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Department of International Economic and Social Affairs

WORLD ECONOMIC SURVEY 1979-1980

UNITED NATIONS
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WORLD ECONOMIC SURVEY 1979-1980

Corrigendum

Page vii, list of tables

In the title of table II-3 replace 1971-1980 by 1977-1980
In the title of table IV-4 replace 1970-1979 by 1977-1979

Page viii, list of tables

In the title of table A-4 replace 1970-1978 by 1970-1977

Page 13, third paragraph, line 7

After relatively small number of insert more

Page 20, table II-3, title

For 1971-1980 read 1977-1980

Page 45, footnote 45

The second line should read countries are influenced[a] to some extent by the growing petroleum exports of half a

Page 53, table IV-4, title

For 1970-1979 read 1977-1979

Page 97, footnote b, line 2

The first two words should read purchasing power

Page 102, table A-4, title

For 1970-1978 read 1970-1977

Page 109, second paragraph, line 2

For 1978 read 1980

Page 111, footnote h, line 1

For 1978 read 1980

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PREFACE

Each year, in accordance with General Assembly resolution 118 (II), the Economic and Social Council, at its second regular session, holds a general discussion on international economic and social policy. In the general discussion, as specified by the Assembly, the Council considers "a survey of current world economic conditions and trends ... in the light of its responsibility under Article 55 of the Charter to promote the solution of international economic problems, higher standards of living, full employment and conditions of economic and social progress and development." The World Economic Survey, 1979-1980 has been prepared to assist the Council in its deliberations at the second regular session in July 1980. The Survey is intended to provide the basis for a synthesized appraisal of current trends in the world economy, particularly as they affect the progress of developing countries. It is accordingly hoped that the Survey will also be of interest and use to other United Nations bodies, to Governments and to the general public.

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

The Survey has been prepared in the Office for Development Research and Policy Analysis of the Department of International Economic and Social Affairs, of the United Nations Secretariat.

CONTENTS

CONTENTS (continued)

List of tables

List of tables (continued)

Explanatory notes

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

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

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

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

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

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

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

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

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

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

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

The following abbreviations have been used:

CMEA	Council for Mutual Economic Assistance
DAC	Development Assistance Committee (Organisation for Economic Co-operation and Development)
FAO	Food and Agriculture Organization of the United Nations
IMF	International Monetary Fund
ISIC	International Standard Industrial Classification
LINK	International Research Group of Econometric Model Builders
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
SDR	special drawing rights
UNCTAD	United Nations Conference on Trade and Development

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

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

The designation "developed" and "developing" economies in the text and the tables is intended for statistical convenience and does not necessarily express a judgement about the stage reached by a particular country or area in the development process.

SUMMARY

/Chapter I. The current world economic situation: some salient features and policy implications/

The present world economic situation is characterized by a slow pace of economic advance in most countries, which is expected to weaken further in the coming months, particularly in developed market economies, high rates of price inflation, which pervade all economies, and substantial changes in the pattern of current-account balances, occasioned principally by the doubling of the price of oil between the end of 1978 and the early months of 1980.

The current situation of developing countries is particularly difficult. It is aggravated by attitudes that are less favourably disposed to the accommodation of increased current account deficits than they were in the past. There is certainly wide-spread agreement on the need for a prompt adaptation of domestic policies to the changed situation. But when adjustment is equated with a reduction of current account deficits, there is considerable doubt whether a rapid process is desirable or even possible. While individual countries may be able to lessen their deficits by shifting their balance-of-payments pressures on to others, the aggregate deficit corresponding to the surplus of oil exporters cannot be reduced as long as the world demand for oil is sustained. Insistence on the reduction of individual current accounts would thus introduce a fresh deflationary force into the world economy.

The adjustment of deficits of individual countries needs to be moderated considerably by the provision of additional finance, and the terms and conditions associated with such finance should fully reflect the fact that the larger deficits will persist for a considerable period of time. Because of their terms, maturity and distribution among developing countries, flows from private banks do not constitute an adequate means of providing the necessary additional finance.

The difficulties currently facing the world economy appear to require a fresh attempt at international economic co-ordination encompassing questions of critical importance to all groups of countries. A primary objective of policy measures in such a programme of co-operation would be to protect rates of growth in developing countries, particularly the poorer countries, from disturbances emanating from the world economy. Considerable benefit would also derive from international understandings concerning production and consumption of energy, which would allow the price of energy to be more predictable. Such understandings would reinforce the tendency for the current accounts of oil-exporting countries as a group to remain in surplus and would raise questions concerning the arrangements for recycling that surplus. International measures in these areas would create an environment in which the solution to the larger problems of inflation and better economic performance could proceed at a more satisfactory pace.

/Chapter II. The growth of world output, 1979-1980/

The growth of world output slowed in 1979, from a rate of 4.4 per cent in 1978 to 3.4 per cent in 1979. A further decline in growth to about 2 1/2 per cent is

expected in 1980. The results of 1979 and those expected in 1980 accentuate the poor growth performance of the years since 1973 and appear to confirm that the world economy is going through an extended period of slower growth.

The developing countries in the aggregate experienced a slightly higher growth rate than in 1978, when the total output was unduly affected by declines or an unusually slow expansion in some oil-exporting countries. In the non-oil-exporting countries, improved growth performance was concentrated in a few large and relatively industrialized countries. The majority of the developing countries, and particularly the low-income countries, experienced no improvement, and in some cases even showed a decline, in the pace of economic growth.

Most of the developing countries that succeeded in attaining rates of growth of gross domestic product in excess of 6 per cent did so at the expense of growing domestic and international disequilibria. In these countries, inflation rates rose steeply, and their current-account deficits worsened appreciably. But higher inflation and much larger deficits were problems even among countries that were unable to raise their growth rates, indicating that the international environment exerted a negative influence on the growth processes of developing countries. The terms of trade of most of the non-oil-exporting countries showed a marked deterioration, and sharply higher import prices contributed to inflation.

The outlook for 1980 is clouded by adverse external developments. The terms of trade are expected to continue to deteriorate in most countries, and balance-of-payments pressures should intensify. Even to maintain growth at the unsatisfactory rates of recent years will require a major domestic and international effort and the low-income countries will need to have access to adequate balance-of-payments financing and higher levels of official development assistance in real terms.

The developed market economies contributed about one half of the overall deceleration in world economic growth during 1979. The slow-down was centred in the United States of America; indeed, most of the major European countries and Japan showed improvements in their growth rates. By the second half of the year, however, clear signs of a weakening in investment and private consumption began to appear in most countries. As concern with inflation grew, most Governments instituted restrictive economic policies. Monetary policy assumed a major role in the fight against inflation, and controls on credit expansion and higher interest rates became important features in the policies of most countries.

As the slow-down becomes more synchronized than in 1979, growth in the developed market economies is expected to decelerate further in 1980, when the United States will again experience the sharpest decline. Slower growth in personal incomes (and even a decline in some countries), high interest rates and tight credit conditions are expected to have an adverse effect on investment and consumption expenditure.

Economic expansion slowed sharply in the centrally planned economies in 1979. In the European centrally planned economies, a trend of several years' standing was exacerbated by unusually unfavourable climatic conditions, and growth declined to less than 2 per cent, the lowest rate recorded in the post-war period. Apart from reduced agricultural output, this decline reflected a tight labour supply situation and difficulties stemming from imbalances in the transport, raw material and energy sectors. In the more trade-dependent countries of Eastern Europe, deteriorating terms of trade and policy decisions to curtail external deficits led

to import constraints, which in a number of countries affected production supplies. In China, the growth of output decelerated after a period of recovery from the natural disasters and political upheavals of the mid 1970s.

The economic policies and plan targets of the centrally planned economies for 1980 are on the whole very similar to those pursued in 1979, aiming at a further easing of internal strains and, in some countries, at the curtailment of external deficits. Overall growth is expected to be higher than in 1979, but not to recover the levels registered earlier in the decade.

/Chapter III. The accelerating pace of inflation/

An acceleration of inflation characterized all groups of countries in 1979. The developed market economies appear to have become increasingly prone to inflation as the various economic actors try to adapt their behaviour to higher rates of price increase. In 1979, a significant inflationary impulse was created by the increase in oil prices. Higher inflation in the developed market economies also contributed powerfully to the acceleration in world-wide inflation. Inflation rates are unlikely to subside significantly in 1980.

In developing countries, the acceleration of prices started from a higher overall level of inflation than in the developed market economies. The majority of the developing countries have to deal with inflation rates that are in excess of 20 per cent per annum. Demand factors appear to have contributed to the acceleration of prices in oil-exporting countries and in a few fast-growing non-oil-exporting countries. For most developing countries, however, increased import prices accounted for much of the acceleration in inflation. Attempts to deal with external imbalance, especially currency devaluation, also pushed up import costs, and higher living costs led to labour pressures and large nominal wage increases in some countries.

In the centrally planned economies, both the frequency and the size of price changes were noticeably larger in 1979 than in earlier years, though their magnitude generally remained well below the rates of increase experienced elsewhere in the world. In several countries, the rise in the price level for the first time exceeded the growth of nominal incomes.

/Chapter IV. World trade and international payments, 1979-1980/

Sizeable shifts in the current-account balances of the various country groupings characterized international payments in 1979. The current-account balance of the oil-exporting developing countries improved by more than $60 billion and that of the centrally planned economies by about $7 billion. The deficit of the non-oil-exporting developing countries increased by more than $15 billion, to a level slightly above $50 billion. The current-account balance of developed market economies experienced a swing of nearly $50 billion, reaching a deficit of more than $10 billion. Changes in the terms of trade were largely responsible for the shifts in current balances.

The rate of increase in the volume of world trade in 1979 was between 6 and 7 per cent, slightly above that of 1978. Trade in manufactures grew at the same pace as in the previous year. The factors that shaped the acceleration in the

volume of trade - large food imports necessitated by adverse weather conditions in certain regions and the decision of a few countries to build stocks of industrial inputs - were largely of a short-term nature.

The pattern of current-account balances among major industrial countries, which had been a source of instability in foreign exchange markets in the past, improved considerably in 1979. However, increased pressures on the external payments of a large number of developing countries, particularly low-income countries, were evident in the second half of the year. Official flows to developing countries do not seem to have increased in real terms in 1979, as international inflation eroded most of the nominal increase in such flows. Many non-oil-exporting developing countries continued to resort heavily to international commercial banks. As a consequence, the debt structure shifted further towards shorter maturities. In many developing countries, international reserves had fallen well below the equivalent of three months of imports. Thus, as regards external payments, most non-oil-exporting developing countries found themselves in a more vulnerable situation.

The outlook for 1980 is one of sluggish growth in trade, accompanied by shifts in the current-account balances in the same direction as 1979. Such shifts will again be largely determined by changes in the terms of trade, the magnitude and direction of which are not likely to be very different from those of 1979. A significant slow-down in economic growth in the developed market economies and continuing import restraint in the centrally planned economies will dampen the increase in world trade in 1980. Moreover, improved weather conditions may ease the need for food imports, while the accumulation of stocks of industrial inputs should taper off.

For non-oil-exporting developing countries, the external financing of current-account deficits will remain a critical problem, and there is ample evidence that available official finance is not adequate, especially for the poorest countries. Among the developed market economies, expected capital flows and present reserve positions will generally permit a smooth adjustment to the increased current-account deficit.

/Chapter V. World economic outlook, 1980-1985/

The prospects for the world economy in the immediate years ahead are generally expected to be somewhat gloomy.

In the developed market economies, the current downward movement in the economic cycle in the biennium 1980-1981 is expected to be followed by relatively slow growth, at 3.3-3.5 per cent. The level of fixed investment in plant and equipment would play an important role in determining future growth rates in these countries. There are still some major barriers to the resumption of an investment boom, such as uncertainties created by accelerated inflation and tight monetary and fiscal policies.

Inflation rates are likely to remain high in the immediate years ahead, adversely affecting growth both in personal consumption and in fixed business investment. Increasing military expenditure is expected to provide additional fuel for inflationary pressures. Another factor working towards sustained inflation is the continuing trend towards decelerated labour productivity growth in most of the developed market economies.

Growth prospects for the oil-exporting and the non-oil-exporting groups in the developing market economies are expected to differ significantly. Oil-exporting countries will benefit from the expected further gains in their terms of trade and should be able to maintain or increase their rates of economic growth.

The immediate prospects for the non-oil-exporting developing countries are not encouraging. A number of adverse factors will be working against these economies, including expected slow growth and protectionist tendencies in the developed market economies, a continuous increase in the world prices of manufactured goods and oil and the softening of prices of other primary commodities.

In the centrally planned economies of Eastern Europe, external deficits, as well as the increasing costs of producing energy and other minerals, will continue to act as constraints on economic growth.

The movement of oil prices will be one of the factors determining economic growth in the short and medium term. The current slow-down in the industrial economies is resulting in a balance between world supply and demand for oil in 1980. However, with an economic recovery in 1981 and thereafter, it is likely that the relative scarcity of petroleum supplies will be a growing problem and that both nominal and real oil prices will once again show a continuous increase.

On the assumption of an economic recovery in 1981-1982, the volume of world trade is projected to resume an annual growth rate of 4.5-5 per cent. However, the terms of trade would continue to move against the non-oil-exporting countries. One critical issue that is now emerging concerns the financing of the growing external deficits of the non-oil-exporting developing countries. Even if the rates of growth of output in these countries were to remain at their current levels, their aggregate deficit would be expected to reach $80 billion by 1981. It is unlikely that the developing countries would be able to maintain the projected growth rates (at 5.5 per cent) if external capital and aid transfer issues were not resolved. This is specially true with respect to the low-income developing countries, which have only a limited potential to mobilize domestic savings and whose ability to borrow on international capital markets is seriously limited.

/Chapter VI. Adjustment policies in developing countries: selected issues/

The current international economic situation has intensified external and domestic disequilibria in most developing countries, requiring considerable efforts on their part to adapt their economies to the new situation. In effect, two interrelated but different sorts of adjustment are called for: more control over the current account to cope with external imbalances, and stabilization measures to reduce inflationary pressures.

The deterioration in the terms of trade has led to a substantial widening of current account deficits. In the course of 1979 and in the early part of 1980, the developing countries took a variety of measures to control these deficits. Chief among these were import constraints and, to a lesser degree, currency devaluation and additional efforts to foster exports. The main impact of these measures is not likely to be felt immediately. But as import constraints and devaluations are likely to affect adversely the availability of industrial inputs and capital goods,

a slow-down in industrial growth may be expected in many developing countries in the not too distant future.

Many developing countries have responded to their worsened payment position by adding to the range of their export incentives. Past experience has shown that large export incentives and measures to shift exports into rapidly growing markets can be a powerful stimulus to export earnings. The success of such measures depends to some extent, however, on the absence of new trade barriers in importing countries. Moreover, many developing countries, particularly the least developed, lack the industrial base and the skilled and semi-skilled labour force required for rapid adaptation to changing conditions in international markets.

On the domestic side, growing imbalances in non-oil-exporting developing countries have been countered by restraining budget expenditure. An effort has generally been made to protect the development budget. Because of rigidities in current expenditure, however, there have been significant cutbacks or postponements of investment programmes in many countries.

Partly because of the expected early pay-offs in terms of foreign exchange earnings or savings, agriculture is being emphasized by many developing countries. At the same time, several countries are adopting a more cautious attitude towards industrial projects requiring long gestation periods. It would seem that under present difficulties, enhanced short-term flexibility has become an important concern in shaping economic policies and, as a result, the projects and policies necessary to meet longer-run objectives are receiving lower priority.

Chapter I

THE CURRENT WORLD ECONOMIC SITUATION: SOME SALIENT FEATURES AND POLICY IMPLICATIONS

1979 was a year in which a number of disquieting trends were evident in the international economy, and the strains produced by these trends will almost certainly intensify in 1980. Four overriding and interdependent events characterize the present situation: the weakening in the pace of economic advance in most countries and particularly in developed economies; the intensification in price inflation that pervades all economies; the more than doubling of the price of crude petroleum between the end of 1978 and the early months of 1980; and the large swings in the current account balances of oil-exporting and oil-importing countries.

While rates of growth in developing countries recovered from the low levels recorded in 1978, this was primarily the consequence of improved performance in the oil-exporting countries and in a relatively small number of more industrialized countries. In the majority of the developing countries, and particularly in the least developed and other low-income countries, there was either a decline in the pace of advance of gross domestic product or a continuation of extremely low rates of growth. The growth of gross domestic product slowed down decidedly in developed countries during 1979. For developed market economies, the outlook for 1980 is for an even sharper deceleration than in 1979, but a recovery is expected in the centrally planned economies.

In a number of the major industrial countries, the acceleration of inflation that accompanied the general slow-down began in 1978. In 1979, upward pressures on prices strengthened and became more widespread, reflecting, in part, sharp increases in the prices of industrial raw materials and the upward adjustment in the price of oil. Early in 1980, these pressures were intensified in a number of countries under the influence of both higher energy prices and the widespread feeling that high rates of inflation had become a permament part of the economic environment.

The price of petroleum, which moved from $13 a barrel at the end of 1978 to around $30 per barrel in the early part of 1980, had a powerful influence on the structure of external payments. The developed market economies moved from a substantial surplus into a deficit, and oil-exporting developing countries from a near balance into a substantial surplus. The combined current-account surplus of developed market economies and oil-exporting developing countries, which had amounted to $44 billion in 1978, expanded to some $57 billion in 1979, and the deficit of non-oil-exporting developing countries widened by a roughly equivalent amount, reaching $50 billion. These tendencies are expected to continue in 1980, with the deficits of oil-importing countries and the surpluses of oil-exporting countries both expanding further.

The recent configuration of events is highly reminiscent of the period spanning 1974 and 1975, which was also characterized by recession accompanied by intensified inflation, particularly in the developed market economies. There are, however, a number of important differences between the current situation and the earlier period. For one thing, the events of 1974-1975 took place after an extended

phase of rapid growth that culminated in a vigorous cyclical upswing in all major developed market economies. During the period 1976-1978, on the other hand, the world economy did not experience vigorous expansion, so that the current slow-down is occurring against the background of a more disappointing medium-term trend. Price inflation also had a different significance in the two periods. In 1974-1975, for most developed market economies, resistance to price increases was only one among a number of policy objectives, and several of these countries took steps to sustain levels of aggregate demand. By the end of 1979, on the other hand, the fight against inflation had become the overriding concern of policy-makers. 1/ Consequently, no developed market economy country took significant action to offset the dampening effect on expenditure of the increases in oil prices, even though it was larger in 1979-1980 than in 1974. 2/

Another source of difference between the present and the earlier period has been the emergence among the oil-producing countries of more complex policies with regard to the production and export of petroleum. In 1974-1975, the primary concern of the oil-exporting countries was to secure control over the price of oil and to raise it to higher levels. More recently, these countries have begun to give greater weight to the long-term management of their petroleum reserves in the light of the exhaustible nature of those reserves and expectations about an upward trend in future energy prices. The indications from a number of these countries are that, where current foreign exchange needs can be met at lower levels of output, any weakening in the demand for oil is likely to give rise to reductions in production. In contrast to the years immediately after 1974 when the real price of oil progressively declined, the present readiness of the oil producers to manage supplies makes it improbable that there will be any significant and sustained deterioration in the terms of trade of these countries from the level attained in 1980. This has important implications. It not only means that the increased transfer of income and wealth to these countries will be maintained; it also increases the probability that the very substantial current account surpluses of some of those countries will become continuing features of the international payments system.

For the non-oil-exporting developing countries, one feature common to both 1974-1975 and 1979-1980 is the unfavourable consequences for their growth of sharply rising prices in the world economy and recession in the developed market economies. In the period 1974-1975, a large number of developing countries experienced both a decline in their terms of trade and a deceleration in the growth of volume of their exports. The growth of total output averaged 4.8 per cent in 1974-1975 compared with 7.3 per cent in 1971-1973; and a decided deceleration took place in the growth of private consumption and in manufacturing production. If the performance of these countries was not still worse in 1974-1975, it was because of

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1/ The communiqué issued by the International Monetary Fund's Interim Committee on 1 October 1979 stated that "the Committee observed with great concern that inflation throughout the industrial world had intensified ... /and/ emphasized that the main task of economic policy was to contain inflationary pressures and to reduce inflationary expectations."

2/ In 1974, the deflationary effect on expenditure in OECD countries resulting from the increase in oil prices amounted to about 2 per cent of the gross national product of those countries. In 1979 and 1980, it amounted to about 1 1/4 per cent of the gross national product of those countries in each of these years.

the considerable flexibility of external trade and payments. The current-account deficit of the group doubled, in real terms, compared with the preceding two-year period, and this provided additional real resources to sustain investment and growth. 3/

In the current period, the non-oil-exporting developing countries experienced a deterioration in the terms of trade in 1979, and a large number of these countries can be expected to experience a further deterioration in 1980, together with a deceleration in the growth of their volume of exports. A weakening of the overall growth performance of these countries can therefore be expected, especially in view of the strong probability that external financial flows in 1980 will be considerably less accommodating than they were in 1974-1975. Though greater in current prices, the net flow of resources, in real terms, to developing countries resulting from external financial transactions will be below the levels reached in the earlier period. Even if the current account deficit of the non-oil-exporting developing countries should reach $70 billion in 1980, this will be significantly smaller in relation to domestic savings, investment and output than in the period 1974-1975. Indeed, the absolute magnitude of the corresponding trade deficit will be smaller, in real terms, than the trade deficits recorded in 1974 or 1975. At the same time, the capacity of these countries to assume a greater debt and debt service burden has been reduced, particularly with respect to debt on non-concessional terms. For these countries as a group, the ratios of external debt to gross domestic product and of debt service to export earnings both doubled between 1973 and 1978, although these increases were magnified by unusually rapid debt accumulation in a small number of countries.

There is little question that present attitudes are less favourably disposed towards the accommodation of increased current-account deficits than was the case in 1974-1975. While a number of considerations have shaped these attitudes, a dominant view has been the desirability of an early and unimpeded adjustment to the recent changes that have taken place in the world economy. This has contributed heavily to the obvious lack of interest in any early action to facilitate the financing of the increased deficits of non-oil-exporting developing countries.

There is widespread agreement on the need for a prompt adaptation of domestic policies to the changes in relative prices of energy and other products and to the longer-term outlook for the availability of petroleum. As indicated in chapter VI, such an adjustment is, in fact, proceeding rapidly in the developing world. However, when adjustment is equated with the reduction of current-account deficits, there is considerable doubt whether a rapid process is desirable or even possible. The counterpart to the surplus of the oil-exporting countries - expected to amount to about $100 billion in 1980 - is an aggregate deficit of corresponding magnitude amoung countries in the rest of the world. While individual countries may be able to lessen their deficits by shifting the balance of payments pressure to others, the deficit in the aggregate cannot be reduced unless the surplus of the OPEC countries is diminished. However, at prevailing international prices and in view of the import policies of oil exporters, such a diminution could only come about through a contraction in oil exports, induced by a reduction in aggregate demand and the domestic economic activity of importing countries generally.

3/ The experience of non-oil-exporting developing countries in the period 1974-1975 is examined in greater detail in annex I.

Insistence on an adjustment of current-account deficits and failure to provide adequate financing facilities could thus have unfavourable consequences for the world economy, and particularly for the developing countries.

The situation of the non-oil-exporting developing countries is aggravated at the present time by the course of events and policies in the developed market economies. These economies are currently seeking to moderate domestic inflation, partly by restricting aggregate demand and expenditure. In so doing, these countries reduce their demand for imports and shift external pressure on to their trading partners. In the aggregate, this means that pressure will be shifted from the developed market economies to the developing countries. This pressure on the external accounts of developing countries is aggravated by interest rate policies in industrial countries that increase the level of external payments required by debtor countries. There is the further danger that slower growth in markets in developed market economies may intensify protectionist demands. Efforts by developed market economies to adjust their own situation are therefore likely to have the unintended consequence of increasing the payments difficulties of developing countries.

Moreover, if short-term adjustment policies in the developing countries are insisted upon, a further round of deflationary impulses will be introduced into the international system as these countries individually attempt to cope with their external deficits. For the sum total of these deficits cannot diminish unless there is a reduction in the surplus of oil exporters or a widening in the deficit of developed countries.

Any adjustment of the deficits of individual countries thus needs to be moderated considerably by the provision of additional finance, and the terms and conditions associated with such finance should fully reflect the fact that the larger deficits will persist for a considerable period of time. Some forms of official finance, such as the regular facilities of IMF, do not correspond to these requirements and, as far as possible, they are eschewed by deficit countries. But the absence of enlarged official flows would leave private banking institutions as the only source of additional payment finance.

Reliance on flows from private banks as virtually the sole significant source of expansion in external finance presents certain difficulties, however. Such finance would be forthcoming at a high cost and at relatively short maturities; it thus creates considerable difficulty for developing countries in managing their external accounts. This situation will engender more cautious policies in these countries in 1980, and, if past experience is any guide, will also result in very cautious import policies in subsequent years, even if export earnings recover briskly. In 1976-1978, for example, substantial increases in export earnings by developing countries were not translated into proportionately higher imports and more rapid growth; instead, countries attempted to improve their external financial position by building up financial assets and reducing current account deficits.

More important, however, access to private sources of finance is not enjoyed equally by all developing countries, and most developing countries may not succeed in securing significant increases in flows from this source. Such countries will bear a particularly severe burden of adjustment. Of particular concern is the situation of the low-income countries most seriously affected by the current crisis. A preliminary estimate suggests that these

countries face increments in their current account deficit amounting to between $4 billion and $6 billion on an annual basis in both 1979 and 1980. 4/ This figure is a very large multiple of the annual increase in the aid and other official capital disbursements that these countries normally receive. Failure to make allowance for the particular situation of these countries would require them to compress their imports, thus endangering their growth and development.

The more sombre outlook for developing countries, and the sense of enhanced vulnerability shared by many participants in the international economy, have complex causes. In no small measure, however, these are the consequence of a lack of policies at the national and international levels to deal with the current situation and of the failure to evolve a co-ordinated approach towards common problems.

This is not to say that attempts at co-ordinated international action have not taken place. Indeed, the economic summit meeting held at Bonn in July 1978 set in motion a concerted action programme designed to stimulate economic activity in the developed market economies as a whole, but along lines that would give rise to a more sustainable pattern of current-account balances among them. This action programme, which had as its major components the deliberate stimulation of output in the Federal Republic of Germany and Japan and some restraint on aggregate demand in the United States of America, was complex by historical standards. Although the exercise had reasonably good results in 1979, the benefits were in large part overtaken by developments in the rest of the world economy. Thus, the shortcomings in the international co-ordination of national policies during the period 1978-1979 were not failures in execution. Rather, what was lacking was a full appreciation of the necessary scope for effective international co-ordination in the economic sphere. By failing to encompass the developing countries, including the oil-exporting countries, this attempt at international co-ordination did not have the breadth and reach required to succeed.

What appears to be needed at the present moment is a fresh attempt at international economic co-operation, characterized by the same commitment to successful implementation as the concerted action programme, but encompassing questions that are of critical importance to developing countries, as well as the question of energy.

A primary objective of policy measures in such a programme of co-operation would be to protect rates of growth and investment in developing countries, particularly the poorer countries, from disturbances emanating from the world economy. In the immediate future this will require additional official financial flows on appropriate terms and conditions. Such additional financing would not imply any lack of adjustment on the part of developing countries. Indeed, as already noted, the developing countries have initiated strong adjustment measures and can be expected to continue to adapt their domestic economies to the requirements of the new situation.

4/ See "Immediate measures in favour of the most seriously affected countries: preliminary report of the Secretary-General" (A/AC.191/50).

The external situation of developing countries would also be eased if developed market economies were to accept their full share of the deficit that is the counterpart of the surplus of the oil-exporting countries. Attempts by individual developed market economies to dampen economic activity will shift payment pressures to their trading partners, including developing countries. To the extent that developed market economies find it necessary to pursue counter-cyclical policies designed to deal with their own domestic inflation, they should realize that the consequences of these policies must invariably be larger deficits in the developing world, and that even larger amounts of external financing will, therefore, be required by these countries.

Another important element in a new approach to international economic co-operation would be an international understanding on the conservation and use of energy to contain demand in the face of limited prospective supplies and the upward movement of the price of oil. It is also clear from the experience of the 1970s that there would be considerable advantage to the world economy if such an understanding ensured that increases in the price of petroleum would be brought about in a way that avoided or mitigated sudden shocks. An arrangement which meets the pricing objectives of the oil-exporting countries, but does so in a way that is predictable and gradual, would eliminate a source of uncertainty in the world economy and would create an international environment in which domestic policies, particularly those designed to deal with inflation, could proceed in a more orderly and effective way.

An international understanding regarding the evolution of demand and supply for oil would reinforce the tendency for oil exporters as a group to maintain a surplus in their current account. The condition for such an understanding would be the availability for the oil-exporting countries of a financial asset of assured safety and yielding an adequate rate of return. Furthermore, the more persistent character of the surplus would need to be taken into account; the recycling of the surplus would no longer be a short-term question but would be a more permanent part of the international financial system. In these circumstances, modifications to the present arrangements would be desirable - modifications that are already being considered by the OPEC countries. More lending directly to borrowers on a long-term basis and more lending through multilateral institutions would be elements of the revised set of arrangements.

As may be seen from the preceding paragraphs, the questions of energy, external finance and financial assets are inescapably entwined.

Measures in the areas outlined above would not in themselves resolve the major problems facing Governments today. Especially in the developed market economies, the problem of inflation has become the primary impediment to better economic performance; and the solutions must be mainly sought in internal policies to bring about adaptations of domestic economies. The measures discussed above, however, could create an international environment in which the solution of these larger problems could proceed at a more satisfactory pace. The creation of such an environment is particularly urgent in the light of prospects for the years ahead. Although the present outlook is for recovery in the growth of the world economy, current projections for the years 1981-1983 indicate that rates of advance in both developed and developing countries will be below those experienced in 1976-1978, the previous period of cyclical recovery. Success in dealing with inflation will exert an important influence on performance in the years to come. For developing countries, the availability of external financing and the expansion of markets in developed countries will be important determinants of growth.

Chapter II

THE GROWTH OF WORLD OUTPUT, 1979-1980

Slowing world economic growth

World economic growth experienced a setback in 1979, and a further slow-down is expected in 1980 (see table II-1). The growth of gross domestic product slowed by one percentage point in 1979, and agricultural production expanded by less than 1 per cent (see table II-2). Especially worrisome was the poor performance of the agricultural sector in developing countries. Largely owing to adverse weather conditions, agricultural production either fell or was practically stagnant in all developing regions, with the exception of Latin America, and food production registered a decline in per capita terms. However, except in the group of centrally planned economies, the growth of industrial output quickened. In the developed market economies, buoyant demand conditions in several European countries and in Japan were responsible for the improvement. In developing countries, the faster pace of industrial growth was concentrated among the oil exporters and a few relatively industrialized countries.

The growth results of 1979 appear to confirm that the world economy is passing through a period of lower economic growth. As can be seen in table II-1, in all groups of countries since 1973 world economic growth has experienced a sharp deceleration in relation to the period 1961-1973. A combination of factors may account for this deceleration. The worsening of inflation in the developed market economies has led to generally more restrictive economic policies, with adverse consequences on the growth of both demand and investment. Investment has also been hampered by growing uncertainties about the future growth of demand and the course of economic policies, by large and unexpected fluctuations in relative prices and costs and, in the more trade-dependent countries, by exchange rate fluctuations. Although specific endogenous factors have affected other regions, the lower rate of economic expansion in the developed market economies has had dampening effects on the growth processes of other country groups via its impact on the expansion of world trade.

While the developed market economies experienced a marked decline in the pace of economic activity in 1979, developing countries as a whole were able to raise the their growth rate by over half a percentage point. This again lent credence to hypothesis that during the 1970s growth in developing countries had become less dependent on growth in the developed market economies. 5/ However, the acceleration resulted primarily from improved performance in oil-exporting countries and in a relatively small number of industrialized developing countries. In the majority of countries, and particularly in the least developed and other low-income countries, there was either a drop in the growth of gross domestic product or a continuation of extremely slow rates of advance. Even in the group of non-oil-exporting countries in which growth accelerated, higher output was purchased at the expense of

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5/ For a discussion of this phenomenon, see annex I.

Table II-1. World production: annual growth rates in constant 1977 prices, by country group, 1961-1980
(Percentage)

Item and country group	1961-1973	1974-1979	1976	1977	1978	1979 a/	1980 b/
Gross domestic product							
World	5.4	3.6	5.4	4.5	4.4	3.4	2 1/2
Developed market economies c/	5.0	2.7	5.3	3.8	3.9	3.2	1 1/2
Developing countries d/	6.0	5.2	7.1	5.6	4.4	5.0	5
Oil-exporting countries e/	7.5	5.4	12.3	5.6	2.6	4.2	5
Non-oil-exporting countries	5.4	5.2	5.0	5.6	5.2	5.4	5
Centrally planned economies f/ g/	6.7	5.2	4.5	5.8	5.8	2.7	4 1/2
Industrial production h/							
World i/	6.8	3.5	4.4	4.8	4.4	5.3	4
Developed market economies	5.6	2.2	6.4	3.4	4.2	5.0	3 1/2
Developing countries	7.3	3.9	4.2	6.5	3.6	6.3	5 1/2
Centrally planned economies	8.1	6.3	5.0	6.9	6.0	4.3	5

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

a/ Preliminary.

b/ Forecast.

c/ North America, northern, southern and western Europe (excluding Yugoslavia), Australia, Japan, New Zealand, South Africa and Turkey. The rates shown are calculated from data in 1977 constant prices. Therefore, they differ from those given in World Economic Survey, 1978: Current Trends in the World Economy (United Nations publication, Sales No. E.80.II.C.1), chap. I, table I-1, which are in 1970 prices. In addition, there have been substantial revisions in the data for a number of countries.

d/ Latin America and the Caribbean area, Africa (other than South Africa), Asia (excluding Japan, Turkey and the centrally planned economies of Asia) and Yugoslavia.

e/ Algeria, Bahrain, Brunei, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libyan Arab Jamahiriya, Nigeria, Oman, Qatar, Saudi Arabia, Trinidad and Tobago, United Arab Emirates and Venezuela.

f/ China, Eastern Europe and Union of Soviet Socialist Republics only.

g/ The data refer to net material product and are thus not fully comparable to those of the other country groups.

h/ ISIC category 2-4, i.e., covering mining, manufacturing, and electricity, gas and water.

i/ Excluding China.

Table II-2. World agricultural production indices, 1971-1979
(1969-1971 = 100)

Country group	Average growth rate 1971-1979 a/	1977	1978	1979 a/
World	2.4	118	123	124
Developed market economies b/	2.2	115	119	120
North America	3.1	122	123	127
Western Europe	1.8	111	116	117
Oceania	2.5	115	128	123
Other developed countries	1.3	110	111	111
Developing countries c/	2.4	120	124	125
Africa	1.3	108	111	113
Latin America	3.1	124	128	133
Near East	3.0	123	128	128
Far East	2.3	121	125	123
Other developing countries	2.9	122	126	129
Centrally planned economies	2.6	119	126	127
Asian centrally planned economies	3.0	121	128	132
Eastern Europe and USSR	2.5	118	125	124

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

a/ Preliminary.

b/ Including Israel and excluding Cyprus and Turkey.

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

growing external and internal disequilibria. Most of these countries were adversely affected by growing balance-of-payments pressures stemming from worsening terms of trade and, in some cases, declining export volumes. In addition, economic policies were constrained by the need to tackle rapidly rising inflation rates, owing mainly to sharp increases in import prices.

There is evidence that the developed market economies, without having fully recovered from the 1974-1975 recession, are now entering a new downswing in the business cycle. Among the major industrialized countries, the deceleration of growth in 1979 was concentrated mainly in the United Kingdom of Great Britain and Northern Ireland and the United States of America, but signs of weakness emerged in other countries as well in the second half of the year, and a more widespread slow-down is expected in 1980. An important factor accounting for these developments was the policy stance of most Governments. Although the oil price increases during 1979 had dampening effects on expenditure, and thus tended to reinforce cyclical weaknesses, policy-makers did not attempt to counter them. As price inflation accelerated in practically all countries, demand management policies were increasingly oriented towards fighting inflation, with monetary policy playing a leading role.

In the centrally planned economies, the rates of growth of the net material product in 1979 were the lowest in the decade and well below targets. Plans in the European socialist countries already called for slower growth in order to work off imbalances in the transport, energy and raw-material-producing sectors. In addition, adverse weather conditions resulted in a drop in agricultural production and also affected industry. In the more trade-dependent countries of Eastern Europe, deteriorating terms of trade and policy decisions to curtail external deficits, particularly with the market economies, led to import constraints that were, in some instances, severe. In China, the fast pace of growth of 1977-1978 could not be sustained and growth targets for 1979 were revised downward.

A further slow-down in world economic activity is expected in 1980, owing to declines in growth in the developed market economies and in the non-oil-exporting developing countries. The latter group of countries is expected to come under considerable external and internal pressures to reduce their growth pace. A further worsening of the international economic environment is likely to lead to severe balance-of-payments strains. In addition, growing domestic inflation may limit the capacity of Governments to counteract the impact of reductions in the purchasing power of exports on aggregate demand. If weather conditions improve, the centrally planned economies are expected to experience some recovery from the poor 1979 results. Nevertheless, the major longer-term problems affecting growth during 1979 will continue to exert an influence on these economies.

Uneven performance in developing countries

In developing countries, although 1979 can be seen as a year of uneven economic recovery, the somewhat higher growth achieved is likely to be transitory. Thus a renewed slow-down in growth is expected in 1980 for developing countries as a whole. For many countries among the non-oil-exporters, the slow-down could represent a major setback.

As shown in table II-1, the combined gross domestic product of developing countries grew at about 5 per cent in 1979. A large share of the recovery from the growth rate of 4.4 per cent achieved in 1978 must be attributed to the oil exporters, whose growth rate more than doubled. Although the non-oil-exporting countries were able to improve their growth performance somewhat, the overall rate of 5.4 per cent for 1979 was still below the target set for the Second United Nations Development Decade. Among the non-oil-exporting countries, the overall improvement in growth performance was due to a comparatively high growth rate in 10 relatively large and generally more diversified economies. Argentina, Brazil, Chile, Colombia, Egypt, Malaysia, Mexico, the Republic of Korea, Thailand and Yugoslavia - all countries with gross domestic products well above $12 billion in 1978 - experienced rates of growth of gross domestic product ranging from 6 to 9 per cent in 1979. The greater number of non-oil-exporting developing countries - that is, 26 out of 49 countries for which reliable indicators exist - experienced a slow-down in the rate of growth. India, the most populous of these countries, suffered an important setback, partly as a consequence of adverse weather conditions. In addition, little or no economic growth was achieved by the majority of the least developed countries and by most of the developing countries in the Caribbean and Central America.

A diversity of specific factors explain the differences in economic performance in individual countries. However, in general, agricultural production generally did not provide a significant stimulus to overall growth in the developing countries in 1979. In Africa and Asia, agricultural production failed to keep pace with population growth. Food production setbacks were particularly severe in the less diversified developing economies. As of mid-January 1980, the FAO Early Warning System listed 26 countries - two thirds of them in Africa - as affected or threatened by food shortages, or more than twice as many as in mid-January 1979. Only in a few countries did agriculture contribute significantly to a higher growth rate for gross domestic product in 1979.

Industry was the sector that provided the greatest impetus to growth. In the oil-exporting countries, crude petroleum production, which had fallen by about 1 per cent in 1978, increased by about 3 per cent in 1979. The recovery in oil production and increased domestic expenditure, particularly on capital formation, as a result of higher incomes from increasing relative oil prices, led to a considerable growth in the industrial sector in this group of countries.

Good performance in the industrial sector also characterized those non-oil-exporting developing countries whose gross domestic product rose by 6 per cent or more in 1979. In practically all of these countries, manufacturing production grew by well over 8 per cent. Several factors contributed to industrial growth in these countries. In most of them, government policies had somewhat expansionary effects on aggregate demand. Owing to the comparatively small degree to which they participated in world markets, some countries benefited from a rather fast growth in their exports of manufactures and semi-manufactures. 6/ In a handful of countries, 7/ petroleum production and exports rose significantly. In several countries, the backward linkages and multiplier effects of relatively large ongoing

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6/ These include Brazil, Chile, Hong Kong, and Singapore.

7/ Congo, Egypt, Malaysia and Mexico.

energy-related investment programmes 8/ had favourable effects on industrial output. Finally, in some countries, faster growth in the industrial sector was stimulated by the recovery of depressed domestic markets and of the construction sector.

From the point of view of policies, at the macro-economic level, one of the most important decisions taken by many of the above countries - partly to compensate for the negative effects of external developments - was the acceptance of growing domestic and external imbalances in order to maintain adequate levels of domestic demand and an increasing supply of imported industrial inputs. Faced with sharply higher import prices, these countries did not resort to more restrictive policies and allowed higher import prices - particularly for oil - to be translated into faster domestic inflation, while at the same time they increased their efforts to finance the enlarged import bill.

An interesting example is provided by the 10 fastest-growing non-oil-exporting developing economies in 1979. 9/ In seven of these countries, the rate of inflation accelerated considerably after December 1978, in two of them it remained at rather high levels, and only in one - Malaysia - were price changes not significant in 1979. In addition, in spite of worsening terms of trade, preliminary evidence suggests that in most of these countries there was a large increase in the supply of imported industrial inputs and of imports in general. As a result, the current-account balance deteriorated considerably in eight of these countries. The enlarged deficits, in turn, were financed by increased net flows from private financial markets, by drawing down reserves, or both. 10/ In sum, to a large extent, faster growth was attained at the expense of increasing disequilibria on the domestic and external fronts.

But similar disequilibria were also experienced in 1979 by non-oil-exporting developing countries with more moderate rates of growth, and even in countries with low growth rates or stagnant economies. This clearly suggests that in most countries the international economy was a disequilibrating factor and that, in general, it did not support development efforts. Indeed, after a sharp deterioration in their terms of trade in 1978, non-oil-exporting developing countries appear to have experienced a further worsening in 1979. Moreover, not only did the growth in import prices outstrip that of export prices, but the rate of growth in the unit value of imports - nearly 20 per cent in dollar terms - was the highest in the last five years. Both factors - deteriorating terms of trade and accelerating prices for traded commodities - affected non-oil-exporting developing

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8/ Encompassing hydroelectricity, gas and oil exploration and development, pipeline construction, oil refinery, petrochemicals and gasohol production.

9/ Argentina, Brazil, Chile, Colombia, Egypt, Malaysia, Mexico, the Republic of Korea, Thailand and Yugoslavia.

10/ The implications of these responses are analysed further in chap. VI and in annex I.

countries across the board. 11/ Their net effect was higher domestic inflation and substantially increased vulnerability in the short and medium term to adverse developments in the international economy.

The outlook for 1980 is for somewhat slower growth in the combined gross domestic product of the developing countries. As in 1979, oil-exporting countries may succeed on average in raising their rates of growth, as a result of high and rising levels of investment and the possible resumption of growth in Iran. For a small number of other developing countries, ambitious investment plans, particularly in energy-related activities, are likely to fuel continued high rates of growth. Even this, however, would be dependent on the availability of adequate external financing, and, where private capital markets are involved, on policy decisions by the countries involved to have further substantial recourse to these markets, despite extremely high borrowing costs and an uncertain outlook for export earnings.

For most developing countries, however, developments in the world economy in 1980 will exert a strong downward pressure on growth. In South Asia and certain regions of Africa, the pressure will be at least partially offset by recovery in agricultural production from the unusually low levels experienced in 1979. None the less, industrial activity and investment - two sectors of prime importance to the development process - can be expected to suffer severely in the coming months in most of these countries. 12/

A further weakening of growth in the developed market economies

The recovery in economic activity in the developed market economies from the 1974-1975 recession continued to weaken during 1979. As can be seen in table II-1, economic growth, as measured by gross national product, declined from 3.9 per cent in the previous year to 3.2 per cent and continued to be well below long-term trends. In 1980, a further weakening is expected, with growth rates in almost all countries dropping. Such a synchronized deceleration to an overall rate of growth of about 1 1/2 per cent would be different from the experience of 1979, when the deceleration in the United States of America was partially offset by acceleration in some of the major European economies and the maintenance of relatively high growth in Japan (see table II-3). Indeed, in 1979, the 2 per cent deceleration in the United States accounted for all of the 0.7 per cent decline in the overall growth of the developed market economies. In Japan and most major European countries, private consumption and fixed investment provided significant boosts to demand. Spurred by stronger demand in the major European countries, the smaller industrial economies recorded higher rates of growth in 1979 than in 1978. The economic performance of the primary producing countries was more varied, though the group as a whole registered a decline in growth.

11/ While the deterioration in the terms of trade has a negative effect on the expenditure multiplier and on the trade balance, the main impact of the relatively large increases in the unit value of imports is on internal price levels and on the size of the trade deficit in current prices.

12/ The impact of the current situation on the growth prospects of developing countries is examined in detail in chap. VI.

Table II-3. Developed market economies: rate of growth of real gross national product/gross domestic product, a/ 1971-1980

(Percentage)

	1977	1978	1979 b/	1980 c/
Developed market economies	3.8	3.9	3.2	1 1/2
Major industrial countries	4.2	4.2	3.3	1 1/2
Canada	2.4	3.4	2.8	1 1/2
France	3.0	3.5	3.4	2
Germany, Federal Republic of	2.6	3.5	4.4	3
Italy	2.0	2.6	4.5	2
Japan	5.4	6.0	6.0	4 1/2
United Kingdom	1.3	3.1	0.5	-2
United States of America	5.3	4.4	2.3	-
Other industrial countries d/	1.5	1.9	3.4	2 1/2
Primary producing countries e/	2.1	2.9	2.4	1 1/2

Source: See table II-1.

a/ Gross national product for Belgium, Canada, Germany, Federal Republic of, Iceland, Japan, Netherlands, Switzerland, Turkey and United States of America; 1977 gross national product/gross domestic product weights and exchange rates.

b/ Preliminary.

c/ Forecast.

d/ Austria, Belgium, Denmark, Finland, Luxembourg, Netherlands, Norway, Sweden and Switzerland.

e/ Australia, Cyprus, Greece, Ireland, Malta, New Zealand, Portugal, South Africa, Spain, Turkey.

In almost all countries, the rate of economic growth declined in the course of the year, and this is expected to continue over much of 1980. One of the factors responsible has been the tightening of economic policies to counteract the inflationary pressures that have been mounting since the middle of 1978. Monetary policy was placed in the forefront of anti-inflation policies, and emphasis was frequently placed on controlling the money supply rather than the price of credit. In addition, it was, and has remained, the intention of most Governments to reinforce restrictive monetary measures by narrowing their present budget deficits.

An important external event contributing to the dampening of aggregate demand was the increase in oil prices. 13/ Since only a small fraction of the additional expenditure on imports of the developed market economies generated by the oil price increase was translated into additional exports, there was an increase in the trade deficit of these countries, which had a deflationary effect on their economies. This effect is estimated to have been of the order of 1 1/4 per cent of the gross national product in 1979. 14/ On the assumption that there will be no further increases in the nominal price of oil from February to December 1980, the deflationary effect this year should amount to roughly the same percentage of gross national product. For the sake of comparison, the effect on demand of the rapid increase in the price of oil in the winter of 1973/74 was about 2 per cent of the gross national product, but was concentrated in a single year.

To a large extent, the deflationary effect of higher oil prices during 1979 was countered by the relatively buoyant behaviour of personal consumption and investment. As a consequence, the decline in the growth of gross national product was substantially smaller than the above estimates would suggest. For 1980, growth prospects are heavily influenced by government policy responses to the oil price increase. Rather than attempt to counter its deflationary effect with fiscal or monetary stimulus, most Governments have decided to allow the negative effect on demand to work its way through their economies. In fact, it was partly in order to lessen the indirect inflationary effects of the oil price increase that policies were tightened throughout 1979 and early 1980.

As a result of Governments' reluctance to undertake any compensatory stimulation of economic activity, public expenditure generally provided little, if any, impetus to growth. To be sure, the Federal Republic of Germany and Japan pursued expansionary policies through the public sector in accordance with the understandings reached at the 1978 Bonn economic summit meeting. However, early in 1979 the Japanese Government reversed its previous policy of increasing public expenditure in order to stimulate the economy. In the United Kingdom, real public expenditure actually declined in 1979. Government policy in that country has laid heavy emphasis on diminishing the State's role in the economy and on reducing the budget deficit as a means of stimulating the private sector.

Private consumption was a major stimulus to growth in most developed market economies as real disposable incomes rose in most countries - the most important exception being the United States of America - and as real interest rates on personal savings became strongly negative in some countries. With the increase in inflation rates and the tightening of credit, however, this stimulus to growth weakened in the course of the year. As a result of continued downward pressures on the growth of real personal incomes, a further weakening is expected in 1980.

13/ For a discussion of the evolution of relative oil prices since 1974 and the factors accounting for the current increase, see annex II.

14/ Calculated as the increase in the oil import bill resulting from higher prices, minus the extra demand for the exports of the developed market economies from the oil-exporting countries (assumed to be 25 per cent of the additional oil-export revenues), times the multiplier of aggregate demand (assumed to be 1.5), and expressed as a ratio to gross national product.

Private non-residential capital formation also showed strong gains in most of the European countries, and especially in the Federal Republic of Germany, and in Japan. Even in the United States, apart from investment in transport equipment, business investment was surprisingly buoyant. The generally encouraging performance of investment can be attributed to the increased rates of capacity utilization and to the need to invest in less energy-intensive means of production in the wake of the oil price increase. The situation in 1980, however, is uncertain. High interest rates and an expected drop in the growth of final demand may bring about substantial downward revisions in investment plans.

As regards residential construction, in all major industrial countries demand was weak during 1979, owing largely to the tightening of credit and high nominal interest rates. In Canada, the United Kingdom and the United States, the volume of residential construction fell. Given the trends in monetary policies, no recovery in residential construction is expected in 1980.

There was considerable stockbuilding of raw materials in the early part of 1979, largely because of precautionary purchases of oil and of other raw materials in the face of an uncertain supply outlook. As regards stocks of finished goods, there does not appear to have been a major build-up of inventories. In fact, in the second half of the year, as raw material stockbuilding slowed, there was an overall reduction in stocks-to-sales ratios in most countries. While this had a negative effect on economic activity in that period, it has reduced the danger of enterprises being left with substantial unsold inventories in the event of a sharp contraction in demand. The only major industrial country which continued investing in stocks throughout the year was Japan, where stocks had fallen below their normal levels.

In the major industrial countries, movements in the real foreign balance closely reflected movements in stocks, for the increase in domestic demand in the first half of 1979, which had stimulated stockbuilding, also encouraged a substantial growth in imports, far surpassing that in exports. Despite a strengthening of export growth and a decline in the growth of imports in the second half of the year as aggregate demand weakened, for the year as a whole the contribution of the foreign balance to growth was negative. This was especially so in the Federal Republic of Germany, Japan and the United Kingdom. The single most important exception was the United States, where the slow-down in the growth of domestic demand and the depreciation of the dollar in the preceding years caused the rate of growth of real exports to exceed that of real imports.

Perhaps the most significant development in 1979, and one that will affect the rate of growth not only in 1980 but also in the longer-term future, was the continuing unsatisfactory performance of productivity. In Canada, the United Kingdom and the United States, labour productivity actually declined in 1979, partly due to cyclical factors. In a longer-term context, the present high interest rates and tightness of credit are working against a prolongation of the revival of business investment, which would help to boost productivity. Business confidence could also be weakened if the attempts to continue to restrain demand after so many years of sluggish growth lead to industrial unrest and to severe losses in output.

Despite the weakening in economic activity in 1979, unemployment in the developed market economies remained almost constant, at roughly 5 per cent of the labour force. While conditions in labour markets varied from country to country,

the major forces preventing an increase in unemployment appear to have been a slow-down in the growth of the labour force and the labour productivity trends described above. In 1980, however, unemployment could rise rather sharply.

The short-term outlook is clouded by an unusual degree of uncertainty, particularly with regard to developments in the United States, where predictions of recession have failed to materialize for the last 18 months. Nevertheless, current information suggests the possibility of a synchronized cyclical down-swing in the developed market economies, with the United States experiencing the sharpest slow-down. A deceleration - and, indeed, a decline in some countries - in real personal incomes should dampen the growth of consumption expenditure in most countries. In the United States, recently instituted restrictions and higher interest rates on consumer credit are likely to add force to the expected slow-down in consumption. Rising real interest rates, tight monetary conditions and expectations of little growth in aggregate demand should also depress capital formation in most countries. Therefore, the 1980 forecast is dominated by growth rates which are even slower than the unsatisfactory ones recorded in the past few years, still higher unemployment, and high, and most likely increasing, inflation.

A marked slow-down in the growth of the centrally planned economies

As shown in table II-4, the marked deceleration of economic growth that has taken place in the centrally planned economies of Eastern Europe 15/ and the Union of Soviet Socialist Republics in recent years continued in 1979 and affects the outlook for 1980. The group's overall growth in output, as measured by real net material product, slowed to less than 2 per cent on 1979, the smallest rate of increase recorded in the post-war period. A decline of almost 3 per cent in agricultural production was the major immediate cause for the sharp slow-down, but industrial growth, which in earlier years had been able to offset agricultural swings of similar magnitude, also dropped to an unusual low of less than 4 per cent. Therefore, production levels in both industry and agriculture fell short of plan targets in all countries. Owing largely to industrial stagnation, overall output registered an absolute decline in Poland, and growth also slowed significantly in countries where agricultural output did not decline.

In addition to domestic and external factors, the economic performance of the region in 1979 reflects the effects of unusually unfavourable climatic conditions. First-quarter production levels were adversely affected by an extraordinarily severe winter in the USSR and the northern-tier countries of Eastern Europe, and a succession of droughts and excessive rainfalls resulted in sharply reduced harvests in the USSR and in all but the southernmost countries of the group. Lags in the execution of already strained construction and investment programmes, caused in part by the climatic disturbances early in the year, slowed the opening of new production capacities, and these events also appear to have aggravated prevalent bottlenecks in the transport system, with repercussions on the generally precarious energy and raw material supply balances throughout the region. In the countries of Eastern Europe, supply tautness resulted also from import constraints, as unanticipated price developments in world markets in some instances appear to have caused sharper cuts in import volume that had been envisaged in the national plans.

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

Table II-4. Eastern Europe and the Union of Soviet Socialist Republics: basic economic indicators, 1971-1980

(Growth rates in percentages)

	1971-1977	1977	1978	1979 a/	1980 b/
Net material product	6.3	5.1	4.7	1.9	4.1
Industrial gross output	7.2	6.1	5.1	3.8	4.8
Agricultural gross output	2.4	3.8	2.8	-2.6	7.7
Gross fixed investment	7.2	5.1	5.8	0.5	2.0
Export volume	8.4	8.5	3.5	3.4	...
Import volume	9.0	5.3	8.2	1.4	...

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

a/ Preliminary.

b/ Plan targets.

The national economic plans for 1979, which had generally posited rather moderate growth goals, were aimed at the consolidation and restructuring goals that have dominated the short-term and medium-term policies of most of the socialist countries in recent years. 16/ For all the countries of the region, this meant in one degree or another working off the imbalances in the domestic economic structure (especially in the transport system and in power generation), which in part had resulted from the rapid growth of the early 1970s. For the trade-intensive Eastern European economies, the adjustment of the domestic economic structure and growth pattern to the long-term worsening of their terms of trade and the containment or reversal of the growing external deficits - especially with the market economies - has become an increasingly important policy priority in the last two years.

Owing to the general faltering of output growth in 1979, specific interindustry and raw material supply imbalances, especially with respect to fuels and energy,

16/ The broad features of these plans included adapting to a slowing labour supply growth, the need to re-orient investment toward the more capital-intensive energy and raw materials sectors, and reducing the backlog of unfinished investment projects. For a more extensive discussion, see World Economic Survey, 1978: Current Trends in the World Economy (United Nations publication, Sales No. E.80.II.C.1), chap. IV.

persisted and in some cases - notably in Poland - appear to have worsened. 17/ In addition, there appears to have been little improvement in the effectiveness of investment activity as measured by the relationship between outlays and the volume of newly commissioned production capacity.

On the other hand, the sharper-than-planned slow-down in the growth of investment outlays was reflected in reduced import requirements. Although, owing to supply difficulties, export targets were generally not attained, 18/ export volumes continued to expand. As a result, several of the Eastern European countries managed to achieve significant reductions in their external deficits, in spite of adverse trends in the terms of trade.

Partly as a result of slow growth in investment, consumption levels in the USSR and some of the Eastern European countries continued to rise, although generally at reduced rates. In a number of countries, however, a reduced growth in output and import constraints resulted in stagnation and even in some decline in the supply of consumer goods. As noted in chapter III, in some of these cases the maintenance of consumer market balance necessitated price increases which were substantial by past experience, though generally still below those observed in the market economies. 19/

The annual economic plans of the European centrally planned economies for 1980 are shaped by policy stances very similar to those adopted in 1979. Generally, the plans' targets envisage a somewhat lower overall and industrial output growth than was planned for 1979, but an acceleration over the actual 1979 performance. Thus, national income is targeted to grow by 4.1 per cent for the region as a whole, as against the 4.5 per cent planned for 1979 and the actual growth of 1.9 per cent. Similarly, industrial output growth is planned at 4.8 per cent, as against the 5.8 per cent target and the 3.8 per cent achievement in 1979. The plans' targets incorporate a significant recovery of agricultural output from the poor 1979 experience. Investment is to be held at or below 1979 levels in three of the Eastern European countries and to increase substantially less than national income in most of the others and in the USSR; for Eastern Europe as a whole this implies a stagnant investment level and, for the group including the Soviet Union, an increase in outlays of only 2 per cent. Foreign trade plans, where available, focus on further improvements in the external balance and stress the intention to constrain or to reduce imports if exports cannot be expanded.

17/ The output of a number of basic factors of production actually declined across the region (e.g., steel and cement) or increased at sharply reduced rates (e.g., oil, coal, electricity and petrochemical products). The increase in output for primary fuels (petroleum, natural gas and hard and brown coal) further declined to 2.7 per cent, after a 3.7 per cent increase in 1978 and about a 5 per cent annual growth rate in 1971-1977.

18/ This at least was the Polish experience (Rynki zagraniczne No. 17 (1980), p. 5).

19/ With consumer price increases ranging from 3 to 9 per cent, prices rose faster than average money wages in Czechoslovakia and Hungary and probably in Poland.

In spite of growth rates that are modest by comparison with past trends, the targets are generally denoted as "taut" in the national policy discussions. Thus, industrial growth will continue to be affected by tight raw material and energy supplies. In addition, the after-effects of the poor 1979 harvest are bound to hamper growth in the sizeable food-processing sector of a number of countries. Imports are unlikely to constrain growth in the USSR, where favourable terms of trade are expected to increase the external surplus. On the other hand, growth in the Eastern European countries may continue to be hindered by import availabilities, especially since an increasing - though still minor - proportion of their petroleum supplies will have to be obtained from non-socialist markets at sharply higher prices than those prevailing within CMEA.

Information on the Asian centrally planned economies is at this point limited to China, where overall growth in 1979 appears to have slowed to about 6 per cent after two years of rapid advance (at close to 10 per cent). The high growth rates of 1977-1978 reflected, on the one hand, recovery from the economic stagnation of the middle years of the decade and, on the other hand, an ambitious development effort, which revealed severe imbalances in the economic structure and proved unsustainable. Under a revised development strategy, inaugurated towards the end of that period, 1979 was to be the first year of a three-year transition and adjustment period, in which a reduced growth pace would permit a restructuring of the economic and management mechanism and a change in the development emphasis toward agricultural modernization, light industry and infrastructure. The actual results for the year reflect an agricultural performance which was probably slightly above trend, and an 8 per cent increase in industrial output. The plans for 1980 envisage some further easing of industrial growth.

Chapter III

THE ACCELERATING PACE OF INFLATION

For a variety of reasons, for the past 10-15 years, the world market economies have experienced rates of inflation which, by post-war standards, have been unusually high. Since the second half of the 1960s, the world economy has been subjected to a series of inflationary shocks, each one of which has taken several years to subside, and these have left the overall rate of inflation at a higher level than before. Even in the centrally planned economies, where domestic price stability has been a major policy stance, price pressures have become increasingly intense since the mid 1970s, especially in the Eastern European countries.

The inflationary shock of 1979 came in the form of sharp increases in the prices of industrial raw materials and the adjustment that took place in the price of oil. To be sure, inflation rates were already turning upward in a number of major industrial countries in 1978, and particularly in the second half of the year. But it was in 1979 that inflation exhibited a generalized and strong upward movement in all major groups of market economies (see table III-1). In the centrally planned economies, external price pressures also resulted in an upward movement of domestic price levels.

Certain forces conducive to inflation have become more deeply entrenched in the developed market economies. For one thing, inflationary expectations have probably become stronger as inflation persists and each socio-economic group attempts to protect its real income. Expressions of this phenomenon are a greater stickiness in real wages and a gradual extension of price and wage indexation throughout the economy. Secondly, when demand pressures increase, bottlenecks tend to arise sooner than before. In recent years, capacity expansion in specific industries has been dampened by uncertainties and by the difficulties that producers experience in distinguishing genuine changes in relative prices from changes in prices brought about by inflation. Therefore, aggregate investment is depressed and its pattern is skewed towards assets with a short write-off period. Thirdly, the slow growth of investment has probably been the major cause of inadequate productivity growth, 20/ and the decline in the growth of labour productivity observed in most countries means that these economies are less able to absorb wage increases in a non-inflationary manner. Fourthly, the absence of effective energy policies has increased the vulnerability of these economies to short-run supply-demand imbalances in international oil markets.

In the developed market economies, ways have not yet been found of dealing effectively with inflation. In 1979, Governments placed greater emphasis on

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20/ For recent evidence for the United States of America, see J. R. Norsworthy, Michael J. Harper and Kent Kunze, "The slowdown in productivity growth: analysis of some contributing factors", Brooking Papers on Economic Activity, No. 2 (Washington, D.C., 1979).

Table III-1. World market economies: rates of change in consumer prices, 1971-1979
(Percentage)

Country groups	1971-1978	1977	1978	1979 a/	Change from preceding half year, at annual rate: 1978, second half	1979, first half	1979, second half
Developed market economies	8.1	8.4	7.5	9.9	8.1	9.4	12.5
Major industrial countries	7.7	7.7	6.8	9.4	7.7	9.0	11.8
Other industrial countries	7.9	7.3	5.5	5.3	4.4	4.9	7.0
Primary producing countries	13.5	18.1	17.3	20.0	16.5	18.8	25.7
Developing market economies	15.0	21.5	20.7	32.6	23.7	32.9	...
Oil-exporting countries	12.1	15.8	11.0	14.3	6.0	19.1	...
Non-oil-exporting countries b/	15.9	23.3	23.4	36.5	27.9	35.8	...
Africa	12.7	23.4	21.1	28.2	24.6	38.1	...
South and East Asia	9.5	8.1	5.8	9.8	9.4	5.9	...
West Asia	18.8	22.9	29.0	50.5	27.9	48.6	...
Western hemisphere	23.7	40.6	39.4	55.7	43.4	54.7	...

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

a/ For developing countries, the average of months available in 1979 in relation to the average of the same months in 1978.

b/ Including Yugoslavia.

monetary policies in their fight against inflation. In addition, relative emphasis was shifted from setting interest rates to control over the money supply. Mainly as a result of tighter monetary conditions, real interest rates rose sharply. At this juncture, it is unclear how far these policies will moderate inflation and what their effects will be on output and employment. In the short term, and barring direct governmental intervention in the price-setting process, price increases are likely to continue at more or less their current rates of advance, and the immediate impact of demand restraint is more likely to fall on output than on prices. Therefore, short-term prospects in the developed market economies are for a continuation of stagflation, with perhaps lower economic growth and similar or higher inflation rates.

The developing countries also shared in the generalized increase in inflation rates. Besides paying higher prices for imported oil, they have also had to absorb substantially higher prices for imported manufactures. The acceleration of inflation in developing countries started from a higher overall level of inflation than in the developed market economies, and now a majority of developing countries have to deal with inflation rates which are in excess of 20 per cent per annum. Rigidities and factor immobility (in a geographical and functional sense) make their economies very vulnerable to inflationary shocks and render anti-inflationary policies less effective.

While inflation in the developing countries has a relatively small impact on the world economy, rising prices in the developed market economies have adverse effects on the developing countries. Increases in the prices of imported machinery disrupt foreign exchange budgets and often result in lower purchases, especially when some kinds of nominal financial flows (for example, official development assistance) are not expanding at the same rate as prices. 21/ In addition, the management of stabilization policies becomes more difficult in an environment of rapidly rising import prices and pressures on the balance of payments stemming from international inflation. 22/ In the present context of stagflation, these pressures are intensified by deteriorating terms of trade.

A variety of institutional mechanisms, especially the separation of internal and external prices, protect the centrally planned economies against foreign inflation or, at least, permit the lagged, gradual transmission of external price changes. Owing to the relatively small share of trade in the economies of the Soviet Union and China, foreign price pressures do not materially affect domestic price stability. In the Eastern European countries, however, where trade dependence is far greater, stable internal prices, in the face of persistent inflation abroad, have become inadequate guides to resource allocation. Faced with external deficits and deteriorating terms of trade, a number of these countries have begun to use changes in centrally set prices and in the consumer price level as supplements to

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21/ For a fuller explanation of this phenomenon, see World Economic Survey, 1978: Current Trends in the World Economy (United Nations publication, Sales No. E.80.II.C.1), chap. I.

22/ Even if import and export prices go up at the same rate, inflation per se increases the nominal current-account deficit in traditionally capital-importing countries.

the traditional direct allocation and trade control instruments, in order to slow down the growth of domestic absorption.

Thus, the worsening of the inflation picture is adversely affecting all participants in the international economy. If unchecked by policy efforts on the part of the entire international community, the upward movement recently experienced by inflation rates may well continue. There is a danger that the inflationary spiral may gather momentum and that the prevailing situation of rapid inflation and slow economic growth may persist for an indefinite period. All groups of countries would stand to lose, particularly the non-oil-exporting developing countries, whose export earnings and development prospects are strongly affected by continued stagflation.

The developing countries

Inflation rates, as measured by consumer prices, rose in the developing countries during 1979 (see table III-1). The acceleration in the pace of inflation was pervasive, affecting countries in all regions. While demand pressures played a role in the rise in inflation in those countries which were able to expand output rapidly, a good share of the deteriorating price performance must be ascribed to the surge in import prices. All developing countries experienced sharp increases in the prices of manufactures imported mainly from the developed market economies. In addition, the oil-importing developing countries had to pay sharply higher prices for imported oil.

Demand factors appear to have been more prominent in the oil-exporting than in the non-oil-exporting countries. The money supply rose sharply in those countries which chose to monetize a share of their larger payments surpluses. In all of these countries, real incomes increased strongly with the improvement in the terms of trade, and so did consumption and investment demand.

For most non-oil-exporting countries, demand factors do not seem to have played a primary role in the quickening of inflation. Economic expansion was generally well below potential, and increases in import prices appear to have been far more important than demand pressures in explaining the pervasive increase in inflation rates. Besides their direct impact on domestic prices, the indirect effect of higher import prices on wages and exchange rates is likely to have added to domestic inflation. Thus, higher prices for imported necessities have resulted in intensified wage pressures. Likewise, growing balance-of-payment difficulties brought about by higher import prices have led in some countries to devaluations which intensify the impact of the rise in import prices on domestic inflation.

Experience, of course, varied from country to country. While the increase in inflation rates was almost universal, among the group of countries for which reliable data are available, 15 registered a particularly strong increase. This group includes countries with relatively moderate inflation 23/ and countries with relatively high inflation rates. 24/

23/ Colombia, Ethiopia, India, Ivory Coast, Mauritius, Philippines, Trinidad and Tobago, Tunisia and Venezuela.

24/ Brazil, Chile, Indonesia, Israel, Uruguay and Zaire.

Demand pressures may partly account for the acceleration in the rate of inflation in countries where economic growth was strong. However, other factors on the cost side were generally more important. Some of the countries showing a particularly pronounced increase in inflation rates are highly vulnerable to increases in imported energy prices, in that the share of imported energy in total energy consumption as a rule is over 75 per cent, or the share of energy imports in their total import bill is over 20 per cent. 25/ In addition, some countries adopted policies to raise further relative energy prices.

Devaluations, induced partly by growing balance-of-payment problems, and large wage gains also added to the inflationary momentum in some countries. In 1979, Chile and Brazil momentarily abandoned their crawling peg policy and sharply devalued their currencies. Indonesia's devaluation of 50 per cent in November 1978 resulted in sharp increases in the prices of imported food. Israel and Zaire devalued their currencies repeatedly throughout the year, in the latter country after three years of stability in the exchange rate. Rapidly rising living costs, in some cases resulting from devaluation and higher import prices, led to labour pressure and large nominal wage increases in Brazil, Chile, Indonesia, Mauritius and Venezuela.

Sharp increases in food prices also played an important role in the increase in inflation in India, as a result of a weather-induced decline in food production, and in Israel, where food subsidies were eliminated.

The developed market economies

The rate of inflation in the developed market economies showed a clear acceleration in 1979 in relation to 1978, and even higher overall inflation is expected for 1980. As can be seen from table III-1, consumer price inflation rose from 7.5 per cent in 1978 to almost 10 per cent in 1979. The increase was concentrated in the major industrial countries, whose inflation rates rose by almost three percentage points.

As measured by the consumer price index, inflation rates had already begun to creep upward during 1978 in the United States of America and Canada, and in the second half of the year in France and the United Kingdom. In the United States, the long economic expansion that had been under way since 1975 probably led to some demand pressures and the emergence of sectoral bottlenecks, particularly in industries producing industrial raw materials. In addition, food prices rose steeply in North America. Sharp increases in unit labour costs also added to inflationary pressures in France, the United Kingdom and the United States. Nevertheless, the generalized outbreak of substantially higher inflation rates did not take place until 1979.

One of the major causes for the increase in inflation rates during 1979 was the oil price adjustment and the sharp rise in the prices of other industrial raw materials. In the short term, these large price increases can be expected to

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25/ In the sample of 15 countries, Brazil, Chile, Israel, the Ivory Coast, Mauritius, the Philippines and Uruguay are in one, at least, of these categories.

be reflected in increases in price levels. In the longer run, however, the full effect on inflation rates of higher prices for raw materials will depend on the policy responses of Governments.

While the high rates of inflation prevailing in the developed market economies are due to a variety of factors not related to oil prices, the generalized acceleration of inflation during 1979 can be partially ascribed to higher oil prices. On average, imported crude petroleum prices rose by almost 50 per cent in 1979 in relation to 1978, with another 55 per cent increase expected in 1980. The resulting increase of 130 per cent in the average price of imported petroleum between 1978 and 1980 might add almost two and a half percentage points to the final demand deflator, or about 1 1/4 per cent per year. 26/ Since consumer price inflation accelerated by about two and a half percentage points in 1979 in relation to 1978, about one half of this acceleration may be attributed to the direct effect of higher imported petroleum prices. 27/ This calculation does not take into account sympathetic increases in the prices of domestically produced energy or other indirect effects. Since these catch-up phenomena occur with a lag, their major impact on price levels is likely to come in 1980. According to OECD, the adjustment of domestically-produced energy prices could add another 1-1 1/2 per cent of the total demand deflator during 1980. 28/

Wholesale prices came under pressure from increases not only in energy prices but also in the prices of other raw materials. The upward trend in these prices, which began in the second half of 1978, gathered momentum during 1979, and the prices of most agricultural raw materials and metals rose sharply throughout the year. With the exception of tropical beverages, food prices also rose at a fast pace and directly affected the consumer price index. Largely owing to the forecast slow-down in growth rates in the developed market economies in 1980, commodity prices are not expected to continue rising at the same rates as in the past 18 months.

As mentioned above, the intensification of inflationary expectations in the developed market economies has contributed to the rapid spread and magnification of externally induced price increases. In recent months, many prices and certain classes of incomes have been quickly adjusted to the expectation of accelerating inflation.

While the experience of individual countries differed, owing to relatively slack labour markets, wages in the developed market economies as a whole may have risen somewhat less than consumer prices in 1979. In 1980, however, wage-earners may succeed in recovering the losses they sustained last year. In spite of the relatively moderate increases in wages in most countries, the trend in unit labour

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26/ Obtained by taking the ratio to final demand of the increase in the net oil import bill due to the expected year-on-year price rise between 1978 and 1980.

27/ This estimate assumes that the impact of higher oil prices was more or less equally distributed between consumption and other components of final demand.

28/ Organisation for Economic Co-operation and Development, Economic Outlook, No. 26 (December 1979), p. 43.

costs was upward. In the major industrial countries, all countries, with the exception of the Federal Republic of Germany and Japan, experienced faster increases in unit labour costs during 1979 than during 1978, essentially owing to a slow-down in productivity growth. In the United States of America, for the economy as a whole, labour productivity may have declined by 1-1 1/2 per cent in 1979.

The decline in the growth of productivity during the 1970s appears to be a long-term phenomenon, and therefore the deceleration experienced in 1979 can be seen as a continuation of longer-term trends. Nevertheless, the decline in 1979 appears to have been particularly pronounced, owing in part, perhaps, to cyclical developments. Overall economic growth peaked in 1978 in a number of countries (Canada, the United Kingdom and the United States), and 1979 saw the beginning of the downward phase of the cycle. Since labour productivity moves in a pro-cyclical pattern, 29/ the considerable slowing growth in these countries may explain their weak productivity performance. In addition, recent research for the United States suggest that at the end of a period of economic expansion firms tend to hire considerably more workers than is justified by the level of output, perhaps due to mistaken expectations or from inertia in changing personnel budgets. 30/ The combination of these factors may explain the relatively strong increase in non-agricultural employment (over 3 1/2 per cent) in the face of weakening growth trends.

Factors specific to individual countries also contributed to the rise in inflation rates. In the United Kingdom, a switch from income to value-added taxes is estimated to have raised by four percentage points the rate of increase of consumer prices, and an increase in value-added taxes in the Federal Republic of Germany may have contributed one percentage point to the rate of consumer price inflation. In Japan, the strong depreciation of the yen since November 1978 was an important factor behind the rise in wholesale prices; nevertheless, consumer prices only began to register the increase in costs towards the end of 1970. Higher social security contributions affected non-wage labour costs in France. In Italy, demand pressures in the first half of 1979 accounted for part of the acceleration in inflation. In addition, the cost-of-living index was influenced by a legislated increase in rents. In the United States, the first stage in the decontrol of oil and gas prices exacerbated the effect of higher prices for imported energy. Consumer prices were also affected by rapid increases in food and housing costs, the latter due to substantially higher interest rates.

Despite sharp increases in import prices, inflation rates remained practically constant between 1978 and 1979 in the more open, smaller, industrial countries. The primary producing countries, on the other hand, experienced an acceleration in inflation much in line with the one recorded in the major industrial countries.

29/ During the downswing of the business cycle, the growth of output tends to decelerate more than that of employment. Conversely, output growth picks up faster than employment in the upswing.

30/ Robert J. Gordon, "The 'end-of-expansion' phenomenon in short-run productivity behavior", Brookings Papers on Economic Activity, No. 2 (Washington, D.C., 1979).

In the near term, inflation rates may well remain at their currently high levels in most countries. Costs may continue to rise rapidly, particularly if workers are successful in their bid to reverse the loss in real wages they sustained in 1979. In addition, a fuller catch-up of domestic energy prices to international price levels than in 1979 will also add to inflationary pressures. In particular, oil prices in the United States are likely to increase by over 30 per cent as that country continues its programme of price decontrol, 31/ and other energy prices may be expected to show similar rises. However, overall price levels may increase less than costs. With the continuation of tight monetary and fiscal policies, firms may find it difficult to pass on to customers their increases in costs, and profit margins may shrink. Nevertheless, the exacerbation of inflationary expectations may have increased the difficulties of reducing inflation purely by monetary means, and Governments may have to resort to direct intervention in the formation of prices and incomes.

The centrally planned economies

Information on changes in consumer and producer prices in the centrally planned economies during 1979 is still very incomplete, but from the data available it is clear that these economies also participated in the world-wide acceleration of price increases, though on a comparatively minor scale. Reported rates of increase in consumer prices ranged from 2 to 3 per cent in Czechoslovakia and Romania to 7 to 9 per cent in Hungary and Poland. Producer price increases announced during the year were of comparable magnitude. As elsewhere, energy prices recorded the largest increases, but price advances were fairly wide-spread and reflected not only imported inflation but also domestic cost pressures. In China, the implementation of revised management policies in 1979 included a new stress on the use of the price mechanism, which - after a long period of frozen prices - probably resulted in a significant increase of the overall price level. 32/

Institutional mechanisms which separate real from monetary flows and maintain fiscal buffers between the external sector and the various spheres of the domestic economy on the whole continued to protect these economies against unplanned price changes that could disturb plan implementation or adversely affect social welfare policies. 33/ Nevertheless, by past experience, price adjustments in 1979 were

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31/ Organisation for Economic Co-operation and Development, op. cit., p. 43. In addition, in March 1980 it enacted a tax on imported oil which will raise the retail prices of oil still further.

32/ Aggregate data are available only for agricultural procurement prices, which rose by 25 per cent.

33/ Economic planning with physical allocation of resources and central control over wages and prices are the basic mechanisms which permit these economies to contain inflationary pressures on prices, which in any case play a rather subordinate role in economic decision-making outside the consumption sphere. Internal price autonomy is maintained through the separation of the domestic economy from the external sector by means of implicit taxes and subsidies. In a similar manner, consumer prices are kept relatively independent of producer and wholesale prices through a system of budgetary transfers.

considerable and widespread, often exceeding the plan's guidelines. 34/ While to a certain extent the transmission of external price changes had an influence on domestic price levels, 35/ changes in the latter were also affected by policy decisions about economic management, which entailed a significant modification of traditional social policies. For one thing, inflation has been made more "open" and the burden of rising internal and external costs is being distributed proportionately, in marked contrast to earlier practice. 36/ Secondly, whereas in earlier years policy-makers had aimed at controlling the price level by offsetting price increases for some goods with price reductions for others, very few downward price adjustments were announced in 1979. In some countries the increase in prices exceeded the growth of nominal wages and hence had a negative impact on real incomes.

The price adjustments of 1979 to some extent amounted to an ad hoc resolution of the conflict between the desire for price stability on the one hand and the need to foster efficiency through price stimuli on the other. In order to encourage productivity, most countries of the group sought in the 1970s to improve the information content of prices for decision-making, but the effectiveness of these policies was blunted by the rapid and large price movements in foreign markets, including since 1975 in intra-CMEA relations. Initially, the centrally planned economies responded to the external price pressures by reducing the demand for imports through a variety of administrative and other measures. At the same time, they sharply increased their budgetary transfers to protect domestic prices from external price instability. (Most countries also revalued their currencies, in spite of external deficits.) However, the avoidance of domestic adjustment has become increasingly more cumbersome, especially in the trade-dependent Eastern European countries. As a result, price changes have recently been undertaken more frequently and, in most countries, they have been much larger than in any other period since post-war stabilization. While external price movements, especially for petroleum products, were an important consideration in the adjustment of domestic prices in Eastern Europe, internal cost pressures and a number of other domestic policy goals contributed too. It bears noting that these price changes have followed external disturbances with a considerable lag, the extent of which depends upon the overall policy objectives sought by the individual countries.

34/ For a discussion of planned price guidelines accompanying the current medium-term plans (1976-1980), see Supplement to World Economic Survey, 1976: Recent Trends in the World Economy (United Nations publication, Sales No. E.78.II.C.2), pp. 83-86.

35/ It bears noting that in trade within CMEA, the prices are modified five-year averages of main world market prices, and therefore only gradually transmit major shifts in world prices.

36/ Between comprehensive price revisions, which are normally undertaken at intervals of at least five years, cost increases for "old" products have traditionally been absorbed through subsidies and affected prices only upon the introduction of "new" products. The infrequent comprehensive price revisions are, of course, designed to harmonize costs and prices. As a major component of social welfare policies, most countries of the group, however, have maintained price stability for essential consumer goods and services even in the event of comprehensive price revisions.

In the context of inflationary trends in the world economy, the upward price movement in the centrally planned economies has been modest, even in countries that are committed to having domestic prices reflect broad internal and external cost changes in order to improve resource allocation. In the early 1970s, average annual changes in consumer and producer prices ranged from well below 1 per cent in most countries to 3-4 per cent in Hungary and Poland. In the second half of the 1970s, however, the upper range moved to 5-7 per cent, 37/ while in several countries previously characterized by virtual stability, the price level began to rise by 1-2 per cent annually. In a number of countries, the major price revisions of 1979 also affected essential goods and services, 38/ and in order to mitigate the potentially negative effect on the cost of living, various monetary compensation instruments were activated or broadened.

The outlook for 1980 is not readily predictable. Nevertheless, in most Eastern European countries there is a continuing need to constrain the expansion of domestic absorption and to pass on rising costs, especially in view of the expected further deterioration in the terms of trade. In view of the apparent increased readiness of policy-makers to use price instruments, changes in 1980 are again likely to be larger than those experienced in earlier years, though far short of the price rises expected in the market economies. For most members of the group this means changes in prices within the range of 1-3 per cent. Hungary and Poland, however, already anticipate another rise of 7-9 per cent.

37/ In addition to harmonizing relative prices with relative cost, a significant impetus to the retail price increase in Poland has been the rapid rise in real income in the 1970s, which was not fully covered by increments in the supply of consumer goods and services; and in Hungary, the neutralization of the deterioration in the terms of trade since the mid 1970s (which in forints averaged 3.3 per cent in 1974-1978) deprived domestic prices of their information value and could no longer be maintained without seriously jeopardizing the functioning of essential components of the Hungarian economic mechanism.

38/ As a matter of policy priority, however, Czechoslovakia, the German Democratic Republic and the USSR reaffirmed their commitment to stable prices for essential consumer goods and services, if necessary at the expense of higher budget price supports.

Chapter IV

WORLD TRADE AND INTERNATIONAL PAYMENTS, 1979-1980

Factors shaping world trade and payments

One of the most significant changes in the world economy in 1979 was in the current-account balances of most countries. When compared with changes in the previous year, oil-exporting developing countries, the developed market economies and the centrally planned economies experienced substantial swings in their current-account balances. Only in the non-oil-exporting developing countries was the shift in the current-account balances in 1979 in the same direction and of a similar magnitude as it had been in 1978 (see table IV-1).

The substantial shifts in the current-account balance that took place in 1979 are mostly explained by changes in the terms of trade, which were largely determined by oil price increases. Oil-exporting developing countries and the centrally planned economies - in which the USSR, an oil exporter, carries considerable weight - experienced a substantial improvement in their current-account balances. The counterpart was a considerable deterioration in the corresponding balances of non-oil-exporting developing countries and developed market economies. The current-account deficit of non-oil-exporting developing countries - $51 billion - reached the highest level ever recorded in absolute terms. 39/

The forces that were generally the main determinants of shifts in current account balances in 1979 will still be present in 1980. Thus, there will be a further improvement in the position of the oil-exporting developing countries and centrally planned economies, while the current-account deficit in the other two country groupings can be expected to deteriorate considerably. The current-account surplus of the oil-exporting developing countries is likely to reach $101 billion, 40/ or the equivalent of the combined current-account deficit of the non-oil-exporting developing countries and developed market economies.

The realization of those deficits, however, presupposes that financial resources will be forthcoming. This poses particular problems for a number of countries, especially among the non-oil-exporting developing countries. But even at the aggregate level some difficulties may cloud the financial picture. The magnitude of the deficit requires large financial transfers, which, in view of the world-wide inflation, should not serve to generate excessive overall liquidity. Thus an efficient, rapid and flexible recycling process, allowing for substantial recycling in the medium and long term, becomes crucial.

39/ If the 1979 current-account deficit of the non-oil-exporting developing countries is adjusted by changes in the unit value of their imports or in the unit value of their exports, it is still less than the corresponding 1975 deficit. It is also less than the 1975 deficit when seen as a ratio to total imports or to gross domestic product.

40/ The basic variable in this forecast is in the price of oil, which is assumed to rise by 55 per cent between 1979 and 1980, on a year-on-year basis.

Table IV-1. Balance of payments on current account, a/ by countries and country groups, 1977-1980
(Billions of dollars)

Countries and country groups	1977	1978	1979 b/	1980 c/
Developed market economies	-7.5	36.4	-11.8	-33
Major industrial countries	10.9	37.8	-0.9	-12
Canada	-4.1	-4.4	-4.9	-7
France	-1.6	5.3	3.8	-2
Germany, Federal Republic of	8.6	13.4	1.0	-4
Italy	4.2	9.2	5.6	3
Japan	11.2	18.0	-8.1	-13
United Kingdom	2.5	5.3	-0.8	5
United States of America	-9.9	-8.9	2.5	6
Other countries	-18.4	-1.4	-10.9	-21
Developing countries	9.3	-28.0	18	32
Oil-exporting countries	33.2	7.5	69	101
Non-oil-exporting countries d/	-23.9	-35.5	-51	-69
Centrally planned economies e/	-1.0	-5.9	-0.2	-
China	1.0	-0.9	-1.9	-3
Eastern Europe	-6.3	-6.6	-5.1	-6
USSR	4.3	1.6	6.9	9
Residual balance f/	-0.8	-2.5	-6	1

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data supplied by the International Monetary Fund and national sources.

a/ Excluding government transfers.

b/ Preliminary.

c/ Forecast.

d/ Including Yugoslavia.

e/ Excluding the centrally planned economies of Asia other than China. Trade balances only.

f/ Reflects errors, omissions and asymmetries in reported statistics, service balances for the centrally planned economies, and the balance of the groups listed with other countries (mainly the centrally planned economies of Asia other than China).

In the 1970s, the private international markets played the main role in the recycling process. They acted as intermediaries by channelling a substantial part of the surplus of some oil-exporting countries to the developed market economies, to the centrally planned economies and, since 1974, to more than 50 non-oil-exporting developing countries. 41/ It is not clear whether this process can continue as readily in 1980. On the one hand, the oil-exporting countries may find that these outlets are not as secure or as profitable as in the past. On the other hand, the private institutions themselves may not wish to increase their role disproportionately. 42/ Under such conditions, world trade would slow down still further, constituting an additional recessionary factor in an already weakening world economy.

In 1979, the value of world trade increased by 25 per cent, the largest increase since 1974. This was partly due to a significant increase in the volume of goods traded; but it was even more a result of accelerated price increases, the latter accounting for about two thirds of the increase in the value of world trade (see table IV-2).

The forces that shaped changes in the prices of various internationally traded commodities in 1979 were not uniform. Nor were they independent of pressures that had been mounting well before 1979, particularly as regards fuels, the item whose price variation was the sharpest in 1979. The movement in prices of manufactured goods in international trade largely reflected domestic inflation in the developed market economies, the main suppliers of these goods. Food prices increased as a consequence of large supply-demand imbalances following unexpected crop shortfalls in some parts of the world. Prices of raw materials also generally rose as speculative demand generated by increasing uncertainties was superimposed on strong final demand in some countries. The different nature of the pressures bearing on prices led to significantly different rates of price changes among commodity groups. None the less, the broad trend was one of considerably higher prices in most traded commodities.

41/ According to publicized Eurocurrency borrowings (which do not include all borrowings from international commercial banks), 53 non-oil-exporting developing countries borrowed from $15 million to nearly $21 billion each in the period 1974-1979. The distribution of these borrowings, however, was skewed. A third of these countries borrowed from $500 million to $21 billion; another third, from $100 million to less than $500 million; and the bottom third, from $15 million to less than $100 million.

42/ International commercial banks since mid-1979 have warned the international financial community that they might not increase operations at a fast rate. Three main reasons have been put forward: (a) the banks' capital has not increased commensurately with their holdings of foreign assets and further deposits might make capital-asset ratios decline to levels beyond which banks would not like to go; (b) the share of loans to what might be considered risky countries is already high; and (c) in many of the borrowers the debt-service ratio is already substantial and their export outlook in the short run is rather bleak.

Table IV-2. Rates of change in trade volumes and prices for the world as a whole, by country groups, 1971-1980

(Percentage)

Items and country groups	1971-1979 a/	1977	1978	1979 a/	1980 b/
Volume of exports					
World	5.7	4.3	5.1	6.1	3 1/2
Developed market economies	6.5	4.2	6.3	7.0	4
Developing countries	3.2	3.2	2.9	4.3	-1
Oil-exporting countries	0.5	0.6	-2.5	1.0	-5
Non-oil-exporting countries	7.0	6.6	9.4	8.0	3
Centrally planned economies c/	7.3	8.7	3.5	3.4	4
Volume of imports					
World	6.3	5.1	6.0	4.9	3 1/2
Developed market economies	5.5	3.0	5.0	7.5	1
Developing countries	7.6	11.3	7.9	-0.9	11 1/2
Oil-exporting countries	14.8	22.2	5.6	-15.0	30
Non-oil-exporting countries	5.5	5.8	9.2	7.0	3
Centrally planned economies c/	8.1	3.9	8.2	1.4	4
Unit value of exports					
Market economies	13.8	9.4	9.5	17.6	19 1/2
Developed market economies	11.7	9.0	12.8	14.0	15
Developing countries	20.6	10.3	0.6	28.7	33 1/2
Oil-exporting countries	30.6	9.1	-0.1	40.7	50
Non-oil-exporting countries	11.4	12.0	1.3	16.5	16
Unit value of imports					
Market economies	13.3	9.7	9.7	18.1	19
Developed market economies	13.3	9.9	9.9	18.2	19
Developing countries	13.3	9.0	9.1	17.7	18
Oil-exporting countries	12.1	9.6	11.4	14.8	15
Non-oil-exporting countries	13.5	8.9	7.8	19.2	20
Terms of trade					
Developed market economies	-1.4	-0.8	2.7	-3.6	-3 1/2
Developing countries	6.4	1.2	-7.8	9.3	13
Oil-exporting countries	16.5	-0.4	-10.4	22.6	30 1/2
Non-oil-exporting countries	-2.0	2.9	-6.0	-2.3	-3 1/2

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on United Nations Conference on Trade and Development, 1979 Handbook of International Trade and Development Statistics (United Nations publication, Sales No. E/F.79.II.D.2), and International Monetary Fund, International Financial Statistics, various issues.

a/ Preliminary.

b/ Forecast.

c/ Centrally planned economies of Europe only.

The forces underlying the higher growth in the volume of trade in 1979, which was slightly above 6 per cent, seem to have been of a short-term and rather erratic nature. Exceptionally bad agricultural harvests owing to adverse weather conditions and the decision of a few countries to build stocks of industrial inputs as a response to increasing uncertainties were two main factors determining the growth of trade volume in 1979.

Trade in agricultural goods rose considerably as a result of bad harvests in certain regions and of substantial real wage increases in some developing countries. 43/ This led in 1979 to a significant growth of exports from countries such as Argentina, Australia, New Zealand and the United States of America. Increasing uncertainties regarding the rate of price increase, but more especially with respect to the availability of certain strategic inputs, caused some countries, such as France, the Federal Republic of Germany, Italy and Japan, to experience an increase in the volume of imports much higher than was warranted by the growth of their industrial output in 1979.

Two other factors shaping the increase in the volume of world trade, although not as important in quantitative terms, were also significant. First, very strong efforts have been made by several developing countries since the end of 1978 to secure access to the markets of oil-exporting countries. These efforts have led to the conclusion of bilateral arrangements with oil suppliers, resulting in important increases in trade. Secondly, the greater participation of China in world trade led to an increase in its imports of almost 50 per cent - $5 billion - in 1979.

Both of these factors may bring about important and sustained increases in trade in the medium term. But by and large it can be said that, taken together, events in 1979 do not provide a firm basis for predicting substantial growth in the volume of trade in the future. The investment attracted by trade-related activities is not likely to have changed considerably, since the factors that determined the acceleration of world trade in 1979 were primarily the weather and transitory stockbuilding.

The growth of trade in manufactures in 1979 did not change significantly in comparison with 1978. None the less, the sources of this growth were significantly different from those in 1978 or earlier years. The substantial increases in the period 1970-1978 in the imports of manufactures of most of the centrally planned economies and oil-exporting countries came to a halt in 1979. Thus, impulses for growth in trade in manufactures came almost exclusively from developed market economies and non-oil-exporting developing countries.

In the developed market economies, changes in relative prices played an important role in determining the pattern and growth of imports of manufactures. The slow growth of income in the developed market economies in 1979 did not warrant any major expansion in their imports of manufactures. But an increase took place in response to the lagged effects of the substantial currency realignments that had taken place before 1979 and sudden shifts in consumers' preferences (for example, towards small or more fuel-efficient cars).

Import demand for manufactures in non-oil-exporting developing countries also advanced at a fast pace in 1979. However, this was concentrated mostly in countries

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43/ For example, Mexico and the Republic of Korea.

that either grew rapidly in 1979 or were endeavouring to build a significant energy export sector. In the former countries, such as Brazil, Chile, and the Republic of Korea, the volume of imported processed industrial inputs grew very rapidly as industrial production expanded considerably; in the latter countries, such as Angola, Mexico, and Tunisia, imports of machinery and equipment increased at a very fast rate.

The increase in the value of world trade in 1980 can be expected to be somewhat lower than in 1979, reflecting in particular a slow-down in the volume of trade. Two of the main factors that shaped the large increases in the level of prices of internationally traded commodities in 1979 - the adjustment in fuel prices and inflation in developed countries - will still be present in 1980 and will affect overall prices with at least the same intensity as in the previous year. No significant stimulus, however, seems to exist for a considerable growth in the volume of trade in 1980. The redoubling of energy conservation efforts and increased use of domestic substitutes for imported fuels in most countries will result in minimal changes in the volume of oil trade. If more normal conditions prevail in agricultural production, food trade might decrease. Finally, stockbuilding should subside, as costs of additional stockbuilding are likely to increase disproportionately. In terms of broad groups of countries, only the oil-exporting developing countries will clearly be in a position to increase expenditure, and therefore imports, at a considerable pace, as in fact, they have already decided to do.

The already difficult payments situation in most non-oil-exporting developing countries and centrally planned economies, partly owing to the size of their debt service, will also have a dampening effect on the growth of real imports in 1980. In the developed market economies, the slow-down of overall growth will be the main factor affecting import increases. But in some of the latter countries, slow import growth emanating directly or indirectly from payments difficulties cannot be ruled out either. As already mentioned, events in 1979 made several developed market economies - and the group as a whole - swing from a current-account surplus into a current-account deficit. These phenomena and their interrelations are discussed in greater detail in subsequent sections.

Pervasive price increases in international commodity markets

In 1979, changes in the prices of internationally traded commodities were a major factor affecting the evolution in the terms of trade and the current accounts of most countries participating in the international economy. The dynamics of international price changes were such that most prices moved upward by a considerable margin. Given current expectations and market pressures, it is very likely that in 1980 the prices of the main internationally traded commodities will continue to increase significantly.

Developments in primary commodity markets were dominated by sharp increases in the prices for raw materials in 1979. After almost five years of a relative decline in crude petroleum prices, the excess demand situation that developed in world petroleum markets towards the end of 1978 permitted producers to raise their prices. 44/ Prices increased sharply throughout the year, and at the end of

44/ For a full discussion of developments in world oil markets, see annex II.

January 1980 they were roughly 130 per cent higher than at the end of 1978. On a year-to-year basis, oil prices rose by about 50 per cent between 1978 and 1979, taking spot market transactions into account. Given the slow-down in world economic growth that is forecast for 1980 and the conservation efforts induced by higher relative oil prices, prices are not likely to rise much more in the course of 1980. However, even if they do not increase in nominal terms in the period February-December 1980, average 1980 prices will be 55 per cent higher than in 1979.

As shown in table IV-3, the prices for other raw materials also increased sharply in 1979. The upward price movement affected a large number of commodities, particularly copper, lead, iron ore, zinc, tin, sisal, rubber, wool, hides and tropical lumber. Several factors accounted for this development, including strong demand in Europe and Japan, the depletion of stocks after several years of low production, individual supply disruptions and speculative buying. Growing uncertainties about future rates of inflation were responsible for a flight from currencies into real assets, such as gold and other metals.

Prices of raw materials are unlikely to continue to rise at the same pace in 1980. Slower world economic growth should lead to a softening of primary commodity markets in general. However, higher costs, inflationary expectations and relatively low stock levels should keep prices from falling as they did in 1975.

Food prices were also sharply higher in 1979 than in the previous year. In particular, cereals, vegetable oils and oil-seeds, beef and sugar prices recorded strong increases. Poor harvest in the USSR and in Eastern Europe and in some developing countries contributed to the increases in cereal prices. The prices for soya beans, the leading oil-seed, rose sympathetically with cereal prices. Beef prices were affected by reduced slaughterings. After a three-year slump, sugar prices rose because of hurricane damage to the Caribbean crops and unexpectedly large Soviet and Chinese imports.

With the current United States embargo on approximately 15 million tons of grains to the Soviet Union, the price picture for cereals has become uncertain. Given the sharp increase in cereal prices throughout 1979, if prices remain at levels prevailing in early 1980, the average for the year should be considerably higher than in 1979. In addition, the decrease in stocks during 1979 may keep prices from falling. With meat prices continuing to climb, overall food prices should record large gains in 1980. The prices of oil-seeds, on the other hand, should come down sharply, as a result of large surpluses and a bumper soya bean crop in the United States of America.

The markets for tropical beverages were in excess supply in 1979, and prices came under downward pressure. Owing to frost damage in Brazil and speculative buying, coffee prices soared towards the middle of 1979 but settled back after September. Although current production probably exceeds world consumption, joint action by producing countries is likely to prevent a fall in prices. In 1979 the cocoa market was in excess supply for the third consecutive year. Despite agreement by producing countries on stockpiling and a minimum export price, prices may drift somewhat lower. Tea prices, on the other hand, could exhibit a mild upward movement in 1980, as a result of shortages of good-quality teas.

The prices of manufactures exported by the developed market economies continued to rise sharply in 1979. Since these prices closely follow the trends in inflation in the developed market economies, no abatement in their rate of increase is expected in 1980.

Table IV-3. Changes in the prices of internationally traded commodities, a/ 1978-1980

(Percentage)

	1978	1979	1980 b/
Non-oil primary commodities c/	-7.3	15.9	10
Food	9.3	19.9	25
Tropical beverages	-27.9	2.8	10
Vegetable oils and oil-seeds	12.1	18.1	-5
Agricultural raw materials	10.5	23.3	5
Minerals, ores and metals	6.3	27.3	10
Crude petroleum	-	45.3 d/	55
Manufactures exported by developed market economies	14.7	14.4	15

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

a/ The price indices have been constructed on the basis of spot market quotations (unit values for manufactures exported by developed market economies) expressed in United States dollars. Figures reflect year-on-year changes.

b/ Forecast.

c/ Individual commodities are weighted by their value in the exports of non-oil-exporting developing countries in 1972-1975.

d/ If transactions in the spot market are included, the price increase may have reached 50 per cent.

In general, the changes in international prices described above explain the movements in the terms of trade. On the one hand, the oil-exporting developing countries - and to a lesser degree the USSR and other oil exporters - benefited from the adjustment in oil prices, and their terms of trade improved very sharply, with a further improvement expected in 1980. On the other hand, the majority of the non-oil-exporting developing countries, the developed market economies and the Eastern European countries experienced deteriorating terms of trade.

The experience of non-oil-exporting developing countries varied from country to country, according to the commodity composition of their trade. For example, some countries that export copper saw their terms of trade improve significantly. At the other end of the spectrum, some of the countries exporting tropical beverages

probably showed the sharpest deterioration in the terms of trade. Since a large number of least developed and other low-income countries are exporters of these commodities, they were among the countries most seriously affected by developments in the international economy.

The terms of trade for non-oil-exporting developing countries are expected to worsen again in 1980. The export prices of those countries are not likely to increase as fast as they did in 1979, 45/ while the prices of their main imports will continue to rise at a very rapid pace. Thus, for them, the overall picture is one of sharply increased pressures on their trade accounts in 1980.

Increasing payments difficulties in non-oil-exporting developing countries

Growing current-account deficits

As noted above, movements in international prices caused large imbalances in the current account to emerge in developing countries. While the oil-exporting countries saw their combined current-account surplus swell, the deficit of the non-oil-exporting countries rose to record levels in nominal terms. Higher international prices swelled current-account deficits in these countries for two reasons. First, as mentioned above, the terms of trade of most countries deteriorated. Secondly, even in the absence of worsening terms of trade, higher rates of international inflation per se caused current-account deficits to rise.

The non-oil-exporting countries experienced an increase of more than $10 billion in their combined current-account deficit in 1979, and the prospects are for a further deterioration in 1980. It is to be emphasized that these very large deficits are not a consequence of accelerated economic growth. On the contrary, the growth rate attained in 1979, while somewhat higher than in the previous year, remained well below the international target for the Second United Nations Development Decade. In 1980, a slow-down in growth is expected.

As shown in table IV-2, the volume of exports of the non-oil-exporting countries in 1979 appears to have risen at a strong pace - about 8 per cent - although this growth was very unevenly distributed. The exports of manufactures from some of the more industrialized developing countries to the developed market economies and to the oil-exporting developing countries continued to expand rapidly. In addition, many developing countries benefited from strong demand for raw materials in the developed market economies.

Despite growing balance-of-payments pressures, the rate of growth in real imports remained strong - about 7 per cent - mostly owing to the strong import demand of fast-growing countries and of some food-importing countries. However, many countries had to restrict imports severely for balance-of-payments reasons. The growth in real imports in 1978-1979 should also be seen in the context of the abnormally low growth rates recorded in the period 1975-1977, when developing

45/ The export price changes shown in table IV-2 for the non-oil-exporting countries are influenced to some extent by the gorwing petroleum exports of half a dozen of the countries included in the group. If these countries are excluded, the rate of increase in export prices is substantially lower and, therefore, the deterioration in the terms of trade is much sharper.

countries had to curtail imports sharply in the aftermath of the 1974-1975 crisis. Therefore, the rather high rates of growth of the past two years represent, to some extent, a replenishing of import stocks. 46/

The growth of real exports in 1980 will most probably be adversely affected by the slow-down forecast for the developed market economies. As regards real imports, their growth will be curtailed by the need to finance sharply higher payments deficits. In fact, many non-oil-exporting developing countries have recently adopted restrictive import measures. 47/ Therefore, it can be expected that they will undergo considerable adjustment. On these bases, growth rates of real imports and of exports are both forecast at 3 per cent, considerably lower than the rates achieved in the past two years or the import growth rates in development plans.

Financing the current-account deficit and the adjustment process

While the current-account deficit of the non-oil-exporting countries increased in 1979, it is not yet known with certainty how it was financed. Although firm evidence is only fragmentary, it appears that long-term flows rose little when deflated by import prices and that the main contribution to the financing of current-account deficits came from a sharp deceleration in the accumulation of international reserves. 48/

In the absence of new policy departures, long-term financial flows are again not expected to increase significantly in real terms in 1980. International reserves, on the other hand, are expected to decline even in nominal terms. As a result, the average reserve-to-import ratio is forecast to fall from 3.8 months' worth of imports in 1978 to 3 months' worth in 1980. For the less well-placed countries, reserves may be essentially exhausted. In addition, short-term flows would have to rise sharply in order to enable non-oil-exporting developing countries to close their payments gaps.

Prospects for additional official development assistance from member countries of the OECD Development Assistance Committee are uncertain. Barring a major policy reversal, in the current circumstances of tight fiscal policies, rising inflation and slowing economic growth, official development assistance from the developed market economies is unlikely to show a significant expansion. In fact, it may prove difficult for some countries to obtain legislative approval even to maintain concessional flows in real terms. As regards aid from OPEC member countries, prospects are different. In 1979, these countries agreed to replenish the OPEC Special Fund for disbursing aid to non-oil-exporting developing countries by $2.4 billion. In addition, some individual countries have begun the practice of allowing developing countries to pay for the increases in their oil bills that are due to higher prices through credit granted on a preferential long-term basis. Therefore, concessional flows from OPEC member countries should rise substantially in 1980.

46/ For a discussion of balance-of-payments adjustment in developing countries during the period 1974-1977, see annex I.

47/ For a more complete discussion of this point, see chap. VI.

48/ Official reserves increased by only $8 billion in 1979, compared with $14.9 billion in 1978. This reduction in the pace of reserve accumulation increased the proportion of capital flows that could be used to finance current-account deficits.

Flows from multilateral institutions may well rise in real terms in 1980. A doubling of the World Bank's capital to $80 billion has been agreed upon, and the Bank is actively considering increasing its long-term programme lending to developing countries, which would be used essentially for balance-of-payments financing.

In IMF, some changes have recently been made which could affect the volume of resources available to developing countries. Total Fund quotas have been raised from SDR 39 billion to SDR 59.6 billion; and new allocations of SDR 4 billion per annum have been agreed upon for 1979 through 1981. As regards the terms and conditions for the use of resources, maximum drawings under the Compensatory Financing Facility have been raised from 75 to 100 per cent of the quotas, 49/ the repayment period under the Extended Fund Facility has been lengthened from eight to 10 years, and new conditionality guidelines have been adopted which take into account to a greater extent the borrowing country's socio-economic objectives.

The enlargement of the Fund's resources, however, will do little to ease the situation of developing countries in 1980. The quota increases are unlikely to be introduced in time this year, and the share of developing countries in the new allocations of special drawing rights is too small to constitute an important addition to their external resources. For the low-income countries, access to concessional balance-of-payments financing will in fact be reduced by the expiration of the Trust Fund in June. 50/ Moreover, without a further relaxation of conditionality, it is unlikely that borrowing from the Fund by developing countries will increase significantly. It is notable that, despite very sharp increases in the current-account deficits of the non-oil-exporting developing countries in 1979, their net use of Fund credit amounted to only $0.7 billion, and Trust Fund drawings amounted to another $0.7 billion. During 1980, however, severe balance-of-payments difficulties may force some countries to accept the conditions of borrowing attached to the higher credit tranches. 51/

Thus, on the whole, the outlook is not promising for countries that rely mainly on official - bilateral or multilateral - financing. International reserves are on the low side in most of these countries, and in the absence of new initiatives, the likely flow of official resources would not be able to finance any significant increase in their import volume in 1980. Nor is the outlook devoid of difficulties for other non-oil-exporting developing countries. Although, in general, their reserves are not on the low side, they cannot be drawn down considerably without affecting their credit rating. Besides, the flow of direct foreign investment is in general not responsive to short-term balance-of-payments needs, and it is not

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49/ The rule that a country could draw only up to 50 per cent of its quota in a 12-month period has been dropped. In addition, workers' remittances may now be included in the calculation of shortfalls in export earnings, and trend exports will be estimated using a geometric rather than an arithmetic average of past and projected exports.

50/ The Trust Fund was set up in 1976 with the profits on the sale of one sixth of the Fund's gold in order to provide long-term concessional financing to low-income developing countries in balance-of-payments difficulties.

51/ In 1979 the number of countries that resorted to stand-by arrangements with the Fund was already twice what it had been in 1978.

certain that the international financial markets will continue in the role they have come to play in recent years. 52/

Indeed, since mid-1979, international commercial banks are giving mixed signals on their future role. On the one hand, they have expressed their anxieties in connexion with emerging payments problems in some non-oil-exporting developing countries and have called for more official multilateral involvement in easing these problems. The main worries affecting bankers' perceptions of the debt servicing capacity in a number of developing countries are their high debt service ratios 53/ and the rather cloudy export outlook. On the other hand, several of these banks have stated that they are in a position to recycle a large part of the increasing financial resources of the oil-exporting developing countries. In fact, notwithstanding the anxiety of the international commercial banks, which had not subsided by March 1980, no significant discontinuities in the recycling process had taken place in the first quarter of this year, and many non-oil-exporting developing countries were still increasing operations in the private international capital markets. Nevertheless, by that month there were clear indications that, besides increasing interest rates, some developing countries would have to pay larger spreads and accept shorter maturities. 54/

Increasing credit costs in international capital markets no doubt present an additional burden to developing countries, particularly to those whose export prices tend to lag in relation to international inflation. However, the crucial issue, at least in the short run, continues to be credit availability. If conditions become such that private bankers feel pressed to tighten international credit to developing countries, the required import adjustment in the latter will be of such a magnitude that not only may industrial activity and investment be severely curtailed in these countries but also world global demand could be affected considerably.

Shifting current-account balances in the developed market economies

As discussed above, the combined current account of the developed market economies swung into substantial deficit in 1979, and a further deterioration is expected in 1980. As shown in table IV-1, both the major industrial countries and the smaller economies contributed to the worsening of the current account. The major factor responsible for this development was the deterioration in the group's terms of trade vis-à-vis other countries. The real balance did not change much in

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52/ For a summary analysis of the recent role of private international capital markets and its implications for development, see World Economic Survey, 1978, Current Trends in the World Economy (United Nations publication, Sales No. E.80.II.C.1), chap. II.

53/ For example, of the 21 non-oil-exporting developing countries which have borrowed heavily in Eurocurrency markets, that is, countries whose Eurocurrency borrowing exceeded $300 million from January 1977 to September 1979, a third had a debt service ratio well above 20 per cent in 1979. The two countries whose borrowings exceeded $10 billion in that period had a debt service ratio well above 50 per cent in 1979.

54/ Eurocurrency loans generally carry fluctuating interest rates based on the interest rate paid on large interbank deposits in London, plus a fixed percentage spread.

1979, exports having grown only slightly less than imports (see table IV-2). During the first half of the year, stockbuilding led to a sharp increase in imports, particularly of raw materials. Trade among developed market economies and strong growth in the exports to the non-oil-exporting developing countries provided the main boosts to exports in 1979.

In 1980, the terms of trade will again be unfavourable to the developed market economies. However, a part of the impact made on the trade balance by the worsening in the terms of trade may be offset by a favourable movement in the real balance. Imports are expected to grow very slowly, owing to a lower growth in output, and exports may benefit from a recovery in exports to the oil-exporting developing countries.

The pattern of current accounts among the major industrial countries, which had been a source of instability in the past, improved considerably in 1979 (see table IV-1). Thus, the large United States deficit on current account of previous years became a small surplus, the surplus of the Federal Republic of Germany disappeared, and the large Japanese surplus became a deficit. Barring big changes in the exchange rates, these trends are expected to continue into 1980, when the United States' current account is expected to record a larger surplus and larger deficits are expected in the current accounts of the Federal Republic of Germany and Japan.

A share of these swings in current accounts may be explained in terms of relative cyclical positions. While economic growth weakened in the United States of America in 1979, when real final demand grew at less than 2 per cent, the growth of final demand in Japan and the Federal Republic of Germany was 7 1/2 and 4 1/2 per cent. In addition, past movements in exchange rates began to have an effect on volumes during 1979. Thus the effective depreciation of the United States dollar up to the end of 1978 stimulated exports, particularly of manufactures, and the appreciation of the yen and the Deutsche Mark contributed to a surge in imports in Japan and the Federal Republic of Germany and a sharp decline in exports in Japan.

Despite the worsening terms of trade and an increase in net oil imports of about $18 billion, the United States trade deficit declined from $33.8 billion in 1978 to $29.1 billion in 1979. In addition, substantially larger investment income swelled the invisibles balance and allowed the current account to show its first surplus since 1975. In 1980, further improvements in the real trade balance, due to stagnating imports, continued export gains, and higher investment income, are expected to result in a larger surplus on current account.

The swing in the Japanese current-account balance from a large surplus to a large deficit was very swift. In addition to the effect of Japan's relative cyclical position and of past appreciation of the yen, the trade balance was adversely affected by a number of factors. In the first place, Japan's trade composition is particularly unfavourable, since it exports manufactures and imports most of its energy needs and a large variety of raw materials. Secondly, the fall in Iranian imports affected Japanese exports more than those of other countries. Thirdly, since November 1978 the yen has depreciated sharply on foreign exchange markets. While the volume effects of the depreciation are still to come, the negative effects on the terms of trade were felt in full force in 1979. Finally, in the context of international commitments to reduce the payments surplus, up to September 1979 the Japanese authorities maintained a special programme of advance import purchases.

The Japanese deficit on current account will probably worsen in 1980. While the depreciation of the yen in 1979 and a slow-down in economic growth are expected to have favourable volume effects, adverse movements in the terms of trade will predominate. Similar factors account for the worsening of the current account forecast for the Federal Republic of Germany in 1980.

The other major European countries also recorded a decline in their current account surpluses in 1979, and Canada experienced an increase in its deficit. In the case of France and Italy, the major factor was the worsening terms of trade. In Canada and the United Kingdom, where oil imports are negligible, the terms of trade appear to have improved. However, the growth of real imports outstripped that of real exports, and this contributed to a worsening of their current accounts.

In 1980 the United Kingdom should return to current account surplus, as favourable terms of trade combine with a substantial slackening of import growth. On the other hand, the current accounts of Canada, France and Italy are expected to worsen, in Canada because of sluggish real export growth and in the two European countries because of the worsening terms of trade. Nevertheless, Italy is likely still to be in surplus. Movements in the terms of trade are also responsible for the deterioration in the combined current account of the smaller developed market economies over the period 1978-1980.

Exchange markets were less turbulent in 1979 than in the two previous years, partly as a result of improvements in the pattern of current accounts among the major countries. With the exception of the yen and sterling, major currencies showed only minor fluctuations. The yen depreciated sharply against all other major currencies and, despite the relatively high rate of inflation prevailing in the United Kingdom, sterling appreciated substantially against all major currencies. In the case of the United Kingdom, its lower dependence on imported oil and favourable energy prospects appear to have encouraged substantial capital inflows. The depreciation of the yen appears to have been caused by the unexpectedly sharp deterioration in the current account, by fears that the oil price increase would affect Japan more than it would its main trading partners, and by some developments in Japanese capital markets. 55/

The movements in current accounts in 1980 are not expected to provoke large exchange rate fluctuations and, therefore, a second year of relative stability in exchange rate markets may be in store. This will depend, to some degree, on the patterns of interest rates that may emerge in the major money and currency markets, and on the scope of the international co-ordination of monetary policies.

External balance and trade volume in the centrally planned economies

In contrast to many of the oil-importing market economies, most of the European centrally planned economies experienced only a mild deterioration in their terms of

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55/ In fact, there were large capital outflows as Japanese financial institutions engaged in substantial international activities. In addition, a large negative differential between Japanese and Euromarket interest rates at a time when the current account was worsening discouraged short-term capital inflows.

trade in 1979 and, by pronounced policy efforts, managed to reduce their trade deficits. The Asian centrally planned economies, on the other hand, appear to have generally incurred increased external deficits. 56/

As a significant exporter of fuel and raw materials, the USSR registered substantial gains in its terms of trade, a much increased overall trade surplus and a marked decline in its deficit with the developed market economies. The Eastern European countries as a group, although they were net importers of fuel and raw materials, also improved their external balance, but only some of the countries succeeded in narrowing their trade deficits with the convertible currency area. China, which as an oil exporter may also have gained on the terms of trade, none the less approximately doubled its external deficit as imports continued to expand almost at the 50 per cent rate of the preceding year.

There are two reasons for the atypical 1979 experience of the European oil-importing centrally planned economies. First, except for Romania, the Eastern European countries procured most of their fuel and raw material imports from within the CMEA region and were therefore only marginally exposed to the shifts in relative prices on the world market. 57/ The trading arrangements within CMEA called for an adjustment of the price-formation base from the world market average for 1973-1977 to that for 1974-1978, which resulted in an advance of fuel prices by about 12 per cent and price increases of 3 to 5 per cent in most other commodity groups. This left the petroleum price significantly below current world market levels. 58/ Secondly, in most countries of the group, improvements in the external balance had been assigned a high priority, backed by strong policy measures. These included the setting of moderate growth targets and a reduction in the pace of investment as a means of easing import demand, as well as direct import constraints and strong export drives.

Owing in part, however, to the faltering of output growth and the ensuing supply constraints, the export effort did not result in a substantial increase, and the adjustment burden was primarily borne by imports. The export volume of the European centrally planned economies probably rose only by some 3 1/2 per cent, the same rate as that registered in 1978 (see table IV-2). This was substantially below the rate of expansion of world trade and significantly below the average annual growth rate of 8 per cent in the volume of exports over 1970-1977. The volume of

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56/ For most of the Asian centrally planned economies, foreign trade trends can at the moment be estimated only from very fragmentary data on trading partners. Comprehensive data have been reported only by China. In the absence of commodity and regional detail for these trade flows, the analysis is limited to the experience of the European centrally planned economies.

57/ About 60 per cent of the foreign trade of the Eastern European countries is transacted within CMEA, but for fuels and raw materials the share of intragroup trade in total imports is appreciably higher.

58/ In the case of the German Democratic Republic, for example, the import price of oil from the USSR was reported to be from 30 to 40 per cent below average world levels in 1979 (Neues Deutschland, 26-27 January 1980).

imports, on the other hand, increased by over 1 per cent as against an annual rate of about 9 per cent earlier in the 1970s. 59/

The external adjustment seems to have been quite costly in some Eastern European countries, since import constraints, coupled with rising external prices, appear to have tightened the supply of industrial inputs, with adverse effects on output and in some cases on supplies of exportables.

As noted earlier, price changes in the two large trading areas that are of relevance for the European centrally planned economies differed widely. In contrast to the 4-5 per cent average price advance on the intragroup market, prices in trade with other countries appear to have risen by some 13-16 per cent (in dollar terms) for most countries of the group not substantially engaged in the fuel trade. They rose by significantly larger amounts for the USSR (as a major fuel exporter) and Romania (an importer of crude petroleum and an exporter of petroleum products). 60/ In trade with the outside markets, these price movements brought a large gain in terms of trade to the USSR (of the order of 15 per cent), while for Eastern Europe import prices appear to have outpaced export prices by about 2 per cent.

Trade among the centrally planned economies, including intragroup trade, increased by some 4-6 per cent in volume, that is, at a higher rate than total trade. In this context it bears noting that in intragroup trade the Eastern European countries generally expanded their exports to the USSR substantially faster than their exports to each other, a development which further accentuates the concentration of intra-CMEA trade on its largest supplier of raw materials, which has been under way since the mid 1970s.

In trade with the market economies, there appears to have been little growth in the volume of Soviet exports and imports. As regards the Eastern European countries, their export volume probably increased by 4-5 per cent - a substantial rise in view of the overall increase in output for the year of only 2 per cent.

Among the trends in trade with the market economies, some acceleration in the growth of the value of exports to developing countries may be noted. Imports from developing countries also increased substantially in the case of Eastern Europe, apparently owing in part to increased petroleum purchases from OPEC member countries, 61/ but stagnated in the case of the Soviet Union.

59/ The data for this section are based on reports on the fulfilment of national plans for the full year, complemented - for regional breakdowns - by information derived from national data and data on trading partners pertaining to the first three quarters of 1979. Quantum and price estimates, which at this point are somewhat approximate, are derived by reweighting, according to the commodity structure of each country, Hungarian foreign trade price indices for the rouble and dollar area trade for the first nine months of 1979 (Statisztikai havi közlemények, No. 10 (1979)).

60/ In terms of national foreign trade currency units, the recorded price changes are in most instances lower, as almost all countries of the group continued to appreciate their currencies of account against the dollar.

61/ This was the case in Poland, for example, whose imports from developing countries increased by over 50 per cent, owing largely to a doubling of petroleum purchases from producer countries. Part of the increase apparently represented a

As shown in table IV-4, trends in the value of exports and imports in 1979 resulted in a pronounced reversal of the aggregate foreign trade imbalance of the group, which changed from a $5 billion deficit in 1978 to a $1.8 billion surplus in 1979. This overall improvement largely reflected the change in the external balance of the USSR, particularly vis-à-vis the market economies. In spite of strenuous efforts to improve its balance with the market economies, Eastern Europe as a group incurred about the same deficit as it did in 1977-1978.

Table IV-4. Eastern Europe and the USSR: trade balance, 1970-1979
(Billions of dollars)

Country group	Eastern Europe			USSR		
	1977	1978	1979 a/	1977	1978	1979 a/
World	-6.3	-6.6	-5.1	4.3	1.6	6.9
Centrally planned economies	-1.6	-1.7	-0.2	2.7	1.0	2.8
Developed market economies	-6.1	-6.3	-6.0	-1.5	-3.3	-1.1
Developing countries	1.4	1.4	1.1	3.1	3.9	5.1

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

a/ Preliminary estimates.

Institutional and other arrangements in the context of the economic integration movement in the region helped to facilitate the financing of intra-CMEA merchandise imbalances. Substantial new borrowing in Western capital markets, Government-supported export credits of the supplier countries, direct supplier credits and gold sales financed the current account gap with the developed market economies. Very little information is available regarding the financing of the net export surplus in trade with the developing countries, but some portion of the increased surplus may have stemmed from new disbursements on loans.

The combined net convertible currency debt of Eastern Europe and the USSR, including the two CMEA banks, which had passed the $58-billion mark by the end of 1978, may have grown in 1979 by another $5 billion-$6 billion, 62/ primarily on

(continued)

substitution of purchases formerly made from international oil companies. As a result, Poland for the first time incurred a deficit with the developing countries as a group, which is expected to increase substantially in future years (Rynki zagraniczne, 8 February 1980).

62/ In the first nine months of 1979, net liabilities to Western commercial banks, which constitute the bulk of the total convertible currency debt, increased by $3.3 billion.

account of the rising indebtedness of Eastern Europe. 63/ In several countries of the region, the interest burden alone now absorbs from one fourth to one third of the convertible currency earnings, 64/ but the total debt service is substantially higher and is not expected to be significantly reduced in the next two years.

The economic plans for 1980, especially of the Eastern European countries, generally stress the continued need for domestic adjustment in order to improve the external balance. To the extent that the countries publish separate trade targets for exports and imports, export growth is expected to exceed import growth, especially in trade with the market economies.

These goals may be somewhat too ambitious for some Eastern European countries, in view of the targeted slow growth of real imports, which will affect output and export performance. Furthermore, these countries are generally expected to increase the imports of fuels and some raw materials from outside the CMEA area, which will appreciably affect their balance of payments. On the other hand, the USSR is likely to obtain a significant gain in its terms of trade, owing to the full year's effect of petroleum price movements in 1979 on exports to outside markets and, to a lesser extent, the partial transmission of these effects to the CMEA region. These movements are likely to result in a further improvement of its balance of trade, in spite of higher grain imports to offset the poor 1979 harvest and perhaps a reduction in the volume of petroleum exports in view of domestic consumption requirements.

63/ In 1979, the German Democratic Republic, Poland and Romania accounted for about four fifths of the increase in the group's gross indebtedness.

64/ National data on the relation of interest payments to convertible currency earnings are not available. Rough estimates indicate that the ratios did not change substantially in 1979. Estimated interest payments in relation to export earnings in trade with developed market economies continued to be over 30 per cent for Bulgaria and Poland, 25-30 per cent for the German Democratic Republic, about 25 per cent for Hungary, and about 10-15 per cent for Czechoslovakia and Romania. For the USSR, this ratio is much smaller, perhaps 6-8 per cent.

Chapter V

WORLD ECONOMIC OUTLOOK, 1980-1985

Short-term economic outlook for the world economy: 1980-1982, the overall perspective

This chapter reviews the short-term outlook of the world economy during the period 1980-1982, and also analyses some of the issues arising in the context of the medium-term perspective to 1985. The projections presented below include assumptions about governmental short-term and medium-term economic policies in individual countries, as well as changes in the world market. These assumptions are discussed in the various sections below dealing with the specific issues of growth, inflation, trade, balance of payments and energy. 65/

A word of caution is necessary. Economic projections are beset with many uncertainties and difficulties. Imponderables in the economic scene may upset or invalidate the assumptions on which the original forecasts may have been made. Other uncertainties related to changes in the international political climate may cause Governments to shift or modify their hitherto established economic priorities. For these and other reasons, projected figures should be viewed with caution, and are meant to show directions of change and orders of magnitude rather than precise quantities.

Prospects for economic growth

Barring the uncertainties referred to above, prospects for economic growth in the world economy in the immediate years ahead are generally expected to be somewhat gloomy. As indicated in chapter II, 1980 is a year of economic deceleration for the world economy as a whole. Negative, zero or very low rates of growth in production are expected in the developed market economies, and retarded growth is a likely prospect for the developing market economies. In the centrally planned economies, growth rates, though higher than in 1979, will be lower than in the long-term trend.

65/ The projections are based on research being carried out by the Department of International Economic and Social Affairs of the United Nations Secretariat. To some extent this research is based on quantitative analysis, using the LINK system in a short-term world model based on the international linkage of national econometric models of some 20 individual developed countries and four regional models of developing countries. Under arrangements with the United Nations Secretariat, the LINK model has been extended to encompass medium-term projections. Other quantitative projections by various international organizations have also been used in the preparation of this chapter. For a detailed description of the LINK system, see J. Sawyer, ed., Modelling the International Transmission Mechanism (Amsterdam, North Holland, Inc., 1979).

Some degree of recovery is expected in all groups of countries in 1981 and 1982 (see table V-1). The strength of the recovery will depend on a number of factors, such as policies to promote investment and abate inflation in the developed market economies; the magnitude of the investment effort in the developing countries; the international conditions for expanded trade, including the availability of finance for capital transfers, terms of trade, and the extent of trade liberalization or protectionism; the availability and relative price of petroleum etc.

Table V-1. Growth of real gross domestic product/ gross national product a/ in the world (Percentage change over preceding year)

Country-grouping	1979 b/	1980	1981	1982
Market economies	3.4	1.7	3.1	3.6
Developed countries	3.	1.5	2.5	3.5
Major industrial countries	3.3	1.5	2.5	3.6
Other industrial countries	3.4	2.3	2.7	2.9
Primary producing countries	2.4	1.3	2.6	3.3
Developing countries	5.0	5.0	5.6	4.1
Oil-exporting countries	4.2	5.0	6.9	6.5
Others	5.4	5.0	5.0	4.7
Centrally planned economies c/	2.7	4.5	5.2	4.9
Total, world economy b/	3.4	2.5	3.5	3.9

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from national and international sources. Figures for 1980-1982 are projections.

Note: In this and subsequent tables in this chapter, projected figures are shown to the first decimal, as they were calculated in the models used. However, they should be treated as approximations indicating directions of change and orders of magnitude rather than precise quantities. In this sense they are in full agreement with the projected figures for 1980 presented in the various chapters and rounded to the nearest half of 1 per cent.

a/ The growth rates for the market economies are weighted averages of country growth rates which relate either to gross domestic product or to gross national product for individual countries. The "weights" used are gross domestic product for the countries for 1977. The growth rates for the centrally planned economies relate to net material product.

b/ Preliminary.

c/ Eastern Europe, the USSR and China.

Although the period under analysis opens with a general economic slow-down in the world economy, in the major economic groupings the underlying causes and the consequent prognosis differ significantly.

The slow-down in the developed market economies is caused, in part, by the downward movement in the economic cycle, particularly in consumer durables and residential construction. These important sectors are subject to a short-term cyclical fluctuation of from three to four years' duration. The phase of contraction does not usually last more than from one to one and a half years, and a resumption of growth in these sectors is already expected in 1981 and even more so in 1982.

Apart from the United Kingdom, there is no widespread evidence of a slump in non-residential fixed investment, which is a necessary feature of a large-scale recession, or of an accumulation of surplus inventory, except in a limited group of sectors. However, in determining future growth in the developed market economies, the level of fixed capital investment in plant and equipment is likely to play an important role. Capital investment in most of these economies has been stagnant and slow to recover from the troughs of the 1974-1975 recession. Though recently investment has been growing, much of it is devoted to an upgrading of equipment and adaptation to alternative fuels, rather than to large-scale modernization intended to increase productive capacity. In the recent past, limited capital investment has been a major factor in reducing productivity growth in the developed market economies. The need is evident for an upsurge in investment to replace obsolete capital stock and increase the capacity to produce additional output.

This need makes the resumption of an investment boom entirely possible. However, major barriers remain. Accelerated inflation is creating uncertainties with respect to the profitability of long-term investment projects. Tighter monetary and fiscal policies, coupled with high rates of inflation and high interest rates, weaken the prospects for economic growth and could have a further dampening effect on long-term business investment. On the other hand, deliberate government policy to stimulate investment through such measures as tax incentives designed to raise productivity could help to improve investment prospects. 66/

The current economic slow-down, unlike the recession of 1974-1975, though general in nature, is not particularly well synchronized. This is likely to apply to the 1981-1982 recovery as well. For example, it is expected that in the United States of America, with its preponderant weight in the group's total gross national product, the slow-down may, in fact, continue well into 1981, particularly if the anti-inflationary measures proclaimed in March 1980 are fully implemented. This is also true of the United Kingdom, where short-term policies designed to counteract inflation are coupled with structural policies, aimed at providing more scope for the market mechanism. Japan and the Federal Republic of Germany are expected to lead the overall recovery, because of the early evidence of strong

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66/ See, for example, "Building a better future: economic choices for the 1980s", issued by the New York Stock Exchange, December 1979. This study was largely based on the simulations of the United States economy by the Wharton Econometric Forecasting Associates of the University of Pennsylvania.

investment spending and, in the case of Japan, an upsurge in exports caused partly by the depreciation of the yen in relation to the dollar. 67/

High rates of inflation and their effect on the purchasing power of the consumer have been another major factor contributing to the current slow-down. Some relaxation of inflation could be expected in the period 1981-1982, but, as shown in the next section, underlying inflationary pressures will continue to be strong, and thus tend to have an adverse effect on growth in both personal consumption and fixed business investment.

Among the factors which, in addition to investment, will determine the economic growth of the developed market economies in the short and medium term, the following are likely to be prominent:

(a) The prices and supply of energy, and of petroleum in particular, which may depend on both technical and political decisions of the oil-exporting countries, as well as on various other economic and political uncertainties - assuming that the oil price shocks of 1979 and 1980 will not be repeated in the next few years, prices of energy are expected to adjust more smoothly to supply-demand conditions; the current slow-down in the industrial economies is resulting in a balance between world supply and demand for oil in 1980, but with the recovery in 1981-1982, a resumption of the continuous increase in both nominal and real oil prices is expected; 68/

(b) The continuation of anti-inflationary policies, which may include a mixed package of tight fiscal, monetary and incomes policies; 69/ in spite of these policies, however, an increase in the levels of military expenditure is likely to provide additional fuel for inflationary pressures.

Economic growth in the developed market economies will have a major effect on the growth prospects of the developing countries through trade, financial flows, prices, and monetary developments.

Growth prospects for the developing market economies in 1980-1982, are expected to differ significantly in the oil-exporting and the oil-importing groups. Oil-exporting countries, including non-members of OPEC, will benefit from the expected further gains in their terms of trade. Most of these countries have recently been capital-deficit economies. An improvement in their terms of trade is tantamount to an increase in the international purchasing power necessary to satisfy the large absorptive capacity of their economies. Therefore, most of the oil-exporting countries should be able to maintain or even increase their rates of growth. In the case of the main capital-surplus oil-exporting countries

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67/ Other factors, such as a higher growth rate in productivity and a lower domestic inflation rate, also contribute to the growth of Japanese exports.

68/ See the section below on the medium-term outlook.

69/ The likely effectiveness of thse policies in countering inflation is discussed in the section below, on prospects for inflation.

such as Saudi Arabia, Kuwait, the Libyan Arab Jamahiriya and the United Arab Emirates, however, cautious attitudes are expected towards economic expansion and modernization. Their growth rates are likely to be kept lower when compared with the recent past. 70/ This cautious attitude will tend to slow down the growth of imports.

The immediate prospects for the oil-importing developing countries are not encouraging. A number of adverse factors will be working against them: the expected slow growth in the developed market economies will put a brake on their volume of imports and, together with protectionist tendencies, will limit exports of the developing countries; high rates of inflation will lead to a continuous increase in world prices of manufactured goods, while prices of primary commodities are expected to soften as a result of the slow-down, leading to increased pressure on the terms of trade of the developing countries; and the pressure from rising international oil prices would further limit their capacity to import goods and services required to support their growth. Added to these adverse features are uncertainties about the future volume of capital inflows and concessional aid from the industrial countries.

The oil-importing developing countries will thus suffer both from imported price inflation from the developed market economies and from the direct effects of the recent increases in oil prices. Imports of fuels constitute from about one fifth to about one third of the total import bill of developing regions and are as high as one half in some countries. A price rise of 50 per cent in imported oil, other things being equal, would drive up the unit value of their imports by 10-17 per cent.

Faced with increasing balance-of-payments problems and constrained by their inability to finance imports, the oil-importing developing countries as a group are likely to reduce the rate of increase of their imports in 1980, with a concomitant decrease in their rates of economic growth. This decrease is not, however, expected to be uniform. The growth rates in countries with a less developed foreign trade sector will depend largely on built-in domestic factors, such as agricultural performance. Countries with a large and developed external trade sector would be the hardest hit, except that economies with a stronger manufacturing base are likely to expand their exports of manufactures to the rapidly growing markets of the oil-exporting countries.

In the centrally planned economies of Eastern Europe and the USSR, economic growth is expected to recover in 1980 to some 4 per cent from the low of 2.2 per cent recorded for 1979. Thereafter, an annual range of from 3.5 to 5 per cent, with an average of 4 per cent, is considered a likely possibility.

Among the constraining factors in these economies, external deficits are expected to play an important role in countries with a large dependence on foreign trade. Increasing costs of producing energy and other minerals in the USSR and the rising cost of primary imports to Eastern European countries will tend to

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70/ For instance, both Saudi Arabia and Kuwait had an estimated annual growth rate in gross domestic product of over 10 per cent during the period 1973-1979. In the projections for 1980-1982, the growth rates in gross domestic product for these countries are expected to vary from 6 to 8 per cent.

divert resources from sectors with a traditionally high growth potential. Capacity constraints have been developing in some of these countries, due mainly to efforts to improve the supply of consumer goods, with the result that investment in heavy industry has been relatively limited. And, finally, a slow-down in the growth of the labour force in these countries, due to demographic factors, will affect overall growth rates in the medium term.

In China, recent changes in economic policy emphasize priorities given to agricultural development, light industries, and infrastructural items, such as energy resources, communication, transportation and construction materials. Barring adverse developments in agriculture, China is expected to maintain growth rates of 5-6 per cent annually in the period 1980-1982.

Prospects for inflation

Neither the economic slow-down of 1980 nor the growth recovery of 1981-1982 are expected to result in a marked slowing down of price inflation in the developed market economies. In addition to the well-known underlying causes of continued inflationary pressure, 71/ the immediate prospects for inflation will be affected by the short-term oscillations in economic growth.

During the recent slow-down in the developed market economies, the growth rates of productivity have tended to fall drastically, or even decline in absolute terms. This has created a strong cyclical upward pressure on unit costs and prices, in spite of the relative slack in aggregate demand. In the recovery phase, productivity normally improves at a rate higher than that seen in the long-term trend. However, business firms and labour unions try to compensate for income losses incurred during the recession, or slow-down, and because of recent acceleration in price inflation. Further on in the recovery period, demand-pull pressures are also likely to develop.

Therefore, in spite of stringent fiscal and monetary policies, the inflation rates as measured by consumer price indices are expected to remain high in the years 1980-1982.

Inflation rates in the developing countries are likely to move at an even faster pace than those in the developed market economies. As a statistical analysis indicates (see table V.14), for each percentage point rise in the consumer price index in the developed market economies, with all other factors assumed to be unchanged, there was, in the 1970s, a corresponding 2 per cent increase in the consumer price index of the developing market economies as a group.

General price increases in some of the centrally planned economies, caused in part by oil price rises, are also expected. A summary of the projected inflation rates for the different economic country groupings for 1980-1982 is given in table V-2.

One factor that may contribute to the upward pressure on prices is the increasing relative scarcity of petroleum supplies. Oil prices are expected, as a minimum, to keep rising in line with general inflation in the developed market

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71/ See chapter III for a discussion of these causes.

economies, that is to say, at 10-13 per cent per annum, even in the absence of formal petroleum price indexing. However, it is highly probable that the recovery in the developed countries, together with more growth in the developing economies, will lead to a continuous demand pressure for oil and a persistent increase in its real prices. In the light of these supply-demand conditions, discussed further in annex III, it is possible that the real price for petroleum after 1980 would rise annually at about 10 per cent and the nominal price at 20-25 per cent.

Table V-2. Private consumption and gross domestic product/gross national product deflators, a/ 1979-1982

(Percentage change from preceding year)

	1979	1980	1981	1982
Gross domestic product/gross national product deflators: a/				
Developed market economies	9.4	9.4	8.7	7.7
Major industrial countries	8.8	9.1	8.4	7.5
Other industrial countries	5.6	6.3	6.3	5.7
Primary producing countries	21.1	17.5	14.6	13.5
Private consumption deflators: b/				
Developed market economies	10.8	10.6	8.6	7.7
Major industrial countries	10.6	9.9	8.1	7.0
Other industrial countries	5.8	7.7	6.4	6.0
Primary producing countries	20.0	22.3	17.4	15.0
Developing market economies c/, d/	31.3	32.0	28.4	27.4
Oil-exporting countries	14.9	14.4	11.7	10.4
Non-oil exporting countries	34.4	34.0	30.3	29.3

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from national and international sources. The gross domestic product/gross national product deflators for 1979-1982 are mainly based on LINK projections.

a/ These deflators are the weighted averages of country deflators, which relate either to gross domestic product or to gross national product for individual countries. The "weights" used for the purpose are the countries' gross national product for 1978.

b/ The private consumption deflators are usually lower than the corresponding consumer price indices, owing to the effects of substitution in the case of private consumption, while the consumer price indices are calculated on the basis of fixed baskets of goods and services.

c/ Figures for 1979-1982 are projections by the United Nations Secretariat, based on projected inflation rates for the developed market economies. For further detailed explanations, see the foot-notes to table V-14.

d/ The figures in this table for developing countries differ from those presented in table III.1, in that Argentina and Chile are excluded from the former but included in the latter calculations.

According to recent estimates, a 10 per cent rise in international oil prices would lead, on average, to a 0.25 percentage point increase in the cost-of-living index of OECD countries. When indirect effects, such as "sympathetic" price rises for related energy products, and increased production costs where oil is used as input, are taken into account, the overall effect on inflation from the oil price rises is nearly twice as great.

Another factor working towards sustained inflation is the trend towards decelerated labour productivity growth in most of the developed market economies. This tendency has been pronounced in the 1970s and is expected to continue into the early 1980s, owing to a slack in fixed capital investment, a decrease in the capital-labour ratio and other factors. The resumption of an investment boom could change this adverse tendency; evidence of recent movement towards a substitution of high-cost energy by labour may, however, go a long way towards counteracting the positive effect of investment on productivity. 72/

Important among the factors affecting the prospects for inflation are changes in the international political climate and government policies associated with it. Recent moves towards higher defence spending in some major industrial countries are likely to have a direct bearing on inflationary forces and could render anti-inflationary measures such as higher interest rates and restrained money supply less likely to achieve their objectives.

Finally, international monetary instability, itself largely a product of accelerated inflation and increasing uncertainty, could add to the inflationary potential.

Various policy instruments are expected to be used by the developed market economies in their attempts to abate inflation. Where the limitations of these instruments become apparent, new approaches to the dilemma of stagflation will have to be sought. Thus, for example, cuts in government spending designed to reduce budgetary deficits or achieve a balanced budget at an early date may conflict with political considerations and the existing commitments of Governments, particularly in countries where unemployment rates are high, and may seriously affect the extent to which this policy instrument can, in fact, be applied.

Tight monetary policies, which are among the most favoured anti-inflationary measures, are currently causing interest rates to rise to historically high levels. However, high interest rates are known to contribute directly to the worsening of the inflation rate through increased capital and housing costs, which are passed on to the consumer. Where interest rates have not been substantially higher than the current inflation rates, they have, in many cases, not created tight credit markets. 73/

72/ Energy-saving and labour-saving investments do not necessarily coincide and may thus compete for the same scarce resources.

73/ Tighter monetary policies do not seem to be an effective brake on inflation. The reason is that inflation itself has drastically reduced the real interest rates. Interest rates have increased but are roughly on a level with current inflation. Consumer expenditure is determined more by the expectation of a loss in real savings (in the absence of adequate alternative means of hedging against inflation).

It is, therefore, expected that more attention in the projected period may be given to credit controls and incomes policies. Credit controls involving the raising of required down payments, the shortening of maturities etc., would have their greatest impact on consumer credit. Direct wage and price controls may be used more widely if high inflation rates continue. If high inflation persists, more attempts are likely to be made to implement tax-induced income policies, which up to now have met with scepticism on the part of labour and business organizations.

Prospects for international trade and external balances

The slow-down in the growth of market economies in 1980 is resulting in near-stagnation in international trade. World export value terms in that year are projected to increase by 23.5 per cent over 1979. However, most of this rise is accounted for by higher prices, with only about 3 1/2 per cent growth in volume, compared with 6 per cent in 1979 and 5 per cent in 1978. This poses major problems, especially for the non-oil-exporting developing countries. While the developed market economies are registering a growth in exports of 4 per cent, the non-oil-exporting developing countries' exports volume is only growing by about 3 per cent.

With an economic recovery in 1981-1982, the volume of world trade is projected to resume an annual growth rate of from 4.5 to 5 per cent, barring further unexpected oil price shocks or other disturbances of a similar magnitude. However, the terms of trade would continue to move against the oil-importing countries. The doubling of oil prices in 1979-1980, plus a projected annual increase in nominal oil prices by 20-25 per cent in 1981 and following years, will result in a sustained increase in the unit value of their total imports. In addition, the prices of imported manufactures, largely from the developed market economies, will continue to increase in line with over-all inflationary trends in the latter group of countries. On the other hand, the export prices of non-oil primary commodities, which are rising at a much slower pace in 1980, on account of the weakened global demand, are expected to at least retain the international purchasing power of these goods in 1981-1982.

All in all, the terms of trade of the non-oil-exporting developing countries could worsen at a rate of about 3.5 per cent annually between 1980 and 1982. 74/ The resulting loss in the terms of trade 75/ of these countries is estimated to reach $US 9 billion in 1980 and from $19 billion to $20 billion in each of the following two years (in constant 1979 United States dollars). This loss of purchasing power will seriously affect the ability of the oil-importing developing countries to import and will thereby retard the rates of economic growth in those countries. As can be seen from table V-4, the rate of growth of their import volume would shrink from 7 per cent in 1979 to a mere 3 per cent in 1980.

The terms of trade of the oil-exporting countries are expected to appreciate by about 30 per cent in 1980, and by about 10 per cent in both 1981 and 1982.

74/ If such net oil exporters as Mexico, Egypt, Peru, Tunisia etc. are excluded, the deterioration in terms of trade in 1980 works out to be about 6 per cent.

75/ A terms of trade gain (or loss) is defined as the difference between the purchasing power of exports and the value of exports deflated by an export unit value deflator.

Though the volume of petroleum exports from these countries is not expected to expand in the next few years, the likely rise in real oil prices would substantially increase these countries' export earnings. Thus, the potential for accelerated imports and product growth of this group of countries would be substantially increased.

In 1979 the oil-exporting countries, as a group, reduced their imports by 5 per cent in value and 15 per cent in volume. This reduction was due mainly to the drastic cut in imports by Iran and deliberate policies of slowing-down in the economies of the large capital-surplus countries. Given the overall low level of imports by the oil-exporting countries in 1979 and their growing trade surplus, it is expected that these countries will substantially increase the volume of their imports in 1981-1982, perhaps at an annual rate of some 20 per cent. In spite of this, the very large trade surplus of these countries, for the group as a whole, is expected to remain at least as large as in 1980, for which year it is estimated at $160 billion 76/ (both exports and imports being valued on an f.o.b. basis).

The developed market economies, which currently account for two thirds of the world's total trade, are also expected to be adversely affected by changes in the terms of trade, but to a lesser extent than the oil-importing developing countries. After a deterioration of 4 per cent in 1980, a further decline of 1-2 per cent annually is expected for 1981-1982, due mainly to the continued appreciation in real oil prices. The reduced volume of imports by the developed market economies in 1980 will certainly have serious repercussions on the exports of the non-oil-exporting developing countries, whose earnings from non-oil primary commodities are expected to be adversely affected. In 1981-1982, in line with the economic recovery of the developed market economies, their trade volumes should resume an annual rise in the range of 3.0-4.5 per cent. It is expected that, in the wake of the economic slow-down of 1980 and as a result of protectionist policies, the volume of exports will be rising faster than that of imports. However, because of the expected deterioration in the terms of trade of these countries, their overall trade deficit is expected to increase beyond $70 billion annually in 1981-1982.

The prospects for a growth in the foreign trade of the centrally planned economies in 1980-1982 are closely linked to their overall economic growth perspectives. It is expected that, with annual increases in their net product of 4-5 per cent, their foreign trade expansion would have to be in the range of 5 per cent at least. In the case of China, trade is expected to grow at a faster rate (in excess of 10 per cent). However, in view of the projected relatively slow recovery of total world trade, these expectations may not materialize, especially in so far as exports are concerned.

Balance of trade figures, with actual figures for 1978, preliminary estimates for 1979 and projections for 1980-1982, are shown in table V-5. It should be emphasized that the projections represent indications of the rough orders of

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76/ It should be noted that, before the recent rise in oil prices in 1979, the price of oil in real terms (that is, after allowing for price inflation in the developed market economies) had been declining from the peak of 1974.

magnitude involved and the direction in which the trade balances are developing. Bearing this in mind, and allowing for services and private transfers, the current account balances (excluding official transfers) for the major economic groupings in 1980-1982 are estimated in table V-3 below.

Table V-3. Estimated balances on current account, excluding official transfers

(Billions of dollars)

	1978	1979	1980	1981	1982
Developed market economies	36.4	-11.8	-33	-45	-55
Oil-exporting countries	7.5	69	101	125	145
Oil-importing developing countries	-35.5	-51	-69	-80	-90

It is apparent that a number of international issues of major importance are in the making. One critical issue concerns the financing of the growing external deficits of the oil-importing developing countries. Even if growth in these countries were to remain at their current modest levels, with no major acceleration to rates envisaged in the new international development strategy, this deficit is expected to reach $80 billion by 1981, namely, about 6 per cent of the projected gross domestic product of these countries or 1.1 per cent of the gross domestic product of the developed market economies. Efforts would have to be made not only to finance these large deficits but also to reduce them, in the immediate future.

The second critical issue involves the possible recycling of the external capital-surplus of some of the oil-exporting countries. This is especially important in view of the fact that the developed market economies, as a group, are expected to experience large current-account deficits. International capital markets would help to channel some of the surplus capital to where it is needed. It is also likely, however, that larger flows of long-term and medium-term capital and increased levels of official transfers would be channelled from the capital-surplus oil-exporting economies directly to the less fortunate non-oil-exporting developing countries. The need for more external finance would be particularly strong in the low-income countries in Africa and Asia, which are expected to encounter increasing difficulties in borrowing funds owing to considerations relating to their credit-worthiness, or institutional or regulatory limitations. For such countries, the alternative to the availability of funds from external sources would be reduced levels of imports, output, income and employment.

Further prospects for growth in trade and output would depend on a number of factors: (a) the probability of a major increase in financial transfers at concessional terms to deficit developing countries in 1981-1982; (b) the readiness of international capital markets to supply finance at commercial terms to the developing countries in view of the expected drastic increase in their external debt burdens; (c) the willingness of the capital-surplus oil countries to invest a sufficient part of their external surplus in such a way that these funds would be readily available for recycling to deficit developing countries; and (d) the unlikelihood that oil-importing developing countries would be able to maintain

projected growth rates in the event that the capital and aid transfer issues were not resolved.

As observed earlier, the increase in concessional aid to developing countries as a percentage of the gross national product of the donor countries has been painfully slow in the 1970s; the annual growth rate of such aid in 1970-1978 was only 3.2 per cent in real terms. Taking into account concessional aid from all sources, the total amounted to $24.1 billion in 1978 and could conceivably reach $30 billion and $34 billion in 1980 and 1981 respectively, if past trends prevail. This represents only about 40 per cent of the developing non-oil-exporting countries' prospective needs to finance their current account deficits. The remaining 60 per cent will have to be covered by non-concessional sources of capital. This would mean accepting higher interest rates, short maturities and higher debt service charges. Given the already high level of debt burden of these countries, with annual debt service charges accounting for from 3 to 4 per cent of their gross national product and about 20 per cent of their export earnings, additional debt burdens created by borrowing from non-concessional sources of capital could seriously hamper these countries' ability to import and, consequently, their development prospects.

A special problem arises in respect of the non-oil-exporting, low-income developing countries, which only have a limited ability to mobilize the domestic savings required to finance investment needed for promoting and sustaining growth. Their ability to borrow on international capital markets would be seriously limited by their economic prospects and credit-worthiness. These countries are currently receiving about a half of the total official development assistance aid, and concessional finance represents about 75 per cent of their total external financial resources. Concerted action to increase concessional aid to these countries would have to be taken.

Table V-4. World trade: projected growth rates by major economic groupings

(Percentage change from preceding year)

	1979	1980	1981	1982
Quantum of exports				
World	6.1	3.5	4.5	4.4
Market economies	6.3	2.6	4.4	4.2
Developed market economies	7.0	4.0	4.6	4.5
Developing market economies	4.3	-1.2	3.8	3.5
Oil-exporting countries	1.0	-5.0	2.0	2.0
Non-oil-exporting countries	8.0	3.0	6.9	6.1
Centrally planned economies	3.4	4.0	5.5	6.0
Quantum of imports				
World	4.9	3.5	4.7	4.6
Market economies	5.6	3.4	4.7	4.5
Developed market economies	7.5	1.0	3.0	2.8
Developing market economies	-0.9	11.3	10.0	9.8
Oil-exporting countries	-15.0	30.0	20.0	20.0
Non-oil exporting countries	7.0	3.0	4.5	3.1
Centrally planned economies	1.4	4.0	6.0	6.0
Unit value of exports				
World	17.5	19.5	11.0	11.0
Market economies	17.6	19.5	10.9	10.9
Developed market economies	14.0	15.0	8.8	8.7
Developing market economies	28.7	33.5	15.5	15.7
Oil-exporting countries	40.7	50.0	20.0	20.0
Non-oil exporting countries	16.5	16.0	8.0	8.2
Unit value of imports				
World	17.3	18.6	11.2	10.8
Market economies	18.1	19.0	11.2	10.8
Developed market economies	18.2	19.0	11.2	10.9
Developing market economies	17.7	18.0	11.5	10.6
Oil-exporting countries	14.8	15.0	9.5	8.6
Non-oil exporting countries	19.2	20.0	12.0	12.0
Terms of trade				
Developed market economies	-3.6	-3.5	-0.5	-2.0
Developing market economies	9.3	13.0	3.6	4.6
Oil-exporting countries	22.6	30.5	9.6	10.5
Non-oil-exporting countries	-2.3 a/	-3.5 a/	-3.5	-3.4

Source: Department of International Economic and Social Affairs of the United Nations Secretariat. Rates for 1980-1982 are projections.

a/ The apparently low rate of deterioration in terms of trade for the oil-importing developing countries in 1979 and 1980 is due to the inclusion in the group of some net oil exporters, such as Mexico, Egypt, Tunisia and Peru.

Table V-5. Projections of the value of world trade and the world trade balance a/

(Billions of dollars)

	1978	1979	1980	1981	1982
Exports f.o.b.					
World	1 277	1 594	1 951	2 257	2 613
Market economies	1 154	1 444	1 776	2 051	2 368
Developed market economies	834	1 041	1 246	1 417	1 610
Developing market economies	301	402	530	634	758
Oil-exporting countries	150	213	304	372	456
Non-oil-exporting countries	150	189	226	261	302
Centrally planned economies b/	123	150	175	206	245
Imports f.o.b.					
World	1 254	1 555	1 908	2 222	2 576
Market economies	1 125	1 405	1 733	2 016	2 334
Developed market economies	844	1 074	1 299	1 488	1 696
Developing market economies	280	331	434	528	638
Oil-exporting countries	96	96	144	188	246
Non-oil-exporting countries	184	235	290	340	392
Centrally planned economies	129	150	175	206	242
Balance of trade					
World c/	23	39	43	35	37
Market economies	29	39	43	35	34
Developed market economies	10	-33	-54	-70	-86
Developing market economies	20	71	97	106	120
Oil-exporting countries	54	117	160	184	210
Non-oil-exporting countries	-34	-46	-64	-78	-90
Centrally planned economies	-6	0	0	0	3

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

a/ 1978 and 1979 are actual figures or partial estimates. Projections for 1980-1982 are based essentially on link simulations, with modifications and adjustments where necessary.

b/ Includes Eastern Europe, the USSR and China.

c/ Discrepancies in the total accounted for by statistical errors or assymetries.

The medium-term outlook, 1982-1985

To provide a medium-term outlook for the world economy, a set of projections up to 1985 has been prepared. The assumptions used in this exercise relate to fiscal, monetary, income and investment policies, concessional aid transfers, oil prices etc.

With regard to policy assumptions, expected high inflation rates and growing current-account deficits will force both fiscal and monetary policies to remain restrictive. Interest rates are assumed to decrease slightly in most developed economies as real growth declines and inflation peaks, while monetary policy seeks to accommodate the rise in output. A slow to moderate growth in public spending is assumed. No explicit incomes policies have been assumed in the baseline projection.

In the absence of special policies for the promotion of investment in the developed market economies, only a mild investment recovery is foreseen, but investment is expected to be strong in the energy sector. A shift towards investment promotion policies seems likely, however, in the medium term. Such policies have been explored as one of the alternatives.

A key consideration in the growth of developing countries is the ability of the oil-importing developing countries to draw on various sources of finance. Obtaining sufficient external financing on currently prevailing terms is likely to be more difficult, as these countries accumulate larger foreign debts in the period 1980-1985. The medium-term outlook suggests that there is likely to be a substantial deterioration in the non-oil-exporting developing countries' current-account position.

The basic medium-term projection indicates that the growth rate of gross domestic product in the developed market economies, after recovering from the 1980 slow-down, would stabilize between 3.3 and 3.5 per cent, so that the average annual growth rate for the first half of the 1980s is likely to be about 3.2 per cent per annum.

In the developing market economies, growth rates after 1982 are likely to be adversely affected by accumulating external deficits and foreign indebtedness in oil-importing countries. In the absence of large increases in aid and capital flows, the overall growth rate for the developing market economies is likely to taper off from about 5.5 per cent in the period 1981-1983 to 5 and even 4.5 per cent in the period 1984-1985.

A separate alternative was investigated, assuming that net concessional aid to the developing countries would increase step by step from the current level of about 0.3 per cent of the total gross domestic product of the developed market economies to about 0.7 per cent in 1985. When distributed among the developing countries according to their current shares, this additional infusion of aid has the effect of accelerating the average growth rate of the developing countries in 1981-1985 from 5.2 to 5.6 per cent, that is to say, by 0.4 percentage points. If most of the increment in official development assistance is channelled to the low-income developing countries, their growth rates will be affected more significantly - by roughly 1.5-2 percentage points per annum. Given the internal problems in these countries, this acceleration would have to be gradual. The

projection shows that such an acceleration would be accompanied by an increase in the share of fixed capital investment in the gross product of the developing countries, indicating that a substantial part of the additional influx of concessional aid would have to be used to increase directly the productive potential in the developing countries.

This alternative also results in an additional growth in the developed market economies of about 0.1 percentage points in the period 1981-1985. Considering the current relative shares of the developed and developing countries in world gross product, this stimulative effect is not insignificant.

As mentioned above, the basic expectation for international oil prices is that they will continue to increase, in real terms, at an annual rate of 10-12 per cent in the years following the second "oil shock" of 1979-1980. The projected increase in oil prices is based on an analysis of the perspective supply and demand situation in the world oil market (see annex III).

Specific prospective issues in the developed market economies

As the decade of the 1980s unfolds, the developed market economies are experiencing a widespread deceleration of growth, combined with a sharp and synchronized acceleration of inflation. Even though the global slow-down is expected to be short, subsequent recovery in most countries is likely to be relatively weak, with growth rates comparable to those prevailing in the latter part of the 1970s.

Barring new oil price shocks or other abnormal situations, inflation is projected to abate somewhat. Nevertheless, the underlying price pressure (7.0-8.5 per cent) is likely to remain abnormally high by historical standards. Therefore, for a few years to come, the overriding policy concern in most developed market economies is likely to centre on the fight against stagflation.

One serious component of stagflation is the continued widespread slow-down in labour productivity throughout most of the industrial world (see table V-8 for current and projected trends in productivity). The inflationary implications of a slow-down and decline in productivity are felt severely in a growing number of countries and sectors. Most studies seem to confirm that, with the possible exception of the Federal Republic of Germany, all the major developed market economies have experienced an unambiguous drop in the growth rate of output per employee-hour in manufacturing in the 1970s.

Given the tendency of labour remuneration to grow in line with or faster than consumer prices, substantial productivity gains are required to counteract the inflationary spiral. Substantial real wage gains, coupled with a declining rate of growth in efficiency, inevitably exert upward pressure on labour costs.

In most cases, several factors have combined to retard productivity. 77/ The slower growth of investment has been of fundamental importance in recent years.

77/ See E. F. Denison, "Explanation of declining productivity growth", Survey of Current Business, vol. 59, No. 8 (August 1979). E. A. Hudson and D. W. Jorgenson, "Energy prices and the US economy", Data Resources U.S. Review, September 1978, pp. 1.24-1.37.

Table V-6. World economic indicators, a/ 1978-1985

(Percentage change)

	1978	1979	1980	1981	1982	1983	1984	1985	Average 1981-1985 c/
Real gross domestic product b/									
Developed market economies	3.9	3.2	1.5	2.5	3.5	3.3	3.2	3.1	3.1
Developing market economies	4.4	5.0	5.0	5.0	5.3	5.5	5.0	4.5	5.1
World inflation rate d/									
Developed market economies	7.5	9.9	10.5	8.6	7.7	7.0	6.7	6.3	7.3
Developing market economies	22.0	31.3	32.0	28.4	27.4	24.5	25.0	24.9	25.9
Volume of world trade	6.0	5.5	3.0	4.7	4.5	6.5	5.0	5.6	5.3

Source: Department of International Economic and Social Affairs of the United Nations Secretariat. Projections based on the medium-term extension of the LINK model (see foot-note 65).

a/ Excluding the centrally planned economies.

b/ 1977 gross national product in billions of United States dollars are used as weights for aggregating regional growth rates. The weights are 0.8226 for the developed economies and 0.1774 for the developing economies.

c/ Figures for the period 1980-1985 are projections.

d/ As measured by the consumer price index. For the developing market economies, the data on the consumer price index shown above exclude Argentina and Chile. For more detailed explanations, see the foot-notes to table V-14.

Table V-7. Private consumption deflators, 1982-1985

(Percentage change)

	1982	1983	1984	1985
Market economies a/	10.8	10.1	9.9	9.6
Developed market economies b/	7.7	7.0	6.7	6.3
Major industrial countries	7.0	6.6	6.2	5.8
Other industrial countries	6.0	5.7	5.8	5.5
Primary producing countries	15.0	13.5	13.6	13.6
Developing market economies c/	27.4	24.5	25.0	24.9
Oil-exporting countries	10.4	10.0	9.6	9.0
Oil-importing countries	29.3	29.9	30.7	30.8

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

a/ Figures for the 1977 gross national product in billions of United States dollars are used as weights for aggregations of regional growth rates.

b/ Figures for the 1978 gross national product in billions of United States dollars are used as weights for developed market economies.

c/ The consumer price index is the inflation measure for the developing market economies. The figures given above exclude Argentina and Chile (see table V-6, foot-note d).

Table V-8. Selected developed market economies: productivity growth a/
(Percentage change)

	Average, 1960-1973	Average, 1973-1978	1980	1981	1982	1983	1984	1985	Average, 1980-1985
Developed market economies b/	5.3	2.8	1.1	2.7	3.2	3.2	2.8	2.7	2.6
Major countries	5.2	2.7	1.1	2.8	3.3	3.3	2.9	2.8	2.7
Canada	4.6	2.5	1.0	3.1	3.6	3.5	4.0	4.7	3.3
France	5.7	4.8	2.3	2.8	4.3	4.6	4.2	4.5	3.8
Germany, Federal Republic of	5.5	5.1	3.7	4.6	4.3	4.5	4.5	4.8	4.4
Italy	7.2	2.6	4.0	3.0	3.1	3.7	3.5	2.7	3.3
Japan	10.0	3.5	2.4	5.4	4.9	6.7	4.5	4.3	4.7
United Kingdom	3.9	.2	-.7	2.5	4.9	3.2	2.5	2.5	2.5
United States of America	3.2	1.7	-.4	1.2	1.9	1.3	1.4	1.1	1.1
Other countries	7.1	4.4	1.2	1.9	1.5	1.6	1.5	1.5	1.5
Austria									
Belgium	7.0	6.6 c/	3.1	2.8	3.7	3.0	3.4	2.5	3.1
Finland			1.2	.5	1.3	1.7	1.3	1.8	1.3
Netherlands	7.4	4.9 c/	1.0	2.9	2.1	2.0	1.2	1.6	1.8
Sweden	6.7	1.5							
Australia d/			-.2	.4	-.7	1.0	.5	.5	.3

Source: Department of International Economic and Social Affairs of the United Nations Secretariat. Projections for the period 1980-1985 are based on LINK simulations, with adjustments. The 1960-1973 and 1973-1978 averages are from E. F. Denison, "Explanations of declining productivity growth", Survey of Current Business, vol. 59, No. 8 (August 1979). The averages are for productivity in manufacturing. The 1980-1985 measures for Italy and the United Kingdom are for manufacturing, measures for Canada are for non-farm business, and those for the United States are for the private sector. The measures for other countries are for the total economy.

a/ Output per employee-hour.

b/ Weights are 1978 gross national product/gross domestic product weights. They are renormalized by the number of countries in the total.

c/ 1973-1977 only.

d/ Gross national product per person, in current prices.

Changes in the average number of hours spent at work and in age-sex composition, accompanied by the different amounts of education brought in by each new wave of the labour-force have affected the direct contribution of labour. Government controls have required business to divert capital resources from ordinary production (accounted for in productivity indices) to pollution abatement and safety improvement (whose output usually escapes inclusion in the national income statistics). The end result has been a safer, cleaner and generally improved standard of living for society, at the expense of lower productivity gains.

Research and development investment has been declining in relative terms in most developed market economies since the beginning of the last decade. The delayed effects of lower outlays for basic research may now be spreading into production, where productivity has been declining because of the progressive aging of capital stock.

Higher energy prices also play a role in the productivity decline. Although estimates of the decline in economic efficiency brought about by higher energy costs have quite a wide range, it is commonly acknowledged that the substitution of labour for capital, as well as of new capital for older, energy-wasteful plant and equipment, tend to lower the volume of output obtained by the same quantity of resources. While the elasticity of substitution among factors of production, and among different outputs with respect to variations of inputs differs from sector to sector, heavy manufacturing tends to suffer the greatest deterioration in productivity in the wake of major increases in energy prices. Since these increases tend to compress permanently the level of production capacity, the phenomenon will be felt acutely as the economic recovery develops.

These tendencies are not likely to be reversed in the near future. In the fight to control inflation, the great majority of developed market economies are expected to continue to implement restrictive monetary and fiscal policies. In most cases the solution to inflation is likely to be pursued through a dampening of demand (at the risk of recession) rather than through the promotion of capital accumulation and productivity growth. A growing number of developed market economies are expected to attempt to move either towards a balanced budget or towards a smaller deficit by reducing government purchases of goods and services and by compressing subsidies to State enterprises, rather than by means of tax increases.

On the labour side, the potentially most inflation-loaded situation could develop when wage negotiations are under way. During the second half of the 1970s, the trade unions in most developed market economies refrained from pressing for major wage advances. However, the substantial erosion of purchasing power experienced in several countries in 1979 and the prospect of a similar deterioration in 1980 are likely to induce labour to press during forthcoming negotiations for wage increases substantially above productivity gains. 78/

78/ In the United States of America, the labour unions announced that they would not abide by the government wage guidelines in the coming year. In the United Kingdom, miners and steel workers are finalizing strike plans, while in Italy, Sweden and the Netherlands, more militancy is expected on the occasion of forthcoming wage negotiations in the manufacturing sector. In a major break with recent economic history in the Federal Republic of Germany, an inflationary 10.5 per cent target wage settlement has been agreed in January 1980 by the metal

This attitude on the part of the labour unions could add fuel to the current inflationary outburst. To reduce its impact, the Governments of a number of developed market economies are expected, beginning in 1980, to alter some of the wage indexation norms which prevailed in the past. In some cases, labour incomes (with or without price controls) are expected to be temporarily frozen and indexation suspended.

In addition to inflation, the lack of full labour utilization is likely to be a major concern for the developed market economies. In the absence of new policy initiatives, the prospects of alleviating the severe unemployment problem in 1980-1982 are expected to remain dim. Since the application of traditional macro-economic instruments to lessen unemployment is thought to be detrimental to the objective of abating inflation, increased unemployment is expected in the period 1980-1982 in most of the industrial market economies. In the United States, for example, computer simulations have shown that conventional policies could drive the unemployment rate up to 7.5 per cent of the work-force in the next five years in order to produce a one percentage point reduction in the core rate of inflation (estimated today at 9 per cent). 79/

Inevitably, additional political and social problems are bound to emerge if this trend continues. To cope with these problems, some countries are expected to increase transfer payments to the unemployed rather than stimulate their absorption into production. In the longer run, most of the developed market economies will benefit from the fact that, before 1985 demographic trends will eventually play in favour of a greater utilization of manpower. Indeed, the highly contracted enrolment now being experienced at the high school and college levels as a result of the slowing down of the population growth in the late 1950s is to be felt soon in the labour market, together with a progressive stabilization of the rate of female participation to the labour force.

The fluidity of the employment picture is aggravated by an uncertain investment outlook. Among decision-makers in developed market economies, the expectation prevails that their countries may be locked into a period of prolonged investment stagnation, which is unlikely to be overcome without strongly stimulative policies and a resulting aggravation of inflation. This may give rise to a growing tendency to revert to more active incomes policies, which would combine incentives aimed at price and wage restraint with stimuli for capital investment and productivity.

(continued)

working unions. In other northern European countries, the expected goals for wage increases which amply exceed government guidelines, contain an even greater inflationary charge, since wage settlements tend to apply to the entire work-force in a given sector of industry, regardless of union membership. This practice, on the other hand, is beneficial to productivity, since it usually helps to account for a lower number of strike days lost in the country.

79/ As measured by the private consumption deflator.

Table V-9. Selected developed market economies: rates of growth of the gross domestic product, in constant prices
(Percentage change)

	Rate of growth				
	1978	1979	1980	1981	1982
Developed market economies	3.9	3.2	1.5	2.5	3.5
Major industrial countries					
Canada	3.4	2.8	1.3	3.4	4.5
France	3.8	3.2	2.0	1.7	3.1
Germany, Federal Republic of	3.5	4.4	3.1	3.4	2.6
Italy	2.6	4.5	2.0	2.6	2.9
Japan	6.0	6.0	4.3	3.9	5.0
United Kingdom	3.1	-0.3	-2.0	0.4	2.4
United States of America	4.4	2.3	0.0	2.0	3.0
Other countries					
Australia	2.3	3.3	1.0	2.0	3.5
Austria	1.4	5.0	2.5	2.4	3.9
Belgium	2.5	3.0	2.5	2.8	3.1
Netherlands	2.0	3.0	2.5	2.5	3.0
Sweden	2.8	4.5	3.1	3.3	3.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from national and international sources (including LINK projections).

Table V-10. Selected developed market economies: private consumption deflators a/, b/
(Percentage change)

	1979	1980	1981	1982
Developed market economies	10.8	10.6	8.6	7.7
Major industrial countries	10.6	9.9	8.1	7.0
Other countries	11.8	13.7	10.9	9.7

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from national and international sources (including the LINK projections) and the Secretariat's own research.

a/ The private consumption deflators are usually lower than the corresponding consumer price index.

b/ Figures for the period 1980-1982 are projections.

Table V-11. Selected developed market economies: current-account balances a/
(Billions of dollars)

	1980	1981	1982
Developed market economies	-33.4	-46.8	-55.0
Major industrial countries	-12.0	-26.2	-38.0
Other countries	-21.4	-20.6	-17.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from national and international sources (including the LINK model).

a/ Excluding official transfers.

Table V-12. Selected developed market economies: unemployment rates
(As a percentage of the total number employed and unemployed)

	1979	1980	1981	1982
Developed market economies				
Major industrial countries				
Canada	7.4	8.1	8.2	7.7
France	5.6	6.8	7.7	8.3
Germany, Federal Republic of	3.8	3.8	4.1	4.6
Italy	6.1	5.6	5.7	5.7
Japan	2.1	2.0	2.2	2.0
United Kingdom	6.7	7.9	8.7	8.7
United States of America	5.8	6.9	7.7	7.9
Other countries				
Australia	6.3	7.0	7.5	7.7
Austria	2.0	2.4	2.6	2.6
Belgium	6.7	7.4	8.6	9.5
Finland	6.3	5.8	6.5	7.4
Netherlands	4.4	4.6	4.9	5.0
Sweden	2.0	2.2	2.4	3.1

Source: See table V-11.

Specific prospective issues in the developing market economies

The economic growth of the developing market economies in the short term is likely to be largely conditioned by such factors as world demand for primary commodities, external aid and other financial flows, internal investment and demand management policies and weather conditions, which can seriously affect the levels of crop harvests. 80/ As many developing economies still suffer from a lack of diversification and have often a relatively large agricultural, pastoral or mineral base, they are particularly vulnerable to external shocks such as adverse developments in prices of their exports of primary commodities (agricultural products, industrial raw materials or minerals) vis-à-vis the prices of their imports of manufactures and other goods. A summary of projected rates of economic growth in 1980-1982 for the developing regions is given in table V-13.

In exploring the growth prospects of countries in the developing regions, a variety of factors affecting the situation in different country groups have to be kept in mind. As indicated earlier in this chapter, the immediate prospects

Table V-13. Growth of real gross domestic product in the developing regions, 1977-1982
(Percentage change from preceding year)

	1977	1978	1979 a/	1980	1981	1982
Developing regions	5.6	4.4	5.0	5.0	5.6	4.1
Africa	6.5	5.0	5.8	4.1	5.2	4.9
South and East Asia	7.2	7.0	4.9	5.1	6.3	5.8
Western Asia	3.5	-0.1	2.4	4.8	6.4	6.1
Western hemisphere	4.8	4.5	6.1	5.6	4.8	4.6
Oil-importing countries	5.6	5.2	5.5	4.7	5.0	4.7
Africa	5.1	4.3	3.7	2.2	3.7	3.2
South and East Asia	7.2	7.0	4.7	4.9	6.2	5.7
Western Asia	3.3	4.4	5.4	3.6	3.0	4.0
Western hemisphere	4.5	4.2	6.4	5.5	4.7	4.5
Oil-exporting countries	5.6	2.6	4.2	5.7	6.9	6.5

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from national and international sources. Figures for 1980-1982 are projections.

a/ Preliminary.

80/ Weather conditions are particularly important for the low-income countries, where the subsistence sector is large and the value added for agriculture accounts for 30-60 per cent of the gross product. Poor weather conditions in such cases often mean less food for domestic consumption, less agricultural raw materials for local agro-based industries, less cash crops for exports and an increased volume of food-grain imports, thereby draining further the already tenuously low foreign exchange reserves.

of the oil-exporting countries are generally favourable. However, even in this group, a distinction should be made between countries with a predominantly primary sector and those with a broader industrial base and greater degrees of diversification.

In the case of the main capital-surplus oil-exporting countries, such as Saudi Arabia, Kuwait, the Libyan Arab Jamahiriya and the United Arab Emirates, economic growth will largely depend on government policies with respect to the level of oil output to be maintained.

Another major factor in these countries is the speed with which modernization schemes will proceed, with the attendant capital investment in the infrastructural and industrial fields, such as the building of ports and roads, and the construction of schools and hospitals and petrochemical and other manufacturing plants. In these countries, the absorptive capacity for imported capital goods is often constrained by inadequate local entrepreneurial and managerial expertise and skilled labour, among other things.

In the case of other oil-exporting countries, such as Algeria, Indonesia, Nigeria, Venezuela, Ecuador, future levels of oil output are likely to be determined primarily by technical and revenue considerations. It is expected that at least some of these countries will attempt to maximize their oil revenues in order to finance the greater volumes of imports needed to speed up development and to diversify their economies still further, through the expansion of non-oil sectors. Some oil-exporting countries, such as Venezuela, have found it necessary in the past to constrain economic growth in order to reduce budget and current-account deficits, and to contain inflation. In some of these countries, recent current account deficits may turn into surpluses and help to balance their Governments' budgets.

The increase in the rate of growth of the oil-exporting countries as a group is expected to amount to 6-7 per cent in 1980-1982, compared with the much slower performance in 1978-1979 (2.6 and 4.2 per cent, respectively); this increase will be partly due to the expected recovery of the Iranian economy after two consecutive years of negative economic growth. In other countries, the relatively slow growth in the oil sector should be supplemented by an accelerated expansion in manufacturing and infrastructure.

As indicated earlier, economic growth in most non-oil developing countries will be constrained by growing external imbalances. In addition, their growth prospects will be affected by the need to contain domestic inflation and budgetary deficits.

For countries with a relatively large industrial base, such as Brazil, India, Singapore and Hong Kong, oil price increases will present major challenges because of their effects on the terms of trade and production costs. The growing protectionism being practised by the industrial countries may aggravate external difficulties. On the other hand, this group of newly industrialized countries will benefit from expanding markets for manufactures in the oil-exporting countries. Their growth prospects vary from country to country, but on the whole the greater degree of flexibility in their manufacturing sectors should enable them to adjust more readily to changed circumstances.

World demand and prices for primary commodities are expected to exert a preponderant influence on the growth prospects of a large number of developing economies, which depend on one or more commodities for the bulk of their export earnings. 81/ The relatively good showing of prices of non-oil primary commodities in 1979, in relation to production costs, will not be repeated in 1980 owing to the economic slow-down in the developed market economies. Price movements over the next two years are likely to be affected by the relative slack in the developed countries, though supply constraints could have a counterbalancing influence. For instance, prices of foods and tropical beverages like coffee and cocoa are likely to remain firm because of unfavourable supply prospects and relatively low levels of producers' stocks. In the case of agricultural raw materials and minerals and metals, prices are likely to be relatively depressed owing to the slack in the industrial economies, though in some instances this effect would be partially offset by rising production costs and supply constraints, on account of the existing high levels of capacity utilization in the basic industries. 82/ All in all, deterioration in the terms of trade of non-oil primary producers vis-à-vis the import prices of manufactures is expected throughout the period 1980-1982 mainly owing to continued stagflation in the developed market economies.

The 1970s saw an acceleration in the tempo of domestic inflation in most developing market economies, which reached its peaks in 1974, 1977 and 1979 (see table V-14). The causes of this upsurge can be traced to several factors, including government deficit spending to stimulate economic growth, a faster growth in money supply than in output; rising money incomes in excess of factor productivity; and also, more significantly, the transmission of rising prices in world markets.

Rising import prices affect the rates of domestic inflation directly, through the prices of imported consumption and capital goods, and indirectly, through the production costs of domestic products, where imported raw materials or fuel enter as important inputs. Rising domestic price levels are likely to induce a response in the shape of demand for higher money incomes, thereby exacerbating inflationary pressures. Internal inflation may also be induced by rising export prices, which may intensify domestic demand pressure.

81/ A partial list of developing countries with a heavy dependence on non-oil primary commodities is given below:

Foods: rice (Burma, Thailand); wheat (Argentina); sugar (Cuba, Dominican Republic, Mauritius, Philippines); groundnuts (Senegal); bananas (Somalia);

Tropical beverages: coffee (Brazil, Colombia, El Salvador, Ethiopia, Ivory Coast, Kenya, Rwanda, Burundi, Uganda, United Republic of Tanzania, Angola); cocoa (Ghana, Nigeria, Ivory Coast, United Republic of Cameroon);

Agricultural raw materials: cotton (Egypt, Sudan); jute (Bangladesh); rubber (Malaysia, Thailand); sisal (United Republic of Tanzania);

Ores, metals and minerals: copper (Zambia, Zaire, Chile, Peru); iron ore (Brazil, Liberia, Mauritania); tin (Malaysia, Bolivia, Thailand); bauxite (Guinea, Guyana); phosphates (Morocco).

82/ As a consequence of depressed rates of return during the past several years, the creation of capacity in the basic industries has been slow: obsolete plant has been scrapped and physical capacity expansion abandoned. This accounts for the relatively high rates of capacity utilization in these industries and constitutes a supply constraint for metals and minerals.

Table V-14. Developing market economies: consumer price indices a/

(Annual percentage changes)

	Average 1971-1978	1971	1972	1973	1974	1975	1976	1977	1978	1979 b/	1980 c/	1981 c/	1982 c/
By type and region													
Oil-exporting countries	12.1	5.6	4.9	11.4	17.7	17.1	15.1	15.8	11.0	14.3	14.4	11.7	10.4
Non-oil-exporting countries	15.9	7.8	8.5	14.3	24.9	17.3	16.2	23.3	23.4	36.5	34.0	30.3	29.3
Africa	18.0	4.1	4.3	8.9	17.1	15.7	18.6	32.7	28.5	36.7			
South and East Asia	9.7	5.0	7.2	16.7	27.5	10.1	-0.9	8.1	6.0	9.3			
Western Asia	26.3	7.9	7.9	19.6	30.5	27.6	24.2	27.2	37.4	62.2			
Western hemisphere d/	24.2	11.0	10.4	13.2	25.3	22.8	28.6	36.2	31.6	42.6			
By level of income e/													
Low-income countries	11.8	3.8	6.5	18.2	27.4	11.2	0.3	14.0	10.5	17.0			
Other than low income countries	21.5	9.2	8.9	12.2	24.0	19.8	23.4	31.2	28.9	39.7			
Medium income	15.3	6.6	7.3	10.4	22.4	14.5	12.9	20.7	19.2	25.4			
High income	23.9	10.5	9.6	13.1	24.8	22.2	27.9	35.2	32.2	44.1			
Total, developing market economies	17.9	7.3	7.7	13.7	23.5	17.3	16.0	21.5	20.7	32.6	32.0	28.4	27.4
Developed market economies	8.7	5.3	4.9	7.9	13.2	11.2	8.5	9.0	8.1	10.5	10.6	8.6	7.7

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data from the Monthly Bulletin of Statistics, issued by the United Nations Statistical Office.

a/ The averages are obtained by weighting the country consumer price indices by each country's private consumption expenditure in 1975 (expressed in United States dollars). The indices cover 83 countries, accounting for 88.6 per cent of the total private consumption expenditure of the developing market economies in 1975.

b/ Preliminary.

c/ Figures for 1980-1982 are projections by the United Nations Secretariat (for explanations, see text).

d/ Excluding Argentina and Chile, both of which have extreme values for 1975-1978 (i.e. high rates of inflation) that would distort the annual average percentage changes appreciably for the western hemisphere and for the oil-importing countries as a whole.

e/ The income groupings are defined as follows: low-income countries - those with a per capita gross domestic product in 1975 of less than $300; medium-income countries - those with a per capita gross domestic product in 1975 of $300-$699; higher-income countries - those with a per capita gross domestic product in 1975 of $700 or more.

To assess the effect of rising international inflation on consumer price movements in groups of developing countries, a quantitative exercise was undertaken, correlating the price movement in low-income, medium-income and high-income developing countries with international inflation rates. 83/

A strong correlation appears to exist between the consumer price movements of the developing and the developed market economies. Preliminary findings appear to indicate that, when the consumer price index of the developed market economies as a group is increased by 1 percentage point, there is a 1.9 per cent increase in the consumer price index of the developing market economies as a group. When the oil-exporting and the oil-importing developing countries are examined separately, it is found that the elasticity, in relation to each percentage point increase in the consumer price index of the developed market economies, works out at 1.3 for the oil-exporting countries and 2.0 for the oil-importing developing countries.

A strong correlation was also found between inflation in the developing market economies and increases in the world price of petroleum. The incidence of its impact varies between the oil-exporting and the oil-importing developing countries on the one hand, and among the various non-oil developing regions on the other hand. The impact appears to be heaviest on the low-income countries.

The outlook for consumer price movements in the developing market economies in the period 1980-1982 is for a continuation of rapid inflation throughout the period, given the expected high inflation in the developed market economies and the likely rise in the real price for oil. Applying the measure of elasticity indicated above, the annual inflation rate (as measured by the consumer price index) in 1980-1982 would be between 10 and 15 per cent on the average in the oil-exporting countries, and between 30 and 35 per cent in the oil-importing developing countries.

83/ In interpreting the figures, one should be aware of the following deficiencies of the raw data on which the calculations were made. The consumer price indices for a large number of developing countries refer to the capital city only, instead of the country as a whole; the data series are not always comparable over a period of time: only those countries for which both consumer price indices and data on gross domestic product are available for the 1970s have been included in the calculations; the use of private consumption expenditure in United States dollars in 1977 as weights for obtaining regional and country grouping averages necessarily give a disproportionately large weight to price movements in about a dozen or so large developing countries. Consequently, in the averaging process, some countries with extreme values (for example, Argentina and Chile) have not been included.

Table V-15. Developing countries: volume and unit value of exports and imports
(Percentage change from preceding year)

	1979	1980	1981	1982
Quantum of exports				
Developing market economies	4.3	-1.2	3.8	3.5
Oil-exporting countries	1.0	-5.0	2.0	2.0
Non-oil-exporting countries	8.0	3.0	6.9	6.1
Africa	-4.2	4.0	6.5	6.8
South and East Asia	12.1	3.0	6.2	5.7
Western Asia	5.8	2.0	4.6	6.0
Western hemisphere	7.3	3.0	8.2	7.0
Quantum of imports				
Developing market economies	-0.9	11.5	10.0	9.8
Oil-exporting countries	-15.0	30.0	20.0	20.0
Non-oil-exporting countries	7.0	3.0	4.5	3.1
Africa	-13.9	0.0	10.7	3.8
South and East Asia	12.9	3.0	3.0	2.9
Western Asia	1.0	3.5	6.0	3.9
Western hemisphere	9.3	3.8	4.0	2.9
Unit value of exports				
Developing market economies	28.7	33.5	15.5	15.7
Oil-exporting countries	40.7	50.0	20.0	20.0
Non-oil-exporting countries	16.5	16.0	8.0	8.2
Africa	15.0	15.0	8.0	8.2
South and East Asia	16.9	16.0	8.0	8.2
Western Asia	15.0	15.0	8.0	8.2
Western hemisphere	17.1	17.2	9.0	9.0
Unit value of imports				
Developing market economies	17.7	18.0	11.5	10.6
Oil-exporting countries	14.8	15.0	9.5	8.6
Non-oil-exporting countries	19.2	20.0	12.0	12.0
Africa	19.0	19.0	13.0	12.0
South and East Asia	19.5	21.0	12.0	12.0
Western Asia	19.5	21.0	12.0	12.0
Western hemisphere	19.0	19.0	12.0	12.0
Terms of trade				
Developing market economies	9.3	13.0	3.6	4.6
Oil-exporting countries	22.6	30.4	9.6	10.5
Non-oil-exporting countries	-2.3	-3.5	-3.5	-3.4
Africa a/	-3.4	-3.4	-4.4	-3.4
South and East Asia	-2.2	-4.1	-3.5	-3.4
Western Asia	-3.8	-5.0	-3.5	-3.4
Western hemisphere a/	-1.6	-1.6	-2.7	-2.7

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on LINK projections and other research. 1979 data are estimates; data for 1980-1982 are projections.

a/ The deterioration in the terms of trade for oil-importing countries in Africa and the western hemisphere in 1979 and 1980 has been understated owing to the inclusion in them of such net oil-exporters as Mexico, Peru, Egypt and Tunisia.

Table V-16. Developing countries: value and balance of trade a/
(Billions of dollars)

	1978	1979	1980	1981	1982
Exports f.o.b.					
Developing market economies	301	402	530	634	758
Oil-exporting countries	150	213	304	372	456
Non-oil-exporting countries	150	189	226	261	302
Africa	19	20.5	24.5	28	33
South and East Asia	74	97	116	133	152
Western Asia	6	7	9	10	11
Western hemisphere	46	58	70	82	96
Other	6	6.5	7	9	10
Imports f.o.b.					
Developing market economies	280.5	331	434	528	638
Oil-exporting countries	96	96	144	188	246
Non-oil-exporting countries	184	235	290	340	392
Africa	28	29	34.5	43	50
South and East Asia	81.5	110	137	158	182
Western Asia	14	17	22	26	30
Western hemisphere	51	67	82	96	111
Other	9	12	15	17	20
Balance of trade (f.o.b.)					
Developing market economies	20	71	97	106	120
Oil-exporting countries	54	117	160	184	210
Non-oil-exporting countries	-34	-46	-64	-78	-90
Africa	-9	-8.5	-10	-15	-17
South and East Asia	-7.5	-13	-21	-25	-30
Western Asia	-8	-10	-13	-16	-19
Western hemisphere	-5	-9	-12	-14	-15
Other	-3.5	-6	-8	-8	-9

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

a/ 1978 and 1979 are actual figures or partial estimates. Projections for 1980-1982 are based essentially on LINK simulations, with modifications and adjustments where necessary.

Chapter VI

ADJUSTMENT POLICIES IN DEVELOPING COUNTRIES: SELECTED ISSUES

The current international economic situation is characterized by pervasive inflation, a slow-down in economic growth, the growing balance-of-payments pressures facing most developing countries, and widespread uncertainties. These developments, which represent an intensification of tendencies that have been evident in most countries for a number of years, have required urgent and strenuous efforts on the part of the developing countries to adapt their economies as best they can to the new situation. In effect, two interrelated but distinct sorts of adjustment are called for: current-account balances must be brought more completely under control and in some cases deficits must be reduced; and imbalances in the domestic economy and attendant inflationary pressures must be mitigated.

A principal phenomenon underlying the need to adjust is the continued decline in the terms of trade of non-oil-exporting developing countries. The terms of trade of these countries deteriorated by 2-3 per cent in 1979 and are expected to worsen further by about 4 per cent in 1980. At that point they will stand 20 per cent below the level of 1970.

In addition to its impact on the current-account balance and on domestic inflation, a decline in the terms of trade necessarily has a depressing effect on growth. In the absence of completely offsetting additional capital inflows, deteriorating terms of trade mean that some combination of an increase in exports and a reduction in imports is required, which implies that fewer resources will be available for domestic use. In other words, the level of real income associated with any given level of output is reduced. A lower level of real income, in turn, must generally be expected to lead to lower domestic saving, reduced investment, and slower growth of productive capacity.

The negative impact of a deterioration in the terms of trade is unavoidable, even in the best of circumstances. Additional and avoidable costs may be incurred, however, if the adjustment path that the country is obliged to follow in order to reduce its external deficit is itself inefficient.

An important consideration in this regard is the distribution of improvements in trade flows between exports and imports. A reasonably efficient process of adjustment is one in which the expansion of exports plays at least as important a role as the compression of imports. When a significant expansion of exports is not possible, an excessive burden must fall on imports and, where imports play an essential role in sustaining investment and current output, these will be impaired. Moreover, when macro-economic policies are used to reduce the levels of expenditure significantly, in order to curtail imports, there will be additional costs in terms of idle capacity.

Given the lack of flexibility that characterizes the structure of production of most developing countries, a sizeable expansion of exports can rarely be achieved quickly. Nor can it be realized in an international environment

characterized by the slow growth of markets and protectionism. An efficient adjustment process thus presupposes an open trading system and the availability of adequate bridging finance, so that adjustment can be spread over a number of years. Of course, where a permanent increase in financial flows can be secured, so that adjustment of the increase in the current account deficit need only be partial, the loss in real income from the decline in the terms of trade and from the operation of the adjustment mechanism will be mitigated. To the extent that an increase in flows of aid can be secured that would not be forthcoming in the absence of the increased deficit, the losses will be shared with aid donors. To the extent that foreign borrowing on commercial terms is undertaken, the losses are pushed into the future, and their realization is spread over a period of time.

The provision of adequate external finance on appropriate terms and conditions is thus an essential component of an efficient adjustment process. The availability of additional financing would in no way imply that developing countries were escaping from the necessity of adjusting. Indeed, as will be seen in the pages that follow, strenuous efforts to deal with external and internal imbalances have been under way in these countries for some time and were sharply intensified in 1979. These corrective measures, the full force of which is only now beginning to be felt, will entail a considerable cost in terms of current welfare and future growth.

The adjustment of external imbalances

Measures to constrain imports

The deteriorating current account balances in the majority of the non-oil-exporting developing countries in 1979, 84/ and the persistence of relatively large current account deficits in many of them have generally forced these countries to adopt policies designed to limit the growth of imports. Such policies - because of diverse underlying conditions and export prospects, as well as differences in access to international capital markets - have varied in intensity from country to country. None the less, the current situation is characterized by three common features: the introduction by a large number of countries of a variety of measures that have a direct bearing on imports; significant cutbacks by most countries in the government budget as a way of dampening aggregate demand and therefore the demand for imports; 85/ and a pervasive effort to reduce oil consumption and to seek alternative domestic energy sources.

Virtually all of the techniques for directly reducing the volume of imports were brought to bear in 1979. In some countries there was a temporary ban on imports of certain goods; in others, non-essential imports were directly curtailed. Some countries reduced significantly the number of import licenses allocated within given licensing systems, while others extended considerably the range of products for which licenses were required. Where systems of import deposits existed, the required size of such deposits was increased substantially; and where such systems did not exist or did not have great scope, they were introduced and used to increase

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84/ The current-account balance deteriorated in about two thirds of the 37 non-oil-exporting developing countries for which 1979 estimates were available.

85/ These measures, which stem partly from decisions to avoid further escalation of domestic inflation, are reviewed in a following section.

significantly the cost of importing. Tariff increases, particularly on luxury goods, were also a common phenomenon. In general, countries used these measures in such a way as to avoid constricting imports of industrial inputs. This was not always possible, however.

In addition to the above measures, a significant devaluation of the national currency was undertaken in a number of countries. 86/ This, of course, was designed to promote exports as well as to constrain imports.

In the area of import constraints, attention has been given to policies with respect to energy. Many countries have undertaken investment programmes geared to increasing self-sufficiency in energy. In addition, measures have been taken to reduce directly imports of crude oil and refined petroleum. These include the freezing of oil imports (Brazil), oil rationing at the consumer level (Botswana, Colombia, Lesotho and Panama), electricity cutbacks (Costa Rica) and, most importantly, considerable efforts to raise the relative prices of oil and oil-related products to reflect more fully higher world market prices. In practically all the developing countries, domestic prices of oil and oil-related products are fixed by the Government. Brazil, Lebanon, Mozambique, the United Republic of Tanzania, Uruguay and Zambia practically doubled their oil prices in 1979, while Chile, Costa Rica, Madagascar and Thailand increased oil prices by 40 to 60 per cent in the course of that year. Some countries introduced higher taxes for petrol, diesel and kerosene, partly as a way of discouraging non-essential consumption and encouraging the use of substitutes. In most of these countries, pricing policies went considerably further than "passing through" the effects of international price changes.

The impact of the policies described above on domestic economies is not easy to measure. However, it seems clear that energy price policies have greatly affected the price level in general and the cost of transport activities, including public transport, in particular.

Although measures to restrict import growth have been a general feature of policies in the non-oil-exporting developing countries in 1979, in some of these countries import restrictions have been aimed at decelerating what had been rather high growth rates in the past. Thus, although Brazil, the Republic of Korea and Yugoslavia are planning reductions in the growth of imports, these would still advance significantly in 1980. There are also a number of non-oil-exporting developing countries that for a variety of reasons 87/ are contemplating significant import increases, namely, over 4 per cent in volume terms, 88/ this year. If the

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86/ Bangladesh, Bolivia, Brazil, Israel, Mauritius, the Sudan, Western Samoa and Zaire in 1979; and the Republic of Korea in early 1980.

87/ Resumption of growth after a painful adjustment period (as in Peru and the Syrian Arab Republic); continuation of import liberalization programmes (e.g., in Argentina and Sri Lanka); a relative easing in the general balance-of-payments situation (Chile and Colombia); wide-ranging development programmes on account of energy-related export prospects (Angola, Egypt, Malaysia, Mexico, Paraguay, Thailand and Tunisia).

88/ Such an increase could be considerably higher if import prices in 1980 on average grew less than in 1979. In some of these countries the price elasticity of imports is well above 1.

intentions of these two groups of countries are realized, given the weight of these countries in international trade, their import demand is likely to have a considerable salutary effect on the world economy.

The realization of these intentions, however, depends on two premises: a significant growth in export revenues and adequate financial availabilities in 1980. In fact, even with a significant increase in export revenues in 1980 - for example, 20 per cent - this group of non-oil-exporting developing countries is still likely to experience a deterioration in the current account deficit of some 40 per cent. These countries as a rule have recourse to private capital flows, so that the realization of their intentions would require a substantial expansion of such flows. 89/

Export promotion and the dynamics of comparative advantages

Since export promotion has generally been a policy of the developing countries for some time, it is possible that many of the export promotion measures introduced in 1979 would have been adopted even in the absence of balance-of-payments difficulties, particularly those that require a longer time horizon and usually involve a substantial reallocation of resources. Nevertheless, the necessity for balance-of-payment adjustment appears to have been a significant factor in their adoption.

Since early in 1979, many countries have strengthened and diversified their export incentives in various ways. Bangladesh and the Philippines, for example, increased tax and tariff incentives to exporters; Brazil and Pakistan increased their financial support through the provision of new credit and repayment guarantees for certain classes of exports; Jamaica's new investment financing schemes supported non-traditional exports; Viet Nam offered exporting enterprises the priority supply of raw materials, foreign currency loans and special food allotments. India introduced, inter alia, guarantees against exchange loss for exports of capital goods and "turnkey" projects. And a number of countries, as mentioned earlier, significantly devalued their exchange rates in 1979 or early in 1980.

In addition to such policies, the developing countries have been giving more intensive consideration to the exploitation of specific market advantages. Morocco, for example, is now emphasizing early-season agricultural products and Somalia has called for the promotion of chilled and frozen meat and fish exports, the demand for which is growing more rapidly than it is for traditional products. Developing countries have also become more active in helping to market their exports through overseas trade promotion centres or increased participation in international trade fairs. Also, a number of countries have organized missions to prospective partner countries. Intergovernmental trading initiatives leading to barter agreements have become increasingly frequent; examples in 1979 include agreements between China and the Philippines, Brazil and Venezuela, and Algeria and Angola.

In 1979 there was a growing recognition of the changes in comparative advantage resulting from structural changes in international prices and the rapid growth of

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89/ The role of private flows and the factors influencing their size in 1980 are discussed in chap. IV above.

certain developing countries. For instance, the medium-term outlook for agricultural commodities such as cotton and rubber, which compete with petroleum-based synthetics, has improved. As a consequence, Bangladesh, with Malaysian technical assistance, is reported to be investigating the possibilities of natural rubber cultivation, and the rate of smallholder rubber replantings in Thailand has accelerated.

The recognition of changing comparative advantage may also be seen in the policies adopted in 1979 by Singapore to encourage an increase in the price of labour in relation to capital, so as to phase out certain low-wage manufactured product lines in favour of higher technology lines, production of the former shifting instead to newly emerging producer countries. Similarly, Hong Kong's garment industry has been "trading-up", that is, shifting out of the production of cheaper products.

Perhaps the most dramatic change in the composition of exports in recent years has been in the export of services. These include the growth of oil exploration and construction operations abroad, especially in the Gulf States, by developing countries such as Brazil, India, the Republic of Korea and, more recently, Cuba and Pakistan. The Gulf States have in fact been a magnet for labour from developing countries. Although this has been predominantly semi-skilled labour, it has also included highly skilled labour.

It would appear that developing countries have generally been entering new export industries, perhaps at an accelerating rate. As a consequence, established developing country exporters have been experiencing more competition and have been forced to adjust. China, for example, is entering the world textile competition and is establishing special zones for the processing of products for export. The Gulf States are seeing the growth of local construction companies, which are competing more effectively for contracts. New members of EEC will become better placed vis-à-vis developing country producers in supplying a number of products to EEC member countries. The markets in certain States in East Asia and the Persian Gulf, which have absorbed very large labour inflows, seem to have reached the point where restrictive policies are being implemented to stem the flow.

The developments described above show that developing countries have undergone and must continue to undergo considerable adaptation. However, the capacity to adapt to rapidly changing conditions in international markets is not evenly distributed. A minimum industrial base and the availability of a sizeable skilled and semi-skilled labour-force have been crucial ingredients in successful export-led strategies in the past. Their lack in a large number of countries, particularly the least developed, points to the low degree of adaptability of these countries.

Recently, developed market economies have in certain cases raised protectionist barriers or have threatened to resort to "orderly marketing arrangements" when some exports of developing countries have found a successful market. Such reactions not only have a direct effect on the restricted products, but also call into question the development of more trade-oriented strategies.

Promoting internal adjustment

Policies to improve the internal balance in the short term

The acceleration of price inflation in important segments of the world economy in 1979 was transmitted directly to developing countries through increases in the costs of imports. Although these new impulses were of a cost-push character, Governments attempted to limit the secondary impact of the price increases by constraining levels of aggregate demand. By and large, this involved limiting public expenditure and restricting the availability of credit.

The pervasiveness of government budget restraints is reflected in the fact that during 1979, and particularly during the second half of the year, developing countries with different degrees of economic diversification or levels of industrialization took steps to limit the growth of government expenditure. Countries in Africa, 90/ Latin America 91/ and Asia 92/ reduced the growth of public expenditure in 1979 or adopted budget cuts - at least in relation to gross domestic product - for 1980. In a large number of these countries, limits on public spending were buttressed by credit restrictions. 93/

Given the political difficulties entailed in reducing current government expenditure, particularly on education, public safety, health, and defence, retrenchment in the public sector invariably falls disproportionately on the public investment budget. Since public investment generally represents a large share of total fixed capital formation, retrenchment in the public sector usually leads directly to a reduction in the growth of productive capacity.

Budget appropriations for 1980 indicate a reduction in public investment, even in nominal terms, in certain countries 94/ and a decline or virtual stagnation in real terms in others. 95/ An examination of actual budget out-turns in 1980 will undoubtedly lengthen this list. The expectation in some countries, particularly in Brazil, Chile and Morocco, is that the private sector, including foreign investment, will compensate for much of the slack. Many countries, however, do not have this kind of flexibility.

Owing to the lagged effects of recent increases in the international prices of fuels and other products on domestic prices in the non-oil-exporting developing countries, the intensity of international pressures on domestic inflation is unlikely to abate during 1980. Thus, the need for restraint will remain and, in some countries, additional cutbacks in expenditure might become

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90/ Burundi, Kenya, Liberia, Mauritania, Morocco, Senegal, Togo, the Upper Volta and Zaire.

91/ Argentina, Brazil, Bolivia, Chile, Costa Rica and Jamaica.

92/ Jordan, the Republic of Korea, Pakistan, Sri Lanka and Thailand.

93/ In most cases, domestic credit restrictions, but also in some countries - Brazil, for example - ceilings on external credit to be used by public enterprises.

94/ For example, Mauritania, Morocco and Senegal.

95/ Argentina, Brazil, Burundi, Chile, Costa Rica, Israel, Jamaica, Jordan, Liberia and Pakistan.

unavoidable. If this were so, the rate of capital accumulation would then be depressed for a second consecutive year.

Towards domestic adjustment in the longer run

Developing countries have no choice but to plan their investment strategies in the world as they find it. Thus, in response to the recent developments in the international economy, there have been significant changes in planned development programmes.

The substantial change in the relative price of energy at the international level has prompted many non-oil-exporting developing countries to intensify the exploration and development of domestic energy sources. In several of these countries, the gradual emergence of an important export capability in the energy field is progressively easing foreign exchange constraints and improving medium-term prospects. The relatively large surplus that can be generated through the exploitation of their energy resources and the significant increases that can be expected in their capacity to import are giving these countries an important opportunity to diversify and carry out relatively more ambitious industrial programmes. In fact, these countries have speeded up development programmes, the likely effect of which is not only to increase output and adapt the structure of production in the long run, but also to increase significantly incomes and output in the short run. However, by early 1980 policy-makers in some of these countries had already started to reassess their industrialization programme in view of growing inflationary pressures and the need to ensure an equitable distribution of benefits among all income groups.

In most other non-oil-exporting developing countries, apart from a gradual move towards more energy self-sufficiency, two important features emerge in present economic policies. One is a stronger emphasis on agriculture, partly as a way of alleviating the difficult short-term and medium-term external payment situation. The other is the accommodation to growing international uncertainties through the introduction of more flexibility into new plans or the revision of ongoing plans to make them more adaptable. The rationale is to avoid rigid commitments for the long run that might jeopardize the degree of manoeuverability required to cope with present difficulties.

Thus the new Brazilian plan for the period 1980-1985 and the recent policy discussions on a new plan in Sri Lanka emphasize flexibility, while Morocco's "austerity" plan - a substitute for the 1978-1982 plan - and Zambia's 1980-1983 plan have as one of their main objectives the provision of the breathing space needed to cope with present difficulties. The emphasis on agriculture is evident in the 1979-1983 plan of Barbados, Somalia's 1979-1981 plan and the guidelines for the 1981-1985 plan of the Syrian Arab Republic. Despite budget-tightening in the public sector, an increase in agricultural investment in real terms has none the less been assured in Brazil, the Ivory Coast and Thailand. The continuation of agricultural programmes in the Republic of Korea and the Upper Volta led to a postponement of certain industrial investments.

In sum, greater agricultural output is expected to make an important contribution to the alleviation of the external payments situation through a reduced food import bill or increased exports in a large number of countries, both in 1980 and beyond. A cautious attitude towards public investment, particularly

as regards programmes with a long maturity period is also likely to strengthen the financial situation. But the alleviation of short-term or medium-term foreign exchange restrictions is only one of the policy objectives sought by policy-makers. Under the present circumstances, for some countries there seems to be a significant trade-off between this objective and that of diversification or rapid industrialization. On the other hand, a more rapid foreign exchange pay-off is usually found in traditional activities; 96/ at the same time, the move towards more financial flexibility adversely affects those activities that require a long gestation period. Thus, the likely result of this process is to hamper diversification and industrialization.

96/ For example, the Sudan, in view of its pressing foreign exchange requirements, has reassessed the programme for agricultural development and diversification. In the short run at least, cotton and ground-nuts are still being emphasized.

Annexes

I. EXTERNAL FACTORS AND GROWTH IN DEVELOPING COUNTRIES: THE EXPERIENCE OF THE 1970s

During the recession of the mid-1970s, the non-oil-exporting developing countries a/ were faced with severe difficulties in maintaining the pace of their growth. Demand for their export products fell sharply in the developed market economies. As a consequence, the commodity boom of 1972-1974 came to an abrupt end and, beginning in mid-1974, the prices of most primary commodities dropped precipitously; in addition, the growth in the exports of manufactures to the main industrial centres, one of the most dynamic components in the exports of developing countries, came to a halt. The slow-down in the developed market economies was accompanied by a sharp acceleration in inflation, which resulted in rapid increases in the prices of manufactures imported by developing countries. And the quadrupling of oil prices in late 1973 and early 1974 complicated the difficulties of maintaining growth rates by putting additional pressures on the current accounts of their balances of payments.

During this difficult period, developing countries were able to run very large deficits on current account. The availability of external financing allowed a number of countries to pursue anti-cyclical policies to counteract the dampening effect on demand of an adverse external environment and thus to keep the slow-down in their growth rates within bounds. The world economy is entering a period that bears some resemblance to the events of 1974-1975. The developed market economies are in the throes of another inflationary recession and oil prices have risen sharply. To be sure, neither the slow-down in the developed market economies nor the oil price increases are likely to turn out to be as sharp as they were in 1974-1975. Nevertheless, questions regarding the ability of developing countries to finance very much larger deficits, and thus to loosen the external constraint on growth, are relevant once again. This note analyses the mechanisms through which developing countries were able to maintain growth during the recession and attempts to derive some lesson for the current circumstances.

The cycle in the industrialized countries and growth in the developing countries

Economic downturns in the industrialized countries are transmitted to the developing countries largely through their impact on the latters' export earnings and balances of payments. On the one hand, the decline in export volumes and the worsening of current accounts induced by recessionary conditions in the major

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a/ Unless explicitly stated, the term "developing countries" refers to the non-oil-exporting developing countries.

industrial countries have an adverse effect on aggregate demand. b/ On the other hand, growing foreign exchange scarcities force some countries to cut back development plans. As shown in table A-1, during the economic downswing of 1974-1975, developing countries did experience a decline in growth rates. In addition, since 1973, growth in developing countries has been considerably below its long-run trend (as measured by growth rates achieved in the period 1961-1973).

The recession and its aftermath had a particularly strong impact on the growth of the manufacturing sector. For several reasons, this sector is most severely affected by a deterioration in the external environment. In the first place, manufacturing production is more dependent upon imported inputs than other sectors of the economy. Secondly, the generally depressive effects on aggregate demand of a large increase in current-account deficits tend to fall particularly strongly on the demand for manufactures, the consumption of which can be more readily curtailed than it can for agricultural products. Thirdly, the drop in the demand for manufactured exports affects manufacturing production in a number of countries that have adopted export-oriented growth strategies.

None the less, growth in developing countries was less adversely affected by the recession than growth in the major industrial countries. While in the latter the growth rates of gross domestic product and manufacturing value added declined, respectively, by 7.2 and 14.3 percentage points in the period 1973-1975, in the former the corresponding declines were 3.1 and 7.4 percentage points, or roughly one half as much.

One of the variables that explains the relatively better growth performance of developing countries is fixed investment. As shown in table A-2, the growth of fixed investment accelerated during the recession, but slowed down considerably during 1976-1977. To some extent, the behaviour of fixed investment was policy-induced. On the expectation that the decline in export earnings would be temporary, policy-makers in a number of countries instituted programmes to stimulate investment in general, and particularly in the construction sector. c/ As discussed below, this was made possible largely through recourse to foreign borrowing and a reduction in reserves. The large increase in the external indebtedness of many countries during the period 1974-1975 was predicated upon a speedy return to the more buoyant conditions prevailing earlier in the decade.

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b/ An externally induced worsening of the current account - due, say, to deteriorating terms of trade - has a dampening effect on aggregate demand. From the point of view of the Keynesian multiplier, a rise in the value of imports increases demand leakages, and a decrease in export earnings adversely affects autonomous expenditure. On the other hand, the fall in export volume has its main impact on the supply side: it affects (immediately or with a certain lag in the event that stocks are low) export activities and export-related industries.

c/ For example, among countries experiencing particularly sharp declines in the terms of trade and export volume, in Brazil, Pakistan and Zambia the annual rates of increase in gross domestic capital formation and in value added in construction were higher in 1974-1975 than historical trends. While below trend, the corresponding rates in the Ivory Coast, the Republic of Korea and Mexico stood in the range of 6-8 per cent.

Table A-1. Rates of growth of gross domestic product and value added in manufacturing in the major industrial countries and in the non-oil-exporting developing countries, a/ 1961-1978

(Percentage)

Period	Major industrial countries b/		Non-oil-exporting developing countries	
	Gross domestic product	Value added in manufacturing	Gross domestic product	Value added in manufacturing
1961-1970	4.9	6.7	5.3	7.0
1971-1973	5.2	6.1	6.0	9.1
1974-1978	2.6	3.3	4.8	4.9 c/
1971	3.6	2.3	5.6	8.5
1972	5.6	6.9	5.5	8.9
1973	6.4	9.3	7.0	9.9
1974	-0.1	-2.1	5.5	5.6
1975	-0.8	-5.0	3.9	2.5
1976	5.6	9.0	4.7	7.1
1977	4.1	4.2	5.4	4.6
1978	4.2	4.5	5.2	...

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

a/ The rates of growth shown in this table for the non-oil-exporting developing countries differ somewhat from those given in the main body of this Survey. While the latter are expressed in constant 1977 United States dollars, the former are in 1975 dollars. In addition, the country coverage is somewhat different.

b/ Canada, France, Germany, Federal Republic of, Italy, Japan, United Kingdom, United States of America.

c/ 1974-1977.

Table A-2. Non-oil-exporting developing countries: rates of growth of real output and demand, by country groups, according to export earning trends, 1961-1977

(Percentage)

Countries classified according to export-earning trends	1961-1970	1971-1973	1974-1975	1976-1977
Non-oil-exporting developing countries				
Gross domestic product	5.3	6.0	4.7	5.0
Value added in manufacturing	7.0	9.1	4.0	5.9
Value added in agriculture	2.5	2.0	3.9	3.3
Private consumption	4.8	5.6	3.8	3.4
Fixed investment	6.3	6.9	8.6	5.5
Net foreign capital inflow a/	2.7	2.5	5.2	3.3
Group I b/				
Gross domestic product	5.8	7.3	4.8	5.2
Private consumption	5.3	6.8	3.9	3.5
Value added in manufacturing	7.4	10.5	4.6	5.9
Value added in agriculture	3.3	3.0	3.8	3.5
Fixed investment	7.0	8.0	7.9	5.2
Net foreign capital inflow	2.3	2.6	5.7	2.9
Group II c/				
Gross domestic product	3.9	2.5	4.0	4.5
Private consumption	3.6	2.8	2.8	2.9
Value added in manufacturing	5.8	4.9	1.8	5.8
Value added in agriculture	2.7	0.4	4.1	3.3
Fixed investment	3.8	3.3	7.4	5.5
Net foreign capital inflow	3.3	1.5	3.0	1.6
Group III d/				
Gross domestic product	6.0	5.8	4.2	5.1
Private consumption	5.7	4.6	4.6	3.4
Value added in manufacturing	7.1	8.1	4.4	6.4
Value added in agriculture	4.1	3.3	0.3	0.7
Fixed investment	7.5	4.3	21.1	8.3
Net foreign capital inflow	2.1	5.4	5.2	12.6
Group IV e/				
Gross domestic product	4.8	5.0	7.5	4.0
Private consumption	4.3	3.9	7.4	4.9
Value added in manufacturing	6.5	5.6	5.5	5.9
Value added in agriculture	2.5	-2.2	10.1	0.3
Fixed investment	6.1	5.6	12.2	2.5
Net foreign capital inflow	8.6	9.3	12.4	14.9

(Source and foot-notes on following page)

(Source and foot-notes to table A-2)

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

a/ Net imports of goods and services, including factor services, as a share of gross domestic product, all in 1975 dollars. First figure is for 1960.

b/ Forty-two countries experiencing a deceleration in the growth of both pruchasing power and volume of exports in 1974-1975 in relation to 1971-1973.

c/ Fourteen countries experiencing a deceleration in the growth of export purchasing power but an acceleration in the growth of export volume.

d/ Thirteen countries experiencing an acceleration in the growth of export purchasing power but a deceleration in the growth of export volume.

e/ Twelve countries experiencing an acceleration in the growth of both purchasing power and volume of exports.

Contrary to expectations, the world economy did not return to the fast growth that had been characteristic of the period immediately preceding the recession. At the same time, as longer-term export prospects became more uncertain, debt service ratios began to rise sharply in many countries. As a consequence, investment plans were in a number of cases scaled down.

The sharpest adverse effects of the recession fell on a large number of countries which experienced both a deterioration in their terms of trade and a severe decline in the growth of their real exports (see table A-2). These countries experienced the strongest negative impact on the growth of gross domestic product, manufacturing value added and private consumption. Perhaps as a result of policy decisions to support aggregate demand, in spite of extremely adverse external developments, investment growth did not slacken appreciably. However, in the longer term these countries were unable to maintain the pace of investment, and its rate of increase slowed down noticeably in 1976-1977.

In a second group of countries, the purchasing power of exports also declined. But improvements in the growth of export volume and agricultural production appear to have been responsible for preventing the continuation of the extremely poor overall growth that characterized the early 1970s. Nevertheless, their growth rates have been far from satisfactory since 1973. Countries in a third group benefited from improving terms of trade, but lagging exports and agricultural production d/ had adverse effects on the expansion of aggregate output. By contrast, a fourth group of countries experienced strong increases in both the purchasing power of their exports and their export volume. They were able to raise their rates of growth of gross domestic product and private consumption. However, the reversal of the favourable trends in their terms of trade in the period immediately following is an important factor explaining the deterioration in growth performance experienced by these countries.

Developing countries, on the whole, appear to have been able to finance large balance-of-payments deficits and therefore the need for adjustment may have been confined to a small group of countries. Indeed, import volume grew faster in the period 1974-1975 than in the earlier years of the decade (see table A-3). Even the countries which were most adversely affected (in terms of declining export volumes and purchasing power) were still able to avoid any sharp deceleration in import growth. Thus, the combined current-account deficit of developing countries almost doubled in real terms, the increase being contributed very largely by countries experiencing a sharp decline in their purchasing power of exports. A rise of this magnitude in current-account deficits in real terms implies that capital inflows were very much larger than those required to finance the deterioration in the terms of trade; and they allowed a number of economies to continue to expand at a relatively fast pace.

The adjustment came in the following period. As shown in table A-3, despite sharp increases in the purchasing power of exports, the growth of import volume decelerated in all groups of countries. In the first two groups, adjustment efforts appear to have been the main cause, since current-account deficits in real terms declined to levels broadly comparable to those prevailing in the

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d/ In the case of agricultural exporters, these phenomena could, of course, be related. The decline in agricultural production may have caused exports to fall and export prices to rise.

Table A-3. Non-oil-exporting countries: trade and payments indicators by country groups, according to export earning trends, 1971-1977

(Rates of change in percentage; current account deficits in billions of 1975 dollars a/)

Country groups b/ and items	1971-1973	1974-1975	1976-1977
Non-oil-exporting developing countries			
Rate of growth of:			
Purchasing power of exports	6.1	-5.9	13.9
Export volume	7.8	-2.1	10.0
Import volume	4.5	6.7	3.8
Current-account deficit c/	16.8	30.6	20.0
Group I			
Rate of growth of:			
Purchasing power of exports	8.7	-8.2	16.6
Export volume	5.5	-8.4	8.5
Import volume	5.7	4.8	4.5
Current-account deficit	12.6	24.4	13.1
Group II			
Rate of growth of:			
Purchasing power of exports	-2.9	-6.7	12.1
Export volume	-1.4	10.5	4.6
Import volume	-0.5	11.0	-1.6
Current-account deficit	2.2	3.9	1.8
Group III			
Rate of growth of:			
Purchasing power of exports	6.1	12.4	-3.8
Export volume	10.8	-10.3	15.4
Import volume	4.4	13.9	3.7
Current-account deficit	1.0	0.9	2.9
Group IV			
Rate of growth of:			
Purchasing power of exports	-4.3	24.2	3.4
Export volume	-1.3	15.1	5.9
Import volume	4.0	13.7	11.9
Current-account deficit	1.0	1.4	2.2

(Source and foot-notes on following page)

(Source and foot-notes to table A-3)

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on 1979 Handbook of International Trade and Development Statistics (United Nations publication, Sales No. E/F.II.D.2).

a/ Current-dollar figures deflated by the UNCTAD index of import unit value.

b/ For a description of each group, see table A-2.

c/ Including estimates for countries excluded from the groupings by income levels because of incomplete data.

early 1970s. In the last two groups of countries, a worsening of the terms of trade led to a curtailment of import growth and to higher real deficits.

Financing current-account deficits

From the above discussion, it is evident that the availability of external finance e/ was the main mechanism by which developing countries were able to deal with the external constraint on growth during the economic downturn of 1974-1975. The following paragraphs present a brief account of how the deficits were financed. In summary, the countries toward the lower end of the income spectrum received substantial increases in concessional flows, the more industrialized countries borrowed heavily from private financial markets, and all groups of countries made extensive use of accumulated reserves.

Capital flows to developing countries increased sharply in the two years immediately preceding the recession (see table A-4). Most of the increase consisted of international bank lending, which had gone to relatively high-income countries. As can be seen in table A-5, the ratios of total flows and non-concessional flows to imports rose sharply in the period 1972-1973 in the higher-income countries. As a result of this borrowing and of strong export earnings, international reserves increased considerably.

During the period 1974-1975, capital flows again rose very steeply in real terms. The increase was shared by private lenders (mostly short-term) and OPEC member countries, largely on concessional terms. While the non-concessional flows tended to concentrate in the middle-income countries, and to a lesser extent in the higher-income countries, most of the concessional finance went to the lower-income group. During this period, all groups of countries, particularly the higher-income group, drew down their reserves very sharply. By the end of 1975, the international reserves of developing countries, deflated by import prices, were 35 per cent below their level at the end of 1973. Whereas in 1973 the average level of reserves was sufficient to finance 4.7 months of imports, by 1975 reserves had dropped to an equivalent of 2.7 months of imports.

The very large recourse to private markets must thus be considered as one of the main mechanisms which prevented a serious setback in the development processes of the higher-income and middle-income countries. However, the maintenance of growth through this means was not without costs, the most important one being the increase in foreign debt at short maturities and the sharp rise in the ratios of debt service to export earnings. In fact, the failure of some countries to return to high rates of economic expansion after the recession can be partially ascribed to the adoption of deliberate policies of import restraint made necessary by rapidly mounting levels of external debt and higher debt-servicing ratios. In addition, the availability of financing from private markets enabled a number of countries to pursue stimulative policies and to increase substantially the deficit of the public sector. In some countries, these policies gave rise to an acceleration of inflation; and the persistence of higher inflation appears to have induced policy-makers to adopt more restrictive demand management policies in recent years.

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e/ Including high levels of reserves in 1973.

Table A-4. Non-oil-exporting developing countries: a/ sources of external finance, 1970-1978

(Billions of constant dollars, in 1975 prices b/)

	1970-1971	1972-1973	1974-1975	1976-1977
Current-account deficit	26.03	19.07	37.73	26.27
Total capital flows c/	27.48	30.20	40.02	38.77
Long-term financing	24.29	28.25	31.75	36.72
Member countries of the Development Assistance Committee of OECD (bilateral flows)	17.84	16.49	16.74	17.06
Official development assistance	7.85	6.93	5.54	5.01
Non-concessicnal flows d/	9.99	9.55	11.20	12.04
OPEC member countries e/	1.12	1.55	5.03	5.81
Official development assistance	1.00	1.44	3.94	4.59
Non-concessional flows	0.12	0.12	1.09	1.22
Centrally planned economies	1.14	1.44	0.67	0.52
International bank lending f/	1.21	5.43	5.37	9.19
Multilateral institutions	2.98	3.34	3.94	4.14
Official development assistance	1.49	1.71	2.15	2.21
Non-concessional flows	1.50	1.63	1.79	1.93
Short-term financing g/	3.19	1.95	8.27	2.05
Memorandum item: Net use of IMF credit	-0.40	0.40	1.76	0.92

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on 1979 Handbook of International Trade and Development Statistics (United Nations publication, Sales No. E/F.II.D.2); and International Monetary Fund, International Financial Statistics, various issues.

a/ Country coverage is that used by UNCTAD in 1979 Handbook of International Trade and Development Statistics for all developing countries other than the major petroleum exporters.

b/ Current-dollar figures deflated by the UNCTAD index of import unit value.

c/ Excluding errors and omissions.

d/ Excluding bilateral portfolio investments.

e/ Including flows from multilateral institutions financed by OPEC member countries.

f/ Including bilateral portfolio investments from member countries of the Development Assistance Committee. These flows are mostly bank loans, which are difficult to distinguish analytically from international bank lending.

g/ Short-term flows were obtained as a residual, after subtracting reported long-term flows from data on the capital account surpluses (excluding errors and omissions).

Table A-5. Non-oil-exporting developing countries: ratios of capital flows and international reserves to imports, by income groups, 1970-1977

(Percentage)

	1970-1971	1972-1973	1974-1975	1976-1977
All oil-importing developing countries				
Concessional flows	9.9	9.5	10.1	10.0
Non-concessional flows	16.0	17.8	21.3	20.1
Total flows	25.9	27.3	31.4	30.1
International reserves a/	28.9	33.5	23.7	26.5
Lower-income countries b/				
Concessional flows	26.8	26.1	32.0	31.7
Non-concessional flows e/	4.3	4.2	4.9	5.6
Total flows e/	31.0	30.3	36.9	37.3
International reserves	34.6	35.5	23.0	34.4
Middle-income countries c/				
Concessional flows	10.0	11.7	12.4	12.1
Non-concessional flows	15.9	9.3	17.1	13.9
Total flows	25.9	21.0	29.5	26.0
International reserves	33.3	33.4	25.4	28.3
Higher-income countries d/				
Concessional flows	3.0	2.7	1.6	1.5
Non-concessional flows	21.3	29.2	30.5	32.3
Total flows	24.3	31.9	32.1	33.8
International reserves	29.4	41.0	28.2	33.1

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on 1979 Handbook of International Trade and Development Statistics (United Nations publication, Sales No. E/F.II.D.2).

a/ Including estimates for countries excluded from the groupings by income levels owing to incomplete data.

b/ Countries with a per capita gross domestic product below $300 in 1975.

c/ Countries with a per capita gross domestic product between $300 and $799 in 1975.

d/ Countries with a per capita gross domestic product of $800 or above in 1975.

e/ Including long-term flows only.

Flows from OPEC member countries more than trebled in real terms between 1972-1973 and 1974-1975, and about 80 per cent of the total was in the form of concessional flows. On the other hand, during the same period concessional flows from member countries of the OECD Development Assistance Committee shrank in real terms. There is also evidence that the distribution of flows among recipients was altered in favour of the lower-income countries. Flows from OPEC member countries tended to go almost exclusively to the lower- and middle-income countries, and flows from member countries of the Development Assistance Committee were redirected toward the lower-income countries. In the absence of this sharp increase in concessional flows, imports in the lower-income countries would have declined at an average annual rate of over 1 per cent between 1973 and 1975, instead of rising by 6.5 per cent per annum.

When compared with other sources of finance, the use of official payments finance through IMF was small (see table A-4), although it represented a considerable increase in relation to past lending. Intensified balance-of-payments pressures on the oil-importing countries coincided during this period with a very large expansion of international liquidity, caused largely by deposits with the international banks from surplus OPEC member countries. Therefore, countries considered credit-worthy by the international banking system were able to obtain balance-of-payments finance, often without the stringent conditions attached to the use of Fund credit beyond the first credit tranche. As a result, virtually all of the increase in IMF financing reflected use of the reserve and first credit tranches and the oil facility; financing available through the higher credit tranches, which is subject to more stringent conditionality, remained virtually unused.

In the years that followed the recession, total capital flows contracted somewhat in real terms, mainly as a result of an abatement in short-term financing. Long-term financing, on the other hand, continued to expand considerably. The main item contributing to this growth was again international bank lending. During this period, funds on international capital markets were in excess supply, and borrowing conditions for developing countries steadily improved. Since current-account deficits declined substantially, developing countries were able to replenish their reserves. However, by 1978 reserves were still below the levels of 1973 in relation to imports.

Lessons for the current slow-down

During the period 1976-1978, the combined current-account deficit of the developing countries was reduced, in real terms, to roughly the levels prevailing in the early part of the decade. This reflected in part the considerable adjustment that took place in a number of countries. By 1979, although the developing countries were still in the process of adjusting to the shocks of the mid-1970s and to the slower rate of expansion of the world economy in the second half of the decade, they were confronted with additional external threats to their development process. Growth in the developed market economies slowed, and an even more drastic deceleration was widely forecast for 1980. While the pace of inflation quickened during 1979, oil prices rose by over 130 per cent from December 1978 to February 1980. As a result of these developments, developing countries are facing a slackening of demand for their exports in the developed market economies and a serious worsening of their terms of trade. Therefore,

severe balance-of-payments pressures ensued in 1979, and further pressures can be expected for 1980.

The two main elements which prevented a major decline in growth in the period 1974-1975 - namely, the maintenance of fixed investment and a sharp increase in capital inflows in real terms - are unlikely to be present this time. Policies to stimulate investment will face both domestic and international constraints. On the domestic front, higher rates of inflation than those prevailing in the mid-1970s may inhibit the use of stimulative policies. On the external front, countries may find it difficult to finance the increase in import volumes necessary to maintain investment growth. In contrast to the early 1970s, more countries may be either unable or unwilling to add substantially to their foreign debt, particularly at a time when the export outlook is uncertain. In addition, borrowing costs have risen sharply. Given the sharp deterioration in their terms of trade expected in the period 1978-1980, unless urgent measures are taken at the international level, protracted adjustment in 1980 and beyond is probably in store for a large number of developing countries.

II. SUPPLY AND PRICE OF PETROLEUM IN 1979 AND 1980

The tightness of the petroleum market, which prevailed throughout 1979, was initially the result of a reduction in supply caused by the sharp drop of output in Iran. World crude oil production in the first quarter of the year was 2.1 million barrels per day below that of the fourth quarter of 1978 as Iranian output dropped to less than 0.5 million barrels per day (from a peak of 6.1 in September 1978), an amount not even sufficient for domestic consumption. The absolute decline was only temporary, however, as increases in the output of other OPEC member countries (notably Iraq, Kuwait and Saudi Arabia) took up most of the slack and as the growth of output in the rest of the world continued. For the year as a whole, global crude production increased by 3.7 per cent, a rate significantly above the 2 per cent per annum of recent years (see table A-6). At the same time, the growth of consumption slowed down substantially in the developed market economies, owing partly to supply shortages in major consumer markets but also in reaction to rising prices.

Despite the accelerated growth in output and slowing consumption trends, the market balance continued to be tight throughout the year. This was because of strong inventory demand caused by uncertainty about the future availability of supplies and the production intentions of the producer countries, as well as by the expectation of further price increases. Although precise figures are hard to come by, some observers have estimated that on the average about 1.1 million barrels per day - about 1 1/2 per cent of the global production - were added to stocks during 1979. a/ While these estimates must be accepted with caution, it is clear from data available for the United States of America that inventories of crude oil and petroleum products at the end of the year were at historically high levels; and the same was probably true for the other developed market economies as a group. In addition, the volume of "floating stocks" is believed to have increased significantly.

The acceleration of structural changes in oil marketing arrangements in 1979 undoubtedly contributed to the rise in inventory demand. As producing countries, besides determining levels of output, have been increasingly taking over control of the marketing of their oil, the long-term supply arrangements with international oil companies and oil field operators have in a number of cases been replaced by arrangements with much shorter time horizons and with smaller shares of output, or even ad hoc transactions. A growing share of the output of oil-exporting countries is thus being marketed directly, partly on the basis of intergovernmental arrangements with consumer country Governments, b/ but also to some extent on the spot market.

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a/ Oil and Energy Trends, vol. 5, No. 2, 15 February 1980. This figure represents the difference between the estimated increase in consumption and the increase in production, and as such is subject to any measurement errors in these two sets of estimates.

b/ The Polish State trading agencies, for instance, increased oil imports directly from producer countries by 100 per cent in 1979, largely to replace purchases formerly made from the international oil companies.

Table A-6. World oil production and consumption, 1974-1980

	Millions of barrels per day				Growth rates (percentage)		
	1974	1978	1979 a/	1980 b/	1975-1978	1978-1979	1979-1980
Production							
Developed market economies	13.3	14.1	14.7	15.3	5.9	4.6	4.1
Developing market economies	34.0	34.5	35.8	34.9	0.4	3.9	-2.5
Oil-exporting countries	31.4	30.7	31.7	30.1	-0.6	3.2	-5.0
Others	2.6	3.8	4.2	4.8	10.2	9.7	14.2
Centrally planned economies	10.9	14.0	14.3	14.6	6.4	2.2	2.1
World	58.2	62.6	64.9	64.8	1.8	3.7	-0.2
Consumption							
Developed market economies	37.6	41.1	41.4	39.9	2.2	0.8	-3.6
Developing market economies	8.8	10.1	10.7	11.3	3.5	5.6	5.6
Oil-exporting countries	1.8	2.2	2.4	2.6	5.5	5.6	8.3
Others	7.0	7.9	8.3	8.7	2.9	5.6	4.8
Centrally planned economies	10.1	12.6	13.0	13.4	5.6	3.3	3.0
World	56.5	63.7	65.0	64.6	3.0	2.4	-0.3
Balance							
Developed market economies	-24.3	-27.0	-26.6	-24.6			
Developing market economies	25.2	24.4	25.2	23.6			
Oil-exporting countries	29.6	28.5	29.3	27.5			
Others	-4.4	-4.1	-4.2	-3.9			
Centrally planned economies	0.8	1.4	1.3	1.2			
World	1.7	-1.1	-0.1	0.2			

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data in Oil and Energy Trends (vol. 5, No. 2, 15 February 1978), national and international estimates and Governments' announcements of production policies.

a/ Preliminary.

b/ Projection.

These developments are progressively changing the role of the private oil companies from producers to buyers of crude and to providers of technical services. Increasingly, decisions on the production and marketing of oil reflect the considerations to which the producer countries give weight. These include the formulation of oil depletion policies, which stress the exhaustibility of this natural resource and seek to extend the lifetime of reserves. Oil production policies also increasingly reflect the changing attitudes of Governments with regard to the optimal pace of domestic development and to the socio-economic implications of rapid increases in oil revenues. Among the major surplus countries, concern about the security and future real value of the financial assets obtained in exchange for oil also has a bearing on these decisions. In view of the limited absorptive capacity for imports of some of the major oil producers, this may imply that the recent increases in oil prices will tend to lead to reduced production levels. For these reasons, a strong preference has developed on the part of oil exporters for restricting their production and towards the end of 1979 and in the first months of 1980, a number of OPEC member countries did indeed announce their intention of cutting back on production.

The price of petroleum rose at a rapid pace - almost month by month - throughout 1979 and into the first quarter of 1980. A schedule of quarterly price increases, which had been agreed at the OPEC meeting in December 1978, became obsolete almost immediately as spot market prices soared in the early months of the year and individual producer countries adjusted their official selling prices in a series of "leap-frogging" steps. In the process, the unitary price structure maintained by OPEC (in which price differences between the marker crude, Saudi Arabian light 34° API, and other types of crude essentially reflected quality differences) fell increasingly into disarray. c/

These price adjustments raised the output-weighted average of official selling prices posted by producer country Governments from just under $13 per barrel at the end of 1978 to $27 per barrel at the end of 1979. Additional increases posted in the early months of 1980 have added another $2-$3 to the end-1979 figure by the end of the first quarter of 1980. Owing to the rapidity of price changes during the year, the average level of official posted prices for the year 1979 as a whole was substantially below the end-year value; it was approximately $19 per barrel, or 46 per cent above the average 1978 level. The actual year-over-year increase of the prices at which consumers purchased oil from producer countries is likely to have been greater by perhaps 5 to 10 percentage points, since an unknown but rising portion of sales is reported to have taken place at spot market prices. These generally moved ahead of the official price adjustments and peaked late in the year at the level of $40 per barrel. d/

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c/ The mean spread between official posted prices and the price of marker crude rose from 4 per cent of the marker crude price at the beginning of 1979 to 15 per cent at the beginning of 1980.

d/ The above price data do not apply to transactions among the centrally planned economies, where contract prices have in recent years been set on the basis of world market averages for the preceding five years and are held stable for the year. However, similar price movements probably characterized the oil exports of the USSR and China to outside markets, as well as the oil imports of centrally planned economies from outside markets.

The 1979 price advances followed a period of several years, in which the nominal price of oil had been relatively stable and the real price (as represented by the purchasing power of oil over exports of the developed market economies) had declined by almost 15 per cent from the peak level reached in 1974 (see table A-7). The price increases of the first six months of 1979 roughly restored this earlier relationship, and the further advances carried the real price much beyond the earlier peak. For the year, the increase in the real price was about 26 per cent. e/

The assessment of prospects for the evolution of oil costs and supplies in 1978 may start from the decisions already taken before the end of the first quarter. As noted earlier, the average of posted official oil prices in March stood at approximately $30 per barrel. Without any additional price adjustments during the year, this would yield an increase of about 55 per cent over the 1979 average of posted prices and, in the light of expected world trade price trends, another advance in the real price of oil of about 30 per cent over the 1979 level. Since spot market prices declined in the early part of the year to a level of about $32-$35 per barrel, the trends for actual transaction prices may be a little lower.

Global demand for petroleum is generally expected to be very soft. In view of the slow-down of economic activity in most of the developed market economies, the expected impact of the increase in relative prices, and the responses of Governments in seeking to promote energy conservation, oil consumption in the developed market economies is in fact expected to decline. In spite of a continued growth of consumption - though at a lower rate - in other parts of the world economy, this will probably bring about an absolute decline in global consumption. f/ Although the motive for inventory build-up continues to be strong, inventory purchases should not stimulate demand as in 1979, if only because the physical limits of storage capacity seem to have been reached in many areas. g/ On the other hand, global production is also expected to be somewhat lower than in the preceding year. As noted earlier, a number of OPEC member countries - Kuwait, the Libyan Arab Jamahiriya and Venezuela - have already announced output cutbacks which add to 1.5 million barrels per day; and a return to the old output limit of 8.5 million barrels per day in Saudi Arabia, which appears to be under consideration,

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e/ It may be worth noting that the real price experience of different consumer countries varied substantially from that shown in table A-7, owing to the fact that the oil price is quoted in United States dollars. Consumer countries whose currency appreciated against the dollar - for example the Federal Republic of Germany and Japan - experienced much sharper drops in the real price of oil after 1974, while the opposite holds true for depreciating countries. By the same token, the recent firming of the dollar imposes on many countries sharper real increases in oil costs in 1979 and 1980 than those noted above.

f/ Table A-6 provides some very approximate projections of the possible dimensions of consumption change. The bulk of the 1.5 million barrels per day consumption cut in developed market economies is expected to occur in the United States of America (-0.8 million barrels per day) and Western Europe (-0.7 million barrels per day).

g/ Government stockpiling, such as the potential United States programme discussed early in the year, which could easily add a demand for about 1 million barrels per day to the oil market, could in any case be pursued only in agreement with producer countries providing for an appropriate adjustment in output levels.

Table A-7. Crude petroleum: indices of nominal and real prices in world trade, 1972-1980

(1975 = 100)

Item	1972	1973	1974	1975	1976	1977	1978	1979 I	1979 II	1979 III	1979 IV	1980 a/ I
Nominal export prices												
OPEC reference price of petroleum (Saudi Arabian light 34° API)	18	21	91	100	107	115	118	126	146	168	205	243
Average world export price of petroleum	22	29	100	100	106	117	117	126	155	184	215	263
Unit value index, exports of developed market economies	59	72	89	100	100	109	123	135	137	144	148	155
Real export price of petroleum b/												
OPEC reference price	30	29	102	100	107	105	96	93	106	117	138	157
Average world export price	37	40	112	100	106	107	95	93	113	128	145	170

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data in Monthly Bulletin of Statistics, various issues, and Petroleum Intelligence Weekly (19 November 1979).

a/ Preliminary estimates.

b/ Purchasing power of petroleum over exports of developed market economies, obtained as the ratio of petroleum price indices over the export unit value index.

could withdraw another million barrels per day from the oil supply stream. h/ The growth of output in other areas - notably the North Sea, Mexico, the USSR and China - is not expected to be large enough to offset these cutbacks. Furthermore, in some of these areas - notably in the European centrally planned economies, but perhaps also in China - internal absorption is likely to pre-empt most of the growth in output, and supplies to the world market from these areas may not increase much. On balance, this leads to the conclusion that the supply and demand equilibrium on the international petroleum market is likely to remain quite precarious in 1980 and could easily be upset by unanticipated events. By the same token, a real easing of price pressure should not be expected.

Indeed, in contrast to attitudes adopted after the last major price increase in 1973-1974, the recent advance in price is seen by most observers as the first phase of a long-term upward movement, which is uncertain only in regard to its pace and continuity. The expected depletion of the global reserves of the more easily exploitable fuels, the consequent incentive for the owners of these reserves to contain the rate of exploitation in expectation of higher prices in the future and the rising cost of developing and operating alternative energy sources are the main factors determining this movement. A major policy issue, as the world economy thus enters into a period of rising real costs of energy, is then the management of the adjustment process in order to avoid unnecessary dislocations resulting from sudden, massive changes in prices or supplies.

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h/ The estimates for 1978 in table A-6 reflect only the production cutbacks already announced, and thus do not include the effect of a possible output reduction in Saudi Arabia.

III. PROSPECTIVE SUPPLY AND DEMAND FOR OIL

Past experience has shown that the market for oil is strongly affected by variations in supply. In the short run a slight shortage in oil supply, in the order, say, of 5 per cent, can send oil prices up very high. While, in the long run, supply is largely determined by the state of the oil reserve, output levels are affected by Governments' attitudes and policies on such matters as energy conservation, the speed of modernization and decisions not necessarily based on purely economic considerations. The determination of short-term demand is relatively price-inelastic, especially in the developed countries. a/ The principal factors determining the levels of oil consumption are the growth rates of domestic product and energy conservation ratios.

To establish the likely oil balance-sheet for the world as a whole for the short and medium term from 1980 to 1985, an exercise has been carried out with a view to assessing the magnitude of the probable surpluses or deficits involved. b/

Projections for the baseline case (see table A-8) appear to convey the following message: "World production of oil, which has stagnated since 1974, is not expected to rise faster than 0.6 per cent per annum. This would be due to an absolute reduction of output in the developed market economies after 1982, a virtual stagnation of output in the oil-exporting developing countries, and an assumption of a very slow increase of output in the centrally planned economies after 1980. A relatively fast growth in the domestic production of oil is expected in developing countries, not currently counted among the large oil exporters. However, this would not materially change the overall global balance.

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a/ Recent calculations point to price elasticities of demand for gasoline in the United States of America averaging -0.35 whereas income elasticities tend to be around or slightly in excess of 1.0 (see United States of America, Economic Report of the President, Transmitted to the Congress, January 1980 (Washington D.C., United States Government Printing Office, 1980) pp. 108-109).

b/ The methodology used consists, first, of the evaluation of past trends in the production and consumption in liquid fuels (i.e., oil and natural gas liquids) in various economic country groupings and regions of the world, for the period 1971-1978. Growth rates in the production and consumption of liquid fuels are calculated and elasticities of energy consumption with respect to gross domestic product obtained for the periods 1971-1973, 1974-1977, and 1971-1977. The demand elasticity in this case is defined as the percentage change in oil consumption for each percentage change in real gross domestic product. To take into account possible future energy conservation ratios and the rates of substitution of oil by other sources of energy (e.g., coal, hydro-nuclear electricity, solar energy etc.), past trends in energy consumption and shares of oil in total commercial primary energy consumption have been analysed. Estimates of prospective oil production are based on various projections by national, international and trade sources. They also take note of official government policies and plans regarding oil output and conservation.

Table A-8. Projections of oil production and consumption, 1979-1985 a/

(Millions of barrels per day)

	1978	1979	1980	1981	1982	1983	1984	1985
Production								
Developed market economies	14.1	14.7	15.3	15.1	15.3	14.9	14.4	13.9
Developing market economies	34.5	35.8	34.9	36.4	37.1	37.6	38.3	39.0
Oil-exporting countries	30.7	31.7	30.1	31.1	31.2	31.1	31.0	30.8
Oil-importing countries	3.8	4.2	4.8	5.3	5.9	6.6	7.4	8.2
Centrally planned economies	14.0	14.3	14.6	14.8	15.0	15.2	15.4	15.8
Total	62.6	64.9	64.8	66.3	67.4	67.7	68.1	68.7
Consumption								
Developed market economies	41.1	41.4	39.9	41.1	41.7	42.3	42.8	43.4
Developing market economies	10.1	10.7	11.3	11.6	12.3	13.2	14.1	14.9
Oil-exporting countries	2.2	2.4	2.6	3.0	3.2	3.5	3.9	4.2
Oil-importing countries	7.9	8.3	8.7	8.6	9.1	9.7	10.2	10.7
Centrally planned economies	12.6	13.0	13.4	13.9	14.3	14.8	15.4	15.9
Total	63.7	65.0	64.6	66.6	68.7	70.3	72.3	74.2
Balance b/								
Developed market economies	-27.0	-26.6	-24.6	-26.0	-26.4	-27.4	-28.4	-29.5
Developing market economies	24.4	25.2	23.6	24.8	24.8	24.4	24.2	24.1
Oil-exporting countries	28.5	29.3	27.5	28.1	28.0	27.6	27.1	26.6
Oil-importing countries	-4.1	-4.2	-3.9	-3.3	-3.2	-3.1	-2.8	-2.5
Centrally planned economies	1.4	1.3	1.2	0.9	0.7	-0.4	0.0	-0.1
Total	-1.1	-0.1	0.2	-0.3	-0.9	-2.6	-4.2	-5.5
As a percentage of total consumption	(-0.5)	(0.5)	(0.8)	(-0.5)	(-1.3)	(-3.7)	(-5.8)	(-7.4)

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on information from national, international and trade sources, including official pronouncements by Governments on their production intentions.

Note: Figures in parentheses are percentages.

a/ The baseline case.

b/ Equals excess of production over consumption.

For the world market economies as a whole, including both the developing and the developed countries, based on the projected growth rates of gross domestic product shown in chapter V, the supply and demand for oil would balance for the years 1980-1982, while in each of the consecutive years there would be a deficit in total supply, increasing from 1 to 2 million barrels per day in 1983 to 4 million barrels in 1985. This deficit could be reduced or bridged by lower economic growth, higher oil prices, a greater energy efficiency ratio, a higher interfuel substitution rate, or more imports from other sources. In the centrally planned economies as a whole, the oil surplus of 1.5 million barrels per day in 1980 is expected to disappear by 1984, and a deficit may be possible in the following years.

Thus, for the world as a whole, an increasing oil deficit is expected after 1980, if recent practices and policies in energy conservation and substitution are maintained. Under alternative assumptions, such as slower economic growth rates (3 per cent per annum) and oil conservation ratios (up to 2 per cent annually for the developed market economies), the global supply and demand of oil would be roughly in balance in the immediate future, but deficits would appear after 1982. More improvement in the balance could be due to a more optimistic projection of oil output in the centrally planned economies.

To conclude, the petroleum situation in the world for the beginning of the 1980s is not altogether bright. The economic slow-down of 1980 will ease the situation somewhat, and this relative stability may continue into early 1981. However, as the economic growth of the industrial countries begins to gather momentum in 1981 and 1982, more demand for oil is likely to create a deficit situation and thereby build up pressures for further oil price increases. Much will depend on government policies in the industrial countries to conserve oil consumption in the short and medium term, through the market price mechanism or other means, and to increase energy supplies in the longer term.

Table A-9. Oil balance projections for the world, based on alternative assumptions, 1979-1985

(Millions of barrels per day)

Cases a/	1979	1980 b/	1981	1982	1983	1984	1985
3.3 per cent growth in gross domestic product and 1.0 per cent conservation	-0.3	-0.3	-0.9	-1.8	-3.6	-5.5	-7.0
3.3 per cent growth in gross domestic product and 1.5 per cent conservation (i.e., the baseline case)	-0.1	0.2	-0.3	0.9	-2.6	-4.2	-5.5
3.3 per cent growth in gross domestic product and 2.0 per cent conservation	0.1	0.6	0.3	-0.1	-1.6	-3.0	-4.0
3.0 per cent growth in gross domestic product and 1.0 per cent conservation	-0.3	-0.2	-1.1	-1.7	-3.4	-5.1	-6.4
3.0 per cent growth in gross domestic product and 1.5 per cent conservation	-0.1	0.2	-0.5	-0.9	-2.3	-3.8	-4.9
3.0 per cent growth in gross domestic product and 2.0 per cent conservation	0.1	0.6	0.1	0.0	-1.3	-2.6	-3.5

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

a/ The growth rates of gross domestic product and energy conservation ratios specified for the six cases listed above refer to the developed market economies, while the growth rates for gross domestic product and energy conservation ratios for the developing market economies and the centrally planned economies are held constant in all six cases. For specific details, see the text.

b/ For 1980, the rate of growth in gross domestic product for the developed market economies has been assumed to grow at only 1.0 per cent for all six cases.

Table A-10. Elasticity of total commercial energy consumption and of oil consumption, with respect to gross domestic product a/

	Elasticity of commercial energy consumption			Elasticity of oil consumption		
	1971-1973	1974-1977	1971-1977	1971-1973	1974-1977	1971-1977
Developed market economies	0.81	0.21	0.59	1.23	0.09	0.81
The seven major developed market economies	0.76	0.11	0.53	1.25	0.04	0.81
Major seven, less the United States of America	0.86	0.06	0.57	1.30	-0.61	0.61
Other industrial countries	1.04	-0.13	0.63	0.54	-1.00	-
Primary producing countries	1.33	1.69	1.48	1.81	1.40	1.64
Developing market economies	1.13	1.43	1.28	1.34	1.46	1.40
Oil-exporting countries	1.08	2.19	1.61	1.33	2.54	1.90
Oil-importing countries	1.17	1.21	1.19	1.38	1.15	1.26
Africa	1.86	2.14	2.00	2.10	2.15	2.13
South and East Asia	1.59	1.11	1.28	2.11	1.01	1.41
Western Asia	0.81	2.43	1.48	0.86	2.14	1.39
Western hemisphere	1.01	1.06	1.03	1.05	0.95	1.01
Centrally planned economies	0.78	0.90	0.84	1.41	1.07	1.23

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data provided by the United Nations Statistical Office.

a/ Elasticity is defined as the percentage change in energy consumption with respect to percentage growth in real gross domestic product.

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