of men questioned in 1984/85 had recently felt worried about the world situation, for example the risk of war, fully 81.8 per cent of women questioned had expressed this concern (p. 248).

Table IX.10. Differences between urban and rural dwellings in developing countries; units without piped water, toilets or electricity; 1980 census round

		Dwellings without		
		Piped water	Toilet	Electricity
			(percentages)	
Africa	Total	56	36	49
	Urban	35	32	28
	Rural	85	57	71
Latin America	Total	48	32	47
	Urban	22	15	20
	Rural	80	55	81
Asia	Total	55	28	54
	Urban	36	13	28
	Rural	77	39	87

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Women's Indicators and Statistics Data Base for Microcomputers (WISTAT) The percentages show the unweighted averages of a number of countries in each region

Table IX.11 Births and survival of children in rural and urban areas

	Rural	*Other urban*	*Major urban*
Mean children ever born			
Africa	6 5	6 0	6 1
Latin America and Caribbean	7.1	5 9	4 8
Asia and Oceania	6 6	6 1	5 8
Total	6 8	6 0	5 4
Percentage of children ever born who were still alive at interview			
Africa	75	79	81
Latin America and Caribbean	87	90	94
Asia and Oceania	81	87	89
Total	81	86	90
Mean number of living children			
Africa	4 9	4 7	5 0
Latin America and Caribbean	6.2	5 3	4 5
Asia and Oceania	5 3	5 3	5 2
Total	5 5	5 1	4 9

Source: Fertility Behaviour in the Context of Development (United Nations publication. Sales No E 868 XIII 5), pp 192-193

Women's representation in government

Women's formal representation in government is a guide to their influence in the decision-making process. Trends in such figures, if interpreted with caution, can be useful.

Table IX.12 gives figures for female representation in the four highest level decision-making positions in government in different regions. In no region did females occupy 10 per cent of these positions. Similarly, women's participation in legislative bodies is low except in China and, before the elections in 1989 and 1990, in Eastern Europe and the Union of Soviet Socialist Republics, where it was over 25 per cent (see table IX 13). However, female representation has tended to increase over time in all regions. This was particularly marked in Africa, Latin America and the Caribbean and the developed market economies.

The figures in table IX.13 give weighted averages for each region. Within each region there are marked differences among countries, even where they share similar political traditions, and where women have enjoyed the right to vote since before the Second World War. For instance, recent figures for elections to the lower house, indicate that women occupied only 5-6 per cent of seats in Australia, the United Kingdom and the United States, as against over 30 per cent in

Denmark, Finland, Norway and Sweden.[34] New Zealand, the first country in which women won the right to vote, in 1893, was in the middle of the range, with 14 per cent. Political parties there are trying to increase female representation without using quotas.[35]

The importance attached to securing greater representation by women in legislatures is itself an indication that women's formal participation in political life does help to set the political agenda. One specific example of this concerns the provision of public day care in Sweden. Sweden provides extensive child care facilities: on an average, public day care is available for 47 per cent of Swedish children aged between birth and six years. These provisions significantly help women to combine family rearing with paid work; 85 per cent of mothers of pre-school children participate in the paid labour market. From a cross-section analysis within Sweden itself, it was found that a factor of particular importance in determining the availability of child care facilities was the proportion of women among elected community officials.[36]

Table IX.12. Women in the four highest levels of government,[a] by region

(Percentage)

Region	*Women in high government office*
Africa	3.6
Asia and the Pacific	2.2
Latin America and the Caribbean	6.0
Eastern Europe	3.7
Western Europe and Other	7.5

Source: United Nations Economic and Social Council; priority theme "Equality": "Equality in political participation and decision-making: report of the Secretary-General" (E/CN.6/1990:2), p. 2

[a] The figures cover the four highest levels of government: Minister, Deputy/Assistant Minister, Secretary of State, Permanent Secretary or equivalent, Deputy of State/Director of Government Department or equivalent.

Table IX.13. Women in legislatures, 1975 and latest year

(Percentage)

	Upper House, 1975	Lower House, 1975	Upper House, latest	Lower House, latest
Developing countries	5.7	6.0	6.6	8.6
Africa	.	4.3	9.3	6.3
Latin America and Caribbean	4.2	4.0	6.5	10.6
Asia and Pacific	6.7	7.7	6.3	9.2
China		22.6		26.9
Developed market economies	4.2	6.4	7.2	11.5
Europe	3.4	7.5	6.9	13.3
Eastern Europe	24.7[a]	23.5	29.3[a]	27.2
USSR	30.5	32.1	31.1	34.5

Source. Department of International Economic and Social Affairs of the United Nations Secretariat, based on Women's Indicators and Statistics Data Base for Microcomputers (WISTAT)

[a] Czechoslovakia only

[34] Figures from *Compendium of Statistics and Indicators on the Situation of Women, 1986* (United Nations publication, Sales No E/F 88.X-VII.6)

[35] Their strategy is to build up active womens' organizations within the parties, and to take steps to remove difficulties facing female candidates running for office, for example by providing food to the woman and her family while she is campaigning and child care (Keynote address by Hon. Margaret Shields (New Zealand) in *Inter-Parliamentary Symposium on the Participation of Women in the Political and Parliamentary Decision-making Process: Reports and Conclusion*. Reports and Documents, No 16, (Geneva, Inter-Parliamentary Union, 1989), pp 47-52.

[36] Centre for Economic Policy Research, *Bulletin*, No 36, (December 1989), p.13 (reporting on a lunchtime discussion by Siv Gustafsson). To test whether there is evidence of a more general connection in the developed market economies between female representation and the enactment of policies that advance equality, a regression was run, using WISTAT data, between female parliamentary representation and the ratio of economically active women to economically active men aged 24-44 in the year 1985. The hypothesis was that societies that had facilitated women's participation in the labour market, by such steps as providing extensive child care programmes, could be expected to have relatively high rates of female labour force participation. A positive and significant relationship was found. The correlation coefficient (R^2) was 0.36

Women as agents of democratization

The large percentage of women in the unreformed legislatures of Eastern Europe is in part a reflection of the very considerable advances that those societies had made in giving women a role in the economy, and especially in the labour force where participation rates were high. Also, rates of enrolment in higher education were high for women and often surpassed male enrolment. However, in spite of such advances, the socio-economic situation did not meet expectations and, in particular, was felt throughout society not to justify the denial of democratic rights.

Women felt the economic deterioration particularly acutely. Not only did they have to perform a regular job in the labour market—and, as in most other countries, they tended to be employed in occupations where rates of pay, working conditions and responsibilities were relatively low—but after work they spent long hours queuing for basic supplies. They also felt directly the lack of adequate hospital facilities for themselves and for their children and the effect on family health of the rising levels of pollution.[37]

The unfavourable situation for women in Eastern European countries as opposed to other European countries can be seen from infant and maternal mortality rates.[38] By 1987, the majority of Western European countries had reduced their infant mortality rates to 10 per thousand or below. Only in the German Democratic Republic was this rate achieved. Little progress was made in the Soviet Union—from 26 in 1965 to 25 in 1987.

Changes in maternal mortality rates after 1970 show progress being made in both regions but with generally better results in Western than in Eastern Europe. A startling exception was Romania where the draconian anti-contraception policies of the previous regime had contributed to a maternal mortality rate of 149 per 100,000 live births in 1984—almost ten times higher than the unweighted average of the other Eastern European countries.

The figures for Romania vividly illustrate the connection between democratization, social progress and women's rights. In Romania, women were in the forefront of the demonstrations against the régime in 1989 and many gave their lives in the struggle. One of the first acts of the new Government was to rescind the previous régime's anti-contraception legislation.

For women's participation in political activity to be truly effective, they must work through political structures that are themselves effective. As noted above, women's participation in the unreformed legislatures of Eastern Europe was higher than in the rest of Europe. It was highest in Romania. Yet the Eastern Europe legislatures did not play the role of translating popular wishes into legislation through debates among delegates chosen in an open electoral process. In 1989, a primary demand was the removal of restrictions on political activity and for free elections open to all parties.[39]

The round table discussions between the previous authorities and the proponents of reform that prepared the way for free elections, the elections themselves and the on-going changes of the socio-economic system have all presented women with challenges to ensure their full participation, particularly in matters most directly affecting them.[40] For instance, in the German Democratic Republic a concern has been that the transition process should not result in a set of social protection provisions, including child care facilities, inferior to the existing ones.[41]

Eastern Europe is not the only region where women have played a major role in political developments. In other regions, whether in Southern Africa, Asia or Latin America, women have been in the forefront of the struggle for democratic freedoms, often exploiting to the full the degree of protection that their gender, and their status as mothers or grandmothers, confers upon them.[42]

With the re-establishment of democracy in Latin America, various women's movements started to develop closer relations with the State and legislative power and women's concerns were given greater weight. For example, in 1985, in Brazil, the National Congress adopted a law creating the National Council for Women's Rights, which later made an important contribution to the establishment of women's rights in the new Constitution. Of demands and proposals made by women, 80 per cent were incorporated in the text of the Constitution.[43]

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[37] For instance, a study on new mothers in Krakow and Katowice in Poland showed concentrations of lead, mercury, cadmium and other toxic metals in the placenta of every woman. Another study in the Katowice region showed that 21 per cent of children up to four years were sick almost constantly, while 41 per cent of the children under 6 had health problems, including hearing or seeing disabilities, anaemia and low weight and height. 50 per cent of Czechoslovakia's water did not meet the established norms (*New York Times*, 6 April 1990)

[38] Figures for infant and maternal mortality rates are from *World Population Prospects, 1988* (United Nations publication, Sales No. E.88.X-III.7), and *Demographic Yearbook, 1988* (United Nations publication, Sales No. E/F.89.XIII.1)

[39] The preliminary results of the multi-party elections in Eastern Europe are that women's representation did fall. In Hungary, their participation fell from 21 per cent in the unreformed legislature to 7 per cent in the multi-party legislature (*Népszabadság*, 29 April 1990). Yet women have assumed important positions as a result of the more open, multi-candidate elections held in Eastern Europe and the Soviet Union. Similarly, women have assumed important positions in countries as a result of multi-party elections. For example, in Dominica, Iceland, India, Israel, Nicaragua, Norway, Pakistan, the Philippines, Portugal, Sri Lanka and the United Kingdom, women became Head of State or Government as a result of multi-party elections

[40] See, for instance, "Nun kommen wir", *Die Zeit* 23 February 1990

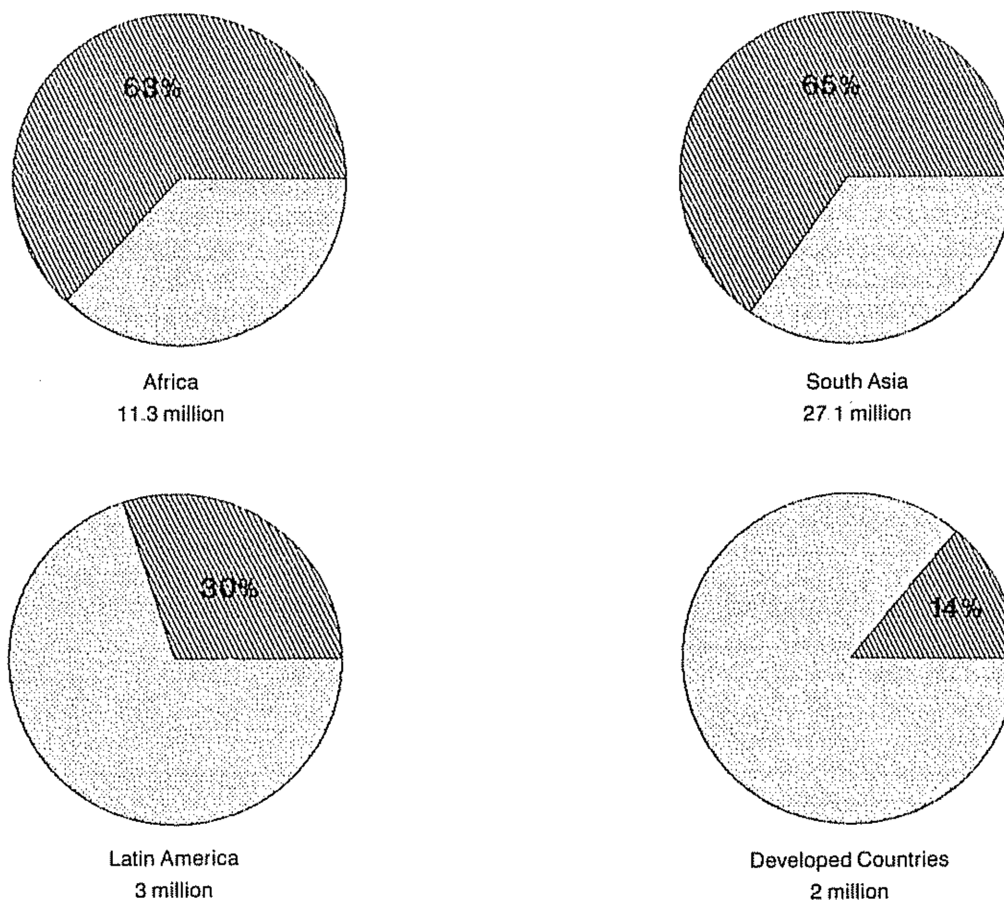
[41] *Der Spiegel*, 9 April 1990, p. 47

[42] For instance, the Women's Movement for Amnesty (Brazil), the Mothers of the Plaza de Mayo (Argentina), Women for Life (Chile) and the Women's Group (Uruguay) played an important role in the struggle for the re-establishment of democracy in their countries. In South Africa, the Black Sash movement is made up of women. Women played a major role in the previously banned movements in South Africa and Namibia. In the Philippines, women, including nuns, were in the front of the "People Power" human wall that prevented military units loyal to the previous President from making an assault on the forces that had declared their loyalty to President Corazon Aquino

[43] Keynote address by Mrs. Jacqueline Pitanguy (Brazil) in Inter-Parliamentary Symposium..., p. 43-44. For further details of developments in Latin America and the Caribbean, see Economic Commission for Latin America and the Caribbean, "Women and politics in Latin America and the Caribbean" (LC/L.515, September 1989)

The trend towards democratization is linked to an easing of tensions and conflicts in many parts of the world,[44] which is bringing about a re-assessment of domestic and foreign policies in many countries. As political tensions ease, and the need to build a society that can successfully compete in a more integrated world economy is brought into sharper relief, such issues as under-investment in ecological protection, in schooling, in child care, in social infrastructure, and in science and technology, are assuming greater importance in domestic political debates in many countries.[45] This reassessment of the national agenda presents many opportunities for women, as voters and legislators, to help set the national agenda and to ensure that their role in overall socio-economic development, and especially in economic activity and in the up-bringing and education of the young, is adequately reflected in new policies and the commitment of society's resources.[46]

Figure IX. 1. Prevalence of anaemia in pregnant women



Source. World Health Organization

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[44] It was estimated that 1989 marked the first time in 31 years that no new wars (i.e. conflicts with deaths of over 1,000) had started and that at least eight wars that were in progress in 1988 had ended and three more were probably winding down (Ruth Leger Sivard, *World Military and Social Expenditures, 1989* (Washington, D.C., World Priorities, 1989) p.23

[45] For instance, it is argued that the line between supposedly "soft" issues such as child care, and "hard" issues, such as defence, is disappearing. (Cf. *The Economist*, 28 April 1990, p.32; and keynote report presented by Brenda Mary Robertson (Canada) in *Inter-Parliamentary Symposium...*, p.23).

[46] One particular reassessment that is taking place in many countries is whether reductions in military expenditure are now possible, and how the resources released should be redirected. For instance, in the United States, a major newspaper suggested that the savings in military expenditure could amount to $150 billion by 1999 and that they should be spent largely on human resources and physical capital. It specifically mentioned spending $1 billion on giving comprehensive pre-natal health care to an additional 1.5 million poor pregnant women and an additional $1 billion to add 400,000 children to the Head Start programme (*New York Times*, 9 March 1990). Similar suggestions on redirecting government expenditures are being made in many different countries

B. SELECTED SOCIO-ECONOMIC INDICATORS

In the present section, statistics at the country and regional levels are given on three major topics of current interest—urbanization, food and agricultural production, and the production of electricity and consumption of motor gasoline. The statistics come from the data banks of the Statistical Office of the Department of International Economic and Social Affairs of the United Nations Secretariat and the Food and Agriculture Organization of the United Nations. These bodies carry out detailed studies of trends in urbanization, food production, and energy markets. The statistics are accompanied by a brief introduction showing the most important trends and some of the more significant deviations from them.

1. Urban and rural population growth, 1985-2000, and the growth of mega-cities, 1970-2000

Present estimates are that the world's urban population may reach 2.9 billion in the year 2000, a projected increase of 29 per cent over 1990. The world's rural population is projected to increase to 3.3 billion in the year 2000, an increase of 10 per cent. Table IX.14 gives estimates for the absolute size of the urban and rural populations for regions and individual countries or areas in the year 1990 and the growth rates of urban and rural populations in the periods 1986-1990, 1991-1995 and 1996-2000.

In the developed market economies, Eastern Europe and the USSR, the absolute population of the rural areas is estimated to continue to decline, and the size of the urban populations to grow, although at a decreasing rate. In the developing countries, rural populations should still continue to increase. The annual rate of urbanization, measured by the difference between the rates of urban and of total population growth, is estimated to be 0.3 per cent in the developed countries and 1.5-1.6 per cent in the developing countries in the period 1990-2000. Because of the faster urbanization in the developing countries, the size of their urban population is estimated to increase to 39.5 per cent of the total population in the year 2000. That of the developed regions is projected to increase to 75 per cent of their total population.

The typical developing country—as indicated by the median growth rate[47], which is shown in brackets—will experience a rate of growth of 4.1 per cent in urban population and 1.2 per cent in rural population in the period 1990-2000.

Major differences among regions will persist. In Africa, the typical country will experience a rate of urban population growth of close to 5 per cent in the 1990s. The corresponding rate will be about 4 per cent in Asia and somewhat above 2.5 per cent in Latin America. For the period 1996-2000, rural population growth is expected to decelerate in the majority of developing countries. The median rate of increase in rural population will be close to 1.5 per cent in Africa and West Asia, and below 1 per cent in China, India and also in South and East Asia as a whole.

Urban growth in developing countries has often not only been rapid but concentrated in a relatively few cities. The task of improving the standards of living and the quality of life of the inhabitants of the world's largest cities is a highly complex activity.[48] Table IX.15 gives the absolute size in 1970, 1985 and 2000 of those mega-cities which are estimated to have populations of over 10 million in 2000. In 1970, only four urban agglomerations had a population of over 10 million and only one, Shanghai, was in a developing country. In 1985, there were 11 urban agglomerations with populations of 10 million or more persons. Four of these were in more developed regions—Tokyo/Yokohama, New York, Los Angeles and London. The remaining seven were located in Latin America (Mexico City, Sao Paulo, Buenos Aires and Rio de Janeiro) and Asia (Calcutta, Shanghai and Seoul). By the year 2000, it is projected that there will be 24 such agglomerations. Only two of the additional 13 agglomerations will be found in the more developed regions (Osaka/Kobe and Moscow). The remaining 11 are expected to be located in the developing regions—nine in Asia and two in Africa.

The projections indicate that Mexico City, Sao Paulo and Tokyo/Yokohama may exceed 20 million persons by 2000. New York, Calcutta and Greater Bombay are projected to reach 15 million. Hence by 2000, four of the six largest agglomerations of the world will be located in developing countries.

The data in the tables for individual countries were compiled by the Population Division of the Department of International Economic and Social Affairs of the United Nations Secretariat. Within the United Nations system, the Population Division has the responsibility to provide comparable estimates and projections of populations of urban and rural areas and large urban agglomerations for countries. To do so, long-established and well-tested methodologies are used which incorporate the past history of urban and city growth for each country and historical norms for such growth throughout the world. Data describing the urban or rural character of settlements and populations or urban agglomerations are collected in population censuses and surveys and are available for most countries of the world. However, countries use diverse criteria to define such settlements

[47] The median is the value of the middle value when the items are arranged according to size. It is therefore affected by the number of items (in this case growth rates for each country), rather than by the size of extreme values, or by the weight that would be accorded to each country in a calculation of the weighted arithmetic mean.

[48] For a full discussion of the population policies and plans of some mega-cities in developing countries, see the series *Population Growth and Policies in Mega-Cities* (ST/ESA/SER.R).

Table IX.14 Urban and rural population and population growth, 1986-2000, medium variant[a]

Region and country or area	Population, 1990 (thousands) Urban	Rural	Annual rate of change (percentage) Urban 1986-1990	Urban 1991-1995	Urban 1996-2000	Rural 1986-1990	Rural 1991-1995	Rural 1996-2000
World	2 260 399	3 031 779	2.47	2.55	2.55	1.19	1.07	0.83
			(3.86)	(3.57)	(3.43)	(0.98)	(0.84)	(0.64)
Developing countries	1 373 432	2 697 565	3.59	3.59	3.51	1.39	1.25	0.97
			(4.24)	(4.16)	(4.01)	(1.36)	(1.16)	(1.22)
Africa	202 345	409 552	5.24	5.08	4.83	2.04	1.98	1.86
			(5.42)	(5.11)	(5.02)	(1.77)	(1.66)	(1.64)
Algeria	11 344	14 020	4.08	4.06	3.85	2.38	1.89	1.25
Angola	2 836	7 184	5.57	5.41	5.15	1.68	1.68	1.65
Benin	1 991	2 750	6.66	5.89	5.20	0.95	1.06	1.30
Botswana	303	982	7.61	7.04	6.37	2.40	2.21	1.98
Burkina Faso	812	8 194	5.37	5.86	6.24	2.42	2.52	2.52
Burundi	398	5 054	8.30	7.71	7.10	2.51	2.46	2.42
Cameroon	5 559	5 686	5.68	4.97	4.36	-0.01	0.22	0.61
Cape Verde	233	146	5.67	4.79	3.91	-1.05	0.16	1.38
Central African Republic	1 357	1 556	4.34	4.21	4.06	0.95	0.95	0.97
Chad	1 893	3 786	6.68	5.81	5.01	0.66	0.68	0.84
Comoros	143	375	4.95	5.11	5.16	2.46	2.34	2.15
Congo	842	1 152	4.09	4.30	4.45	1.79	1.56	1.32
Côte d'Ivoire	5 870	6 725	6.21	5.65	5.24	2.45	2.26	2.26
Djibouti	328	78	3.71	3.55	3.43	0.09	0.69	1.36
Egypt	26 381	27 678	3.52	3.35	3.17	1.67	1.12	0.60
Equatorial Guinea	284	156	3.91	3.53	3.20	-0.23	0.21	0.71
Ethiopia	6 044	40 699	4.26	5.18	5.50	1.70	2.25	2.22
Gabon	535	636	5.68	5.11	4.65	1.75	1.63	1.64
Gambia	193	665	5.08	5.11	5.03	2.22	1.96	1.63
Ghana	4 958	10 063	4.06	4.35	4.55	2.70	2.46	2.17
Guinea	1 763	5 113	5.36	5.23	5.04	1.57	1.52	1.45
Guinea-Buissau	304	684	4.60	4.62	4.56	1.06	1.11	1.12
Kenya	5 923	19 207	7.84	7.30	6.72	3.22	3.00	2.78
Lesotho	359	1 414	6.67	6.25	5.80	1.98	1.87	1.77
Liberia	1 124	1 429	5.33	5.09	4.81	1.64	1.69	1.76
Libyan Arab Jamahiriya	3 189	1 356	5.35	4.67	4.12	0.16	0.90	1.79
Madagascar	2 999	8 981	5.97	5.90	5.76	2.32	2.24	2.16
Malawi	1 244	7 183	7.38	7.05	6.60	2.69	2.60	2.44
Mali	1 793	7 568	4.20	4.71	5.12	2.65	2.58	2.44
Mauritania	852	1 173	6.62	5.66	4.85	0.32	0.44	0.77
Mauritius	467	636	1.34	1.73	2.06	1.18	0.81	0.39
Morocco	12 180	12 959	4.12	3.82	3.42	1.19	0.87	0.50
Mozambique	4 190	11 473	9.03	7.63	6.28	0.75	0.53	0.45
Namibia	1 068	807	5.27	4.76	4.46	0.73	0.68	0.89
Niger	1 385	5 725	6.74	6.50	6.19	2.21	2.22	2.20
Nigeria	39 732	73 284	5.92	5.68	5.33	2.20	2.14	2.02
Réunion	380	215	3.05	2.52	2.12	-0.45	-0.50	-0.40
Rwanda	555	6 677	7.60	7.45	7.17	3.08	3.05	2.90
Senegal	2 831	4 538	3.79	4.10	4.26	2.03	1.83	1.52
Sierra Leone	1 335	2 815	5.09	4.95	4.76	1.37	1.37	1.37
Somalia	2 748	4 807	5.55	4.44	4.73	2.15	1.08	1.45
Sudan	5 548	19 647	4.18	4.57	4.88	2.53	2.39	2.19
Swaziland	261	528	7.98	6.90	5.98	1.52	1.49	1.67
Togo	889	2 565	6.12	5.88	5.60	2.14	2.07	2.02
Tunisia	4 439	3 730	2.86	2.66	2.53	1.78	1.14	0.59
Uganda	1 923	16 519	5.53	6.10	6.57	3.26	3.22	3.10
United Republic of Tanzania	8 971	18 357	9.59	7.91	6.46	1.31	1.28	1.58
Zaire	14 209	21 781	4.67	4.80	4.73	2.25	2.10	1.80
Zambia	4 700	3 756	6.09	5.52	5.02	1.18	1.15	1.25
Zimbabwe	2 680	7 040	5.47	5.40	5.15	2.33	2.15	1.83

Table IX.14. (*continued*)

Region and country or area	Population, 1990 (thousands)		Annual rate of change (percentage)					
			Urban			Rural		
	Urban	Rural	1986-1990	1991-1995	1996-2000	1986-1990	1991-1995	1996-2000
South and East Asia	728 824	2 072 642	3.33	3.53	3.54	1.34	1.18	0.82
			(3.95)	(3.99)	(3.78)	(1.69)	(1.37)	(0.89)
Afghanistan	3 598	12 959	5.84	9.72	5.59	1.82	5.77	1.75
Bangladesh	15 759	99 834	5.44	5.57	5.56	2.27	2.19	2.00
Bhutan	81	1 435	5.43	5.90	6.25	1.98	2.04	2.01
Cambodia	959	7 287	3.96	4.19	4.22	2.29	1.92	1.36
China	243 475	892 021	2.16	2.65	2.95	1.18	0.97	0.58
East Timor	97	640	4.46	4.76	4.83	1.92	1.48	0.84
Fiji	329	419	2.93	2.58	2.43	0.61	-0.01	-0.38
Hong Kong	5 444	397	1.52	1.20	1.04	-0.74	-0.94	-0.97
India	238 946	614 427	3.94	4.07	3.96	1.40	1.26	0.93
Indonesia	51 975	128 539	4.18	3.96	3.62	0.67	0.45	0.14
Korea	46 854	19 665	3.24	2.57	2.11	-1.88	-1.67	-1.26
Democratic People's Republic of Korea	15 457	7 480	3.45	3.03	2.64	0.28	0.22	0.21
Republic of Korea	31 397	12 185	3.14	2.33	1.83	-3.10	-2.92	-2.38
Lao People's Democratic Republic	758	3 313	5.70	5.45	5.18	1.82	1.59	1.38
Malaysia	7 336	10 003	4.34	3.87	3.32	0.94	0.56	0.15
Myanmar	10 247	31 428	2.65	3.21	3.61	1.91	1.72	1.40
Mongolia	1 141	1 086	3.28	3.55	3.64	2.90	2.52	1.99
Nepal	1 837	17 307	6.86	6.48	6.11	2.06	1.85	1.67
Pakistan	39 229	83 437	4.87	4.48	4.49	2.81	2.07	1.76
Papua New Guinea	634	3 377	4.74	4.88	5.00	2.30	2.06	1.83
Philippines	26 432	35 977	3.81	3.71	3.53	1.56	1.15	0.71
Singapore	2 702	0	1.09	0.97	0.79	0.00	0.00	0.00
Sri Lanka	3 677	13 532	1.57	2.18	2.70	1.25	0.99	0.65
Thailand	12 609	43 093	4.22	4.02	3.91	0.80	0.59	0.33
Viet Nam	14 705	52 466	3.75	4.16	4.34	1.83	1.63	1.23
West Asia	79 316	51 174	4.48	3.95	3.86	1.86	1.47	1.60
			(4.50)	(3.94)	(3.86)	(1.75)	(1.44)	(1.49)
Bahrain	427	88	3.94	3.36	2.82	2.29	1.61	0.98
Democratic Yemen	1 078	1 413	4.68	4.85	4.74	1.92	1.90	1.65
Iran (Islamic Republic of)	31 066	25 519	4.57	3.72	3.91	2.16	1.21	1.33
Iraq	14 034	4 886	4.46	4.15	3.81	0.90	1.03	1.15
Israel	4 196	385	1.87	1.66	1.58	-1.37	-1.22	-0.93
Jordan	2 908	1 361	5.08	4.93	4.60	1.72	1.89	1.90
Kuwait	1 998	92	4.42	3.30	2.75	-3.18	-2.33	-0.90
Lebanon	2 483	482	2.92	2.55	2.11	-1.58	-0.70	0.12
Oman	156	1 312	7.00	6.94	6.90	2.95	2.87	2.84
Qatar	329	39	4.48	3.65	2.86	1.56	1.26	1.00
Saudi Arabia	10 926	3 206	5.11	4.56	4.19	0.47	1.16	2.04
Syrian Arab Republic	6 479	6 022	4.51	4.53	4.38	2.61	2.37	2.01
United Arab Emirates	1 235	353	3.26	2.24	1.87	3.26	2.24	1.87
Yemen	2 001	6 016	7.43	6.62	5.81	1.77	1.97	2.23
Mediterranean	39 575	40 944	2.78	2.69	2.53	0.45	0.24	-0.02
			(2.30)	(2.08)	(1.87)	(-0.61)	(-0.83)	(-0.99)
Cyprus	370	331	2.35	2.19	2.01	-0.32	-0.58	-0.82
Malta	307	46	0.87	0.69	0.56	-1.89	-1.65	-1.36
Turkey	26 928	28 688	3.05	3.03	2.88	1.05	0.77	0.41
Yugoslavia	11 970	11 879	2.25	1.97	1.73	-0.89	-1.07	-1.16
Western Hemisphere	323 372	123 253	2.99	2.67	2.36	-0.08	-0.08	-0.09
			(3.10)	(2.75)	(2.55)	(0.27)	(0.07)	(-0.07)
Argentina	27 856	4 466	1.65	1.49	1.39	-0.95	-0.95	-0.88
Barbados	117	144	1.79	2.12	2.33	-0.28	-0.29	-0.38
Bolivia	3 759	3 554	4.21	4.17	4.11	1.34	1.29	1.26
Brazil	115 674	34 694	3.19	2.70	2.28	-1.27	-1.19	-1.00
Chile	11 280	1 894	2.15	1.94	1.71	-1.01	-0.92	-0.84
Colombia	22 371	9 448	2.89	2.59	2.29	0.19	0.05	-0.07
Costa Rica	1 617	1 398	4.12	3.59	3.09	1.06	0.59	0.18
Cuba	7 736	2 588	1.61	1.59	1.31	-1.64	-1.41	-1.41

Table IX.14 (*continued*)

Region and country or area	Population, 1990 (thousands) Urban	Rural	Annual rate of change (percentage) Urban 1986-1990	Urban 1991-1995	Urban 1996-2000	Rural 1986-1990	Rural 1991-1995	Rural 1996-2000
Dominican Republic	4 329	2 841	3.85	3.32	2.79	-0.03	-0.25	-0.42
Ecuador	6 136	4 645	4.49	4.09	3.66	0.74	0.59	0.46
El Salvador	2 332	2 920	2.72	3.47	3.67	1.33	1.64	1.44
Guadeloupe	165	175	1.52	1.68	1.82	-0.72	-0.94	-1.13
Guatemala	3 861	5 335	3.86	4.04	4.10	2.21	2.00	1.71
Guyana	360	680	3.19	3.24	3.36	1.01	0.45	0.01
Haiti	1 968	4 536	3.98	4.00	3.90	1.03	0.90	0.71
Honduras	2 240	2 899	5.06	4.73	4.32	1.84	1.54	1.20
Jamaica	1 319	1 202	2.65	2.55	2.40	0.34	0.09	-0.17
Martinique	247	84	1.17	1.13	1.31	-2.50	-1.82	-0.92
Mexico	64 304	24 294	3.03	2.71	2.39	0.16	0.03	-0.07
Nicaragua	2 313	1 558	4.46	4.20	3.88	1.84	1.57	1.27
Panama	1 324	1 094	2.94	2.86	2.70	1.06	0.67	0.23
Paraguay	2 030	2 247	4.25	4.01	3.76	1.82	1.43	1.07
Peru	15 681	6 651	3.32	3.08	2.77	0.72	0.53	0.31
Puerto Rico	2742	967	2.33	2.01	1.71	-0.87	-0.87	-0.83
Suriname	192	212	2.27	2.68	2.92	0.76	0.40	-0.07
Trinidad and Tobago	887	396	3.16	2.56	1.94	-1.53	-0.97	-0.42
Uruguay	2 673	455	0.96	0.95	0.93	-0.39	-0.55	-0.73
Venezuela	17 859	1 876	3.27	2.79	2.40	-2.71	-2.15	-1.47
Developed market economies	615 813	195 093	0.71	0.71	0.67	-0.02	-0.15	-0.66
			(0.69)	(0.67)	(0.66)	(-0.71)	(-0.86)	(-0.82)
Australia	14 318	2 428	1.22	1.11	1.10	1.16	1.04	0.48
Canada	20 274	6 251	1.03	1.01	0.99	0.41	-0.02	-0.44
Japan	95 037	28 420	0.52	0.56	0.51	0.18	0.11	0.18
New Zealand	2 844	534	0.90	0.85	0.82	0.23	0.17	0.02
South Africa	20 778	14 470	3.21	3.11	2.95	0.81	0.61	0.39
United States	184 559	64 677	0.86	0.79	0.69	0.68	0.47	0.38
Europe	278 003	78 313	0.45	0.47	0.45	-0.87	-0.97	-1.05
			(0.57)	(0.54)	(0.53)	(-1.02)	(-1.12)	(-1.19)
Austria	4 324	3 168	0.53	0.50	0.50	-0.76	-0.79	-0.87
Belgium	9 634	304	0.21	0.18	0.17	-3.82	-3.25	-2.67
Denmark	4 422	698	0.29	0.30	0.28	-1.77	-1.73	-1.71
Finland	3 378	1 597	1.48	1.20	0.98	-2.01	-2.03	-1.95
France	41 603	14 570	0.53	0.63	0.70	-0.11	-0.43	-0.76
Germany, Federal Republic of	52 282	8 258	0.03	0.07	-0.02	-1.33	-1.29	-0.90
Greece	6 293	3 754	1.05	0.96	0.92	-1.08	-1.28	-1.42
Iceland	229	24	1.21	1.03	0.90	-1.20	-1.24	-1.22
Ireland	2 197	1 523	1.62	1.71	1.74	-0.04	-0.21	-0.42
Italy	39 320	18 002	0.43	0.54	0.62	-0.71	-0.93	-1.16
Luxembourg	310	58	0.65	0.45	0.26	-2.93	-2.33	-1.73
Netherlands	13 051	1 701	0.38	0.36	0.29	0.25	0.22	0.03
Norway	3 135	1 077	0.73	0.70	0.56	-0.96	-0.99	-0.64
Portugal	3 427	6 858	1.60	1.81	1.97	-0.39	-0.54	-0.71
Spain	30 839	8 494	1.05	0.93	0.84	-1.91	-1.83	-1.70
Sweden	7 004	1 335	0.11	0.14	0.20	-0.71	-0.98	-1.21
Switzerland	3 884	2 636	0.61	0.54	0.46	-0.50	-0.57	-0.73
United Kingdom	52 671	4 256	0.28	0.26	0.20	-1.86	-1.70	-1.58

Table IX.14. *(continued)*

Region and country or area	Population, 1990 (thousands) Urban	Rural	Annual rate of change (percentage) Urban 1985-1990	Urban 1990-1995	Urban 1995-2000	Rural 1985-1990	Rural 1990-1995	Rural 1995-2000
Eastern Europe and USSR	268 081	136 729	1.27 (1.18)	1.14 (1.04)	0.98 (0.98)	-0.47 (-0.70)	-0.57 (-0.93)	-0.35 (-0.85)
Albania	1 147	2 099	2.57	2.71	2.87	1.43	1.01	0.63
Bulgaria	6331	2 679	1.22	0.87	0.81	-2.28	-2.01	-2.07
Czechoslovakia	10 749	4 918	1.14	1.08	1.09	-1.68	-1.64	-1.50
German Democratic Republic	12 982	3 667	0.27	0.27	0.34	-0.90	-1.16	-1.33
Hungary	6 368	4 184	0.96	0.96	0.97	-1.81	-1.77	-1.68
Poland	24 268	14 155	1.34	1.14	0.95	-0.49	-0.69	-0.37
Romania	11 727	11 545	1.01	0.99	0.99	-0.06	-0.09	-0.17
U.S.S.R.	194 509	93 482	1.36	1.22	1.01	-0.36	-0.48	-0.21

Source: World Population Prospects, 1988 (United Nations publication, Sales No. E.88.XIII.7)

[a] *Urban areas as defined by national statistical authorities.*

[b] *Below the weighted growth rates for each region, the median growth rates are given in parentheses. For the world, the total urban and rural populations include small countries or areas not listed here.*

Table IX.15. Urban agglomerations with projected populations of 10 million or more in the year 2000

Agglomeration	Population (millions) 1970	1985	2000
Mexico City (Mexico)	8.74	16.65	24.44
Sao Paulo (Brazil)	8.06	15.54	23.60
Tokyo/Yokohama (Japan)	14.87	19.04	21.32
New York (United States)	16.19	15.62	16.10
Calcutta (India)	6.91	10.29	15.94
Greater Bombay (India)	5.81	9.47	15.43
Shanghai (China)	11.41	12.06	14.69
Teheran (Islamic Republic of Iran)	3.29	7.21	13.73
Jakarta (Indonesia)	4.32	7.79	13.23
Buenos Aires (Argentina)	8.31	10.76	13.05
Rio de Janeiro (Brazil)	7.04	10.14	13.00
Seoul (Republic of Korea)	5.31	10.07	12.97
Delhi (India)	3.53	6.95	12.77
Lagos (Nigeria)	2.02	5.84	12.45
Cairo/Giza (Egypt)	5.33	7.92	11.77
Karachi (Pakistan)	3.13	6.16	11.57
Metro Manila/Quezon City (Philippines)	3.53	7.09	11.48
Beijing (China)	8.29	9.33	11.47
Dhaka (Bangladesh)	1.50	4.76	11.26
Osaka/Kobe (Japan)	7.60	9.56	11.18
Los Angeles (United States)	8.38	10.04	10.91
London (United Kingdom)	10.55	10.49	10.79
Bangkok (Thailand)	3.11	5.86	10.26
Moscow (USSR)	7.11	8.91	10.11

Source: Prospects of World Urbanization, 1988, (United Nations publication. Sales No. E.89.XIII.8)

When studying urban and rural population growth, it is the practice to accept national definitions rather than to impose uniform definitions on all countries. This practice was adopted on the grounds that the national statistical authorities are in the best position to distinguish between urban and rural populations in their own countries.

When studying the populations of large cities, the concept of "urban agglomeration" is used—an area with a population concentration that usually includes a central city and surrounding urbanized localities. If recorded city data are based on a different definition, the data are adjusted to the urban agglomeration concept. National Governments also sometimes change their urban, rural or city definitions from census to census. These types of changes often do lead to incomparability over time and adjustment must be made in order to ensure that recorded changes are not misleading. If such adjustments have not been made by national authorities, it is the practice of the Population Division to adjust past definitions to the current definition to the extent possible.

2. Agricultural and food production in developing countries, 1975-1989

Tables IX.16 and IX.17 give the rates of change of agricultural and food production in individual developing countries over the periods 1976-1980, 1981-1985 and 1986-1989, and in the different regions as classified by the Food and Agriculture Organization of the United Nations (FAO). The rates are both for total output and output per head of the population and are based upon indices calculated by FAO.

In the low-income developing countries, in particular, failures in the domestic agricultural sector can be a major cause of hunger and malnutrition. Unlike many of the developed market economies and some of the more industrialized developing countries, many of these countries cannot rely on export earnings to obtain food supplies from international commercial markets. Moreover, in low-income countries, the agricultural sector provides a livelihood for large sections of the population. Production increases do not just improve direct consumption of food, but also provide many poor people with an increased income—with which to purchase, *inter alia*, a wider variety of food products.

High rates of population growth can translate negative or even modest rates of total agricultural or food production into severe declines in per capita production. Rates of growth in total agricultural and food production depend on many factors—such as technological advances, availability of infrastructure, price incentives, credit facilities for women farmers—and so movements in production per head of the population are not so much indicators of productivity changes in the agricultural sector as of changes in the ability of the domestic agricultural sector to satisfy domestic consumer demand.

The failure of the domestic agricultural sector in this respect was most apparent in many African countries. This was the only region shown in which per capita agricultural and food production declined in each of the sub-periods. In 3 of the 46 African countries shown, total food production in 1989 was lower than in 1975. However, in 37 African countries per capita food production was lower in 1989 than in 1975. In 18 of the countries shown, per capita food production declined in each of sub-periods. In some countries, annual rates of decline of about 5 per cent in per capita food production were experienced in a single sub period. With high population growth, large increases in agricultural and food production were needed to bring about an increase in overall per capita supplies. For instance, in Kenya, food production rose at 5.6 per cent per year between 1986 and 1989, yet per capita food production rose at only 1.3 per cent.

In Latin America, per capita agricultural and food production expanded between 1976 and 1985 and declined in the last sub-period, 1986-1989. Over the whole period, however, the region's per capita output expanded. Total food production fell between 1976 and 1989 in four countries, Barbados, Martinique, Nicaragua and Trinidad and Tobago. Total agricultural production fell in these countries and also in El Salvador, Guatemala and Guyana. The production declines in the Central American countries would appear to be reflections of the unsettled domestic conditions in the area. In Nicaragua, food production per head was, in 1989, half its level of 1975.

Among the Asian countries, substantial increases in total agricultural and food production were recorded in many of the low-income countries. In South Asia, per capita agricultural and food production increased in many of the low income countries, contributing to an increase in food security. Notable exceptions were Bangladesh, Nepal and Sri Lanka. The first are two least developed countries in which natural disasters severely affected output. In West Asia, the picture was mixed, several countries, such as Jordan, the Syrian Arab Republic and Saudi Arabia, experiencing rapid changes in rates of growth between sub-periods. These swings largely reflect changes in the availability of resources to devote to investment in agriculture.

3. Trends in the production of electricity and the the consumption of motor gasoline, 1970-1988

The Statistical Office of the Department of International Economic and Social Affairs of the United Nations Secretariat prepares annually the *Energy Statistics Yearbook* with quantitative information on commercial energy production, trade and consumption. The coverage includes liquid, gaseous and solid fuels and electrical energy. These data are given for the world, regional groupings and approximately 200 countries and territories. This publication serves the needs of a broad spectrum of users, ranging from national energy planners and research institutions to oil companies and academics.[49]

Data on the production of electricity and the consumption of motor gasoline are presented in tables IX.18 and IX.19.

The production and consumption of electricity has continued to expand faster than any other form of energy, reflecting electricity's versatility in most economic sectors.

Between 1970 and 1988, world production of electricity rose at an average annual rate of 4.5 per cent, a considerably higher rate of growth being recorded in developing countries (8.6 per cent) than in the developed market economies (3.5 per cent) or Eastern Europe and the Soviet Union (4.6 per cent). By 1988, per capita production of electricity in the world stood at 2,155 kilowatt hours (KWh), as shown in table IX.18

In 1988, per capita electricity production in developing countries was 578 KWh. This represented only 7.3 per cent of that of the developed market economies and 10.5 per cent of that of Eastern Europe and the Soviet Union. In several developing countries and areas with high per capita incomes, such as Bahrain, Bermuda, Hong Kong, Kuwait, Qatar and the United Arab Emirates, per capita electricity production is comparable to or even higher than in many of the industrialized countries. However, despite significant increases in generating capacity, there are still considerable shortages, particularly in the rural areas of most developing countries. In a large number of developing countries, particularly in sub-Saharan Africa, per capita production remains almost negligible, at less than 50 KWh. This is the case in such countries as Benin, Bhutan, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, Equatorial Guinea, Ethiopia, Guinea Bissau, Madagascar, Mali, Mozambique, Nepal, the Niger, Rwanda, Somalia, the Sudan, Togo, Uganda and the United Republic of Tanzania.

In the case of oil, progress has been made towards diversification and substitution by other sources of energy in the industrial and energy generation sectors. The transportation sector remains the only sector where substitution could not take place and where oil retains its dominant market share. World consumption of motor gasoline reached a level of 726 million tons in 1988 (table IX.19). It has continued to grow in spite of improved efficiency, environmental regulations and increased motor gasoline taxation. In many developed market economies, increases in gasoline taxes after 1986 helped offset the effect of lower crude oil prices.

Except in developing countries, motor gasoline consumption declined in 1980 from its peak in 1978. Yet it grew in all regions over the following eight years, surpassing the 1978 peak in 1985, as shown in figure IX.2. By 1988, motor gasoline consumption accounted for nearly 29 per cent of world consumption of oil products. Between 1980 and 1985, average annual growth in motor gasoline consumption was relatively modest, at 0.6 per cent, but accelerated to about 3 per cent between 1985 and 1988. During this period, average annual growth in the developing countries was 4.1 per cent per year, in the developed market economies, 3.0 per cent, and in Eastern Europe and the Soviet Union, 1.3 per cent. Among the developing countries, growth was particularly strong in the newly industrializing countries of South-East Asia: the Republic of Korea reported an increase of 96 per cent between 1985 and 1988. Similarly, in China, gasoline consumption almost doubled between 1980 and 1988. The strong demand for gasoline can be attributed to various factors: the prolonged economic expansion and rising per capita incomes in many countries, the growth in the number of cars and the relaxation of previously mandated speed limits.

The United States continues to play a dominant role in gasoline markets. It accounts for 44 per cent of world gasoline consumption. Its gasoline consumption accounts for about 45 per cent of all oil consumed domestically. In the other developed market economies, the comparable figure is about 25 per cent, in the developing countries, 21 per cent, and in Eastern Europe and the Soviet Union, 18 per cent.

[49] The historical series published in various issues of the *Energy Statistics Yearbook* are also stored on magnetic tapes for all years from 1950 to 1988 and are available to interested users. Inquiries about these data should be addressed to the Office of the Director, Statistical Office, Department of International Economic and Social Affairs, United Nations, New York, New York 10017

Figure IX.2. Consumption of motor gasoline, 1970-1988
(Million metric tons)

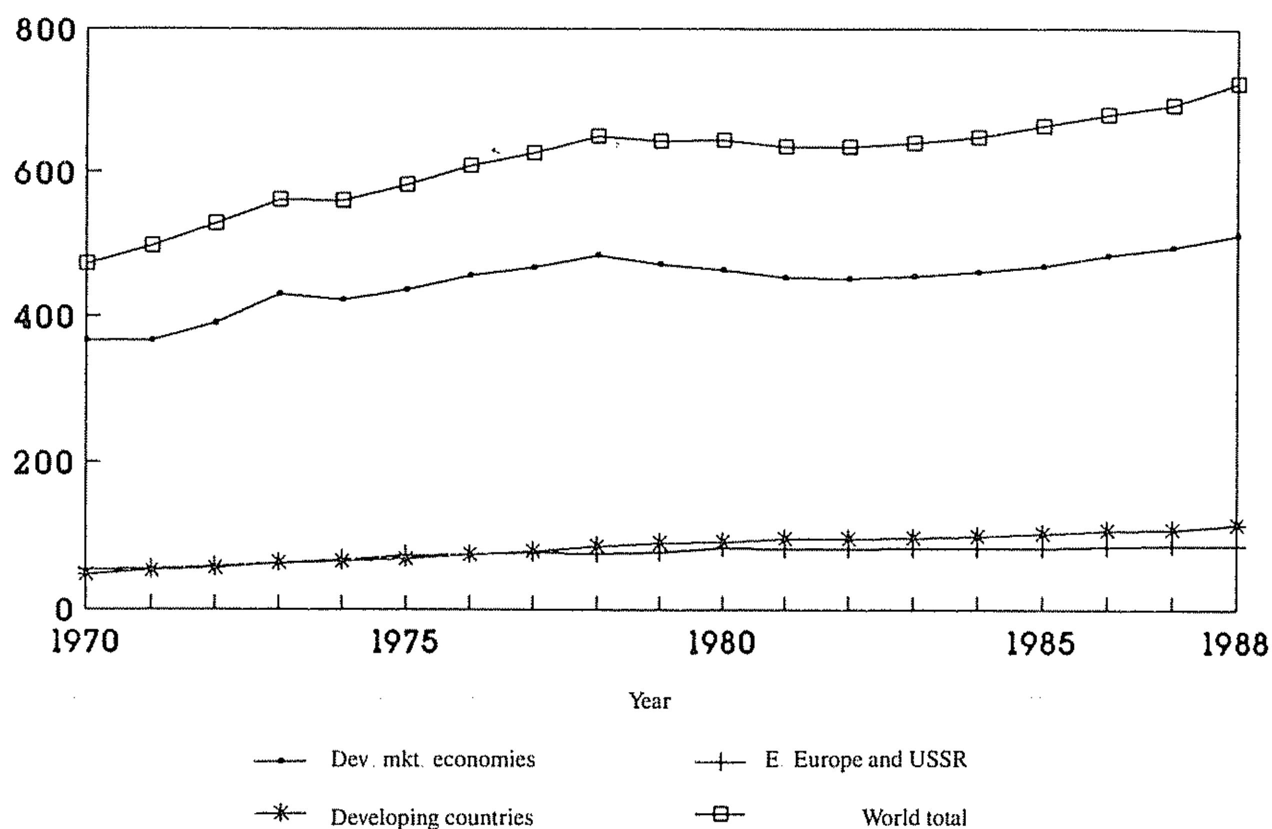

Table IX.16 Average annual rates of growth of total and per capita agricultural production, 1976-1989

	Agricultural production					
	Total			Per head of population		
	1976-1980	1981-1985	1986-1989	1976-1980	1981-1985	1986-1989
Africa						
Algeria	0.1	3.7	-2.7	-2.9	0.7	-5.7
Angola	-3.4	-0.8	-0.2	-6.6	-3.2	-2.8
Benin	3.8	6.8	2.1	1.0	3.7	-1.1
Botswana	-3.6	0.7	1.5	-7.2	-2.9	-2.0
Burkina Faso	-0.7	6.2	2.8	-2.7	3.6	0.1
Burundi	1.1	4.2	-1.1	-0.8	1.3	-4.0
Cameroon	-0.1	1.9	2.8	-2.6	-0.8	0.1
Central African Republic	1.7	0.4	0.4	-0.5	-1.8	-2.0
Chad	1.5	2.7	0.9	-0.6	0.4	-1.6
Congo	2.1	1.3	2.6	-0.3	-1.3	-0.2
Côte d'Ivoire	5.0	3.8	4.6	1.1	-0.4	0.3
Egypt	1.7	3.0	3.0	-1.0	0.2	0.3
Ethiopia	2.8	-0.5	2.0	0.4	-2.3	0.0
Gabon	2.6	-0.2	1.7	1.4	-4.1	-1.7
Gambia	-7.5	3.3	4.2	-9.4	0.3	1.3
Ghana	-2.5	10.7	-1.2	-5.6	6.8	-4.3
Guinea	1.9	0.2	1.4	-0.3	-2.1	-1.0
Guinea-Bissau	-0.5	7.4	3.9	-5.5	5.4	1.8
Kenya	2.1	4.2	5.0	-1.9	0.1	0.7

Table IX.16 (*continued*)

	Agricultural production					
	Total			Per head of population		
	1976-1980	1981-1985	1986-1989	1976-1980	1981-1985	1986-1989
Lesotho	1.5	0.3	-1.4	-0.9	-2.4	-4.1
Liberia	2.8	2.8	-0.1	-0.6	0.4	-3.2
Libyan Arab Jamahiriya	0.4	6.5	-0.1	-3.5	2.0	-3.8
Madagascar	0.6	1.9	2.0	-2.1	-1.2	-1.2
Malawi	3.5	2.2	2.1	0.6	-1.0	-1.2
Mali	2.7	2.4	3.7	0.4	-0.5	0.6
Mauritania	4.7	0.3	2.2	4.3	-2.3	-0.5
Mauritius	1.6	4.9	1.5	-0.3	3.3	0.2
Morocco	4.4	2.5	5.8	2.1	-0.2	3.1
Mozambique	1.0	-0.9	1.8	-3.2	-3.4	-0.9
Namibia	0.1	-0.1	3.1	-2.5	-3.1	-0.1
Niger	10.5	-0.1	0.4	7.7	-2.9	-2.5
Nigeria	2.5	4.1	1.8	-1.0	0.7	-1.7
Réunion	0.3	-2.1	0.6	-0.8	-3.5	-1.1
Rwanda	4.2	3.3	-2.7	0.8	-0.1	-5.9
Senegal	-8.6	7.6	3.4	-11.6	4.8	0.7
Sierra Leone	0.6	0.5	0.4	-1.0	-1.8	-2.0
Somalia	1.2	3.0	3.7	-2.9	-0.6	0.2
Sudan	1.3	3.2	0.3	-1.8	0.0	-2.6
Swaziland	5.3	1.2	3.4	2.3	-2.1	-0.1
Togo	2.0	1.3	3.2	-0.5	-1.6	0.0
Tunisia	0.4	4.7	-4.9	-2.1	2.1	-7.2
Uganda	-2.4	0.8	1.6	-5.5	-2.5	-1.9
United Republic of Tanzania	4.3	2.3	2.6	0.8	-1.4	-1.1
Zaire	1.0	2.7	1.4	-1.9	-0.4	-1.8
Zambia	-1.0	2.4	3.8	-4.0	-1.6	-0.1
Zimbabwe	0.7	6.4	-0.3	-2.7	3.2	-3.3
Latin America						
Argentina	1.8	2.2	-1.1	0.1	0.7	-2.3
Barbados	6.5	-6.2	-1.1	6.3	-6.5	-1.6
Bolivia	0.5	2.9	0.9	-2.1	0.2	-1.8
Brazil	3.4	4.6	1.7	1.1	2.3	-0.4
Chile	2.0	1.7	5.3	0.5	0.0	3.6
Colombia	3.9	0.8	4.0	1.7	-1.3	1.9
Costa Rica	2.5	1.6	2.9	-0.5	-1.3	0.2
Dominican Republic	2.0	1.9	2.1	-0.4	-0.5	-0.2
Ecuador	1.8	4.1	1.1	-1.1	1.1	-1.7
El Salvador	1.6	-3.3	-5.4	-1.4	-4.3	-7.1
Guatemala	-4.3	1.5	1.4	-0.1	-1.3	-1.4
Guyana	0.9	-2.7	-0.2	-1.2	-4.5	-1.9
Haiti	1.0	1.6	-1.3	-1.4	-0.2	-3.2
Honduras	6.4	0.7	3.6	2.7	-2.8	0.3
Jamaica	1.4	2.2	-3.0	0.2	0.7	-4.4
Martinique	-8.8	10.6	-5.1	-8.7	10.5	-5.3
Mexico	4.5	2.3	2.2	1.6	-0.1	0.0
Nicaragua	-4.3	1.7	-5.2	-6.9	-1.6	-8.3
Panama	2.3	2.7	1.4	0.1	0.5	-0.7
Paraguay	5.7	7.0	5.3	2.3	3.6	2.2
Peru	-1.2	3.1	2.7	-3.7	0.4	0.1
Suriname	1.2	5.2	-5.3	1.6	4.1	-6.7
Trinidad and Tobago	-5.9	-1.0	4.3	-7.4	-2.6	2.6
Uruguay	0.2	1.7	2.4	-0.4	1.0	1.6
Venezuela	1.1	0.8	1.2	-2.3	-2.0	-1.4
Asia						
Afghanistan	-0.3	0.6	-0.3	-1.2	2.6	-1.9
Bangladesh	2.2	2.2	0.3	-0.6	-0.6	-2.3
Bhutan	2.6	3.4	4.9	0.5	1.5	2.7
Cambodia	-4.0	8.6	2.2	-2.2	5.8	-0.3
China	3.1	6.0	2.6	1.7	4.7	1.3

Table IX.16 (*continued*)

	Agricultural production					
	Total			Per head of population		
	1976-1980	1981-1985	1986-1989	1976-1980	1981-1985	1986-1989
Democratic Yemen	-0.1	-3.9	2.2	-2.4	-6.5	-0.9
Fiji	6.0	0.2	-0.6	4.1	-1.6	-2.3
Hong Kong	-12.3	0.9	-2.2	-14.7	-0.6	-3.5
India	1.6	4.8	3.4	-0.5	2.6	1.3
Indonesia	5.1	4.8	3.9	2.8	2.7	2.2
Iran (Islamic Republic of)	2.6	3.6	0.9	-0.1	-0.7	-2.6
Iraq	3.1	8.1	-3.3	-0.7	4.3	-6.7
Israel	0.9	4.9	-4.5	-1.4	3.1	-6.0
Jordan	13.9	5.1	-1.1	11.1	1.3	-4.9
Lao People's Democratic Republic	6.7	6.3	2.1	5.1	3.9	-0.3
Malaysia	3.9	5.8	4.7	1.6	3.4	2.3
Myanmar	3.9	6.8	1.2	1.8	4.6	-0.9
Nepal	0.9	2.7	1.1	-1.5	0.1	-1.4
Pakistan	3.7	4.7	4.7	0.8	0.8	1.1
Philippines	4.2	0.0	2.8	1.6	-2.6	0.2
Republic of Korea	-0.2	4.1	0.3	-1.8	2.6	-0.9
Saudi Arabia	-2.3	23.6	3.4	-7.1	18.4	-0.6
Singapore	-3.1	1.3	-3.8	-4.4	0.1	-4.9
Sri Lanka	4.5	1.4	-2.8	2.7	-0.3	-4.2
Syrian Ar Rep	9.1	0.6	-0.1	5.5	-2.8	-3.6
Thailand	3.7	3.6	1.4	1.4	1.5	-0.1
Yemen	2.3	-0.7	3.7	-0.3	-3.4	-0.6
Mediterranean						
Cyprus	3.7	-1.5	3.1	3.0	-2.6	1.9
Malta	7.3	1.1	-3.7	5.7	2.2	-4.1
Turkey	2.4	1.7	0.8	0.3	-0.8	-1.2
Yugoslavia	1.7	0.3	1.4	0.8	-0.4	0.8
Developing countries[a]	2.8	4.0	2.3	0.6	1.8	0.15
Africa[b]	1.0	2.2	2.3	-2.0	-0.8	-0.76
Latin America	3.0	2.8	1.4	0.6	0.6	-0.74
Near East[c]	2.5	2.4	1.0	-0.1	-0.4	-1.85
Far East[d]	2.9	4.0	2.9	0.7	1.6	0.65

Source: Food and Agriculture Organization of the United Nations.

[a] The aggregates are those used by the Food and Agriculture Organization of the United Nations. China is included in the total for developing countries.

[b] Excluding Egypt, Libyan Arab Jamahiriya and Sudan.

[c] Afghanistan, Bahrain, Cyprus, Democratic Yemen, Gaza, Islamic Republic of Iran, Iraq, Jordan, Kuwait, Lebanon, Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, Sudan, Syrian Arab Republic, Turkey, United Arab Emirates and Yemen.

[d] Bangladesh, Bhutan, Brunei Darussalam, East Timor, Hong Kong, India, Indonesia, Republic of Korea, Lao People's Democratic Republic, Macau, Malaysia, Maldives, Myanmar, Nepal, Pakistan, Philippines, Singapore, Sri Lanka and Thailand.

Table IX.17 Average annual rates of growth of total and per capita food production, 1976-1989

	Food production					
	Total			Per head of population		
	1976-1980	1981-1985	1986-1989	1976-1980	1981-1985	1986-1989
Africa						
Algeria	0.1	3.6	-2.8	-2.9	0.5	-5.8
Angola	0.7	0.2	0.0	-2.6	-2.3	-2.6
Benin	3.9	6.1	2.0	1.1	3.1	-1.2
Botswana	-3.7	0.7	1.5	-7.3	-2.9	-2.0
Burkina Faso	-0.8	6.0	2.5	-2.8	3.4	-0.2
Burundi	0.6	3.5	-1.9	-1.3	0.6	-4.7
Cameroon	-0.6	2.2	2.4	-3.1	-0.5	-0.3
Central African Republic	2.0	0.3	0.2	-0.3	-1.9	-2.2
Chad	3.0	2.6	0.4	0.8	0.3	-2.0
Congo	2.0	1.3	2.6	-0.4	-1.3	-0.1
Côte d'Ivoire	6.2	3.9	4.9	2.3	-0.4	0.6
Egypt	1.0	3.9	3.8	-1.7	1.1	1.1
Ethiopia	2.8	-0.4	1.9	0.5	-2.1	0.1
Gabon	2.6	-0.2	1.7	1.3	-4.2	-1.8
Gambia	-7.7	3.1	4.6	-9.7	0.1	1.6
Ghana	-2.5	11.0	-1.2	-5.7	7.1	-4.3
Guinea	1.9	0.1	1.5	-0.3	-2.2	-1.0
Guinea-Bissau	-0.5	7.4	3.9	-5.5	5.4	1.8
Kenya	0.4	3.9	5.6	-3.5	-0.2	1.3
Lesotho	1.3	0.0	-1.5	-1.1	-2.8	-4.3
Liberia	2.4	3.5	1.2	-0.9	0.3	-2.0
Libyan Arab Jamahiriya	0.5	6.6	-0.1	-3.5	2.0	-3.8
Madagascar	0.9	1.9	2.1	-3.5	2.0	-3.8
Malawi	3.2	1.1	2.3	0.3	-2.0	-1.0
Mali	2.1	2.5	3.0	-0.2	-0.3	0.0
Mauritania	4.7	0.3	2.2	1.9	-2.3	-0.5
Mauritius	1.2	4.9	1.8	-0.8	3.2	0.5
Morocco	4.6	2.3	5.8	2.2	-0.4	3.1
Mozambique	1.0	-0.3	1.4	-3.3	-2.8	-1.3
Namibia	0.1	0.2	3.1	-2.5	-2.8	-0.1
Niger	10.6	-0.1	0.4	7.8	-2.9	-2.5
Nigeria	2.6	4.1	1.7	-0.9	0.7	-1.7
Réunion	0.8	-2.0	0.7	-0.3	-3.5	-1.0
Rwanda	4.1	3.0	-3.3	0.8	-0.4	-6.6
Senegal	-8.6	7.6	3.3	-11.7	4.9	0.6
Sierra Leone	0.3	0.5	0.6	-1.3	-1.8	-1.9
Somalia	1.2	3.0	3.6	-2.9	-0.6	0.2
Sudan	2.6	2.7	0.8	-0.5	-0.5	-2.1
Swaziland	4.7	1.5	3.7	1.8	-1.8	0.2
Togo	2.0	0.9	2.9	-0.5	-2.0	-0.2
Tunisia	0.3	4.8	-5.1	-2.2	2.1	-7.3
Uganda	-2.0	0.7	1.7	-5.1	-2.6	-1.8
United Republic of Tanzania	4.6	3.1	2.1	1.1	-0.7	-1.6
Zaire	1.1	2.7	1.4	-1.8	-0.4	-1.8
Zambia	-1.1	2.2	3.3	-4.1	-1.8	-0.6
Zimbabwe	-1.4	7.4	-1.1	-4.7	4.2	-4.1
Latin America						
Argentina	2.0	2.3	-1.2	0.3	0.8	-2.4
Barbados	6.5	-6.2	-1.1	6.3	-6.5	-1.6
Bolivia	0.8	3.1	0.9	-1.8	0.4	-1.8
Brazil	4.2	3.8	2.6	1.8	1.5	0.5
Chile	1.9	1.7	5.4	0.4	0.0	3.6
Colombia	3.7	1.5	4.4	1.5	-0.7	2.2
Costa Rica	1.3	1.2	1.4	-1.6	-1.7	-1.3
Dominican Republic	1.8	1.7	4.0	-0.6	-0.7	1.7
Ecuador	1.9	3.7	1.1	-1.0	0.8	-1.6

Table IX.17 (*continued*)

	Food production					
	Total			Per head of population		
	1976-1980	1981-1985	1986-1989	1976-1980	1981-1985	1986-1989
El Salvador	2.2	-0.5	-0.4	-0.8	-1.6	-2.2
Guatemala	1.9	3.2	1.9	-0.8	0.4	-1.0
Guyana	3.2	-2.6	-0.2	-1.2	-4.5	-1.9
Haiti	1.2	2.1	-1.1	-1.2	0.3	-2.9
Honduras	6.3	0.3	2.3	2.6	-3.3	-0.9
Jamaica	1.4	2.2	-3.0	0.1	0.8	-4.6
Martinique	-8.9	10.8	-5.2	-8.8	10.7	-5.3
Mexico	4.5	2.6	2.1	1.6	0.2	-0.1
Nicaragua	-2.5	0.9	-4.4	-5.2	-2.4	-7.5
Panama	2.1	2.6	1.0	-0.2	0.4	-1.1
Paraguay	5.2	5.6	5.3	1.8	2.3	2.2
Peru	-2.2	3.6	2.9	-4.7	0.9	0.3
Suriname	1.3	5.2	-5.3	1.7	4.1	-6.7
Trinidad and Tobago	-5.5	-1.0	4.8	-7.1	-2.6	3.1
Uruguay	-0.1	1.9	2.0	-0.7	1.2	1.2
Venezuela	1.6	0.6	1.2	-1.8	-2.2	-1.5
Asia						
Afghanistan	0.5	0.7	-0.1	-1.4	2.7	-1.7
Bangladesh	2.2	1.9	1.0	-0.7	-0.9	-1.7
Bhutan	2.6	3.4	5.0	0.5	1.5	2.8
Cambodia	-3.8	8.1	2.0	-2.0	5.3	-0.5
China	3.1	5.5	2.8	1.7	4.2	1.5
Democratic Yemen	0.6	-4.4	2.3	-2.0	-7.0	-0.8
Fiji	6.0	0.2	-0.5	4.1	-1.6	-2.1
Hong Kong	-12.3	0.9	-2.2	-14.7	-0.6	-3.5
India	1.6	4.8	3.7	-0.5	2.6	1.5
Indonesia	4.9	4.9	4.1	2.7	2.9	2.4
Iran (Islamic Republic of)	3.0	3.6	0.8	0.0	-0.5	-2.7
Iraq	3.3	8.1	-3.1	-0.5	4.3	-6.5
Israel	-0.6	5.0	-2.2	-2.9	3.2	-3.7
Jordan	13.8	5.3	-1.2	11.1	1.5	-4.9
Lao People's Democratic Republic	6.6	6.4	2.1	5.1	4.0	-0.4
Malaysia	5.0	7.8	5.0	2.7	5.4	2.6
Myanmar	3.7	7.0	1.4	1.6	4.8	-0.7
Nepal	0.8	3.0	1.3	-1.6	0.3	-1.2
Pakistan	3.5	4.1	4.8	0.6	0.2	1.2
Philippines	4.1	-0.1	2.8	1.5	-2.7	0.3
Republic of Korea	-0.1	4.5	0.4	-1.6	3.0	-0.8
Saudi Arabia	-2.3	23.8	3.4	-7.2	18.6	-0.6
Singapore	-3.1	1.4	-3.8	-4.3	0.2	-4.9
Sri Lanka	7.0	1.2	-3.3	5.2	-0.5	-4.6
Syrian Arab Republic	10.5	0.3	-0.1	6.8	-3.2	-3.6
Thailand	3.4	3.6	1.4	1.0	1.6	-0.2
Yemen Arab Republic	2.4	-0.8	3.7	-0.1	-3.5	0.6
Mediterranean						
Cyprus	3.7	-1.5	3.0	3.0	-2.6	1.9
Malta	7.3	1.1	-3.7	5.7	2.2	-4.1
Turkey	2.4	1.9	0.6	0.3	-0.6	-1.4
Yugoslavia	1.8	0.2	1.6	0.9	-0.6	0.9

Table IX.17 (*continued*)

	Food production					
	Total			Per head of population		
	1976-1980	1981-1985	1986-1989	1976-1980	1981-1985	1986-1989
Developing countries[a]	2.9	3.8	2.4	0.7	1.7	0.3
Africa[b]	1.1	2.2	2.3	-1.9	-0.8	-0.7
Latin America	3.3	2.8	1.7	0.9	0.5	-0.5
Near East[c]	2.8	2.6	1.1	0.1	-0.2	-1.8
Far East[d]	2.9	4.0	3.1	0.6	1.6	0.9

Source: Food and Agriculture Organization of the United Nations.

[a] The aggregates are those used by the Food and Agriculture Organization of the United Nations. China is included in the total for developing countries.

[b] Excluding Egypt, Libyan Arab Jamahiriya and Sudan.

[c] Afghanistan, Bahrain, Cyprus, Democratic Yemen, Gaza, Islamic Republic of Iran, Iraq, Jordan, Kuwait, Lebanon, Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, Sudan, Syrian Arab Republic, Turkey, United Arab Emirates and Yemen.

[d] Bangladesh, Bhutan, Brunei Darussalam, East Timor, Hong Kong, India, Indonesia, Republic of Korea, Lao People's Democratic Republic, Macau, Malaysia, Maldives, Myanmar, Nepal, Pakistan, Philippines, Singapore, Sri Lanka and Thailand.

Table IX.18. Production of electricity, 1970-1988

Country or area	Total (millions of kWhs)			Per capita (kWhs)		
	1970	1980	1988	1970	1980	1988
World	4 949 083	8 236 440	11 017 167	1 338	1 851	2 155
Eastern Europe and the USSR	988 386	1 717 201	2 202 109	2 838	4 547	5 510
Albania	973	3 715	4 100	455	1 390	1 308
Bulgaria	19 513	34 835	45 039	2 298	3 930	5 007
Czechoslovakia	45 163	72 732	87 374	3 151	4 750	5 602
German Democratic Republic	67 650	98 808	118 328	3 964	5 903	7 108
Hungary	14 541	23 876	29 216	1 404	2 229	2 759
Poland	64 532	121 871	144 372	1 984	3 426	3 801
Romania	35 088	67 486	75 280	1 723	3 040	3 266
USSR	740 926	1 293 878	1 698 400	3 050	4 873	5 987
China	115 900	300 620	537 846	142	307	496
Developed market economies	3 458 163	5 224 508	6 581 048	4 209	6 638	7 960
Australia	53 892	96 135	139 356	4 293	6 542	8 518
Austria	30 036	41 627	48 273	4 033	5 513	6 442
Belgium	30 523	53 129	64 606	3 161	5 392	6 509
Canada	204 723	377 518	504 285	9 600	15 768	19 326
Denmark	20 024	27 128	27 992	4 062	5 294	5 466
Finland	21 185	38 710	53 771	4 598	8 097	10 858
France	146 787	245 713	391 926	2 890	4 558	7 021
Germany, Federal Republic of	241 101	367 532	428 856	3 975	5 970	7 063
Greece	9 820	22 652	33 167	1 117	2 349	3 312
Iceland	1 470	3 155	4 159	7 171	13 777	16 636
Ireland	6 091	10 563	13 228	2 061	3 105	3 622
Israel	6 885	12 528	19 560	2 314	3 230	4 402
Italy	116 827	183 464	200 690	2 170	3 250	3 503
Japan	361 233	577 521	753 728	3 509	4 944	6 157
Luxembourg	1 483	918	1 331	4 362	2 515	3 617
Netherlands	40 859	64 806	69 611	3 135	4 580	4 752
New Zealand	13 706	21 982	29 895	4 859	7 059	8 983
Norway	57 606	83 601	109 350	14 855	20 455	26 098
Portugal	7 438	15 263	22 415	822	1 563	2 187
South Africa	50 791	89 637	156 738	2 261	3 169	4 644

Table IX.18. *(continued)*

Country or area	Total (millions of kWhs)			Per capita (kWhs)		
	1970	1980	1988	1970	1980	1988
Spain	56 306	109 201	138 511	1 667	2 909	3 547
Sweden	60 645	96 316	146 534	7 539	11 588	17 555
Switzerland	32 565	47 061	57 953	5 177	7 405	8 863
United Kingdom	247 975	283 749	308 230	4 443	5 020	5 407
United States	1 639 771	2 354 384	2 856 624	7 997	10 337	11 640
Developing countries	386 634	994 111	1 696 164	197	412	578
Afghanistan	396	965	1 109	29	60	73
Algeria	1 979	7 123	13 966	144	382	586
American Samoa	40	75	85	1 429	2 273	2 237
Angola	644	1 500	1 810	115	194	191
Antigua	30	60	92	448	789	1 082
Argentina	21 727	39 676	53 062	907	1 405	1 683
Bahamas	489	853	975	2 843	3 791	3 839
Bahrain	419	1 660	3 320	1 896	4 770	6 888
Bangladesh		2 653	6 866		30	63
Barbados	146	332	449	608	1 328	1 740
Belize	23	54	77	190	370	440
Benin	33	5	5	12	1	1
Bermuda	226	332	458	4 185	6 036	7 897
Bhutan	4	17	21	4	14	14
Bolivia	787	1 564	1 883	182	281	272
Botswana	30	473	816	48	524	681
Brazil	45 460	139 485	214 117	474	1 150	1 483
British Virgin Islands	6	23	43	545	1 769	3 071
Burkina Faso	27	105	128	5	15	15
Brunei Darussalam	138	469	1 030	1 053	2 522	4 120
Burundi	1	3	56	0	1	11
Cambodia	133	100	70	19	16	9
Cameroon	1 163	1 452	2 395	172	168	224
Cape Verde	7	16	35	26	54	97
Cayman Islands	10	62	178	909	3 444	8 091
Central African Republic	47	68	93	25	30	34
Chad	42	47	52	11	10	10
Chile	7 550	11 751	16 914	794	1 054	1 327
Colombia	8 650	20 624	38 338	416	800	1 254
Comoros	2	10	14	7	26	29
Congo	76	156	292	63	102	155
Cook Islands	5	11	12	227	579	571
Costa Rica	1 028	2 202	3 193	594	963	1 114
Côte d'Ivoire	517	1 752	2 210	94	210	190
Cuba	4 888	9 990	14 543	570	1 026	1 432
Cyprus	610	1 034	1 668	990	1 641	2 424
Democratic People's Republic of Korea	16 500	35 000	53 000	1 188	1 942	2 420
Democratic Yemen	192	318	510	128	171	218
Djibouti	43	117	173	256	389	451
Dominica	9	11	29	125	149	363
Dominican Republic	1 003	3 317	5 300	227	582	772
Ecuador	949	3 352	5 603	157	413	549
Egypt	7 591	18 939	35 410	230	456	688
El Salvador	671	1 543	1 870	187	341	372
Equatorial Guinea	16	18	17	55	51	40
Ethiopia	520	668	815	17	17	18
Fiji	158	310	420	303	492	577
French Guiana	55	113	250	1 122	1 614	2 809
French Polynesia	100	255	256	909	1 711	1 463
Gabon	97	530	877	192	657	800
Gambia	13	39	44	28	61	54
Ghana	2 920	5 317	4 750	339	495	336

Table IX.18. (*continued*)

Country or area	Total (millions of kWhs) 1970	1980	1988	Per capita (kWhs) 1970	1980	1988
Grenada	15	25	26	163	269	257
Guadeloupe	99	310	681	308	945	2 009
Guatemala	759	1 671	1 785	145	242	206
Guinea	388	380	512	88	70	78
Guinea-Bissau	10	14	15	19	17	16
Guyana	323	414	385	455	478	382
Haiti	118	315	445	26	58	71
Honduras	315	928	1 090	120	253	226
Hong Kong	5 097	12 649	25 508	1 293	2 510	4 481
India	61 212	119 260	237 800	110	173	290
Indonesia	4 668	14 234	36 510	39	94	209
Iran (Islamic Republic of)	6 758	22 380	38 770	238	575	730
Iraq	2 750	11 426	23 450	294	860	1 328
Jamaica	1 542	2 195	2 380	825	1 010	973
Jordan	200	1 070	3 262	87	366	827
Kenya	583	1 490	2 844	51	90	123
Kiribati	2	5	7	40	83	104
Kuwait	2 661	9 417	19 998	3 572	6 844	10 314
Lao People's Democratic Republic	46	975	1 100	17	304	284
Lebanon	1 230	2 752	4 505	498	1 031	1 593
Liberia	502	890	834	366	479	348
Libyan Arab Jamahiriya	426	4 833	16 000	214	1 588	3 780
Macau	61	262	676	248	809	1 523
Madagascar	246	437	516	36	50	46
Malawi	145	412	583	32	68	74
Malaysia	3 543	10 098	19 287	326	734	1 164
Maldives	1	4	14	9	26	69
Mali	57	105	205	10	15	23
Malta	277	527	1 030	847	1 444	2 951
Martinique	103	275	585	315	841	1 767
Mauritania	73	93	121	60	60	63
Mauritius	220	466	639	259	486	593
Mexico	28 707	66 954	110 876	544	951	1 306
Mongolia	548	1 566	3 300	439	941	1 577
Montserrat	6	12	13	500	923	1 000
Morocco	1 935	4 924	8 834	126	254	369
Mozambique	682	14 000	475	73	1 157	32
Myanmar	600	1 487	2 272	22	44	57
Nauru	21	26	29	2 625	2 889	3 222
Nepal	76	215	589	7	14	32
New Caledonia	901	1 333	1 181	8 045	9 521	7 335
Nicaragua	627	1 068	1 068	305	385	295
Niger	39	130	160	9	24	24
Nigeria	1 550	7 177	9 925	27	89	94
Oman	105	957	3 895	160	972	2 827
Pakistan		14 974	36 940	0	176	321
Panama	1 526	1 813	2 778	996	926	1 196
Papua New Guinea	191	1 252	1 745	79	406	459
Paraguay	218	725	2 900	93	230	718
Peru	5 529	10 039	14 135	419	580	665
Philippines	8 666	18 009	24 538	231	373	413
Puerto Rico	7 308	13 206	14 403	2 688	4 127	3 993
Qatar	282	2 431	4 500	2 518	10 570	13 196
Republic of Korea	9 597	40 079	85 462	301	1 051	2 005
Reunion	89	344	764	201	676	1 326
Rwanda	83	118	172	22	23	25
Samoa	11	39	46	76	250	274
Saint Lucia	18	58	104	176	487	776

Table IX.18. (*continued*)

Country or area	Total (millions of kWhs)			Per capita (kWhs)		
	1970	1980	1988	1970	1980	1988
Saint Pierre and Miquelon	5	17	38	833	2 429	5 429
Saint Vincent and the Grenadines	12	27	32	135	270	294
Sao Tome and Principe	3	9	15	40	105	140
Saudi Arabia	1 060	18 909	42 201	184	2 017	3 229
Senegal	334	635	763	83	112	109
Seychelles	7	50	83	130	781	1 221
Sierra Leone	197	201	201	74	62	51
Singapore	2 205	6 940	13 018	1 062	2 873	4 920
Solomon Islands	9	21	30	55	93	98
Somalia	28	121	257	8	23	36
Sri Lanka	816	1 668	2 799	65	113	167
Sudan	392	1 000	1 061	28	54	45
Suriname	1 322	1 577	1 350	3 544	4 430	3 435
Swaziland	138	284	348	328	503	472
Syrian Arab Republic	947	3 837	8 110	151	436	697
Thailand	4 545	15 112	33 964	127	323	628
Togo	68	15	41	34	6	13
Tonga	4	10	20	47	102	171
Trinidad and Tobago	1 202	2 056	3 470	1 257	1 876	2 789
Tunisia	794	2 797	5 169	155	438	662
Turkey	8 624	23 275	48 048	244	524	897
Uganda	778	603	599	79	46	35
United Arab Emirates	35	6 297	13 150	156	6 198	8 755
United Republic of Tanzania	479	766	879	35	41	35
Uruguay	2 200	3 355	6 998	783	1 153	2 271
United States Virgin Islands	578	800	970	8 892	8 081	8 739
Vanuatu	9	20	28	107	169	179
Venezuela	12 708	35 932	57 800	1 198	2 391	3 082
Viet Nam	2 120	3 700	5 700	50	69	89
Yemen	18	185	820	4	31	109
Yugoslavia	26 024	59 435	83 654	1 277	2 665	3 549
Zaire	3 230	4 445	5 392	166	169	160
Zambia	949	9 192	8 485	226	1 602	1 081
Zimbabwe	6 410	4 541	7 750	1 216	636	849

Source: United Nations, *Energy Statistics Yearbook*, various issues.
Note: The regional and world totals include figures for countries and areas not listed in the table.

Table IX.19. Consumption of motor gasoline, 1970-1988

(Thousands of tons)

Country or area	1970	1975	1978	1980	1985	1988
World	472 025	581 529	650 090	644 742	664 977	725 933
Eastern Europe and the USSR	53 673	73 889	76 103	83 602	84 056	87 392
Albania	81	90	140	175	200	215
Bulgaria	1 379	1 680	1 720	1 850	1 800	1 700
Czechoslovakia	1 112	1 572	1 726	1 633	1 900	2 100
German Democratic Republic	1 772	2 417	2 852	3 110	3 575	4 076
Hungary	777	1 249	1 456	1 408	1 467	1 653
Poland	2 564	2 702	3 538	3 968	2 909	3 698
Romania	1 988	2 584	2 581	2 258	1 405	1 800
USSR	44 000	61 595	62 090	69 200	70 800	72 150

Table IX.19. (*continued*)

(Thousands of tons)

Country or area	1970	1975	1978	1980	1985	1988
China	3 005	7 950	9 562	9 210	13 996	17 533
Developed market economies	367 350	435 493	484 516	463 170	468 308	509 727
Australia	7 532	9 333	10 678	10 796	11 505	12 282
Austria	1 583	2 140	2 280	2 436	2 404	2 558
Belgium	2 207	2 795	3 148	2 894	2 512	2 975
Canada	19 608	25 442	26 825	27 692	22 496	24 618
Denmark	1 497	1 623	1 796	1 523	1 573	1 562
Finland	1 060	1 326	1 393	1 370	1 718	2 034
France	12 281	15 271	16 955	18 305	18 063	18 964
Germany, Federal Republic of	15 911	19 999	23 230	26 279	25 442	27 369
Greece	649	948	1 356	1 377	1 795	2 110
Iceland	53	86	97	90	88	122
Ireland	617	809	942	1 013	879	863
Israel	479	667	748	760	1 011	1 354
Italy	9 744	10 583	10 645	11 415	12 495	13 540
Japan	15 602	21 550	24 989	25 535	27 076	29 127
Luxembourg	103	181	247	286	304	328
Netherlands	3 035	3 473	4 325	4 655	5 448	7 076
New Zealand	1 406	1 668	1 667	1 700	1 594	1 590
Norway	1 001	1 143	1 402	1 499	1 643	1 827
Portugal	497	802	794	763	858	1 189
South Africa	2 349	3 758	3 540	3 700	4 400	4 355
Spain	2 528	4 535	5 476	5 421	5 826	6 592
Sweden	2 761	3 248	3 697	3 560	3 654	4 290
Switzerland	2 113	2 444	2 608	2 751	3 066	3 459
United Kingdom	14 313	15 783	17 394	18 392	19 094	23 605
United States	248 413	285 874	318 267	288 943	293 345	315 908
Developing countries	47 997	64 197	79 908	88 760	98 647	111 281
Afghanistan	108	83	92	102	95	108
Algeria	422	653	958	1 214	1 680	1 740
American Samoa	5	7	8	5	8	8
Angola	65	51	100	80	84	70
Antigua	4	6	50	41	111	113
Argentina	3 979	3 879	4 554	5 306	4 383	4 039
Bahamas	64	72	73	83	50	50
Bahrain	31	50	87	110	170	198
Bangladesh		50	53	57	40	53
Barbados	44	61	54	51	47	53
Belize	11	18	24	22	24	21
Benin	17	34	37	34	59	58
Bermuda	22	21	22	22	21	27
Bolivia	220	347	324	342	340	363
Brazil	7 067	10 386	11 245	10 346	11 712	14 302
British Virgin Islands	3	3	3	3	4	5
Burkina Faso	17	26	49	53	51	53
Brunei Darussalam	20	27	53	67	110	164
Burundi	8	9	14	17	17	17
Cambodia	45	15	15	18	25	32
Cameroon	88	109	142	320	413	394
Cape Verde	1	2	2	2	3	4
Cayman Islands	4	5	8	8	15	19
Central African Republic	21	13	19	14	15	14
Chad	14	20	21	24	25	24
Chile	1 156	866	1 003	1 007	997	1 233
Colombia	1 798	2 436	3 006	3 102	3 639	4 485
Comoros	2	3	2	3	3	3
Congo	22	28	35	35	42	51
Costa Rica	76	120	151	129	163	167

Table IX.19. (*continued*)

(Thousands of tons)

Country or area	1970	1975	1978	1980	1985	1988
Côte d'Ivoire	236	189	241	270	367	407
Cuba	791	991	1 138	1 126	1 156	1 207
Cyprus	97	78	100	100	124	148
Democratic People's Republic of Korea	340	490	700	700	950	1 020
Democratic Yemen	75	90	151	171	272	286
Djibouti	8	9	9	14	14	15
Dominica	4	5	5	5	8	9
Dominican Republic	203	322	321	289	297	360
Ecuador	365	668	1 010	1 264	1 089	1 347
Egypt	494	876	924	1 233	1 958	2 109
El Salvador	90	115	158	133	135	152
Equatorial Guinea	3	5	6	3	5	5
Ethiopia	87	70	85	102	116	119
Fiji	34	35	43	44	45	44
French Guiana	10	13	27	25	22	25
French Polynesia	21	29	26	31	36	38
Gabon	23	18	13	30	38	41
Gambia	8	11	19	22	22	25
Ghana	156	237	267	233	280	177
Grenada	8	7	7	7	5	7
Guadeloupe	38	48	56	45	89	104
Guam	40	91	98	90	85	85
Guatemala	165	263	298	265	250	265
Guinea	34	48	52	58	65	69
Guinea-Bissau	4	7	6	7	7	9
Guyana	41	43	38	42	49	30
Haiti	24	30	43	45	42	41
Honduras	82	88	110	103	130	115
Hong Kong	92	118	164	189	195	196
India	1 463	1 221	1 526	1 459	2 238	2 683
Indonesia	1 135	1 754	2 386	2 793	3 011	3 789
Iran (Islamic Republic of)	946	2 151	2 971	3 396	4 457	4 575
Iraq	382	420	953	1 150	1 450	1 710
Jamaica	328	270	283	205	177	170
Jordan	100	154	245	270	332	338
Kenya	165	234	301	313	239	250
Kuwait	314	449	760	892	1 127	1 200
Lao People's Democratic Republic	44	39	30	20	14	14
Lebanon	362	478	473	500	739	650
Liberia	55	62	63	89	49	54
Libyan Arab Jamahiriya	196	450	670	818	983	1 055
Macau	5	10	10	12	14	19
Madagascar	84	82	75	128	71	58
Malawi	26	34	55	54	46	47
Malaysia	548	578	1 044	1 237	1 955	2 249
Mali	27	36	50	48	51	55
Malta	37	40	41	39	20	45
Martinique	41	84	81	77	66	69
Mauritania	11	18	28	31	32	309
Mauritius	17	31	47	33	35	47
Mexico	6 187	8 337	10 360	13 775	13 971	15 553
Mongolia	133	150	190	220	260	270
Morocco	315	363	395	378	332	366
Mozambique	87	55	78	96	40	36
Myanmar	162	178	219	246	234	152
Nauru	1	4	5	6	6	6
Nepal	10	7	8	10	13	16
New Caledonia	33	49	89	93	47	52

Table IX.19. *(continued)*

(Thousands of tons)

Country or area	1970	1975	1978	1980	1985	1988
Nicaragua	109	143	172	149	121	131
Niger	14	21	27	35	42	43
Nigeria	439	1 026	1 061	2 950	2 979	3 705
Oman	30	81	197	200	397	410
Pakistan	269	344	542	784	942	
Panama	194	277	246	218	186	180
Papua New Guinea	60	83	87	86	84	85
Paraguay	88	64	123	89	112	115
Peru	1 131	1 478	1 171	1 219	1 129	1 200
Philippines	1 770	1 795	1 791	1 314	992	1 294
Puerto Rico	1 184	1 607	1 883	1 619	1 700	1 750
Qatar	39	69	126	170	247	490
Republic of Korea	640	444	893	826	814	1 597
Reunion	44	62	69	98	69	74
Rwanda	7	12	21	23	21	23
Samoa	5	10	8	10	14	14
Saint Lucia	7	9	10	11	15	20
Saudi Arabia	500	1 144	2 370	3 240	6 100	6 200
Senegal	78	112	121	100	101	93
Seychelles	1	4	5	6	5	6
Sierra Leone	43	39	46	20	30	34
Singapore	208	279	300	349	695	799
Solomon Islands	2	3	4	4	8	9
Somalia	28	30	44	11	68	83
Sri Lanka	148	95	130	108	123	159
Sudan	180	149	147	151	194	187
Suriname	25	30	41	42	48	35
Syrian Arab Republic	196	289	533	602	845	960
Thailand	649	1 324	1 708	1 664	1 547	2 177
Togo	16	29	41	50	34	36
Tonga	2	3	3	3	4	8
Trinidad and Tobago	162	205	969	756	402	460
Tunisia	91	131	145	154	220	240
Turkey	970	1 743	2 214	1 728	1 620	2 665
Uganda	112	121	82	88	56	82
United Arab Emirates	60	210	437	585	770	900
United Republic of Tanzania	129	98	94	31	87	92
Uruguay	239	202	193	221	166	191
United States Virgin Islands	76	117	183	182	86	85
Vanuatu	3	5	7	7	4	4
Venezuela	2 978	4 488	6 108	6 721	6 625	5 300
Viet Nam	933	750	185	250	270	280
Yemen	17	47	55	85	107	170
Yugoslavia	1 134	1 765	2 028	2 176	1 700	2 100
Zaire	119	182	168	198	175	185
Zambia	136	177	195	170	110	109
Zimbabwe	171	238	189	188	184	170

Source: United Nations, *Energy Statistics Yearbook*, various issues

Note: The regional and world totals include figures for countries and areas not listed in the table

Annex

STATISTICAL TABLES

Contents

		Page
A.1.	Developed market economies: rates of growth of real gross domestic product, 1980-1989	227
A.2.	Developed market economies: unemployment rates, 1980-1989	227
A.3.	Developed market economies: two measures of inflation, 1980-1989	228
A.4.	Eastern Europe and the Soviet Union: selected macro-economic indicators, 1980-1989	229
A.5.	World trade: changes in volume, prices and terms of trade by major country groups, 1980-1989	230
A.6.	Indices of prices of non-fuel primary commodities exported by developing countries, 1980-1989	231
A.7.	World balance of payments on current account: by country group, 1980-1989	232
A.8.	Balance of payments on current account: developed market economies, 1980-1989	233
A.9.	Balance of payments of the Federal Republic of Germany, 1980-1989	234
A.10.	Balance of payments of Japan, 1980-1989	235
A.11.	Balance of payments of the United States, 1980-1989	236
A.12.	Balance of payments on current account: Eastern Europe and the Soviet Union, 1980-1989	237
A.13.	Balance of payments on current account: developing countries, 1980-1989	238
A.14.	Official reserves of the capital-importing developing countries, 1980-1989	239
A.15.	Net IMF lending to developing countries: by facility, 1980-1989	240
A.16.	Resource commitments of multilateral development institutions, 1980-1989	240
A.17.	Resource commitments of Arab national and regional development institutions, 1982-1989	241
A.18.	Value of oil exports of OPEC member countries, 1970-1989	241
A.19.	OPEC crude oil production, 1989	242

Table A.1. Developed market economies: rates of growth of real gross domestic product, 1980-1989

(Annual percentage change)[a]

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
All developed market economies	1.4	1.5	-0.2	2.5	4.6	3.3	2.7	3.2	4.3	3.5
Major industrial countries	1.1	1.7	-0.4	2.7	4.9	3.4	2.8	3.3	4.5	3.5
Canada	1.5	3.7	-3.2	3.2	6.3	4.6	3.2	4.0	4.5	2.7
France	1.6	1.2	2.6	0.7	1.3	1.9	2.3	1.9	3.5	3.6
Germany, Federal Republic of[c]	1.5	—	-1.0	1.9	3.3	2.0	2.3	1.7	3.7	4.4
Italy	4.2	1.0	0.3	-1.4	5.4	2.9	2.5	3.0	3.9	3.5
Japan[c]	4.3	3.7	3.1	3.2	5.1	4.7	2.7	4.5	5.9	4.9
United Kingdom	-1.9	-1.1	1.3	3.7	1.8	3.8	3.5	4.4	3.9	2.3
United States[c]	-0.2	1.9	-2.6	3.6	6.6	3.5	2.9	3.4	4.6	3.0
Smaller industrial countries	2.8	0.7	0.5	1.4	3.4	2.8	2.3	2.7	3.3	3.4
Memorandum item										
European Economic Community	1.3	0.1	0.7	1.4	2.7	2.5	2.6	2.7	3.7	3.6

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on IMF, *International Financial Statistics* and Secretariat estimates

[a] Data for country groups are weighted averages, where weights for each year are the previous year's GDP valued at 1980 prices and exchange rates.

[b] Estimate.

[c] Real gross national product

Table A.2. Developed market economies: unemployment rates, 1980-1989[a]

(Percentage of total labour force)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
All developed market economies	5.7	6.5	7.9	8.5	7.9	7.7	7.6	7.2	6.7	6.2
Major industrial countries	5.5	6.2	7.7	8.1	7.3	7.2	7.1	6.7	6.1	5.7
Canada	7.4	7.5	10.9	11.8	11.2	10.4	9.5	8.8	7.7	7.5
France	6.3	7.4	8.1	8.3	9.7	10.2	10.4	10.5	10.0	9.5
Germany, Federal Republic of	3.0	4.4	6.1	8.0	7.1	7.2	6.4	6.2	6.1	5.6
Italy	7.5	7.8	8.4	8.8	9.3	9.6	10.5	11.2	11.3	11.3
Japan	2.0	2.2	2.4	2.6	2.7	2.6	2.8	2.8	2.5	2.3
United Kingdom	6.4	9.8	11.3	12.4	11.7	11.2	11.2	10.2	8.3	6.4
United States	7.0	7.5	9.5	9.5	7.4	7.1	6.9	6.1	5.4	5.2
Smaller industrial countries	6.3	7.6	8.9	10.0	10.4	10.4	10.0	9.7	9.3	8.6
Memorandum item										
European Economic Community	6.4	8.0	9.4	10.4	10.6	10.7	10.7	10.5	9.8	9.0

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] Unemployment data standardized by OECD for comparability among countries and over time, in conformity with the definitions of the International Labour Organisation (see OECD, *Standardized Unemployment Rates: Sources and Methods* (Paris, OECD, 1985))

[b] Partially estimated

Table A.3. Developed market economies: two measures of inflation, 1980-1989

(Annual percentage change)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
					GDP deflator[b]					
All developed market economies	9.5	8.9	7.3	5.6	4.7	4.3	4.2	3.6	3.7	4.4
Major industrial countries	9.3	8.8	6.8	5.1	4.1	3.6	3.4	3.0	3.0	4.0
Canada	10.6	10.8	8.7	5.0	3.1	2.9	2.5	4.3	4.2	5.2
France	11.4	11.4	11.7	9.7	7.5	5.8	5.1	2.9	3.1	3.2
Germany, Federal Republic of[c]	4.8	4.0	4.4	3.3	2.0	2.2	3.1	2.0	1.5	1.6
Italy	20.0	19.8	15.9	17.9	8.9	8.6	7.6	6.1	5.5	5.6
Japan[c]	3.8	3.2	1.9	0.8	1.2	1.5	1.7	-0.2	0.2	1.2
United Kingdom	19.5	11.4	7.6	5.3	4.6	5.6	3.5	4.8	6.6	6.8
United States[c]	9.1	9.6	6.4	3.9	3.9	2.8	2.7	3.3	3.1	4.9
Smaller industrial countries	10.1	9.4	9.6	8.4	7.9	7.5	7.7	6.3	6.7	5.9
					Consumer price index[d]					
All developed market economies	11.6	9.7	7.3	5.1	5.0	4.4	2.7	3.3	3.6	4.8
Major industrial countries	11.8	9.6	6.8	4.4	4.6	3.9	2.0	2.9	3.2	4.4
Canada	10.1	12.5	10.8	5.9	4.3	4.0	4.2	4.3	4.1	5.0
France	13.2	13.4	11.8	9.6	7.5	5.7	2.5	3.3	2.7	3.5
Germany, Federal Republic of	5.5	6.3	5.2	3.4	2.4	2.2	-0.1	0.2	1.3	2.8
Italy	21.0	17.9	16.5	14.7	10.8	9.2	5.9	4.7	5.1	6.3
Japan	7.7	5.1	2.7	1.8	2.3	2.0	0.6	0.1	0.7	2.3
United Kingdom	18.0	11.9	8.6	4.5	5.0	6.0	3.4	4.2	4.9	7.8
United States	13.5	10.3	6.2	3.2	4.3	3.5	1.9	3.7	4.0	4.8
Smaller industrial countries	10.2	10.3	10.0	8.4	7.2	7.0	6.2	5.5	5.5	6.5
Memorandum items										
European Economic Community										
GDP deflator[b]	11.5	10.1	9.8	8.3	6.3	5.9	5.5	4.3	4.5	4.4
Consumer price index[d]	11.9	10.8	9.6	7.6	6.4	5.6	3.3	3.2	3.7	5.4

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on IMF, *International Financial Statistics* and Secretariat estimates.

[a] Partially estimated.

[b] Data for country groups are weighted averages, where weights for each year are GDP valued at 1980 prices and exchange rates.

[c] GNP deflator.

[d] Data for country groups are weighted averages, where weights for each year are consumption expenditures valued at 1980 prices and exchange rates

Table A.4. Eastern European economies: selected macro-economic indicators, 1980-1989

(Annual percentage rate of growth)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
Net material product produced										
Bulgaria	5.7	5.0	4.2	3.0	4.6	1.8	5.3	5.0	2.4	-0.4
Czechoslovakia	2.9	-0.1	0.2	2.3	3.5	3.0	2.6	2.1	2.4	1.3
German Democratic Republic	4.4	4.8	2.6	4.6	5.5	5.2	4.3	3.3	2.8	1.9
Hungary	-0.9	2.5	2.7	0.3	2.5	-1.4	0.9	4.1	0.3	-2.0
Poland	-6.0	-12.0	-5.5	6.0	5.6	3.4	4.9	1.9	4.9	0.0
Romania	2.8	2.2	2.7	3.7	7.7	5.9	7.3	4.8	3.2	-9.9
Industrial output										
Bulgaria	4.2	5.4	4.6	4.3	4.2	3.2	4.0	4.2	5.0	2.2
Czechoslovakia	3.5	2.1	1.1	2.8	3.9	3.5	3.2	2.5	2.1	1.0
German Democratic Republic	4.6	4.7	3.2	4.2	4.2	4.4	3.7	3.1	3.2	2.3
Hungary	-1.7	2.4	2.5	1.2	3.2	0.7	1.9	3.5	-0.7	-2.0
Poland	0.0	-10.8	-2.1	6.4	5.2	4.5	4.7	3.4	5.3	-2.0
Romania	6.5	2.6	1.1	4.7	6.7	4.9	7.7	4.5	3.6	-2.1
Agricultural output										
Bulgaria	-4.6	5.9	5.2	-7.2	7.0	-12.3	11.7	-5.1	0.1	0.4
Czechoslovakia	4.8	-2.5	4.4	4.2	4.4	-1.6	0.6	0.9	2.9	1.1
German Democratic Republic	0.7	1.6	-4.0	4.1	7.7	3.2	0.0	0.1	-2.9	1.5
Hungary	4.6	2.0	7.3	-2.7	2.9	-5.5	2.4	-2.0	4.3	-2.0
Poland	-10.7	3.8	-2.8	3.3	5.7	0.7	5.0	-2.3	1.2	2.0
Romania	-4.3	-0.9	7.6	-1.6	13.3	0.1	12.8	2.3	2.9	-4.3
Investment										
Bulgaria	7.5	10.5	3.6	0.7	0.3	8.6	8.0	7.2	2.4	-7.7
Czechoslovakia	1.4	-4.6	-2.3	0.6	-4.2	5.4	1.4	4.4	4.1	2.1
German Democratic Republic	0.1	2.4	-5.1	-0.3	-4.9	3.4	5.3	8.0	8.2	-4.0
Hungary	-5.5	-4.7	-1.6	-3.4	-3.7	-3.0	6.5	9.8	-7.2	-2.0
Poland	-12.3	-22.3	-12.1	9.4	11.4	6.0	5.1	4.2	5.4	-2.0
Romania	3.0	-7.1	-3.1	2.4	6.0	1.6	1.2	0.9	-1.3	-1.8

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

[a] Preliminary

Table A.5. World trade: changes in volume, prices and terms of trade by major country groups, 1980-1989

(Annual percentage rate)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
Volume of exports										
World	-0.8	1.0	-2.1	1.7	8.6	3.7	5.2	5.7	8.9	6.5
Developed market economies	4.9	3.1	-2.1	2.4	10.4	5.0	3.5	4.1	7.8	7.3
Developing countries	12.3	-4.8	-5.0	-1.1	4.4	1.2	9.5	9.9	12.0	6.3
Capital surplus countries	-27.1	-18.0	-18.9	-15.9	-11.1	-6.4	19.2	3.1	9.9	6.0
Other net energy-exporters	-6.1	-6.2	-2.8	1.7	6.0	-1.7	3.2	5.2	14.7	5.4
Net energy importers	7.9	11.6	5.5	6.8	11.5	5.7	9.0	14.8	11.6	6.9
China	-6.9	18.6	13.4	3.4	15.5	12.4	19.3	31.8	16.9	14.3
Eastern Europe and the USSR	2.3	1.5	5.1	5.4	5.5	-0.2	5.3	1.3	6.9	-1.3
Volume of imports										
World	1.8	1.4	-1.9	1.1	9.0	3.9	3.7	4.9	9.1	6.8
Developed market economies	-0.7	-2.9	-2.1	2.0	12.0	4.4	7.4	6.0	8.0	6.7
Developing countries	9.6	14.6	-2.3	-2.4	1.3	-4.2	4.3	3.8	13.8	8.5
Capital surplus countries	15.8	27.2	8.3	-3.4	-10.9	-19.0	-18.2	-7.6	0.9	6.0
Other net energy-exporters	18.9	24.9	-5.3	-11.2	-0.4	-3.1	-14.4	-7.4	15.1	5.9
Net energy importers	4.6	6.7	-4.7	2.3	6.6	0.1	3.1	9.5	15.6	9.5
China	2.1	18.8	-3.8	11.5	24.8	69.4	-23.2	-2.7	15.3	14.2
Eastern Europe and the USSR	3.9	-0.1	1.5	3.7	4.9	10.8	0.5	-1.8	6.9	1.3
Unit value of exports										
World	21.4	-2.3	-4.3	-3.8	-2.6	-2.3	4.8	11.1	4.3	2.3
Developed market economies	12.8	-5.0	-3.5	-3.5	-3.4	-1.6	12.9	12.4	6.0	0.9
Developing countries	44.7	3.8	-7.2	-6.1	0.0	-4.3	16.5	10.5	2.0	7.2
Capital surplus countries	69.2	11.4	-4.1	-9.9	-2.0	-3.0	-37.6	14.0	-15.2	17.2
Other net energy-exporters	50.2	6.1	-5.6	-5.8	-0.9	-4.5	-28.6	10.9	-7.1	11.2
Net energy importers	13.2	-4.3	-8.9	-2.2	2.3	-4.4	-1.6	8.2	9.5	3.9
China	43.6	1.6	10.4	-3.9	0.3	-3.8	-4.6	2.4	3.9	2.2
Eastern Europe and the USSR	12.5	-0.3	-0.0	-0.3	-3.7	-1.1	5.2	8.1	-1.6	2.0
Unit value of imports										
World	20.3	-1.8	-4.0	-3.7	-2.6	-2.2	5.8	11.4	4.5	2.3
Developed market economies	21.5	-1.8	-4.1	-4.0	-2.5	-2.2	5.3	11.9	4.7	2.3
Developing countries	19.9	-2.4	-4.1	-3.9	-2.3	-2.2	3.8	11.5	4.4	2.7
Capital surplus countries	14.4	-4.3	-4.0	-3.3	-2.5	-2.1	8.7	11.6	5.9	2.0
Other net energy-exporters	16.1	-3.6	-4.0	-3.6	-2.4	-2.1	7.6	11.8	5.3	2.0
Net energy importers	22.8	-1.1	-4.2	-4.4	-2.3	-2.4	1.5	11.7	4.0	3.0
China	22.1	-5.2	-8.9	-0.6	-4.9	-1.7	18.8	7.2	10.0	0.4
Eastern Europe and the USSR	10.7	0.4	-2.9	-0.5	-3.4	-1.5	11.5	8.4	1.4	1.7
Terms of trade										
World	0.9	-0.5	-0.3	-0.2	0.0	-0.1	-0.9	-0.2	-0.2	-0.0
Developed market economies	-7.2	-3.3	0.6	0.6	-0.8	0.6	7.2	0.5	1.2	-1.4
Developing countries	20.7	6.4	-3.2	-2.2	2.4	-2.1	-19.5	-1.0	-2.3	4.4
Capital surplus countries	47.9	16.8	-0.1	-6.8	0.5	-0.9	-42.6	2.2	-19.9	14.9
Other net energy-exporters	29.3	10.1	-1.6	-2.4	1.6	-2.4	-33.6	-0.7	-11.8	9.0
Net energy importers	-7.8	-3.2	-5.0	2.4	4.7	-2.0	-3.0	-3.2	-5.3	0.8
China	17.6	7.2	-1.7	-3.3	5.5	-2.1	-19.7	-4.6	-5.5	1.8
Eastern Europe and the USSR	1.6	-0.7	3.0	0.1	-0.3	0.5	-5.6	-0.3	-3.0	0.3

Source: Department of International Economic and Social Affairs of the United Nations Secretariat.

[a] Preliminary estimates

Table A.6. Indices of prices of non-fuel primary commodities exported by developing countries, 1980-1989

(1985=100)

	Food	Tropical beverages	Vegetable oilseeds and oils	Agri-cultural raw materials	Minerals and metals	Combined index Dollar	Combined index SDR	Prices of manufac-tures[a]	Real prices of commodities[b]
1980	240	118	117	136	144	171	134	116	147
1981	192	97	112	119	121	142	122	109	130
1982	131	92	90	103	105	111	102	107	104
1983	138	96	107	110	113	118	112	103	114
1984	116	110	144	111	105	114	112	100	114
1985	100	100	100	100	100	100	100	100	100
1986	110	124	62	102	95	104	90	120	87
1987	117	81	73	119	113	107	84	135	79
1988	152	82	96	129	164	135	102	144	94
1989	161	70	85	129	164	135	107	144	94
1988 I	139	85	87	128	149	126	94	144	88
II	150	82	95	133	174	137	102	145	94
III	163	77	105	129	158	137	107	141	98
IV	156	82	95	127	178	139	105	147	95
1989 I	154	86	92	131	182	140	108	144	97
II	163	80	92	129	168	139	111	142	98
III	164	56	78	127	158	131	106	148	89
IV	163	56	78	127	158	131	106	148	89

Source: UNCTAD, *Monthly Commodity Price Bulletin*; and United Nations, *Monthly Bulletin of Statistics*

[a] Unit values of exports of manufactures from developed market economies The base of the original index was shifted to 1985.

[b] Dollar index deflated by prices of manufactures

Table A.7. World balance of payments on current account:[a] by country group, 1980-1989

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Developed market economies	-36.4	-5.7	-3.6	-0.4	-33.3	-18.7	21.0	2.1	-11.0	-39.1
Major industrial countries[c]	-10.0	22.1	18.1	6.9	-35.0	-19.7	23.3	7.0	-0.4	-17.8
of which:										
Germany, Federal Republic of	-7.1	2.4	11.1	10.6	16.1	22.4	46.6	55.3	59.7	64.5
Japan	-9.5	6.2	8.1	22.2	36.4	50.5	87.3	89.7	82.7	60.2
United States	7.0	13.3	-0.9	-37.9	-95.5	-101.4	-121.4	-133.0	-116.1	-95.6
Other industrial countries	-26.4	-27.7	-21.7	-7.3	1.7	0.9	-2.3	-5.0	-10.5	-21.3
Developing countries	34.4	-37.2	-74.9	-56.7	-28.8	-30.6	-50.0	-6.9	-21.9	-20.0
Capital-surplus countries	104.4	61.4	17.9	-5.0	-0.2	6.2	-9.0	5.0	-0.7	10.5
Capital-importing countries	-69.9	-98.7	-92.8	-51.6	-28.6	-36.8	-41.0	-11.9	-21.1	-30.4
Energy exporters	0.5	-29.5	-35.1	-11.4	-1.8	-2.5	-21.0	-4.5	-18.5	-15.6
Energy importers	-68.0	-71.2	-63.6	-44.7	-29.1	-22.7	-12.9	-7.7	1.3	-11.6
Recent surplus economies[d]	-8.9	-7.1	-2.9	1.5	6.7	10.4	23.3	31.1	28.8	22.5
Other	-59.1	-64.0	-60.7	-46.1	-35.8	-33.1	-36.1	-38.8	-27.5	-34.1
China	-2.4	2.0	5.9	4.4	2.4	-11.5	-7.2	0.3	-3.9	-3.3
Eastern Europe and the Soviet Union[e]	-4.0	-7.1	3.1	7.5	9.6	1.5	-0.3	8.6	3.0	-5.8
Eastern Europe	-6.5	-4.8	0.1	2.0	3.2	1.2	-0.9	1.1	0.3	-2.3
Soviet Union	3.0	-1.6	3.6	5.8	6.7	0.6	0.9	7.8	3.1	-3.2
World residual[f]	6.0	50.0	75.4	49.6	52.5	47.8	29.3	-3.7	29.8	64.8
of which:										
Trade residual (imports, f.o.b.)	-43.2	-33.1	-18.2	-23.5	-30.9	-4.8	-6.5	-39.7	-38.6	-18.0
Services and private transfers	49.2	83.1	93.7	73.1	83.4	52.6	35.8	36.0	68.5	82.9

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

[a] Balance on goods, services and private transfers.

[b] Preliminary estimate.

[c] Canada, France, Federal Republic of Germany, Italy, Japan, United Kingdom and United States.

[d] Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

[e] Balance with market economies; total including estimated investment income deficits of CMEA banks.

[f] Unreported trade, services and private transfers, as well as errors and timing asymmetries in reported data.

Table A.8. Balance of payments on current account:[a] developed market economies, 1980-1989
(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Major industrial countries[c]										
Merchandise exports	895.9	905.3	846.5	836.8	897.7	926.1	1 071.9	1 239.3	1 435.3	1 540.1
Merchandise imports (f.o.b.)	-929.4	-905.4	-845.8	-848.8	-944.3	-965.2	-1 070.5	-1 249.5	-1 425.4	-1 548.6
Balance of trade	-33.5	-0.1	0.7	-12.0	-46.6	-39.1	1.3	-10.2	9.9	-8.5
Net services and private transfers	23.5	22.2	17.4	18.9	11.6	19.4	22.0	17.2	-10.4	-9.3
Current account	-10.0	22.1	18.1	6.9	-35.0	-19.7	23.3	7.0	-0.4	-17.8
Smaller countries										
Merchandise exports	340.1	317.0	302.6	309.1	323.5	333.0	394.3	474.4	538.1	575.9
Merchandise imports (f.o.b.)	-376.6	-348.3	-327.7	-319.2	-323.6	-332.2	-398.6	-486.6	-551.4	-597.0
Balance of trade	-36.5	-31.3	-25.2	-10.2	-0.1	0.8	-4.3	-11.8	-13.3	-21.2
Net services and private transfers	10.0	3.6	3.4	2.9	1.7	0.1	2.0	6.9	2.7	-0.1
Current account	-26.4	-27.7	-21.7	-7.3	1.7	0.9	-2.3	-5.0	-10.5	-21.3

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

[a] Balance on goods, services and private transfers.

[b] Preliminary (based in part on Secretariat estimates).

[c] Canada, France, Federal Republic of Germany, Italy, Japan, United Kingdom and United States.

Table A.9 Balance of payments of the Federal Republic of Germany, 1980-1989

(Billions of dollars)[a]

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Merchandise exports	182.2	165.6	164.9	159.0	160.4	171.4	229.0	275.8	307.3	324.1
Merchandise imports, f.o.b.	-174.3	-150.2	-140.9	-138.5	-138.8	-144.3	-175.0	-207.8	-230.1	-249.5
Balance of trade	7.9	15.3	24.0	20.6	21.6	27.2	54.0	68.0	77.2	74.6
Net services and private transfers, of which:	-15.0	-12.9	-12.9	-9.9	-5.5	-4.7	-7.4	-12.7	-17.4	-10.0
Net investment income	2.0	0.5	-1.2	1.6	3.6	3.2	4.0	3.9	4.6	10.6
Current account balance[c]	-7.1	2.4	11.1	10.6	16.1	22.4	46.6	55.3	59.7	64.5
Official transfers (net)	-6.7	-5.9	-6.0	-5.3	-6.2	-6.0	-7.4	-10.1	-11.2	-11.8
Current account balance[d]	-13.8	-3.6	5.1	5.3	9.8	16.4	39.2	45.2	48.5	52.7
Long-term capital, net	3.2	3.7	-5.8	-2.7	-7.0	-4.4	15.6	-12.9	-48.3	-13.3
Investment abroad	-15.5	-11.9	-11.7	-14.3	-15.8	-21.0	-25.5	-34.8	-54.9	-48.5
Directinvestment	-4.0	-3.9	-2.5	-3.2	-4.4	-4.8	-9.6	-9.0	-10.4	-13.0
Securities	-4.2	-2.7	-4.7	-4.1	-5.5	-10.7	-9.8	-13.9	-41.5	-26.4
Long-term credit transactions	-6.1	-4.3	-3.6	-5.8	-5.0	-4.4	-4.7	-10.3	-1.4	-7.4
Other	-1.1	-1.1	-0.9	-1.3	-0.9	-1.0	-1.4	-1.5	-1.6	-1.7
Foreign investment in the Federal Republic of Germany	18.7	15.6	5.8	11.6	8.9	16.6	41.1	21.8	6.5	35.2
Direct investment	0.4	0.3	0.8	1.8	0.6	0.6	1.1	1.9	1.6	4.1
Securities	0.5	0.4	1.1	5.3	6.1	13.0	34.1	18.5	4.4	24.3
Long-term credit transactions	17.9	14.8	3.9	4.5	2.2	3.0	5.9	1.4	0.6	6.9
Other	-0.1	--	--	-0.1	--	--	-0.1	--	-0.1	-0.1
Short-term capital, net	-3.4	-1.2	4.5	-4.5	-6.2	-14.2	-52.4	-10.1	-20.5	-49.3
Net bank flows	-4.9	-4.5	3.3	0.7	—	-9.4	-27.2	-3.4	-11.5	-30.1
Enterprises, individuals	1.2	2.6	1.3	-3.5	-5.7	-4.8	-24.8	-7.1	-10.3	-17.2
Official	0.2	0.8	-0.1	-1.7	-0.6	--	-0.4	0.5	1.3	-2.0
Errors and omissions	-1.3	--	-2.5	0.3	2.3	2.7	0.3	0.8	0.5	-0.2
Reserve-related flows	15.3	1.0	-1.3	1.6	1.1	-0.6	-2.7	-22.9	19.7	10.1
Memorandum item: Net transfer of resources[e]	8.4	-2.3	-12.7	-9.5	-12.7	-19.6	-43.3	-52.2	-56.8	-55.5

Source: Federal Republic of Germany, *Statistical Supplements to the Monthly Report of the Deutsche Bundesbank*

[a] Minus sign (-) indicates outflow from the Federal Republic of Germany or increase in reserves; dollar values are converted from deutsche mark at average annual exchange rates

[b] Trade data are partly estimated

[c] Balance on goods, services and private transfers.

[d] Including official transfers.

[e] Expenditure definition (negative of balance on goods, services and labour-related transfers, excluding investment income).

Table A.10. Balance of payments of Japan, 1980-1989
(Billions of dollars)[a]

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Merchandise exports	126.7	149.5	137.7	145.5	168.3	174.0	205.6	224.6	259.8	269.6
Merchandise imports, f.o.b	-124.6	-129.6	-119.6	-114.0	-124.0	-118.0	-112.8	-128.2	-164.8	-192.5
Balance of trade	2.1	20.0	18.1	31.5	44.3	56.0	92.8	96.4	95.0	77.1
Net services and private transfers	-11.6	-13.8	-9.9	-9.3	-7.9	-5.4	-5.5	-6.7	-12.4	-16.9
of which:										
Net investment income	0.9	-0.8	1.7	3.1	4.2	6.8	9.5	16.7	21.0	23.4
Current account balance[c]	-9.5	6.2	8.1	22.2	36.4	50.5	87.3	89.7	82.7	60.2
Official transfers (net)	-1.3	-1.4	-1.3	-1.4	-1.4	-1.4	-1.5	-2.7	-3.0	-3.3
Current account balance[d]	-10.7	4.8	6.9	20.8	35.0	49.2	85.8	87.0	79.6	57.0
Long-term capital, net	2.3	-9.7	-15.0	-17.7	-49.6	-64.5	-131.5	-136.5	-130.9	-87.9
Japanese investment abroad	-10.8	-22.8	-27.4	-32.5	-56.8	-81.8	-132.1	-132.8	-149.9	-190.8
Direct investment	-2.4	-4.9	-4.5	-3.6	-6.0	-6.5	-14.5	-19.5	-34.2	-43.8
Trade credits	-0.7	-2.7	-3.2	-2.6	-4.9	-2.8	-1.8	-0.5	-6.9	-3.7
Loans	-2.6	-5.1	-7.9	-8.4	-11.9	-10.4	-9.3	-16.2	-15.2	-22.5
Securities	-3.8	-8.8	-9.7	-16.0	-30.8	-59.8	-102.0	-87.8	-86.9	-113.3
Other	-1.4	-1.3	-2.0	-1.8	-3.2	-2.3	-4.5	-8.8	-6.6	-7.6
Foreign investment in Japan	13.1	13.1	12.4	14.8	7.1	17.3	0.6	-3.7	19.0	102.8
Direct investment	0.3	0.2	0.4	0.4	--	0.6	0.2	1.2	-0.5	-1.1
Securities[e]	13.1	13.2	11.9	14.1	7.2	16.7	0.5	-6.1	20.3	85.1
Other[f]	-0.3	-0.3	0.2	0.2	-0.1	-0.1	-0.1	1.2	-0.9	18.8
Short-term capital, net	16.3	8.7	-1.5	-3.5	13.3	9.9	56.9	95.7	64.0	29.4
Non-bank transactions	3.1	2.3	-1.6	--	-4.3	-0.9	-1.6	23.9	19.5	20.8
Foreign exchange banks	13.1	6.4	--	-3.6	17.6	10.8	58.5	71.8	44.5	8.6
Errors and omissions	-3.1	0.5	4.7	2.1	3.7	4.0	2.5	-3.9	2.8	-23.2
Reserve-related flows	-4.7	-4.2	4.9	-1.6	-2.4	1.5	-13.7	-42.3	-15.5	24.7
Memorandum item										
Net transfer of resources[g]	10.1	-7.2	-6.5	-19.3	-32.3	-44.0	-78.4	-74.0	-62.7	-37.8

Source: Bank of Japan, *Balance of Payments Monthly*

[a] Minus sign (-) indicates outflow of capital from Japan or addition to reserves.

[b] Provisional.

[c] Balance on goods, services and private transfers.

[d] Including official transfers.

[e] Excluding Gensaki transactions, which are included in short-term capital.

[f] Mainly loans.

[g] Expenditure definition (negative of balance on goods and services, excluding investment income).

Table A.11. Balance of payments of the United States, 1980-1989

(Billions of dollars)[a]

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Merchandise exports	224.3	237.1	211.2	201.8	219.9	215.9	233.4	250.3	319.3	361.9
Merchandise imports, f.o.b.	-249.7	-265.1	-247.6	-268.9	-332.4	-338.1	-368.4	-409.9	-446.5	-475.1
Balance of trade	-25.5	-28.0	-36.4	-67.1	-112.5	-122.1	-135.1	-159.5	-127.2	-113.2
Net services and private transfers	32.5	41.3	35.5	29.2	17.0	20.7	13.6	26.5	11.1	17.7
of which:										
Net investment income	30.4	34.1	28.7	24.9	18.5	25.9	21.6	22.3	2.2	1.0
Current account balance[c]	7.0	13.3	-0.9	-37.9	-95.5	-101.4	-121.4	-133.0	-116.1	-95.6
Official transfers (net)	-5.5	-5.1	-6.1	-6.4	-8.7	-11.3	-11.8	-10.2	-10.5	-10.3
Current account balance[d]	1.5	8.2	-7.0	-44.3	-104.2	-112.7	-133.2	-143.2	-126.5	-105.9
Net private capital flows	-30.2	-22.6	-19.9	35.4	85.8	105.1	88.1	86.5	98.9	87.9
United States private capital	-72.8	-100.7	-110.1	-43.6	-13.7	-25.9	-98.0	-86.4	-81.5	-101.5
Direct investment	-19.2	-9.6	2.4	-0.4	-2.8	-18.1	-26.3	-44.2	-17.5	-32.3
Securities	-3.6	-5.7	-8.0	-6.8	-4.8	-7.5	-4.3	-5.3	-7.8	-22.6
Banking flows	-46.8	-84.2	-111.1	-29.9	-11.1	-1.3	-60.0	-42.1	-54.5	-47.2
Non-banking flows	-3.1	-1.2	6.6	-6.5	5.0	0.9	-7.4	5.2	-1.7	0.6
Foreign private capital	42.6	78.1	90.2	79.0	99.5	131.1	186.0	172.8	180.4	189.3
Direct investment	16.9	25.2	13.8	11.9	25.4	19.0	34.1	46.9	58.4	61.3
Securities, of which:	8.1	9.8	13.1	16.9	35.6	71.4	74.8	34.5	46.6	69.7
Equity shares	4.2	5.1	3.6	6.4	-1.3	4.3	17.2	15.5	-0.7	-0.7
Banking flows	10.7	42.1	65.6	50.3	33.8	41.0	79.8	89.0	68.8	58.0
Non-banking flows	6.9	0.9	-2.4	-0.1	4.7	-0.4	-2.6	2.5	6.6	0.3
Net official flows	3.3	-4.2	-7.5	-0.4	-5.5	-7.8	33.9	55.3	38.3	-16.9
Foreign official capital	15.5	5.0	3.6	5.8	3.1	-1.1	35.6	45.2	38.9	7.4
United States official reserves[e]	-7.0	-4.1	-5.0	-1.2	-3.1	-3.9	0.3	9.1	-3.6	-25.3
Other United States Government assets	-5.2	-5.1	-6.1	-5.0	-5.5	-2.8	-2.0	1.0	3.0	1.0
Statistical discrepancy	25.3	18.7	34.4	9.2	23.9	15.3	11.3	1.9	-10.6	34.9
Memorandum item										
Net transfer of resources[f]	22.3	19.6	28.1	61.5	112.2	125.3	141.2	153.9	116.5	95.0

Source: United States Department of Commerce, *Survey of Current Business*.

[a] Minus sign (-) indicates payment outflow from the United States or increase in official reserves

[b] Preliminary.

[c] Balance on goods, services and private transfers

[d] Including official transfers

[e] Change in reserves from flows (excluding valuation changes in stocks and net of SDR allocations).

[f] Expenditure definition (negative of balance on goods, services and labour-related transfers, excluding investment income)

Table A.12. Balance of payments on current account: Eastern Europe and the Soviet Union, 1980-1989[a]

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Eastern Europe										
Merchandise exports	32.5	33.1	32.5	33.3	34.8	33.2	33.6	36.2	37.9	39.5
Merchandise imports (f.o.b.)	-35.3	-32.1	-27.4	-27.3	-27.8	-28.8	-31.3	-32.9	-34.9	-37.1
Balance of trade	-2.8	1.0	5.1	6.0	7.0	4.4	2.3	3.3	3.0	2.4
Net services and private transfers	-3.7	-5.8	-5.0	-4.0	-3.8	-3.2	-3.2	-2.2	-2.7	-4.7
Current account	-6.5	-4.8	0.1	2.0	3.2	1.2	-0.9	1.1	0.3	-2.3
Soviet Union										
Merchandise exports	38.2	39.1	43.4	44.2	43.3	36.9	34.6	40.8	42.7	45.1
Merchandise imports (f.o.b.)	-34.8	-39.9	-39.1	-38.0	-36.6	-36.2	-33.3	-32.7	-39.2	-47.4
Balance of trade	3.4	-0.8	4.3	6.2	6.7	0.7	1.3	8.1	3.5	-2.3
Net services and private transfers	-0.4	-0.8	-0.7	-0.4	--	-0.1	-0.4	-0.3	-0.4	-0.8
Current account	3.0	-1.6	3.6	5.8	6.7	0.6	0.9	7.8	3.1	-3.2
Estimated net investment income of CMEA banks	-0.5	-0.7	-0.6	-0.3	-0.3	-0.3	-0.3	-0.3	-0.4	-0.3
Regional current account	-4.0	-7.1	3.1	7.5	9.6	1.5	-0.3	8.6	3.0	-5.8

Source: United Nations Economic Commission for Europe.

[a] Balance on goods, services and private transfers in convertible currencies

[b] Preliminary estimates.

Table A.13. Balance of payments on current account:[a] developing countries, 1980-1989

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
Surplus energy exporters (8 economies)										
Merchandise exports	215.9	197.5	155.9	121.2	110.5	93.7	60.9	76.0	71.4	85.8
Merchandise imports (f.o.b.)	-75.1	-91.5	-95.3	-86.4	-74.5	-59.1	-50.8	-51.4	-55.7	-58.2
Balance of trade	140.8	106.0	60.6	34.8	36.0	34.6	10.0	24.5	15.8	27.6
Net services and private transfers	-36.5	-44.5	-42.7	-39.8	-36.2	-28.4	-19.0	-19.5	-16.5	-17.1
Current account	104.4	61.4	17.9	-5.0	-0.2	6.2	-9.0	5.0	-0.7	10.5
Deficit energy exporters (19 economies)										
Merchandise exports	140.3	140.1	125.9	121.4	132.4	126.6	90.0	108.3	111.1	131.3
Merchandise imports (f.o.b.)	-108.0	-128.5	-116.1	-97.5	-97.1	-91.9	-80.4	-84.7	-100.7	-114.1
Balance of trade	32.3	11.6	9.8	23.9	35.3	34.7	9.6	23.6	10.4	17.1
Net services and private transfers	-31.9	-41.1	-44.8	-35.2	-37.1	-37.2	-30.6	-28.2	-29.0	-32.7
Current account	0.5	-29.5	-35.1	-11.4	-1.8	-2.5	-21.0	-4.5	-18.5	-15.6
Energy-importing countries (100 economies)										
Merchandise exports	200.9	214.7	204.1	211.5	240.5	236.8	262.3	325.1	401.6	440.3
Merchandise imports (f.o.b.)	-258.7	-271.4	-249.7	-240.7	-248.0	-241.8	-257.7	-319.5	-381.7	-429.0
Balance of trade	-57.8	-56.7	-45.6	-29.2	-7.5	-5.1	4.5	5.6	19.9	11.3
Net services and private transfers	-10.1	-14.4	-18.0	-15.5	-21.6	-17.7	-17.4	-13.3	-18.6	-22.9
Current account	-68.0	-71.2	-63.6	-44.7	-29.1	-22.7	-12.9	-7.7	1.3	-11.6
Recent surplus economies (4 economies)[c]										
Merchandise exports	74.7	84.7	83.1	90.7	107.6	108.6	130.1	175.1	221.2	244.8
Merchandise imports (f.o.b.)	-83.9	-93.7	-90.5	-93.2	-101.0	-99.8	-111.1	-149.9	-198.7	-226.7
Balance of trade	-9.2	-9.0	-7.4	-2.5	6.6	8.8	19.0	25.2	22.5	18.1
Net services and private transfers	0.2	1.9	4.5	4.0	0.2	1.6	4.3	5.9	6.3	4.4
Current account	-8.9	-7.1	-2.9	1.5	6.7	10.4	23.3	31.1	28.8	22.5
Other energy importers (96 economies)										
Merchandise exports	126.1	130.0	121.0	120.8	132.9	128.2	132.2	150.0	180.4	195.5
Merchandise imports (f.o.b.)	-174.8	-177.7	-159.2	147.5	-147.0	-142.0	-146.6	-169.6	-183.0	-202.3
Balance of trade	-48.7	-47.7	-38.2	26.7	-14.1	-13.8	-14.5	-19.6	-2.6	-6.8
Net services and private transfers	-10.4	-16.3	-22.5	-19.5	-21.8	-19.3	-21.7	-19.2	-24.9	-27.3
Current account	-59.1	-64.0	-60.7	-46.1	-35.8	-33.1	-36.1	-38.8	-27.5	-34.1
China										
Merchandise exports	18.5	22.0	21.1	20.7	23.9	25.1	25.8	34.7	41.0	45.4
Merchandise imports (f.o.b.)	-21.2	-20.3	-16.9	-18.7	-23.9	-38.2	-34.9	-36.4	-46.4	-49.6
Balance of trade	-2.8	1.7	4.2	2.0	—	-13.1	-9.1	-1.7	-5.3	-4.2
Net services and private transfers	0.3	0.3	1.6	2.4	2.4	1.6	2.0	2.0	1.4	0.9
Current account	-2.4	2.0	5.9	4.4	2.4	-11.5	-7.2	0.3	-3.9	-3.3
Long-term capital-importing countries (120 economies)										
Merchandise exports	359.7	376.8	351.1	353.6	396.8	388.5	378.0	468.1	553.8	617.0
Merchandise imports (f.o.b.)	-387.9	-420.2	-382.7	-356.9	-369.0	-372.0	-373.0	-440.6	-528.8	-592.7
Balance of trade	-28.3	-43.4	-31.6	-3.3	27.8	16.5	5.0	27.6	25.0	24.2
Net services and private transfers	-41.7	-55.2	-61.2	-48.3	-56.4	-53.3	-46.0	-39.5	-46.2	-54.7
Current account	-69.9	-98.7	-92.8	-51.6	-28.6	-36.8	-41.0	-11.9	-21.1	-30.4

Table A.13. *(continued)*

(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[b]
All developing countries (128 economies)										
Merchandise exports	575.6	596.3	528.2	495.5	531.3	507.2	464.7	578.8	666.3	748.2
Merchandise imports (f.o.b.)	-463.0	-532.0	-494.9	-462.0	-467.5	-469.3	-458.8	-528.4	-630.8	-700.6
Balance of trade	112.5	64.3	33.3	33.5	63.8	37.9	5.9	50.4	35.5	47.6
Net services and private transfers	-78.1	-101.5	-108.2	-90.1	-92.6	-68.6	-55.9	-57.3	-57.3	-67.6
Current account	34.4	-37.2	-74.9	-56.7	-28.8	-30.6	-50.0	-6.9	-21.9	-20.0

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

[a] Balance on goods, services and private transfers.

[b] Preliminary estimate.

[c] Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

Table A.14. Official reserves of the capital-importing developing countries, 1980-1989

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
					Billions of dollars					
Level of reserves[b]	113.9	111.0	100.8	109.2	127.4	139.0	157.1	207.2	208.7	226.5
of which:										
Energy exporters	44.5	39.8	28.8	31.3	36.4	38.9	33.0	42.1	28.8	34.5
Energy importers	66.3	65.7	60.1	62.5	73.2	86.9	112.1	148.2	160.8	173.5
Recent surplus countries[c]	11.9	17.6	20.0	23.6	29.0	38.5	62.8	96.0	104.0	111.7
Other	54.4	48.1	40.2	38.8	44.2	48.4	49.3	52.2	56.8	61.8
China	3.1	5.6	11.8	15.5	17.8	13.2	12.0	16.9	19.1	18.5
Miscellaneous groupings										
Fifteen heavily-indebted countries[d]	50.0	41.7	26.3	27.5	39.6	40.9	34.4	38.7	33.5	38.3
Sub-Saharan Africa[e]	3.4	3.1	2.6	2.9	3.0	4.0	5.0	5.7	6.2	6.5
					Number of months					
Coverage of current expenditures[f]	2.8	2.3	2.0	2.4	2.8	2.8	2.7	2.9	2.6	2.7
of which:										
Energy exporters	3.2	2.4	1.8	2.3	2.6	2.9	2.8	3.5	2.1	2.5
Energy importers	2.5	2.2	2.2	2.5	2.9	2.7	2.6	2.6	2.8	2.7
Fifteen heavily-indebted countries[d]	3.1	2.3	1.6	2.1	3.0	3.2	2.7	2.9	2.3	2.4
Sub-Saharan Africa[e]	1.1	1.0	0.9	1.1	1.1	1.5	1.6	1.7	1.7	1.9

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

[a] Partly estimated.

[b] Total reserves, end of period (with gold valued at SDR 35 per ounce).

[c] Republic of Korea, Singapore and Taiwan Province of China (data for Hong Kong unavailable).

[d] Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia.

[e] Excluding Nigeria.

[f] Expenditures on goods and services (including interest payments) for given year relative to total reserves at end of year, sample of 96 countries.

Table A.15. Net IMF lending to developing countries: by facility, 1980-1989
(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Regular facilities	2.3	6.2	4.2	8.4	4.4	1.1	0.1	-3.8	-4.0	-3.0
Credit tranche drawings	1.5	3.9	1.9	3.5	1.2	1.1	1.0	-1.8	-1.2	-1.5
Extended facility drawings	0.7	2.4	2.3	4.9	3.2	--	-0.9	-1.9	-2.8	-1.4
Special facilities	1.2	0.3	1.4	2.2	-0.2	-0.8	-2.1	-1.0	-0.5	1.0
Buffer stock financing	--	--	0.1	0.3	--	-0.2	-0.2	-0.1	--	--
Compensatory financing	0.3	0.6	1.7	2.1	--	-0.4	-1.4	-0.7	-0.4	0.2
Oil facility	-0.7	-0.7	-0.4	-0.1	--	--	--	--	--	--
1970s Trust Fund	1.6	0.4	--	--	-0.2	-0.3	-0.6	-0.7	-0.7	-0.5
Structural adjustment facility	--	--	--	--	--	--	0.1	0.5	0.3	0.6
Enhanced structural adjustment facility	--	--	--	--	--	--	--	--	0.3	0.7
Total	3.4	6.6	5.7	10.6	4.2	0.2	-2.0	-4.7	-4.5	-2.1
Memorandum items										
Selected characteristics of higher conditionality lending agreements										
Number initiated during year	28	31	19	33	20	26	31	25	28	23
Average length (months)	20	23	14	18	14	16	22	26	25	25
Total amount committed	7.5	24.4	2.6	15.7	4.0	3.4	4.0	4.4	5.4	13.8

Source: Data of IMF, *International Financial Statistics* and *IMF Survey*.

Table A.16. Resource commitments of multilateral development institutions, 1980-1989[a]
(Millions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Financial institutions										
African Development Bank	571	636	766	899	897	1 154	1 640	2 140	2 176	2 856
Asian Development Bank	1 452	1 694	1 702	1 922	2 257	1 845	2 044	2 508	3 241	3 761
Caribbean Development Bank	45	42	45	48	65	50	67	41	74	77
Inter-American Development Bank	2 341	2 534	2 793	3 099	3 615	3 102	3 057	2 408	1 738	2 611
International Fund for Agricultural Development	394	377	338	282	211	131	147	233	244	277
World Bank Group	12 780	13 385	12 695	15 786	13 255	17 527	18 005	19 310	20 182	22 765
International Bank for Reconstruction and Development	8 148	8 905	9 398	11 721	9 448	12 952	13 593	14 066	14 411	16 251
International Development Association	3 817	3 688	2 832	3 112	3 222	3 541	3 373	3 841	4 350	4 924
International Finance Corporation	815	792	465	953	585	1 034	1 039	1 403	1 421	1 590
Subtotal	17 583	18 668	18 339	22 036	20 300	23 809	24 960	26 640	27 655	32 347
Operational agencies of the United Nations										
United Nations Development Programme[b]	639	696	621	527	531	567	656	809	942	1 063
United Nations Population Fund	146	127	115	117	134	141	116	134	169	194
United Nations Children's Fund	279	295	405	182	204	452	248	330	454	498
World Food Programme	479	543	613	696	925	642	629	621	779	577
Subtotal	1 543	1 661	1 754	1 522	1 794	1 802	1 649	1 894	2 344	2 332
Total commitments	19 126	20 329	20 093	23 558	22 094	25 611	26 609	28 534	29 999	34 679
Memorandum item										
Commitments in units of 1980 purchasing power[c]	19 126	21 627	21 840	26 470	25 691	29 780	25 834	24 598	24 193	27 967

Source: Annual reports and information supplied by individual institutions.

[a] Loans, grants, technical assistance and equity participation, as appropriate; all data are on a calendar year basis.

[b] Including UNDP-administered funds.

[c] Total commitments deflated by the United Nations index of manufactured export prices in dollars of developed market economies.

Table A 17 Resource commitments of Arab national and regional development institutions,[a] 1982-1989

(Millions of dollars)

	1982	1983	1984	1985	1986	1987	1988	Two thirds 1989
Functional composition								
Project finance								
(loans, equity or grants)	2 085 8	1 410 2	1 158 2	999 6	1 163 1	1 011 7	1 005 5	1 019 4
Technical assistance								
(grants and loans)	52 9	24 2	20 9	42 1	37 1	85 2	37 8	27 8
Import financing								
(grants,loans and leasing)	436 4	506 0	768 3	603 9	658 6	529 8	539 7	285 3
Balance of payments								
(mainly OPEC Fund loans)	83 5	25 5	3 7	--	5 8	11 4	13 2	--
Other (grants)[b]	35 0	6 4	7 4	6 1	0 9	1 0	11 5	2 4
Total	2 693 6	1 972 3	1 958 5	1 651 7	1 865 5	1 639 1	1 607 7	1 334 9
Geographical distribution								
Africa	1 458 4	841 7	864 5	616 4	1 008 5	748 1	814 4	935 1
West Asia	425 6	424 1	544 0	485 8	378 1	419 2	432 7	242 5
Other Asia and Pacific[c]	655 0	507 3	393 4	393 6	314 1	343 2	326 6	152 1
Other[d]	154 6	199 2	156 6	156 0	164 8	128 6	34 0	5 1
Total	2 693 6	1 972 3	1 958 5	1 651 7	1 865 5	1 639 1	1 607 7	1 334 9

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from the Co-ordination Secretariat of Arab National and Regional Development Institutions (Kuwait)

[a] Abu Dhabi Fund for Arab Economic Development, Arab Bank for Economic Development in Africa, Arab Fund for Economic and Social Development, Iraqi Fund for External Development (1982), Islamic Development Bank, Kuwait Fund for Arab Economic Development, OPEC Fund for International Development and Saudi Fund for Development The funds included here account for roughly a third (1982) of ODA commitments by developing countries as reported by OECD (i e , data exclude contributions to most multilateral institutions and bilateral ODA outside the listed institutions and ODA by non-Arab donors)

[b] Including contributions to IFAD, subscriptions to the UNCTAD Common Fund on behalf of low-income countries and research projects to be undertaken by various institutions

[c] Including China

[d] Including international agencies and organizations

Table A 18 Value of oil exports of OPEC member countries,[a] 1970-1989

(Millions of dollars)

Country	1970	1980	1985	1986	1987	1988	1989[b]
Algeria	681	12 647	9 170	4 819	6 057	4 988	3 400
Ecuador	1	1 563	1 927	983	724	976	1 200
Gabon	62	1 745	1 629	723	896	779	1 100
Indonesia	446	15 595	9 083	5 501	6 157	5 185	4 500
Iran (Islamic Republic of)	2 358	13 286	13 115	7 183	10 515	8 170	12 000
Iraq	788	26 296	10 685	6 905	11 416	10 952	15 400
Kuwait	1 596	17 678	9 817	6 378	7 520	6 295	9 800
Libyan Arab Jamahiriya	2 357	21 378	9 962	5 787	6 011	5 169	6 300
Nigeria	716	25 290	12 353	6 177	7 023	6 126	9 300
Qatar	227	5 406	3 068	1 720	1 829	1 709	2 200
Saudi Arabia	2 418	105 813	24 180	16 975	19 271	20 500	24 300
United Arab Emirates	485	19 558	11 842	7 453	8 665	7 352	10 300
Venezuela	2 371	18 248	10 352	6 713	6 959	8 162	7 600
Total[c]	14 505	284 503	127 181	77 314	93 042	86 364	107 400

Source: OPEC, *Annual Statistical Bulletin, 1988* for 1970, 1980 and 1985-1988, and *Petroleum Intelligence Weekly*, 12 February 1990 for 1989

[a] Where appropriate, petroleum product exports are included Data for some countries may include exports of condensates Starting 1980, Saudi Arabia data excludes natural gas liquids

[b] Estimate

[c] Totals may not add up because of rounding

Table A.19. OPEC crude oil[a] production, 1989

(Thousands of barrels per day)

Country	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Algeria	1 040	1 080	1 040	1 100	1 100	1 100	1 110	1 110	1 110	1 110	1 110	1 110
Ecuador	310	280	280	280	250	280	280	300	300	300	290	290
Gabon	175	175	180	180	200	210	210	230	230	280	280	260
Indonesia	1 320	1 320	1 320	1 345	1 350	1 350	1 350	1 340	1 340	1 390	1 390	1 250
Iran (Islamic Republic of)	2 700	2 850	3 000	2 930	2 530	2 630	2 930	3 030	2 880	2 980	2 780	2 929
Iraq	2 650	2 650	2 650	2 750	2 750	2 800	2 800	3 020	2 920	3 020	2 970	3 018
Kuwait[b]	1 250	1 350	1 400	1 695	1 995	2 095	1 840	1 905	1 920	1 920	2 110	2 116
Libyan Arab Jamahiriya	1 100	1 050	1 050	1 100	1 100	1 100	1 100	1 120	1 120	1 120	1 170	1 170
Nigeria	1 400	1 400	1 550	1 635	1 635	1 635	1 835	1 750	1 750	1 650	1 850	1 850
Qatar	350	320	300	300	360	400	400	400	400	400	380	404
Saudi Arabia[b]	5 000	4 750	4 590	4 845	4 945	4 920	5 015	5 115	5 330	5 430	5 820	5 824
United Arab Emirates	1 570	1 560	1 595	1 620	1 620	1 725	1 835	1 925	2 120	2 220	2 320	2 395
Venezuela	1 830	1 830	1 830	1 850	1 860	1 910	1 910	1 890	1 890	1 940	1 940	1 800
Total	20 695	20 615	20 785	21 630	21 695	22 155	22 615	23 135	23 310	23 760	24 410	24 416

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on *Petroleum Economist*, vol. LVII, No. 2 (February 1990), p. 72

[a] Crude oil and condensates (excluding natural gas liquids)

[b] Includes share of Partitioned Zone

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