

Department of International Economic and Social Affairs

WORLD ECONOMIC SURVEY 1980-1981



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PREFACE

Each year, in accordance with General Assembly resolution 118 (II) of 31 October 1947, the Economic and Social Council, at its second regular session, holds a general discussion on international economic and social policy. In the general discussion, as specified by the Assembly, the Council considers "a survey of current world economic conditions and trends ... in the light of its responsibility under Article 55 of the Charter of the United Nations to promote the solution of international economic problems, higher standards of living, full employment and conditions of economic and social progress and development". The World Economic Survey 1980-1981 has been prepared to assist the Council in its deliberations at the second regular session in July 1981. 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 and is based on information available to the Secretariat as at 1 April 1981.

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Explanatory notes

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

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

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

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

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

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

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

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

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

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

Fractions rather than decimals are used in order to indicate an approximate magnitude.

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 |
| EEC | European Economic Community |
| FAO | Food and Agriculture Organization of the United Nations |
| GATT | General Agreement on Tariffs and Trade |
| GDP | Gross domestic product |
| GNP | Gross national product |
| IMF | International Monetary Fund |
| ISIC | International Standard Industrial Classification |
| LIBOR | London Inter-Bank Offered Rate |
| LINK | International Research Group of Econometric Model Builders |
| ODA | Official Development Assistance |
| OPEC | Organization of Petroleum Exporting Countries |
| SDR | Special Drawing Rights |

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

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

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

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

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

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

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

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

Deficit countries, subdivided into the following two subgroups:

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

Net energy importers: All other developing countries

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

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Chapter I

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

During 1980, there was a decided deterioration in the performance of the world economy. The growth of world output, which had declined from 4.6 per cent in 1978 to 3.8 per cent in 1979, dropped to 2.2 per cent in 1980. Moreover, deflationary forces are still predominant in the world economy and output is expected to weaken further during most of 1981. Poor economic performance was widespread during the past 12 months, with no major group of countries or geographical area escaping. Developing countries experienced a significant decline in the pace at which output advanced, with growth rates falling to 3.9 per cent in 1980. The sharpest decline in performance, however, occurred in the developed market economies where the rate of growth of output fell to 1.5 per cent. In the centrally planned economies, including China, the rate of growth of output declined somewhat to 3.1 per cent.

It was the experience of energy-importing developing countries during 1980 which is particularly disturbing. Rates of growth of output in these countries have weakened steadily during the past several years. In 1980, there was a further substantial drop, with output growing at only 3.9 per cent. Further, when the growth of output is adjusted for changes in the terms of trade, the progressive decline in the pace of growth is even sharper. ^{1/} From a rate of growth of 6 per cent in 1977, it fell to 3.9 per cent in 1978 and 2.9 per cent in 1979. In 1980 it dropped to 1.6 per cent, an advance that was below the rate of population growth for these countries as a group.

The general deterioration in growth performance was accompanied by a very marked slowdown in the expansion of world trade, by worsened imbalances in current accounts and by an acceleration in the pace of inflation. The rate of increase in the volume of world exports, in fact, fell to less than 2 per cent in 1980 from a rate of some 5 to 7 per cent over recent years. The deficits on current account of the developed market economies and the energy-importing developing countries widened very substantially, while the position of the energy-exporting countries was greatly strengthened: the centrally planned economies also experienced an improvement in their external accounts. The pace of inflation accelerated in most parts of the world, reaching rates unknown for many years.

^{1/} When the terms of trade decline, a given level of production for export will purchase a smaller volume of imports than had previously been the case, and the availability of goods and services to the economy will be correspondingly lower. Such changes in the prices of imports and exports have occurred for energy-importing developing countries in recent years: their terms of trade declined by 3 per cent in 1978 and 5 per cent in 1979; they then fell by 7 1/2 per cent during 1980. Besides these changes in the terms of trade, account has also been taken of actual net capital inflows. Thus, the figures measure the changes in the availability of real goods and services.

The events of 1980-1981 mark the second major period of recession in the world economy during the past 10 years. Although the current recession is not likely to be as deep as that which occurred in 1975, it will clearly be of longer duration and of broader scope. It will also be costly in terms of human resources idled: in the developed market economies more than 20 million members of the work force were unemployed at the end of 1980, and the lessening of unemployment and under-employment in developing countries can only have suffered a comparable setback. Moreover, the current recession has come after a period of only hesitant recovery in the developed market economies and of sluggish or declining growth trends in developing and centrally planned economies. Although some recovery in growth rates is anticipated beginning in late 1981, the pace of advance is not expected to be vigorous. The poorer medium-term trend that has been in evidence since the mid-1970s is thus likely to continue. One important consequence is that prospects for early movement toward the objectives of the new International Development Strategy have been dimmed.

The remainder of the present chapter comments selectively on developments during 1980, giving special attention to the way in which recent disturbances were transmitted throughout the world economy and to emerging changes in the character and functioning of the trade and payments system.

Trade, growth and developing countries: recent experience

During the course of 1979, a clear consensus emerged in industrial countries that the latest round of oil price increases should give rise to prompt adjustment. This consensus was accompanied by agreement that inflation was the principal policy problem and that policies of demand constraint were called for. An important expression of this stance was the view that monetary policies should not accommodate all of the inflationary pressures being generated in domestic economies. Thus the tendencies toward recession which were, in any case, in evidence as a result of the weakening of the cyclical upswing that had begun in 1976 were reinforced by general policy measures as well as by the expenditure-reducing effects of the oil price increase itself. Activity turned down in a number of developed market economies in the first half of the year and by mid-year weakness had emerged in all these economies, with rates of growth in the second half of the year distinctly below those achieved in the first quarter.

These events in the developed market economies had their effect on the external transactions of developing countries. The slide into recession during the year weakened demand for the exports of developing countries. Prices of metals and agricultural raw materials declined after the first quarter of 1980. At the same time, prices of beverages fell precipitously, owing primarily to supply factors, and the prices of oil seeds declined. The volume of exports of energy-importing developing countries grew less rapidly than in 1979, but the 5 per cent rate of advance in 1980 was none the less impressive in the light of market conditions in the major industrial countries. In particular, exporters of manufactures were apparently reasonably successful in maintaining the pace of their sales during 1980. There is evidence that the relatively good export performance of these countries resulted in part from their capacity to shift exports to the rapidly growing markets of energy-exporting countries. Even taking this into account, however, it appears that the negative effects on the trade of developing countries resulting from recession in the developed market economies was less than would have been expected on the basis of past experience.

A major source of pressure on the external payments of developing countries was exerted through the rising cost of imports. Oil prices were, on average, some 64 per cent higher in 1980 than in 1979. Continued price inflation in the developed market economies further raised the import costs of developing countries. The unit values of exports of industrial market economies rose by 14 per cent in 1980 over levels reached in 1979.

Another source of additional pressure on external accounts which came to the forefront in 1980 was interest rate changes. In late 1979, United States monetary authorities decided to attach greater importance to the growth of monetary aggregates and less to levels of interest rates. The resulting sharp increases in interest rates, which, after some respite in mid-1980, returned in the final months of the year, were rather quickly transmitted to the Euro-currency market. Since a major part of the outstanding loans of developing countries in the market carries variable interest rates, higher interest rates translated directly into higher interest payments. It appears that interest payments of energy-importing developing countries may have increased by \$6 to \$8 billion in 1980 over their levels in 1979, mainly because of higher interest rates rather than higher levels of indebtedness.

The cumulative impact of the above phenomena - recession, higher prices of imports and larger interest payments - on the external accounts of the energy-importing developing countries can be examined by measuring the purchasing power of these countries' exports after taking account of their need to meet interest payments and oil import requirements. This measure ^{2/} indicates that the external purchasing power of energy-importing countries over goods from developed market economies was reduced by about 2 per cent in 1978 and declined slightly in 1979. In 1980, however, the measure shows a drop of about 10 per cent. Somewhat more than one half of the deterioration in 1980 was the result of higher interest payments and costs of imports from developed market economies, and somewhat less than half was higher oil prices. Thus, for three years running, energy-importing developing countries have seen the purchasing power of their exports decline and this tendency accelerated noticeably in 1980.

The incidence of this decline was much different in 1978-1980 from 1974-1975. In the earlier period, the general fall in commodity prices and rise in petroleum prices generated reductions in earned purchasing power for a broad spectrum of energy-importing developing countries. In 1979-1980, on the other hand, commodity prices remained relatively strong and a major source of disturbance was through the effects of higher interest rates. Consequently, declines in purchasing power were much more concentrated in countries that had significant industrial sectors dependent on energy imports and/or that were significant borrowers in Euro-currency markets. When the measure described in the preceding paragraph is calculated for 10 major countries with relatively large industrial sectors and/or substantial borrowings in the Euro-currency market, the calculations indicate that these countries suffered a decline in earned purchasing power of as much as 25 per cent in 1980. ^{3/} For this smaller group of countries, the difficulties encountered in 1980 appear to be of the same order of magnitude as those experienced in the earlier period.

^{2/} Constructed by subtracting the value of oil imports and interest payments from export earnings and deflating the remainder by the index of export unit values of developed market economies.

^{3/} The 10 countries in question are Argentina, Brazil, Chile, Colombia, India, the Ivory Coast, the Philippines, the Republic of Korea, Thailand and Turkey. Almost all of these countries are also exporters of primary commodities and, for some of them, movements in the prices of individual commodities also influenced the external accounts.

This is not to say that other energy-importing developing countries escaped difficulties emanating from deceleration of exports and adverse terms of trade. The poor trade results obtained by these countries in 1979 continued in 1980, and the unsatisfactory advance in external purchasing power was a tight constraint on growth and on development policies.

The situation was especially serious for the poorer energy-importing countries, particularly those exporting tropical beverages and oil seeds, both because the recent economic performance of these countries has been so disappointing and because their capacity to adapt to adverse external events is limited.

For the energy-importing developing countries as a group, the pressure on external accounts in 1980 was clearly severe. Although the volume of imports was allowed to grow by only 1 per cent, the trade balance deteriorated substantially and the deficit on current account widened from \$48 billion in 1979 to \$72 billion in 1980. The outlook for 1981 is for a continuation of adverse trends affecting the external accounts of energy-importing developing countries. It is difficult to foresee an acceleration in their export earnings; although energy price increases will moderate as compared with 1980, they will nevertheless remain significant; interest rates can be expected to remain at high levels; and there is little expectation for moderation in price increases in the developed market economies. Thus, the present external disturbances are much more persistent than those which occurred in 1974-1975. The stagnation or reduction in earned external purchasing power is almost certain to persist into 1981; and if this occurs, 1981 will be the fourth consecutive year of decline.

Finance, adjustment and development

The worsening of the current trade and payments position of the energy-importing developing countries over recent years has outpaced improvements in the underlying circumstances affecting capital flows. In fact, the ability of the international financial system to cushion energy-importing developing countries from unfavourable disturbances from abroad and the willingness and capacity of those countries to use the system have both been significantly reduced in the past several years.

The official development assistance provided to developing countries by developed countries has not expanded significantly in recent years. Indeed, when measured in real terms, such flows appear to have stagnated or even declined slightly. There has been a significant increase in lending, including lending on concessional terms, by oil-exporting countries. While these have played a useful role, it is clear that the availability of concessional finance to low-income countries generally has not responded in an elastic fashion to the deterioration in their over-all economic situation.

In previous years, countries with access to private capital markets have enjoyed a greater degree of freedom in managing their external accounts and have been able to influence the distribution of payments pressures between adjustment and financing. These countries still enjoy greater flexibility than do countries without access to private markets. However, the range of options facing them has narrowed considerably. The heavy burden of external indebtedness acquired in earlier years is a factor which now obliges countries to respond more promptly to

disturbances in the external accounts. The high cost of loans obtained from private markets has made potential borrowers wary of policies that imply continuous increases in recourse to these markets. At the same time, the shortened maturity of debt outstanding has increased the problem of cash flow management, requiring more cautious policies on the part of borrowers. This tendency is reinforced by general uncertainties regarding the future evolution of the world economy and the perception that the scope for increases in export earnings and improvements in the terms of trade is limited. For their part, private lenders have expressed growing concern regarding the extent of their risk exposure to some developing country borrowers and regarding the adequacy of the equity underpinning their lendings.

Hesitancies of this character resulted in a marked reduction in the pace of new commitments of medium-term banking loans to developing countries. With payments pressures growing, this led to more substantial use of other kinds of financial facilities, including greater recourse to short-term financing and renewed interest in increasing direct investment inflows. More credit is also being provided directly from oil-exporting countries, including loans on commercial terms granted directly by those countries or financial institutions associated with them.

Financial stringency gave rise to increased recourse by countries to official payments finance, the character and role of which evolved during the year. Structural adjustment lending by the World Bank was initiated in 1980. Such loans were granted to five countries and had a total value of \$640 million. The main expansion in official payments financing, however, occurred through the International Monetary Fund. While total borrowing from IMF by energy-importing developing countries amounted to only \$350 million in 1978 and \$1.8 billion in 1979, this reached \$3.2 billion in 1980. A substantial proportion of these funds was made available through facilities carrying longer maturities than regular tranche drawings. Also of importance during 1980 was the use by energy-importing developing countries of SDR holdings to settle external imbalances, which amounted to \$1.3 billion over the course of the year. Use of financial facilities and instruments made available through IMF accounted for about 20 per cent of the additional external financing required by these countries in 1980 compared with some 8 per cent in 1979. Moreover, undrawn amounts under stand-by agreements and other facilities totalled over \$7 billion at the end of 1980, suggesting that the flow of funds through IMF in 1981 may also be substantial.

The general background against which the Fund participated in financing the external payments of developing member countries was quite different in 1980 from previous years. In 1974-1975, it was seen that the deficits of energy-importing developing countries were a part of the aggregate deficit that is the counterpart of the structural surpluses of some oil-exporting countries. Since the magnitude of this structural surplus was seen as unlikely to change significantly over time, it was recognized that any attempt by an individual country to reduce its current account deficit through deflationary demand policies or other means would only shift the deficit onto other countries. Because of the appreciation of these interrelationships, the IMF Oil Facility was established to provide member countries with resources at low levels of conditionality.

Although the same considerations are relevant to the situation of deficit countries in 1980-1981, the policy stand of the international community is quite

different and greater emphasis is being given to adjustment. As the Managing Director has recently stated, "in the period following the first oil shock, approximately three quarters of the resources provided by the Fund to its members were made available on terms involving a low degree of conditionality. At present, by contrast, some three quarters of new lending commitments involve upper credit tranche programmes, that is to say, they require rigorous adjustment policies". 4/

It is true, however, that the working definition of adjustment policies has evolved during the period between 1974-1975 and 1979-1980. As the Managing Director states further in the passage quoted above, IMF has come increasingly to recognize "that to rectify a balance of payments position may also require structural change in the economy and that these may take longer than the one to three years normally set as the length of our programmes. Thus, while we continue to stress the importance of appropriate demand management, we now systematically emphasize the development of the productive base of the economy and we contemplate that countries may, therefore, need our financing for longer periods". 5/

To the extent that adjustment policies continue to be aimed primarily at reductions in expenditure and in the magnitude of external deficits, the considerations recognized in 1974-1975 continue to be relevant: since the counterpart deficit of the surplus of oil exporters cannot be reduced unless that surplus itself is diminished, attempts to adjust the deficit of a single country or of a group of countries can only result in a lowering of income and levels of activity in those countries while shifting the deficit onto other countries. If countries are to be able to return to a situation characterized by vigorous growth and a sustainable payments position, further emphasis in adjustment policies needs to be given to the restructuring of their productive base. For this to be achieved, they must have sufficient time and sufficient resources to effect the necessary new investments.

Contrary to some impressions, very considerable adaptation has already taken place in energy-importing developing countries over the past several years, and this has had a decided positive effect on the external accounts. During the period 1974-1980, the volume of imports of energy-importing countries, when measured as a proportion of real GDP, was virtually unchanged. The volume of exports, on the other hand, advanced steadily over the period from somewhat less than 16 per cent of GDP in 1974 to more than 20 per cent of GDP in 1980. Consequently, when the trade deficit of these countries is measured at constant prices, it moves from a peak of 5.4 per cent of GDP in 1974 to 3.7 per cent in 1978 and 1.5 per cent in 1980. The widening of the deficit measured in current prices that has occurred since 1978 has thus masked a substantial adjustment of the deficit measured at constant prices.

The possibilities undoubtedly exist for further substantial adjustment principally through import substitution in the energy sector and swift exploitation of new opportunities for export. The potential for rapid development in the

4/ International Monetary Fund Survey, 9 February 1981, p. 35.

5/ International Monetary Fund Survey, loc. cit.

production of energy is great in a large number of developing countries. Moreover, recent increases in the price of petroleum have opened up new possibilities for production and export of commodities, such as jute, cotton and natural rubber, that compete with petroleum-based synthetics. Developing countries are also able to develop successful export products in a number of other areas. However, efforts to adjust external positions through rapid import substitution in the energy sector and expansion of exports require substantial investment, and a potential conflict therefore exists between the need to increase expenditure to bring about adjustment over the medium term and the perception that, in the short run, expenditure must be constrained for balance-of-payments reasons. In economies having considerable flexibility with regard to the allocation of resources and the capacity to increase savings at the expense of current consumption, this conflict may not be pronounced. In developing countries, however, this kind of flexibility is rarely present, so that programmes necessary to bring about adjustment over the medium term may require increased aggregate expenditure in the near term. Policies which fail to take this into account and which require reductions in expenditure as part of a payments adjustment programme may bring about a better balance between aggregate supply and demand in the short run, but at the expense of the more fundamental adjustment that is required in the longer run.

The experience of energy-importing developing countries in recent months indicates that the international financial system has not had the ability to protect adequately the process of growth from disturbances emanating from abroad. This contrasts with the experience of 1974-1975 when recourse to external financing allowed the volume of imports to advance and growth proceeded at relatively high, though somewhat diminished, rates. In 1980, however, the volume of imports of energy-importing developing countries grew by only 1 per cent and growth dropped to the lowest levels recorded in the past decades. The capacity that developing countries had in 1974-1975 to "de-link" their own growth performance from that experienced in the rest of the world appears, for the time being at least, to have been lost.

The financing of deficits and the evolution of the financial and payments system

During 1980, there was a severe strain on the external accounts of a large number of countries, both developed and developing. In the process of dealing on a day-to-day basis with urgent requirements for external financing, Governments took decisions of a short-run character that may bring about significant changes in the structure of the financial and payments system.

One example of this phenomenon was the efforts of a number of developed market economies to finance their payments deficits by issuing liabilities denominated in their own currencies. Until quite recently, the authorities of the Federal Republic of Germany and Japan had resisted attempts to allow their currencies to play the role of reserve currencies, and the reserve role of the French franc occurred only in the context of the franc zone. The magnitude of the current account deficits of these countries in 1979 and 1980, however, has led to revision of these policies as Governments sought ways of attracting external financing at the lowest possible cost.

Investment in yen and official Deutsche Mark denominated assets has so far been restricted to surplus countries and investors in those countries have

consequently been able to diversify their investment portfolio, particularly with respect to currencies in which assets are denominated. The new facilities thus help meet the policy objectives of the surplus countries as well as the deficit countries concerned. The liquidity of the investments made by surplus countries in currencies other than the United States dollar is somewhat unclear, and the funds held would not fulfil all of the functions usually assigned to reserve currencies. ^{6/} Nevertheless, the process which has been under way during the past year and a half has enhanced the role of the currencies concerned as international reserve assets.

The arrangements entered into between surplus countries and some developed market economies are limited in scale and their continuation undoubtedly depends on the evolution of the external accounts of these developed market economies. One of the ironies of the present situation is that investors have long desired to hold assets in those currencies because the currencies themselves were strong. Yet, the opportunity for acquiring these currencies is occurring when some of the countries concerned are running substantial deficits and their currencies are experiencing weakness. The dilemma which plagued the old Bretton Woods system - namely that dollars could be supplied to international holders only when the United States payments were in deficit while continued United States deficits weakened the dollar - is also present in the new situation.

A further irony is that the number of countries able to settle external deficits by issuing their own indebtedness has increased substantially. In the past, one of the weaknesses and inequities of the Bretton Woods system and of the arrangements that evolved during the 1970s was that whereas the United States, as the principal issuer of reserve currencies, was able to finance external imbalances by issuing dollar debt, other countries were subject to the discipline implied by finite reserve holdings. This weakness was addressed in the deliberations on reform of the international monetary system undertaken by the Committee of 20 and was to be eliminated, within a broad package of reform, by the introduction of asset settlement for all countries. Now, instead of being eliminated, this privilege is being extended to a wider but still select group of countries, including some that were severe critics of this practice in the past.

Borrowing by developed market economies is essential if these countries are to shoulder an appropriate share of the counterpart deficit. The procedures adopted, however, appear to be contributing to a gradual and unplanned evolution toward a multicurrency reserve system. Continuation of this evolution could have a number of possible consequences for the system as a whole: international liquidity may be more difficult to control, the future of SDR is likely to be affected and exchange rates may be subject to increased pressures. Yet, not only is this evolution taking place outside the ambit of the international decision-making process and as the by-product of the needs of a small number of countries, but the potential advantages and disadvantages to the system of these developments have never been explicitly examined in the relevant international bodies.

Reviving the world economy: the scope for international policy co-ordination

Revival of the world economy is attendant on finding a successful approach to

^{6/} They would not, for example, be used to any significant extent for the purpose of intervening in foreign exchange markets.

the problem of inflation in the market economies. Such an approach would allow adjustment to lower rates of price increase to take place in the context of vigorous growth. Policies that depend solely or primarily on restraint of aggregate demand are unlikely to be successful in this sense and can restore greater stability in prices only at the cost of an extended and painful period of under-utilization of economic potential. Although transition costs in moving to greater price stability are inevitable, it is likely that these will be minimized by a broad and multifaceted set of policy measures designed to tackle inflation without arresting growth. The particular combination of measures would vary from country to country and a pragmatic approach to the search for such a combination in each country is required. The major ingredients are reasonably clear, however. They include some continued monetary and fiscal restraints (although the mix of these two elements may require changes, and their intensity may need to be moderated in some countries); encouragement of greater personal and business savings, a search for social and political consensus on the distribution of real income losses, where such losses are inevitable; and incentives to effect rapid changes in productive structures made inevitable by changes in relative prices and comparative advantage.

A strong stand against protectionism would be an essential ingredient in all countries. Although increased protectionist pressures have been present in the developed market economies for some years, in recent months they have intensified markedly. If these pressures are not resisted, there is a danger that the process of adaptation in the developed market economies will be slowed, inflationary pressures intensified and trade, including trade with developing countries, lowered from levels that would otherwise have occurred.

Policies to deal with the joint problems of inflation and growth are principally matters requiring elaboration at the national level. Recent experience has demonstrated that anti-inflationary policies pursued in one country can have significant repercussions on others. The effect on developing countries of higher interest rates in the Euro-currency markets was mentioned earlier. Among the developed market economies, through interactions between interest rates, capital flows, exchange rates and increases in domestic prices, anti-inflationary policies of major countries may induce others to take restrictive measures not warranted by the level of current economic activity. In early 1981, for instance, the high interest rates in the United States contributed to the depreciation of the German mark. The authorities of the Federal Republic of Germany responded to the resulting upward pressure on prices by tightening credit conditions and interest rates, which may be expected to accentuate the weakening in domestic economic activity already evident. Thus, anti-inflationary policies in one country contributed to losses of output in another, adding to the forces tending to depress world demand for imports.

The management of the international aspects of anti-inflationary policies thus requires greater attention. Here again, international management is likely to be more successful when individual countries are relying on a broad range of measures for combating inflation, and are prepared to adjust at the margin this mix of policies in the light of international requirements. A case in point is the proposal that developed market economies should agree on a co-ordinated reduction in interest rates designed to stimulate investment and economic recovery. Although such a co-ordinated reduction could have obvious advantages 7/ it is

7/ A recent study using the LINK model has concluded that a co-ordinated reduction of interest rates by 2 percentage points could lift growth rates in developed market economies by as much as one half percentage point. See L. R. Klein, R. Simes and P. Voisin, "Co-ordinated monetary policy and the world economy" (mimeo., March 1981).

unlikely to be feasible as long as one or more major country is relying solely on monetary policies to combat inflation and those policies imply high interest rates. It is possible to enter into international co-ordination of interest rates or of any other policy variable without damaging national anti-inflationary programmes only when those programmes are being undertaken through a wide variety of policy measures.

Revival of the world economy also requires that close attention be given to the management of deflationary forces in the system. An important consideration in this regard is policies influencing the deficit which is the counterpart of the surplus of some energy-exporting countries. The likely continuation of this surplus over the medium term has, as its inevitable consequence, the maintenance of deficits of comparable magnitude elsewhere in the system. Attempts to eliminate them by applying restrictive policies in the particular countries in which the deficit has emerged can only result in an intensification of deflationary forces within the system as a whole and a shifting of the deficit onto other countries. While this phenomenon is widely recognized at the level of general analysis, it has yet to be applied in a systematic way to the analysis of the payments situation of individual deficit countries.

This failure has particular consequences for energy-importing developing countries, which bear a large proportion of the counterpart deficit. As mentioned earlier, these countries require substantial additional resources from abroad in order to bring about the rapid adaptation of their productive structures to the increased price of energy and the need to enhance export earnings. The development of new mechanisms for transforming the financial claims of surplus countries into development finance could play an important role in this regard. Another area of concern is the needs of low-income countries which depend primarily on concessional flows and for which adaptation of the productive structure is often particularly difficult. In 1980 the elastic component of official financial flows was not concessional development assistance, but official payments financing. This suggests the need for further efforts to enhance the capability of IMF to make funds available to its members at costs appropriate to their stage of development. It also suggests that Fund policies and activities are playing a larger role in determining the distribution among developing countries of deficits and the consequent absorption of resources from abroad. This trend seems likely to continue, provided that the Fund succeeds in securing additional resources. Fund policies will thus have increased importance in influencing patterns of development and economic performance in developing countries.

The events of 1980 and early 1981 have brought numerous changes in the operation of the world economy and the benefits it yields to its members. In general, these changes have not been for the better. In August 1980, the international community declined the opportunity to embark on global negotiations designed to "contribute to the solution of international economic problems, within the framework of the restructuring of international economic relations, and to steady global economic development ...". The need to enhance the capacity of the international community to find effective solutions to these problems, none the less, remains acute.

Chapter II

WORLD ECONOMIC ACTIVITY: CURRENT TRENDS AND POLICIES

Sharp slowing of world growth in 1980 and poor outlook for 1981

The pace of world economic growth fell in 1980 to the lowest rate experienced since the 1975 recession. The growth of world output, which had slowed down in 1979, declined further in 1980 to a rate of just over 2 per cent. The expansion of industrial production was only about 1.5 per cent and agricultural output stagnated near the level reached in 1978 (see table II-1).

The deceleration of growth over the last two years has been world-wide, affecting both market economies and centrally planned economies. Trade linkages contributed towards spreading the slowdown throughout the world economy. The rate of increase of the flow of goods among countries declined even more sharply than that of production - from 6-7 per cent annually in recent years to about 1.5 per cent in 1980.

The present slowdown has not been as sharp as in 1975 when over-all growth came to a virtual standstill and world industrial production declined in absolute terms. It has, however, come after a period of only hesitant recovery in the developed market economies and of sluggish or declining growth trends in developing economies and centrally planned economies. The forces which might make for a resumption of growth are weak in all parts of the world economy, and the recessionary trough is likely to be of longer duration than that in the preceding downswing. The forecasts for the developing and developed market economies and the national economic plans of the centrally planned economies all anticipate growth rates for 1981 that essentially repeat the 1980 performance. Moreover, the acceleration projected for the developed market economies in 1982 is hardly impressive in view of the fact that it would constitute the recovery phase of the cycle.

The poor current performance of the world economy is not only a reflection of a cyclical downturn in the economic activity of developed market economies; it is also indicative of a general trend towards slower economic growth that has persisted for some years. While there is considerable controversy and uncertainty about the nature of the forces at work, there are clearly a number of difficult circumstances which confront policy-makers in their endeavours to improve the performance of their economies. These include entrenched inflationary tendencies, the need to adapt both productive structures and consumption to higher energy costs, intensified balance-of-payments constraints, and in the developed economies, the slow growth of investment and productivity. There appears to be a spreading realization that these circumstances will not be quickly removed, and accordingly, expectations for economic growth in the medium term are generally not optimistic.

For a large number of countries, particularly energy-importing countries, 1980 was a year in which the terms of trade deteriorated further. This, together with other factors, put severe strains on the external accounts of many countries. A large number of countries, particularly developing countries and some of the

Table II-1. World production: annual growth rates of output volume,
by country group, 1971-1981

(Percentage)

| Item and country group <u>a/</u> | 1971- 1980 | 1976- 1978 | 1979 | 1980 <u>b/</u> | 1981 <u>c/</u> |
|---------------------------------------|---------------|---------------|-------|----------------|----------------|
| <u>Gross domestic product d/</u> | | | | | |
| World | 4.3 | 4.8 | 3.8 | 2.2 | 2 |
| Developed market economies | 3.5 | 4.4 | 3.7 | 1.5 | 1 1/2 |
| Developing countries | 5.7 | 5.3 | 4.8 | 3.9 | 4 |
| Centrally planned economies <u>e/</u> | 5.5 | 5.5 | 3.3 | 3.1 | 3 1/2 |
| <u>Agricultural production f/</u> | | | | | |
| World | 2.4 | 3 | 1 | 0 | ... |
| Developed market economies | 2.0 | 2 | 2 1/2 | -2 | ... |
| Developing countries | 2.8 | 3 1/2 | 0 | 2 1/2 | ... |
| Centrally planned economies | 2.6 | 3 | -1 | 1 | ... |
| <u>Industrial production g/</u> | | | | | |
| World | 4.3 | 5.6 | 4.4 | 1.5 | ... |
| Developed market economies | 3.3 | 5.4 | 5.0 | 0.4 | ... |
| Developing countries | 4.6 | 5.6 | 2.4 | 1.8 | ... |
| Centrally planned economies <u>e/</u> | 6.6 | 5.9 | 4.1 | 3.8 | ... |

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

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

b/ Preliminary estimates, based in some cases on data for a period of less than 12 months. Estimates for the developing countries are based on a sample of 70 countries which jointly account for more than 90 per cent of the population and for 95 per cent of the aggregate gross domestic product of the group.

c/ Forecasts.

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

e/ China, Eastern Europe and the USSR only.

f/ Based on gross output indices prepared by FAO. Data for 1980 are estimates as of December 1980. The 10-year growth rates reflect growth trends obtained by fitting regression lines to the data points.

g/ Based on indices of value added, except in the centrally planned economies for which the indices are based on gross output at constant prices. The coverage is International Standard Industrial Classification categories 2-4, that is, mining, manufacturing, and electricity, gas and water.

trade-intensive economies of Eastern Europe, adopted policies designed to reduce external imbalances. In other countries, expenditure was reduced as part of governmental programmes to deal with inflation. Most Governments, consequently, shared the dilemma of how to bring expenditure into line with resource availabilities while simultaneously channelling significant new investment into those sectors constraining present and future growth. Moreover, these objectives had to be sought in a context in which there were strong political pressures to avoid a decline in real income. The difficulties inherent in such a situation were substantial, and many countries experienced stagnation or significant cutbacks in investment expenditure. Most countries thus find themselves in the difficult position of attempting to restructure their productive sectors at a time when growth is slow, the increment in available resources is small and its use is strongly contested by various economic groups.

Setback in developing countries linked to world downturn

In the developing countries, after two years of only very moderate expansion, over-all economic growth declined in 1980 to a rate barely above that in 1975, when the world economy was in the trough of the steep recession of the mid-1970s. Inclusive of the poor performance in 1980, the annual growth rate for the period commencing in 1971 averaged 5.7 per cent, appreciably short of the target set for the Second United Nations Development Decade. 8/

The slower growth in 1980, which occurred in spite of a strong agricultural performance in most regions of the developing world, was accompanied by sharply increasing balance-of-payments deficits and double-digit inflation in the majority of countries. Both these factors effectively constrained national Governments in pursuing policies to enhance growth. Moreover, in view of the expected continued weakness in the world economy and in external demand, the outlook for an acceleration of growth in the developing countries in 1981 is not encouraging.

All groups of developing countries experienced a setback in 1980, but its sharpness varied significantly (see table II-2). The growth rate of energy exporters declined by 1 1/2 percentage points, a drop which in part mirrored the decrease in the volume of oil production and exports, but also reflected the economic consequences of the Iran-Iraq war. The deficit countries among the group of energy exporters - more diversified economies less dominated by petroleum production, but relatively free of serious import constraints - were able to maintain a substantial pace of growth.

The rate of increase of gross domestic product in the energy-importing countries of 3.9 per cent in 1980 was the lowest rate achieved in any year in the

8/ If gross national product weights of the year 1970, instead of 1978, were used to aggregate national growth data for the decade, the 1971-1980 growth rate for developing countries as a whole would, in fact, fall to 5.0 per cent.

Table II-2. Developing countries: rates of growth of real gross domestic product, 1971-1980 a/
(Percentage)

| Country group <u>b/</u> | 1971- 1976- | | 1973 | 1979 | 1980 <u>c/</u> | 1981 <u>d/</u> | 1982 <u>d/</u> |
|---|-------------|------|------|------|----------------|----------------|----------------|
| | 1980 | 1978 | | | | | |
| Developing countries | 5.7 | 5.3 | 4.6 | 4.8 | 3.9 | 4 | ... |
| Net energy-exporting countries of which: | 5.8 | 5.2 | 4.1 | 5.5 | 4.0 | ... | ... |
| Capital surplus countries | 6.1 | 4.3 | 1.5 | 4.0 | 0.5 | ... | ... |
| Other countries | 5.6 | 5.9 | 5.8 | 6.5 | 6.1 | 6 1/2 | 6-7 |
| Net energy-importing countries | 5.6 | 5.4 | 5.0 | 4.3 | 3.9 | 4 | 4-5 |

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

a/ Growth rates computed for a sample of 70 developing countries which jointly account for more than 90 per cent of the population and for 95 per cent of the aggregate gross domestic product of the group. Country data have been aggregated with 1978 gross domestic product weights.

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

c/ Preliminary.

d/ Forecast.

1970s. 9/ The rate of growth of manufacturing production declined substantially though agricultural crops generally were good. Taking into account the deterioration in the terms of trade, which was about 7 1/2 per cent in 1980, real national income per capita in these countries fell below the level of the preceding year. Whereas this group of countries grew by nearly 5 per cent in 1975, it did not succeed in insulating itself from the current world recession: the "de-linking" of growth rates, which had taken place in the earlier downturn, could not be repeated. 10/

In these countries, most stimuli to growth were weak in 1980. On the domestic side, the adjustment policies that had been introduced early in 1979 to cope with rising payments deficits and inflationary pressures, coupled with the large deterioration in the terms of trade, depressed internal demand. External demand lagged as a consequence of the recession in the industrial countries, slowing the growth in the volume of exports from 9 per cent in 1979 to 5 per cent in 1980. The resulting constraints on import capacity 11/ led to a sharp drop in the growth of import volume, which advanced by only 1 per cent in 1980.

Downward revisions of development targets have recently been a common response to emerging problems in the energy-importing countries. The outlook for 1981 does not promise any improvement in this respect. A likely scenario for many of these countries has the following ingredients: continuing inflationary pressure, in part externally determined, will slow down public investment programmes and hamper the adoption of stimulative credit policies, thus affecting global demand; the growth in export volume is likely to remain low; a further worsening of the terms of trade is probable; and constraints on import growth will not ease since not enough external financing is likely to become available to compensate for lagging export receipts, rising import prices and mounting debt service payments. Under such conditions, growth in the energy-importing countries in 1981-1982 is unlikely to be significantly above the 1980 rates. What is perhaps more disturbing is the likelihood that stagnant per capita national income in 1981, after the 1980 decline, will not allow for a significant increase in investment in most of these countries; and this, in turn, will jeopardize prospects for an acceleration of growth in subsequent years.

The rate of increase of gross domestic product in the net energy-exporting countries fell to 4.0 per cent in 1980 from 5.5 per cent in the preceding year. The sharp deceleration, however, mainly affected the capital-surplus countries of

9/ The rate of growth declined significantly in 1980 in 29 out of the 46 energy-importing countries for which estimates are available. The growth of total output accelerated, however, in Brazil and India, two of the largest countries of the group, largely owing to significant increases in agricultural production. Owing to their large weight in the group, the performance of these two countries has a significant impact on the growth estimates for the energy-importing group. If they were to be excluded from the measurement, registered output growth of the group would show a much steeper deceleration - from 5.3 per cent in 1979 to 2.1 per cent in 1980.

10/ For an analysis of "de-linking", see World Economic Survey 1979-1980 (United Nations publication, Sales No. E.80.II.C.2), annex I, "External factors and growth in developing countries: the experience of the 1970s".

11/ This point is analysed in chapter IV.

the group, in whose output the volume of petroleum production plays a dominant role. The volume of exports of these countries declined by 11 per cent, and though non-energy activities grew at a substantial pace as development programmes were continued or accelerated, the decline in the volume of petroleum production pulled down the rate of growth in total output. In the other net energy-exporting countries, economic growth continued with very little deceleration at a rate in excess of 6 per cent. Though their export volume declined by 2 1/2 per cent, the large improvement in their terms of trade of more than 30 per cent permitted these countries both to expand their volume of imports by 15 per cent and to reduce their combined external deficit. Among traditional energy exporters, industrial expansion outside of the energy sector continued rapidly or accelerated, and in several of these countries, the rate of increase of gross domestic product was significantly above 6 per cent. 12/ A number of other countries in whose exports energy assumed a significant place in the second half of the 1970s also experienced fast growth in 1980. 13/ As most of these countries still have a relatively small share of energy markets, they have increased oil production and oil exports considerably. This has not only directly affected their over-all industrial production, but has also served to lessen import constraints that were impeding structural change and rapid over-all growth.

The outlook for substantial growth in the non-energy activities of the energy-exporting countries as a group in 1981 hinges on two main factors. These are, first, the effectiveness of the policy measures undertaken by several countries starting in the second half of 1980 to control inflation and secondly, the return of normal conditions in Iran and Iraq. 14/ Some countries are redirecting development efforts to achieve more balanced growth, and the reorientation of investment programmes to activities with longer gestation periods is likely to impede an acceleration of growth in the short run. A return to normal conditions in Iran and Iraq would not only affect the over-all growth rate for developing countries as a group, but is also likely to have a substantial impact on demand for the exports of other developing countries - as well as of industrial countries - once normal trade flows are re-established. Reconstruction requirements will undoubtedly add further to that demand.

12/ Algeria, Indonesia and Nigeria.

13/ Angola, Egypt, Malaysia, Mexico, the Syrian Arab Republic, Tunisia, and the United Republic of Cameroon all registered growth rates above 6 per cent.

14/ Owing to their considerable weight in the combined gross domestic product of energy-exporting countries, the results for these two countries significantly affect the growth in total output of the group.

The recession in the developed market economies

During 1980, the developed market economies experienced their second major recession since 1973. As can be seen in table II-3, rates of growth of gross domestic product for the group as a whole and for all major industrial countries declined sharply in the 1979-1980 period, and only a modest recovery is expected in 1981-1982. What is perhaps of greater concern is the downward long-term trend in growth rates -- from 5 1/2 per cent during 1961-1973, to 2 1/2 per cent in 1974-1980, and a probable 2 1/2 per cent in the recovery period of 1981-1982. The decline in growth rates during the 1970s is due in no small measure to the sluggishness of investment. From the cyclical peak of 1973 to the peak of the most recent cycle in 1978, gross fixed capital formation in the Organisation for Economic Co-operation and Development (OECD) area rose by less than 2 per cent in real terms. ^{15/} A relatively weak recovery, accelerating inflation, uncertainties as to the future course of policies and of economic growth, and exchange-rate volatility have all contributed to depress investment. In addition, since 1973 the developed market economies have been experiencing a transition to less energy-intensive technologies and patterns of production, and this has had its costs in terms of over-all growth.

The slowdown in economic activity leading to the present recession began at the end of 1978, at a time when the developed market economies had not fully recovered from the 1974-1975 recession. In 1978, unemployment rates were not only higher than before 1974 but, with the exception of those in the United States, were actually rising. Thus, the present setback was not the result of an unusually high rate of expansion in the immediately preceding period, as had been partially the case in the preceding recession.

The current situation is similar to 1974-1975, however, in that countries were simultaneously confronted with an external shock which had deflationary effects on aggregate demand and, at the same time, tended to raise costs and to contribute to inflationary pressures. As in 1974-1975, policy responses to the sharp increase in energy prices played an important role in determining the pattern and magnitude of the downturn. Whereas the policy response in 1974-1975 had varied from country to country, some countries attempting to counter the deflationary impact of higher energy prices and other countries paying more attention to mounting inflation, the reaction of Governments this time has been far more uniform. In general, monetary policies have been tightened and discretionary fiscal action has constrained public consumption, thereby tending to counteract the effects of automatic stabilizers which usually tend to operate during periods of recession. ^{16/}

As noted, the increases in imported energy prices themselves had a deflationary impact on the developed market economies. It is estimated that these price increases represented a drain on aggregate demand of 3 per cent of

^{15/} Organisation for Economic Co-operation and Development, National Accounts of OECD Countries, 1950-1978 (Paris, 1980), vol. 1, pp. 80-81.

^{16/} For a more complete discussion of anti-inflationary policies in developed market economies, see chap. III.

Table II-3. Developed market economies: rates of growth
of real gross national product/gross domestic
product, a/ 1978-1982

(Percentage)

| Country or country group | 1961- 1973 | 1974- 1980 | 1978 | 1979 | 1980 <u>b/</u> | 1981 <u>c/</u> | 1982 <u>c/</u> |
|---------------------------------|---------------|---------------|------|------|----------------|----------------|----------------|
| Developed market economies | 5.6 | 2.6 | 4.1 | 3.7 | 1.5 | 1 1/2 | 3 |
| Major industrial countries | 5.6 | 2.7 | 4.5 | 3.8 | 1.4 | 1 1/2 | 3 |
| Canada | 5.6 | 2.7 | 3.4 | 2.7 | 0.1 | 1 | 3 |
| France | 5.6 | 2.8 | 3.6 | 3.2 | 1.4 | 1 1/4 | 2 1/2 |
| Germany, Federal Republic of | 4.5 | 2.4 | 3.6 | 4.5 | 1.8 | -1/2 | 2 1/2 |
| Italy | 5.2 | 2.7 | 2.6 | 5.0 | 3.6 | 1/2 | 3 1/4 |
| Japan | 10.4 | 4.3 | 6.0 | 5.9 | 5.4 | 4 | 4 1/2 |
| United Kingdom | 3.1 | 0.7 | 3.6 | 0.9 | -2.9 | -1 1/4 | 2 1/2 |
| United States | 4.2 | 2.4 | 4.8 | 3.2 | -0.1 | 1 1/2 | 3 |
| Other countries | 5.4 | 2.2 | 2.2 | 2.9 | 1.9 | 1 | 2 3/4 |

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

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

b/ Preliminary.

c/ Forecast.

gross domestic product for the two years 1979-1980, as compared to 2 1/2 per cent in 1974. 17/

The international transmission mechanism among industrial countries tended to magnify the deflationary forces operating within each economy. In general, the growth of real imports from other developed market economies slowed down from almost 10 per cent in 1979 to less than 2 per cent in 1980. Moreover, the only country which could have acted as a growth pole - Japan - did not fulfil this role. Although the decline in growth of Japanese output in 1980 was mild - about half a percentage point - its non-oil imports fell by about 6 percentage points in real terms, as compared to an increase of over 15 per cent in 1979. Furthermore, Japan's strong growth performance in 1980 was due largely to a very sharp increase in exports. Thus, increasing penetration by Japanese exports tended to reduce further the demand for domestically produced goods in Europe and North America.

While the costs of the policies pursued in the developed market economies were severe in terms of foregone output and rising unemployment, they did succeed in limiting increases in nominal wages. The moderate behaviour of nominal wages in 1980 allowed the financial position of the company sector to remain comparatively stronger than in the previous recession. Furthermore, the sharp fall in investment in 1974 and 1975, and the slow recovery afterwards, meant that the net additions to the capital stock since 1973 had been substantially smaller than during earlier periods. This in itself presented opportunities for capital formation, and it was reinforced by the rise in energy costs which stimulated investment in energy production and energy-saving techniques. Consequently, during 1979 and 1980, though there was a mild slowdown, business investment held up relatively well, continuing to expand at a rate which averaged about 0.5 per cent.

The external sector also worked to sustain aggregate demand. The volume of exports expanded at somewhat more than 3 per cent while there was no growth in the volume of imports. Since trade among developed market economies was sluggish, export growth occurred largely in shipments to energy-exporting developing countries.

Most of the deceleration in aggregate demand and output was accounted for by the behaviour of private consumption. The squeeze on real earnings brought about by the economic policies mentioned above was responsible for a drop in the rate of expansion of consumer expenditures from almost 4 per cent in 1978 to only slightly more than 0.5 per cent in 1980. Investment in residential construction and stocks also turned down under the influence of higher interest rates.

The adoption by the major developed market economies of similar policies to deal with rising inflation meant that the course of the recession followed

17/ This deflationary effect results from the fact that energy exporters spent only a fraction of their additional export earnings on imports from the developed market economies. Owing to multiplier effects of a Keynesian nature, the total impact of such an exogenous drain on demand tends to be a multiple of the original shock.

a broadly similar pattern: gross national product peaked in the first quarter and actually fell in the second quarter, the drop at an annual rate of 10 per cent in the United States being particularly sharp. In the next two quarters, a hesitant revival took place.

There are two major exceptions to this pattern - Japan and the United Kingdom of Great Britain and Northern Ireland. The British slowdown started earlier and has been more protracted than that in the other major industrial economies. In Japan, the main source of economic growth during 1980 was the rapid growth of exports. Personal consumption and housing investment remained weak throughout the year, and the growth in government expenditure peaked in 1978 and continued declining through 1979 and 1980. The strength of Japanese exports can be partly attributed to the lagged impact of the effective depreciation of the yen from the fourth quarter of 1978 to the first quarter of 1980. Together with a more favourable performance of labour productivity and generally more moderate wage settlements than in its major trading partners, the depreciation of the yen resulted in a decline in relative unit labour costs of over 30 per cent vis-à-vis other developed market economies between the third quarter of 1978 and the first quarter of 1980.

It is difficult to foresee any major improvement in the growth performance of the developed market economies in the short term. While the recession is expected to bottom out in the second or third quarter of 1981, the forces at work in these economies point to a very weak recovery. Policy concerns continue to revolve around the control of inflation. Moreover, the slow growth of investment since 1973 implies that a revival in economic activity could soon run into capacity bottle-necks in some sectors. Therefore, in the absence of new policy initiatives, sluggish economic growth may well become one of the predominant features of the developed market economies for the foreseeable future.

The greatest uncertainty revolves around the eventual shape and the effect of the package of fiscal measures introduced by the new United States administration that took office in January 1981. In brief, these measures include large cuts in business and personal taxes and reductions in government expenditure, the latter to be achieved by substantially trimming non-defence spending. The full effects of the programme should be felt only in 1982. During 1981, growth should continue to be adversely affected by high interest rates and very modest gains in personal incomes. As for 1982, if most of the fiscal measures proposed are approved by Congress, the fiscal sector would provide a positive stimulus to demand in 1982, and the growth of output may accelerate.

Exports are no longer expected to provide the major source of economic growth in Japan because of trade problems with other developed market economies, the appreciation of the yen since the second quarter of 1980 and the reduction in sales to the Middle East because of the conflict in the area. The current fiscal policy stance implies that government expenditure will not act as a spur to growth. However, the Japanese economy is expected to continue along a fairly vigorous growth path with private investment and consumers' expenditure providing the main stimulus.

In Europe, where the slowdown began later than in North America, the recovery is expected to occur later. In the Federal Republic of Germany, the depreciation of the Deutsche Mark has led to the adoption of restrictive monetary policies and, unless there is a substantial lowering of international interest rates, a change from this policy is not easy to foresee. Therefore, weak business investment and residential construction should lead to a further decline in growth rates in the first half of 1981 and a relatively hesitant recovery thereafter. In the other European countries, a similar pattern of growth is likely as the recession continues into the first half of 1981. The expected timing of the trough of the present recession in Europe is continually being put further back, and it is probably optimistic to expect any significant revival in activity until at least the fourth quarter of 1981.

No recovery of growth in the centrally planned economies

Economic growth in the centrally planned economies of Eastern Europe ^{18/} and in the Union of Soviet Socialist Republics recovered only marginally in 1980 from 1979. Variations among countries were unusually wide, however. While aggregate output growth improved slightly in the USSR, ^{19/} most Eastern European countries experienced a further slowing of growth, or - as in Hungary and Poland - an absolute decline in output.

Growth for the group as a whole, as measured by real net material product, remained below 3 per cent, more than 1 percentage point short of the expansion rate envisaged in the combined national development plans for the year and well below the rates of the past (see table II-4). Disappointing or poor harvests in most countries contributed to this outcome. Agricultural production dropped by 3 per cent, following on a 2 per cent decline in the preceding year. However, there was also a further deceleration in industrial growth which extended beyond the sectors affected by the decline in agricultural inputs.

^{18/} Albania, Bulgaria, Czechoslovakia, German Democratic Republic, Hungary, Poland and Romania.

^{19/} Data for the USSR are available only on the growth of national income distributed (total final uses), which rose from 1.9 per cent in 1979 to 3.8 per cent in 1980. However, this aggregate reflects substantial terms of trade gains in 1980 in addition to production growth. Net material product (national income produced) rose by 2.5 per cent in 1979. With an increase of 3.6 per cent in industrial output and 1 per cent in construction output, and a drop of 3 per cent in gross agricultural output, its growth in 1980 cannot have been much above 3 per cent.

Table II-4. Eastern Europe and the Union of Soviet Socialist Republics: basic economic indicators, 1971-1981
(Growth rates in percentages)

| | 1971- 1975 | 1976- 1980 | 1978 | 1979 | 1980 <u>a/</u> | 1981 <u>b/</u> |
|---------------------------|---------------|---------------|------|------|----------------|----------------|
| Net material product | 6.3 | 4.2 | 5.0 | 2.5 | 2.9 | 3.2 |
| Industrial gross output | 7.8 | 4.7 | 5.1 | 3.7 | 3.3 | 3.9 |
| Agricultural gross output | 1.6 | 1.6 | 2.8 | -2.3 | -3.1 | 4 |
| Gross fixed investment | 8.2 | 3.3 | 5.8 | 0.2 | 0.8 | 2.2 |
| Export volume | 8.5 | 6.0 | 5.5 | 5.6 | 2.3 | ... |
| Import volume | 10.5 | 4.5 | 8.3 | 2.1 | 1.9 | ... |

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.

Economic policy for 1980, as formulated in the national economic plans of the European centrally planned economies for the year, reflected the priority of consolidation and adjustment over the acceleration of growth. This is particularly evident in the sharp deceleration of investment growth in the last two years, especially in the countries of Eastern Europe, but also in the Soviet Union. Against a background of slowing labour supply growth, high initial investment rates and a highly material-intensive and energy-intensive pattern of production, all countries of the region found themselves confronted with conflicting claims in the second half of the 1970s. On the one hand, a response to the faltering growth of the production of primary materials and fuels, the removal of emerging bottle-necks in the economic infrastructure (especially in transport and power generation) and the retooling required to adjust to rising energy and materials costs all demanded sustained and perhaps increased investment efforts, largely in sectors whose investments have very long gestation periods. On the other hand, the evident strains already imposed by existing investment programmes on the capacity of the construction sector, as revealed in the persistent increase in the stock of unfinished projects and the desire to maintain some growth of consumption in the face of declining over-all output expansion called for curtailment of the growth of investment. For the trade-intensive economies of Eastern Europe, faced by the need to adjust to the long-term worsening of their terms of trade and to curtail the growth of external deficits - especially in trade with the market economies - the problem

was aggravated by the high import content of investment. For the USSR, external constraints were probably not binding to the same extent. The conflict was resolved in all countries of the region in favour of reducing the growth of investment substantially below what was originally envisaged in the five-year plans for the 1976-1980 period, 20/ most of the cutbacks occurring in the last two years. In the national plans for 1980, three of the Eastern European countries scheduled unchanged or reduced absolute levels of investment, and in most of the other countries and in the USSR, growth was to be held substantially below that of national income. 21/ Apart from agriculture, where a substantial recovery from the poor 1979 results was expected, production targets for 1980 generally envisaged lower growth of output than had been planned for the first four years of the medium-term planning period. With a target for growth of combined national income of 4 per cent and of industrial output of almost 5 per cent, this, none the less, implied some acceleration in comparison to the depressed 1979 results. Foreign trade plans of the Eastern European countries focused on further reductions of external deficits and stressed the intention to constrain or reduce imports if exports could not be expanded.

The priorities outlined appear to have been closely adhered to in the course of the year, even though targets for growth of production could not be attained in any country of the group. As noted earlier, the expected recovery of agricultural production in the region did not materialize, which not only depressed over-all output growth but also necessitated additional import requirements. In industry, the achievement of targets was hampered by output shortfalls and the continuing deceleration of growth in the primary goods sectors. 22/ Shortages of industrial inputs held down industrial production in several of the Eastern European countries, where the import constraints in 1979 and 1980 had not only affected investment goods but also resulted in a running down of stocks. Adjustments in the aggregate balance appear to have been sought mainly through a further slowing of investment activity. And though export volume growth slowed sharply for the Eastern European centrally planned economies, from a rate of almost 9 per cent in 1979 to about 3 per cent in 1980, the severe import constraints permitted all countries of this group except Poland

20/ The cutback was especially sharp in the countries of Eastern Europe, where investment outlays had grown at an average annual rate of 11 per cent in 1971-1975 (with national income growth of 8 per cent) and had been planned to expand faster than national income also in 1975-1980 (at 8 per cent, with national income growth of 7 per cent). The adjustments to this development strategy of the last few years reversed this relationship, with average growth rates over the period of 3 per cent for investment and 4 per cent for national income.

21/ The combined investment outlays of the Eastern European countries were to rise by 0.5 per cent in 1980, while in the USSR, an increase of 2.7 per cent was scheduled.

22/ In particular, there was a further slowing of growth in the production of primary fuels (petroleum, natural gas, hard and brown coal) in the region. Output growth in this sector has declined every year since 1977, from an average rate of increase of 5 per cent in 1971-1976 to 2.0 per cent in 1980. Coal production declined in absolute terms, a loss only partially offset by continued growth in oil and gas. The output of metals also appears to have stagnated in 1980, after an absolute decline in the preceding year.

to register improvements in the external balance for the year. 23/ In the case of the USSR, favourable terms of trade movements permitted a substantial acceleration of import volume growth - from 1 per cent in 1979 to an estimated 5 per cent in 1980 - with almost steady export volume a further increase in the foreign trade surplus.

The economic situation of the two centrally planned economies which experienced a decline in over-all production in 1980 merits separate attention. In Hungary, the 1 per cent drop in total production was the outcome of a deliberate slowing of economic activity in order to bring about a reduction of the external deficit and rapid adjustments in domestic production. 24/ While the downturn appears to have been sharper than anticipated, the policy is judged to have been quite successful in terms of its over-all goals. In Poland, the downturn was more serious 25/ and is likely to carry over into the current year. Apart from transitory factors, notably a very poor harvest and the work stoppages of the second half of the year, it also reflected a permanent structural change. This was the introduction of the five-day work week, which has lowered the over-all production capacity of the economy in the short run. The impact of this change appears to have been particularly strong on the mining sector, especially on coal output which provides the bulk of Polish energy supplies and a substantial share of Polish export proceeds. A three-year stabilization programme, including reforms in the planning and management system and further cutbacks in investment, is under preparation to lay the bases for the resumption of economic growth after 1983. In the short run, however, the reduced production potential, especially for exportables, has already had some spill-over effects outside of the Polish economy. On the one hand, established supply patterns within the Eastern European region have been disrupted. On the other hand, the capacity of the Polish economy to service its external debt with the market economies within the existing maturity schedules has come under considerable strain. Early in 1981, negotiations were therefore started to lengthen the maturity structure in order to provide some breathing space for the stabilization programme.

23/ The volume of exports to the market economies rose by an estimated 5 per cent, which in the inauspicious trading environment of the year must be considered a remarkable result of the export drive of these countries. Imports from the market economies, on the other hand, declined by 1-2 per cent in volume.

24/ Hungarian industrial production dropped 2 per cent and gross investment declined about 9 per cent, while consumption remained at the preceding year's level, all measured in real terms. The squeeze on domestic demand allowed a further reduction in the external deficit of \$0.2 billion in 1980, following an improvement of \$0.8 billion in 1979.

25/ Over-all output dropped by 4 per cent in 1980, the second year of declining production, and a further drop is likely in 1981. Since all of the decline came in the second half of the year, after a healthy upswing in the first six months, the year-over-year figures understate the depth of the downturn. Industrial production in January 1981 was 11 per cent below that of a year earlier and with nominal wages 20 per cent higher than in the earlier period, strong inflationary pressures cloud the outlook for over-all equilibrium in 1981, in spite of a planned further cutback in investment outlays by 15 per cent.

The plans for 1981 of the European centrally planned economies continue to take a cautious approach towards the expansion of activity and pay close attention to the external balance. Targets for growth in almost every country are lower than those posited for the preceding year. ^{26/} Thus, national income is targeted to grow by 3.2 per cent for the region as a whole, as against the 4.1 per cent planned for 1980 and the actual growth of 2.9 per cent. Similarly, industrial output growth is planned at 3.9 per cent, as against the 4.8 per cent target and the 3.3 per cent achievement in 1980. In contrast to the experience of the 1974-1975 period, when planned and actual growth in the European centrally planned economies was maintained at a high level right through the downturn experienced elsewhere in the world, the outlook for the current period has thus become much more closely linked to global economic prospects. Among external factors which may constrain the acceleration of growth in Eastern Europe is the sharp decline of demand in Western Europe, which will make the achievement of export growth, even at the 1980 rate, very difficult. Under the prevailing policy priorities, this is likely to result in curtailed availability of imported materials. Plans of the Eastern European economies for 1981 envisage an even more decisive containment of investment activity than those for the preceding year, largely with a view to the import-saving effect of such measures: the planned reduction in the combined investment volume is almost 3 per cent. In the USSR, on the other hand, which suffers no balance-of-payments constraint and is likely to benefit from a further terms-of-trade improvement in 1981, investment outlays are planned to increase at an accelerated rate of 4.5 per cent.

For all of the European centrally planned economies, 1980 was the closing year of a five-year plan period, and new medium-term plans for 1981-1985 are in the final stage of preparation or have been adopted recently in most countries. While the development programmes formulated in the middle of the 1970s anticipated a general weakening of growth, their underlying assumptions and expectations turned out to be over-optimistic. ^{27/} Though not all of the medium-term plans for 1981-1985 are yet available, preliminary data and policy discussions indicate that a further deceleration is anticipated - in the case of national income, to about 3 1/2 per cent or slightly more and, in the case of investment, to some 2 1/2-3 per cent.

Harvest shortfalls and infrastructural bottle-necks appear to have hampered economic growth in 1980 in several of the Asian centrally planned economies, notably in China and Viet Nam. In both countries, industrial growth targets and investment expenditures for 1981 have been curtailed to permit an easing of economic imbalances.

In China, over-all growth slowed from almost 7 per cent in 1979 to an estimated 4-5 per cent in 1980, owing primarily to a decline in agricultural production. Industrial output increased by over 8 per cent, approximately the same rate as in 1979. The three-year readjustment programme, which had been inaugurated in 1979 to permit a change of emphasis towards agricultural modernization, light industry and infrastructural development, gained impetus in

^{26/} The exception is the German Democratic Republic, which from the base of a relatively strong performance in 1980 - with national income growth of 4.2 per cent - expects to accelerate over-all and industrial expansion to 5.0 per cent.

^{27/} For a discussion, see World Economic Survey 1978: Current Trends in the World Economy (United Nations publication, Sales No. E.80.II.C.1), chap. IV.

1980 with a very rapid expansion of light industry - by about 17 per cent - as resources were shifted into this sector on a major scale. A significant improvement was registered in the external balance. The trade deficit declined from \$1.9 billion in 1979 to \$0.6 billion in 1980, as export volume rose by 14 per cent while import growth was held to 2 per cent in volume terms. Domestically, however, severe imbalances in the production structure developed. Bottle-necks appeared in transport and in energy supplies. The output of the fuel and energy industry declined by almost 3 per cent, owing to stagnating oil production and a sharp drop in coal output. At the same time, investment appears to have expanded much more rapidly than planned, probably owing to excess liquidity at the level of enterprises and local authorities, and significant inflationary pressure was fed by a rising deficit in the budget of the central Government and accommodated by a substantial increase in the money supply. This induced a further readjustment of economic policy early in 1981, including a downscaling of output targets, especially for the material-intensive heavy industry sectors, a sharp cutback in planned investment outlays (by about 40 per cent), the issuance of treasury bonds to mop up financial surpluses at the local and enterprise levels and further constraints on imports.

Agricultural production and the worsening world food situation

Global agricultural and food production stagnated in 1980, following a very small advance in 1979. World food output has thus essentially remained at an unchanged level for three consecutive years, and per capita food production, which had shown a slowly rising trend from 1973 to 1978, has been declining again in the last two years. The global performance in 1980 reflects divergent experiences in different parts of the world economy. With better harvests than in the preceding year, all developing regions registered advances in food production, but this was offset by a downturn in the developed market economies and another year of poor harvests and reduced livestock production in the centrally planned economies.

At the end of the 1970s, world food output was one quarter above the level of the beginning of the decade. The increase was somewhat larger - about 30 per cent - in the developing countries, but the annual rate of growth of 2.9 per cent for the period fell significantly short of the 4 per cent growth target called for in the International Development Strategy for the Second United Nations Development Decade. Food production in the developing countries as a group, in fact, has only barely kept up with population growth: per capita output in 1978-1980 was a precarious 2 per cent higher than in 1969-1971 (see table II-5), and in a significant number of individual developing countries per capita food production in 1978-1980 was lower than in 1969-1971. This was the case, for example, in 15 of the 27 developing countries in Asia and for 12 of the 28 developing countries of the Western Hemisphere for which such data are available.

It is in Africa, however, that the food situation has become particularly preoccupying. For most countries of the continent, food output decelerated in 1979-1980. The deceleration was particularly sharp in the countries in East and South-East Africa where output fell from an average annual rate of 2.2 per cent in 1971-1978 to one of 0.7 per cent in 1979-1980. This latter figure is a full 2 percentage points below the natural rate of growth in population in this area. ^{28/} For Africa as a whole, two consecutive years of particularly bad crops and a production trend in previous years that was itself below the rate of growth in population have left per capita food output at the end of the decade 10 per cent below that registered at the beginning of the decade. This phenomenon was widespread: only 12 of the 46 individual African countries for which such data are available were able to avoid a fall in per capita output. ^{29/} According to recent estimates of the Food and Agriculture Organization of the United Nations (FAO), the present situation is of such gravity that 26 African countries with a combined population of 150 million people will be suffering abnormal food shortages in early 1981.

Thus, in spite of significant growth in global output during the decade, the world food situation remains unsatisfactory. In many countries, the normal year-to-year swings in the harvest could reverse the small gains in per capita output or turn a deteriorating situation into one of famine. Over the decade, the growth

^{28/} See Selected Demographic Indicators by Country, 1950-2000, December 1980 (ST/ESA/SER.R/38).

^{29/} In 12 other countries, the drop in per capita output was 15 per cent or more.

Table II-5. World food production, 1970-1980: indices and trends
(1969-1971 average = 100)

| Country group | Total food production a/ | | | | Per capita production | | | |
|-------------------------------|--------------------------|------|------|------|-----------------------|------|------|------|
| | Growth trend b/ | 1978 | 1979 | 1980 | Growth trend b/ | 1978 | 1979 | 1980 |
| World | 2.5 | 124 | 125 | 125 | 0.6 | 107 | 106 | 104 |
| Developed market economies c/ | 2.1 | 119 | 122 | 120 | 1.3 | 111 | 114 | 111 |
| Developing countries d/ | 2.9 | 127 | 127 | 131 | 0.4 | 104 | 101 | 102 |
| Africa | 1.6 | 113 | 115 | 118 | -1.2 | 91 | 89 | 89 |
| Latin America | 3.6 | 132 | 137 | 140 | 0.9 | 107 | 108 | 108 |
| Near East | 3.3 | 132 | 131 | 136 | 0.5 | 106 | 103 | 103 |
| Far East | 2.9 | 128 | 125 | 130 | 0.4 | 106 | 100 | 102 |
| Other developing countries | 2.9 | 124 | 131 | 133 | 0.5 | 103 | 106 | 105 |
| Centrally planned economies | 2.6 | 127 | 126 | 126 | 1.2 | 113 | 111 | 110 |
| Asia | 3.3 | 129 | 137 | 137 | 1.8 | 114 | 119 | 118 |
| Eastern Europe and USSR | 2.0 | 125 | 118 | 117 | 1.1 | 117 | 109 | 108 |

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

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

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

c/ Including Israel and excluding Cyprus and Turkey.

d/ 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 the Sudan; "Latin America" includes the Caribbean; "Near East" includes Afghanistan, Bahrain, Cyprus, Democratic Yemen, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, the Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, the Sudan, the Syrian Arab Republic, Turkey, the United Arab Emirates and Yemen; "Far East" includes Bangladesh, Bhutan, Brunei, Burma, Democratic Kampuchea, East Timor, India, Indonesia, the Lao People's Democratic Republic, Malaysia, Maldives, Nepal, Pakistan, the Philippines, the Republic of Korea, Singapore, Sri Lanka, Thailand and also includes the territory of Hong Kong and the Chinese territory of Macao.

of output in food-exporting countries - mainly developed market economies - has exceeded the expansion of domestic requirements and the volume of food trade has consequently increased at almost twice the rate of world food production. The counterpart has been a growth of food imports of the developing and centrally planned economies of more than 8 per cent per annum (see table II-6). For most countries, especially the developing economies, this development can, at best, mitigate the impact of low production trends on consumption and nutrition levels, and this can only happen if the world market retains a certain margin of supply ease. Late in 1980, a disquieting tightness developed in the world market for cereals, causing FAO to call a "global alert". After two years of insufficient growth in food crops world wide, the capacity of the global distribution system to compensate for local swings in output or wider shortfalls appears to be more contingent on the outcome of the next harvest than it has been for some time.

The output of all cereals - wheat, coarse grains and rice - declined in 1979, owing to poor harvests in most regions of the developing world and a sharp drop in grain output in the European centrally planned economies (see table II-7). Net cereal imports into the deficit regions increased significantly, but domestic stocks in the importing countries were also drawn down substantially. Global consumption exceeded production by a margin of almost 2 per cent.

In 1980, world cereals output increased only marginally over the poor 1979 levels. Globally, rice and wheat crops were higher, though there was a steep decline in the output of coarse grains in the grain-exporting countries of North America. The output of the developing countries improved, but mainly on the strength of record rice crops in a number of South-East Asian countries. Other regions registered only small increases or remained below 1978 output levels. Output declined in North America and China, and another disappointing harvest - though above the 1979 level - was reaped in Eastern Europe and the USSR. In the face of continued growth in consumption requirements, import demand for the crop year 1980/81 is expected to show another increase, and global consumption is estimated to exceed production by about 3 per cent, a much wider margin than in the preceding year.

While supplies on hand are judged sufficient to meet this demand, carryover stocks will have been drawn down by another 40 million tons by the end of the crop year. This will bring them down to 210 million tons or 14 per cent of annual consumption, a ratio equal to the previous 20-year low of the food crisis years 1973/74-1975/76 and one which FAO considers only 30 million tons - or one week's world consumption - above pipeline level. In contrast to the preceding year, when importers ran down their reserves, most of the draw-down of stocks occurred in the exporting countries.

In consequence, international food supply adequacy in 1981/82 will be uncomfortably dependent on the vagaries of the weather, and cereal prices can be expected to remain highly volatile in the absence of a substantial reserve cushion. Merely in order to meet the normal growth of global consumption requirements without a further reduction of stocks, an increase of some 4 per cent or 62 million tons in cereal output is considered necessary by FAO. A rather more substantial increase of 7 per cent or 107 million tons is needed if stocks are to be rebuilt to the level of 17 per cent of annual consumption which is necessary to safeguard world food security.

Table II-6. World trade in food products, a/ 1968-1979: volume indices and trends
(1969-1971 = 100)

| Country group <u>b/</u> | Growth trend <u>c/</u> | Exports | | | Growth trend <u>c/</u> | Imports | | |
|-----------------------------|---------------------------|---------|------|------|---------------------------|---------|------|------|
| | | 1977 | 1978 | 1979 | | 1977 | 1978 | 1979 |
| World | 4.8 | 139 | 148 | 156 | 4.7 | 136 | 146 | 155 |
| Developed market economies | 6.7 | 154 | 172 | 183 | 3.1 | 123 | 127 | 131 |
| North America | 8.5 | 173 | 205 | 213 | 1.6 | 113 | 113 | 114 |
| Developing countries | 2.8 | 129 | 124 | 127 | 7.5 | 164 | 190 | 200 |
| Africa | -2.8 | 82 | 81 | 75 | 8.2 | 178 | 208 | 204 |
| Latin America | 4.0 | 140 | 138 | 139 | 7.7 | 163 | 199 | 212 |
| Near East | 3.2 | 126 | 151 | 136 | 13.0 | 234 | 274 | 289 |
| Far East | 5.8 | 170 | 147 | 165 | 3.6 | 123 | 132 | 148 |
| Other developing countries | 0.4 | 99 | 96 | 115 | 5.3 | 139 | 155 | 159 |
| Centrally planned economies | -1.1 | 95 | 90 | 96 | 8.1 | 167 | 185 | 223 |
| Asia | -0.4 | 90 | 101 | 104 | 5.7 | 155 | 177 | 209 |
| Eastern Europe and USSR | -1.2 | 97 | 87 | 95 | 8.8 | 170 | 187 | 227 |

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Food and Agriculture Organization of the United Nations, FAO Trade Yearbook, vol. 33 (Rome, 1980).

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

b/ Coverage of regional groupings as in table II-5.

c/ Average annual growth rate 1969-1979, obtained as the slope of a regression line fitted to the data.

Table II-7. World cereals production trends and trade volumes, 1970-1980 a/

| Country group <u>b/</u> | Per capita production index (1969-1971 = 100) | | | | Cereals trade (million tons) | | | | | |
|-----------------------------|--|------|------|------|------------------------------|------|------|---------|------|------|
| | Growth trend <u>c/</u> | 1978 | 1979 | 1980 | Exports | | | Imports | | |
| | | | | | 1978 | 1979 | 1980 | 1978 | 1979 | 1980 |
| World | 0.7 | 110 | 105 | 103 | 168 | 195 | 202 | 169 | 195 | 202 |
| Developed market economies | 1.3 | 115 | 115 | 110 | 136 | 169 | 175 | 58 | 60 | 57 |
| North America | 2.4 | 122 | 130 | 117 | 109 | 131 | 136 | 1 | 1 | 1 |
| Developing countries | 0 | 102 | 95 | 98 | 25 | 22 | 22 | 70 | 78 | 80 |
| Africa | -2.0 | 87 | 81 | 82 | 0 | 0 | 0 | 11 | 13 | 15 |
| Latin America | 0.2 | 101 | 98 | 98 | 16 | 12 | 13 | 18 | 23 | 23 |
| Near East | 0.1 | 102 | 96 | 98 | 2 | 1 | 1 | 19 | 20 | 20 |
| Far East | 0.3 | 106 | 97 | 102 | 7 | 9 | 8 | 24 | 23 | 23 |
| Centrally planned economies | 1.2 | 117 | 111 | 109 | 7 | 4 | 5 | 41 | 57 | 64 |

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Food and Agriculture Organization of the United Nations, Food Outlook, 1981, No. 1 and other FAO data.

a/ Production data refer to calendar years; export and import data refer to crop years starting in the year shown in column heading. Figures for 1979 are estimates and those for 1980 forecasts. Cereals include wheat, coarse grains and rice on a milled basis. Trade data include wheat equivalent of wheat flour. Components may not add to totals because of rounding.

b/ Coverage of regional groupings as in table II-5.

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

Increases of this order of magnitude are not impossible. The 1978 gain in global cereal production came to over 100 million tons, and a good harvest in the Soviet Union alone after two mediocre years could contribute one half of the required increment. However, there can be no assurance that this will happen. If not, further increases in grain prices would impose a significant burden on food-deficit developing countries, in whose import bill cereals assume a significant share. This is all the more disquieting since, at the same time, rising prices are likely to have the effect of further reducing the commodity equivalent of food-aid shipments, which are often budgeted by donor countries in nominal terms. Something of this sort already appears to have happened in 1980/81, when food aid in cereals declined below the 1979/80 level, that is, from 9.2 to 9.1 million tons; since cereal imports of low-income developing countries rose at the same time, this caused the share of these imports covered by food aid to drop to an estimated 17 per cent, as against 24 to 26 per cent in the middle of the decade.

Energy production and use, 1980-1981

The first year of the 1980s saw a pronounced reversal of the energy production and use trends which had prevailed in the world economy since the middle of the 1970s, and preliminary estimates indicate that there will be no reversion to fast trends in 1981. World production of primary energy, which had expanded at an annual rate of almost 4 per cent in 1976-1979, 30/ declined by an estimated 2 per cent in 1980, and consumption probably fell at a slightly lower rate. While the outlook for 1981 is very uncertain, on present estimates, energy production is likely to rise by less than 1 per cent and may even show a further small decline.

This is the first decline in global energy production and use since 1975; and it is a sharper decline than occurred in that year, when world energy production fell by about 1 per cent. As in the earlier year, it reflects, in part, the effect on energy consumption of slower real growth of the world economy and, in part, the energy conservation and reduced use stemming from changes in consumption patterns in reaction to higher energy prices. While the data on hand do not yet permit a determination of the relative contribution of these two factors, the fact that world economic growth had contracted much more sharply in 1975 than in 1980 - although the drop in energy output was substantially greater in the latter year - would suggest that conservation measures and adjustments in energy use have played a significantly greater role in the more recent period.

The 1980 drop in over-all energy production primarily reflects declines in the production of petroleum and natural gas. However, there was also a pronounced slowing in 1980 in the expansion of coal production. World coal output increased by less than 1 per cent, as against an average annual growth rate of 3.3 per cent over the preceding five years, owing to a 2 per cent decline of coal production

30/ Coal, petroleum, natural gas, hydro and nuclear electricity, aggregated in terms of coal equivalents. See 1979 Yearbook of World Energy Statistics (United Nations publication, Sales No. E/F.80.XVII.7), table 1. The data exclude non-commercial energy sources.

in the centrally planned economies. ^{31/} Since in 1981, a further decline in output is expected in this group of countries, which provides about 55 per cent of world coal production and since United States production may also be curtailed by the labour conflict which emerged in this industry in the second quarter of the year, world coal production is not likely to increase significantly in the current year. This will mean that, at least in the immediate future, the share of coal in global energy supplies will not rise much above the level of just under 30 per cent, where it has been hovering since the middle of the 1970s ^{32/} in spite of the relative cheapening of coal in comparison to other fuels.

Developments in petroleum production and consumption in 1980 reflected the adjustment of the world economy to the major price increases which had taken place in the preceding year. Although the price of oil continued to climb in 1980 - by about 17 per cent between January and December - most of the 64 per cent increase in the average price level on a year-over-year basis had taken place by the beginning of the year. During the first three quarters of 1980, prior to the eruption of the war between Iran and Iraq and the virtual cessation of exports from these countries, the world oil market was in a relatively soft state. Consumption, especially in the industrial countries, had declined sharply and while production was also lower, the downturn was not as steep, which permitted a considerable volume of stock-building to take place during this period. Spot market prices declined throughout this part of the year, reflecting the easing of the supply-demand balance. This situation was reversed by the eruption of hostilities in the Gulf area at the end of September, which resulted in a sudden loss in export of 4 million barrels per day or 14 per cent of world oil exports. None the less, though spot market prices rose again to their previous high, a rapid expansion of output in other producing countries, the partial resumption of exports from Iran and Iraq and the concerted efforts of the consuming countries to discourage panic recourse to the spot market (which had characterized developments in 1979) and to maintain a prudent rate of stock depletion, coupled with the high initial levels of inventories, kept oil markets relatively calm through the rest of the year.

On an annual basis, world oil consumption declined by almost 3 per cent, from a level of 64.6 million barrels per day in 1979 to 62.7 million barrels per day in 1980. This reduction was centred entirely in the developed market economies, where consumption was reduced by about 2.8 million barrels per day, or almost 7 per cent of the preceding year's level. Oil use continued to rise, if at a somewhat reduced pace, in the developing countries and the centrally planned economies (see table II-8). Among the developing countries, however, significant oil consumption increases were registered mainly in the energy-exporting countries,

^{31/} Coal output declined in 1980 in China, Poland and the USSR, the major producers in this group, and while some growth is likely in the USSR in 1981 as important new mines are expected to come on stream, further drops in output are anticipated in China and Poland. In China and the USSR, the production lags probably reflect the exhaustion of older deposits and delays in the completion of new capacities. In Poland, which in recent years has been providing about 20 per cent of world coal exports, production capacity has been reduced by 10-15 per cent by the shortening of the work week in 1980, and coal exports have been curtailed even more sharply - probably to about one fifth of the earlier level in 1981.

^{32/} This compares to a share of 32 per cent in 1970 and of 47 per cent a decade earlier.

Table II-8. World oil production and consumption, 1976-1980

| | Million barrels per day | | | | Growth rates a/ | | |
|-----------------------------|-------------------------|------|------|---------|-----------------|------|-------|
| | 1976 | 1978 | 1979 | 1980 b/ | 1977-1978 | 1979 | 1980 |
| <u>Production</u> | | | | | | | |
| Developed market economies | 12.5 | 14.0 | 14.7 | 14.8 | 5.6 | 5.0 | 0.7 |
| North America | 11.3 | 11.8 | 12.0 | 12.0 | 2.2 | 1.7 | - |
| Western Europe | 0.8 | 1.7 | 2.3 | 2.5 | 43.1 | 35.3 | 8.7 |
| Developing countries | 34.5 | 34.6 | 36.0 | 32.8 | 0.3 | 4.0 | -8.9 |
| OPEC | 30.7 | 29.9 | 30.9 | 27.0 | -1.3 | 3.3 | -12.6 |
| Centrally planned economies | 12.6 | 14.0 | 14.3 | 14.6 | 5.5 | 2.1 | 2.2 |
| World | 59.7 | 62.6 | 65.0 | 62.2 | 2.4 | 3.8 | -4.3 |
| <u>Consumption</u> | | | | | | | |
| Developed market economies | 38.8 | 40.5 | 40.5 | 37.7 | 2.2 | - | -6.9 |
| United States | 17.4 | 18.8 | 18.3 | 16.8 | 3.9 | -2.7 | -8.2 |
| Western Europe | 13.5 | 14.2 | 14.5 | 13.7 | 2.6 | 2.1 | -5.5 |
| Japan | 5.0 | 5.2 | 5.3 | 5.0 | 2.0 | 1.9 | -5.7 |
| Developing countries | 9.1 | 10.1 | 10.6 | 11.1 | 5.2 | 5.0 | 4.7 |
| Centrally planned economies | 11.8 | 13.0 | 13.5 | 13.9 | 4.7 | 3.6 | 3.0 |
| World | 59.6 | 63.6 | 64.6 | 62.7 | 3.3 | 1.6 | -2.9 |
| <u>Stock change</u> | +0.1 | -0.5 | +0.7 | +0.2 | | | |

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data in Oil and Energy Trends (vol. 6, No. 7, January 1981, and other issues); United States Department of Energy, Monthly Energy Review (February 1981); and other national and international sources.

a/ Average annual and annual growth rates, in percentage.

b/ Preliminary.

whereas in a number of energy-importing developing countries consumption was reduced or held at the preceding year's level. The continued growth of consumption in the centrally planned economies, largely made possible by reductions in the volume of oil exports to non-socialist markets from the USSR and probably also from China, in part reflects the fact that price increases for the oil-importing countries of this group were substantially smaller than those affecting the rest of the world economy, owing to the special pricing arrangements in intra-group trade. 33/

The slowdown in economic activity in the developed market economies was an important factor in reducing oil consumption in 1980, as it had been in the 1974-1975 period when, for the first time in recent history, consumption fell in absolute terms. In comparison to the earlier period, when oil consumption in the developed market economies declined by approximately 3 per cent, the fall in 1980 was substantially larger, and it was distributed differently with more than half of the drop occurring in the United States (as against less than 20 per cent in 1975). However, in contrast to 1975, when gross domestic product in the industrial countries actually declined by 0.5 per cent, the sharper 1980 oil consumption cut came against a background of continued, if much reduced, growth in these countries. It thus testifies to intensified conservation efforts, particularly in the United States where significant progress in conservation had long been delayed. Although it is always difficult to disentangle the various factors leading to changes in consumption patterns, preliminary econometric analysis of past relationships between oil demand and the level of economic activity in the developed market economies suggests that higher oil prices combined with conservation measures have resulted in oil savings of 3 million barrels per day, this amount representing the difference between the predicted consumption level and the level actually observed.

Global oil production declined by more than 4 per cent on an annual basis, from 65.0 million barrels per day in 1979 to 62.2 million barrels per day in 1980. The reduction in output occurred wholly in the OPEC countries, where production declined to approximately the 1975 level. Output rose by some 14 per cent in other oil-producing developing countries (primarily in Mexico), by almost 9 per cent in the North Sea, and by about 2 per cent in the centrally planned economies (see table II-8).

Higher incentives to producers from rising energy prices triggered a substantial increase in exploratory and developmental activities in all energy fields. Drilling activity rose substantially in most of the potential oil-bearing areas of the world, particularly in the United States, where the number of active drilling rigs increased by almost 30 per cent from December 1979 to December 1980. As a result of these and other efforts, the world as a whole added more to its proven reserves of oil and gas in 1980 than it consumed. Development efforts also rose in other energy fields, such as heavy oil, tar sands, oil shale and coal.

33/ Contract prices in trade among the Council for Mutual Economic Assistance countries have, in recent years, been set on the basis of world market prices averaged over the preceding five years, a formula under which the 1979 world market oil price increase affected the intra-group price for 1980 only with a weight of one fifth and the further 1980 increase did not enter into price determination for that year at all. The price of Soviet oil, which constitutes about 85 per cent of the oil imports of the Eastern European centrally planned economies other than Romania, would on this formula have risen by some 36 per cent between 1978 and 1980, as against the 140 per cent price increase registered in the world market. Hungarian data on the unit value of energy imports from the rouble area indicate that actual price changes were of approximately this order of magnitude.

Venezuela's intention to invest about \$4.7 billion in a project to yield 125,000 barrels of upgraded heavy crude oil from the Orinoco oil belt by 1988 is one indication of this trend.

None of this, however, is likely to have a substantial impact in the very near future. The supply-demand balance in the energy markets will probably remain precarious through 1981 and may easily be upset by unanticipated supply constraints. Coal production, as noted earlier, is likely to grow at a relatively low rate again in 1981. The volume of oil production will depend upon producer country decisions, the extent to which exports from Iran and Iraq are restored to their pre-war levels and the rate of output growth in other producing areas. On the demand side, it is uncertain whether the cutback in oil consumption in the developed market economies indicates the beginning of a continuing energy conservation trend or whether it will once again be sharply reversed, as it was in 1975-1976, as soon as economic activity revives. Since the inventory drawdown, which has, in part, aided the maintenance of market balance in late 1980 and early 1981, is by its nature self-limiting, a renewed tightening of the market and sharp price pressures could easily develop later in the year.

Chapter III

INFLATIONARY TRENDS AND CURRENT POLICY STANCES

Inflation accelerated in most parts of the world between 1979 and 1980. In both the developed market economies as a group and the developing countries as a group, the pace of inflation reached a level unknown for many years. Even some of the centrally planned economies found it necessary to permit substantial increases in domestic prices.

The recent acceleration in the pace of inflation began in late 1978, and it constitutes the latest in a succession of upward movements that have marked the performance of prices in many countries since the late 1960s. In numerous countries, both developing and developed, the response of Governments to this most recent bout of inflation has been to adopt firm anti-inflationary policy stances by restricting demand. Indeed, the control and lessening of inflation has been identified as the first priority of governmental economic policy in a number of major economies. Because of the apparently entrenched nature of the inflationary process and the uncertainties about the early effectiveness of the policy instruments in use, however, it is widely believed that the task may not only be lengthy but also costly in terms of output and employment forgone. For the world economy, this probability can only dim the prospects for an early restoration of vigorous economic growth.

The world-wide character of present inflationary trends is significant. Over the 1950s and the 1960s, and even into the 1970s, inflation was generally regarded as a phenomenon affecting individual countries in isolation. Only exceptionally, as during the Korean War period, was there a widespread and interrelated advance in domestic price levels. Over the last decade or so, however, the most striking feature of inflationary experience has been the interaction between the domestic inflationary process of individual countries and changes in external prices; the changes in external prices have originated either in inflation elsewhere or in markets for key internationally traded commodities, particularly fuel and food. Trends in major industrial countries have played a leading role in the interaction. Upward shifts in the pace of domestic inflation have taken place in these countries in response to temporary demand pressures or to large changes in the relative price of key commodities, particularly oil. Other countries have accordingly been faced with increases in prices, not only of key commodities, but also of manufactures. The acceleration of inflation in major developed market economies has thus radiated out to other countries, both developing and developed, and there has been a tendency towards synchronization of changes in the pace of inflation among the different groups of countries (see table III-1).

The instability that has characterized the international economy since the early 1970s may have also contributed to the exacerbation of inflation. The uncertainties brought about by unsettled international economic conditions have given rise to fluctuations in the prices of primary commodities which are much larger than those warranted by underlying supply-demand conditions. If the prices of manufactures adjust more rapidly to increases than to decreases in costs, the fluctuations in the prices for raw materials that have taken place in recent

Table III-1. Market economies: annual rates of change in
consumer prices, 1961-1981
(Percentage)

| Period ^{a/} | Developed market economies | Developing countries ^{b/} | | | | |
|----------------------|----------------------------------|------------------------------------|----------------------|------------------------------|--------------|--|
| | | Total | Africa ^{c/} | South and East Asia | West Asia | Latin America and the Caribbean ^{d/} |
| 1961-1968 | 3.3 | 14.5 | 2.6 | 7.0 | 2.3 | 25.4 |
| 1969-1972 | 5.1 | 8.9 | 6.1 | 6.6 | 6.5 | 12.4 |
| 1973-1975 | 11.0 | 19.0 | 14.0 | 19.9 | 17.6 | 20.2 |
| 1976-1978 | 8.0 | 18.6 | 17.6 | 6.0 | 21.8 | 29.0 |
| 1978 | 7.2 | 18.3 | 17.5 | 6.4 | 24.2 | 27.0 |
| 1979 | 9.2 | 24.4 | 16.3 | 11.7 | 31.4 | 35.8 |
| 1980 | 11.9 | ... | ... | ... | ... | ... |
| 1979 | | | | | | |
| First half | 8.7 | 23.2 | 17.0 | 9.4 | 32.1 | 33.5 |
| Second half | 11.5 | 32.4 | 17.0 | 19.4 | 41.9 | 46.7 |
| 1980 | | | | | | |
| First half | 13.2 | 41.6 | 18.8 | 13.5 | 84.1 | 55.5 |
| Second half | 9.9 | ... | ... | ... | ... | ... |

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

a/ Data for individual years refer to changes relative to the preceding year. Data for half-years refer to changes relative to the immediately preceding half-year, at annual rates.

b/ Including Yugoslavia; excluding Argentina, Chile and Ghana. Atypically high inflation rates in Argentina and Chile and large unexplained semi-annual fluctuations in the price series for Ghana distort the averages for developing countries as a whole and for the regions to which they belong.

c/ Excluding Ghana.

d/ Excluding Argentina and Chile.

years may have been an additional inflationary factor affecting a broad number of countries. Likewise, the large swings in exchange rates since the demise of the system of fixed exchange rates established at Bretton Woods may have also added to inflation. ^{34/}

The inflationary process in perspective

Several phases can be identified in the acceleration of inflation since the middle of the 1960s. A significant increase in the rate of inflation occurred in the late 1960s and early 1970s at a time when the developed market economies were experiencing a strong synchronized upswing. The demand pressures associated with this upswing, together with the policy stance adopted in some of these countries, resulted in an upward movement in prices. Beginning in 1972, there were steep increases in the prices of food, energy and fertilizers, which added significantly to the upward movement.

These price shocks were not repeated in the period 1976-1978, and the anti-inflationary policies followed by Governments succeeded in bringing the rate of inflation down somewhat. None the less, inflation remained significantly higher than it had been at the beginning of the decade. The maintenance of a higher rate of inflation in the face of anti-inflationary policies was the result of a combination of factors. By and large, however, the outcome reflected the efforts of various groups, through both political and economic means, to maintain the levels and, if possible, the growth in their real incomes.

Against this background a series of events beginning in mid-1978 again served to raise substantially the pace at which the prices in the world economy advanced. The most recent inflationary surge began in the second half of 1978 in North America. A good share of the acceleration appears to have been due to increases in the prices of food - because of poor weather conditions - and of other raw materials. Despite a relatively weak recovery from recession, sectoral capacity constraints may have been met in a number of countries. During the first half of 1979, as the economies of Europe and Japan began to expand at a more rapid pace than at any time since the beginning of the recession, the upward movement in the prices of raw materials gathered momentum. These upward pressures on consumer prices and on industrial costs were intensified by the developments in the international oil markets which caused oil prices to rise by an estimated 160 per cent in the two years from the end of 1978 to the end of 1980. The increases in imported energy prices of 1979-1980 appear to have been more rapidly passed on to final users than in the past, and domestic energy prices have also tended to respond more rapidly to increases in the prices for imported energy products. ^{35/} The deterioration in the terms of trade of oil-importing countries occasioned by the sharp increase in oil prices meant a reduction in real income, which, through relative changes in domestic prices and incomes, had to be distributed in some way among the different economic groups within their societies.

^{34/} The ratchet effect of exchange rate fluctuations on domestic inflation has been examined in detail in H. Johannes Witteveen, "Inflation and the International Monetary Situation", American Economic Review, May 1975.

^{35/} Organisation for Economic Co-operation and Development, Economic Outlook, No. 28 (December 1980), pp. 42 and 53.

With each group seeking to protect its own real income by upward adjustments in prices or wages, the new circumstances pointed to a marked aggravation of the wage-price spiral. The pace of inflation, in fact, rose substantially in 1979 and 1980.

In the developing countries, taken as a group, the periods of acceleration in the rate of price increase and of comparative stabilization have paralleled those in the developed market economies (see table III-1). 36/ Beginning in 1973 there was a marked acceleration of inflation in all the regional groups of developing countries and since 1978 it has generally accelerated further. In the energy-exporting countries, while there is no doubt that higher prices for manufactures and other imported goods have contributed to inflation, inflationary pressures seem to have resulted primarily from changes in domestic demand. On the whole, prices in these countries advanced more slowly in 1980 than in the rest of the developing world. Among the net energy-importing developing countries, while domestic factors were also important in explaining their experience, external factors contributed significantly to the exacerbation of inflation recorded during the 1970s. Increases in international prices for manufactures and oil, which account for a high percentage of total imports and GDP, account in good part for the acceleration of inflation in these countries. 37/ There are, however, some differences between the effects of the external price increases of the mid-1970s and the more recent increases. In 1974-1975 and 1979-1980, the external price increases were similar, but the initial rate of price inflation was considerably higher in 1979. When the former shock occurred, four out of five countries had rates of inflation of 10 per cent or under; by 1979 more than 60 per cent of these countries had rates of inflation of over 10 per cent.

Among some centrally planned economies, inflation has also become a significant phenomenon for the first time since post-war stabilization. For most of these economies, consumer price levels have remained stable or have risen at very low rates. The fiscal buffers interposed between domestic and external prices, as well as between consumer and producer prices, have permitted Governments to absorb most of the price pressures emanating from the world market and domestic cost developments, mostly at the expense of significant growth in budgetary subsidies and reduced effectiveness of the price mechanism. 38/ However, countries which began to rely to a greater extent on the price system for resource allocation, such as Hungary, Poland and more recently China, found it necessary to allow prices to rise at unusually high rates - in the 7 to 9 per cent range annually - during 1980 and, in the absence of price controls, would have undoubtedly experienced much larger increases.

36/ The average rate of inflation for developing countries as a whole shown in table III-1 for 1961-1968 is unduly influenced by the experience of Brazil and Uruguay, which recorded rates of about 50 per cent during that period.

37/ In 1977, manufactures accounted for 59 per cent of the total imports and 14 per cent of the aggregate GDP of oil-importing developing countries. The corresponding figures for fuels were 21 and 5 per cent.

38/ For a brief review of the institutional and policy features governing the price systems of the centrally planned economies, see World Economic Survey 1979-1980 (United Nations publication, Sales No. E.80.II.C.2), pp. 34-36.

There have, of course, been many divergences from the broad international trends in the behaviour of price levels of individual countries. Countries have differed widely in the extent of their control over domestic demand pressures and in the influence of institutional and structural factors on the domestic inflationary process. In addition, the strength or weakness of a country's balance of payments and exchange rate has often been a significant source of divergence in domestic prices. A clear instance can be found in the recent experience of the Federal Republic of Germany, Japan and Switzerland. In these countries, exchange rate appreciation during the period 1976-1979 considerably lessened the impact on the domestic economy of rising foreign prices (see table III-2). This appreciation reflected the exceptionally strong current account position of these countries and the general expectation that this position would be maintained. This expectation was, of course, influenced by the whole set of policies followed by these countries having a bearing on the external accounts, including anti-inflationary policies. By contrast, in Canada, Italy and the United Kingdom of Great Britain and Northern Ireland, currency depreciation during the same period magnified the effect of increases in import prices, and domestic inflation rates were correspondingly higher. The same experience has been true in recent years in many developing countries whose adverse shifts in the terms of trade have intensified balance-of-payments pressure. In order to promote exports or reduce imports, countries have opted for depreciation of their exchange rates. One consequence of such action, however, is to magnify the domestic effect of increases in the prices of internationally traded commodities. Indeed, in some countries already suffering from serious domestic imbalances, increased pressure on current account deficits has tended to give rise to a vicious circle of depreciation, higher domestic wages and prices, and further depreciation.

However, while individual countries have differed widely in their experience, the evidence of widespread international trends is strong. Common sources of the acceleration of inflation in many parts of the world are to be found in the domestic inflationary process of leading industrial countries, the sharp increases in prices of key internationally traded commodities, most especially fuel, and the interaction between these factors. The current anti-inflationary policies being pursued by the developed market economies, and the effectiveness of these policies, are thus of wider international interest.

Table III-2. Major industrial countries and Switzerland:
annual rates of change in import and consumer
prices, 1976-1979
(Percentage)

| | Import prices | | Consumer prices |
|------------------------------|---------------|----------------------|-----------------|
| | In dollars | In domestic currency | |
| Canada | 6.0 | 9.8 | 8.4 |
| France | 8.5 | 8.3 | 9.7 |
| Germany, Federal Republic of | 11.2 | 3.4 | 3.7 |
| Italy | 9.5 | 16.3 | 15.2 |
| Japan | 9.6 | 1.5 | 6.2 |
| Switzerland | 10.1 | -1.4 | 1.9 |
| United Kingdom | 11.4 | 12.7 | 13.5 |
| United States | 9.5 | 9.5 | 7.8 |

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

Policy stances in developed market economies, 1979-1980

The recent acceleration of inflation in the developed market economies has been met by a determined effort on the part of policy makers to bring it under control. Considerable reliance has generally been placed on monetary policy, though fiscal policy has also been expected to play a significant complementary role.

In most countries, targets for the growth of the various monetary aggregates have been set which imply considerable deceleration in the growth of money income. In the major industrial countries, the rates of expansion of the money supply in real terms have tended to fall, with growth rates turning negative in all countries with the exception of Canada (see table III-3). ^{39/} These figures appear to indicate that the monetary authorities have become increasingly unwilling to accommodate price increases.

Partly as a consequence of these monetary developments, short-term interest rates rose sharply in 1979 and 1980 (see table III-4). When these rates are deflated to take into account likely changes in expected inflation, the resulting increases in real interest rates are considerably more moderate, implying that a share of the rise in nominal rates must have been due to increases in inflationary expectations. ^{40/} Nevertheless, interest rates during 1979 and 1980 were high in relation to the economic cycle. In the preceding cycle, nominal interest rates had started to rise at a time of economic expansion in 1972, and reached their peak in 1974, when the expansion was faltering. In the present interest rate cycle, the upswing in nominal rates began in early 1979 when economic growth was already slowing down from the relatively modest levels reached in 1978, and continued through 1980, a year of recession throughout the developed market economies.

^{39/} The money supply is not in itself a policy instrument. The monetary authorities affect the monetary aggregates through the setting of discount rates, bank reserve requirements, or open market operations. Besides, the large variety of new sources of credit for both businesses and consumers that have emerged in recent years make it difficult properly to define and measure the money supply. Therefore, the figures in table III-3 should be taken only as indicative of general trends in monetary policies.

^{40/} The measure used as a proxy for inflationary expectations - the increase in consumer prices in the preceding two years - may overestimate expected inflation during 1980 to the extent that market participants did not expect the bulge in inflation that took place in that year to be fully incorporated into the underlying inflation rate. This is likely to be particularly true for the United Kingdom, where the rate of increase in consumer prices has decelerated substantially in recent months. Overestimation of the expected rate of inflation may partially account for the declining trend in estimated real interest rates in the United Kingdom since the first quarter of 1980 shown in table III-4.

Table III-3. Major industrial countries: rates of change in the money supply in real terms, a/ 1979-1980

(Percentage change over corresponding period of preceding year)

| | 1979 | | | | 1980 | | |
|------------------------------|---------------|----------------|---------------|----------------|---------------|----------------|---------------|
| | First quarter | Second quarter | Third quarter | Fourth quarter | First quarter | Second quarter | Third quarter |
| Canada | 7.6 | 10.1 | 9.7 | 7.4 | 8.0 | 5.2 | 0.6 |
| France | 3.3 | 2.7 | 1.7 | 2.2 | -1.2 | -2.6 | -5.6 |
| Germany, Federal Republic of | 7.4 | 6.6 | 3.4 | 1.4 | 1.0 | -0.6 | -2.3 |
| Italy | 5.9 | 4.6 | 3.5 | 1.4 | -3.2 | -4.4 | -7.0 |
| Japan | 9.9 | 7.9 | 7.7 | 3.3 | 1.4 | -0.6 | -2.5 |
| United Kingdom | 0.8 | 0.7 | -3.6 | -4.1 | -4.7 | -5.4 | 0.1 |
| United States | -1.6 | -3.4 | -3.4 | -5.0 | -4.6 | -5.2 | -3.9 |

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

a/ Currency in circulation, demand deposits, and time and savings deposits (M2), deflated by the consumer price index of the corresponding period.

Table III-4. Major industrial countries: commercial bank lending rates to prime borrowers, end of period, 1977-1980
(Percentage)

| | 1978 | 1979 | 1980 | | | |
|---|-------|-------|------------------|-------------------|------------------|-------------------|
| | | | First quarter | Second quarter | Third quarter | Fourth quarter |
| <u>Nominal rates</u> | | | | | | |
| Canada | 11.50 | 15.00 | 16.50 | 13.25 | 12.25 | 18.25 |
| France | 10.95 | 13.65 | 14.65 | 14.15 | 13.40 | 13.40 |
| Germany, Federal Republic of | 5.50 | 9.75 | 10.50 | 11.50 | 11.50 | 11.50 |
| Italy | 15.00 | 19.50 | 19.50 | 19.50 | 19.50 | 20.50 |
| Japan | 4.50 | 6.51 | 7.70 | 9.27 | 8.99 | 8.55 |
| United Kingdom | 13.50 | 18.00 | 19.00 | 17.50 | 17.50 | 15.00 |
| United States | 11.75 | 15.25 | 19.50 | 11.50 | 13.00 | 21.50 |
| <u>Nominal rates adjusted for expected inflation a/</u> | | | | | | |
| Canada | 2.4 | 5.4 | 6.6 | 3.4 | 2.3 | 7.5 |
| France | 1.4 | 2.9 | 2.6 | 2.0 | 1.1 | 0.8 |
| Germany, Federal Republic of | 2.4 | 5.6 | 6.1 | 6.5 | 6.1 | 5.9 |
| Italy | 1.4 | 4.2 | 2.3 | 2.0 | 1.0 | 0.8 |
| Japan | -0.3 | 2.2 | 2.5 | 3.3 | 2.8 | 2.0 |
| United Kingdom | 2.6 | 4.7 | 4.1 | 1.2 | 1.1 | -1.2 |
| United States | 3.7 | 3.9 | 6.6 | -1.0 | 0.6 | 7.7 |

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

a/ Nominal rates deflated by the average increase in consumer prices in the preceding two years, taken as a proxy for expected inflation.

Despite sharp quarterly fluctuations, the upward trend in interest rates is clearest in the United States of America. ^{41/} Increasingly tighter monetary policies pursued by the United States beginning in late 1978 were responsible for these trends in interest rates. In turn, higher interest rates in the United States put pressures on the authorities in other major financial centres to raise interest rates there. In order to avoid capital outflows and to reduce pressures on exchange rates, in 1980, nominal interest rates were raised in 1979 and early 1980 in Europe and Japan, and they were later maintained at high levels despite the pronounced weakening of economic activity that set in during the second quarter of 1980.

More restrictive fiscal policies have also been pursued, though these were generally less so than Governments had originally planned. The automatic stabilizers which normally operate during recessions and the difficulty of reducing expenditure in an inflationary environment are probably the most important factors responsible for the failure of the authorities to reduce their budget deficits to the extent that they had wished. Indeed, if no discretionary action had been taken, in all the major developed market economies automatic changes in the central Governments' financial balances would have imparted a stimulus to aggregate demand. However, this positive stimulus was generally counteracted by discretionary budgetary changes. ^{42/} These discretionary measures included the raising of nominal rates of indirect and direct taxation, refraining from adjusting the latter to take into account the effects of inflation, and the paring down of planned programmes.

The restrictiveness of the budgetary stance can best be appreciated by comparing it to that adopted during the recession of 1974-1975. In 1975, the budget deficits in all the major industrial countries, measured as a percentage of gross national product, were appreciably larger than they had been before the recession in 1973 (see table III-5). By comparison, in 1979 and 1980, budget deficits contracted or were stabilized as a percentage of GNP. This different approach was evident in Italy, Japan and the United Kingdom of Great Britain and Northern Ireland. In both Italy and Japan, the slowdown or postponement of planned public expenditure were important factors making for fiscal restriction, while in Italy no action was taken to counter fiscal drag. In the United Kingdom, the budget deficit turned out to be higher than anticipated,

^{41/} The shift of emphasis by the United States authorities from fixing interest rates to controlling the monetary aggregates has led to wide interest rate fluctuations. In recent months, expectations about the future course of monetary policy have become an important determinant of short-term fluctuations in interest rates. Therefore, the trend over the past two years is a more significant indicator of the general policy stance than quarter-to-quarter fluctuations.

^{42/} Organisation for Economic Co-operation and Development, Economic Outlook, No. 28 (December 1980), pp. 37-38.

Table III-5. Major industrial countries: central government surplus or deficit
(Percentage of GNP)

| | 1973 | 1974 | 1975 | 1978 | 1979 | 1980 <u>a/</u> |
|--------------------------------|----------------|----------------|----------------|-------|-------|----------------|
| Canada | -1.3 <u>b/</u> | -1.1 <u>b/</u> | -3.8 <u>b/</u> | -4.4 | -4.0 | -4.4 |
| France | 0.6 | 0.3 | -3.0 | -0.8 | ... | ... |
| Germany, Federal Republic of | -0.3 | -1.0 | -3.3 | -2.0 | -1.9 | -2.0 |
| Italy | -8.9 | -8.1 | -13.2 | -15.4 | -11.2 | -9.2 |
| Japan | -1.6 | -1.3 | -4.7 | -6.5 | -5.3 | -5.4 |
| United Kingdom | -3.2 | -4.1 | -8.0 | -5.0 | -5.5 | -2.5 |
| United States | -0.6 | -0.8 | -4.9 | -2.1 | -1.2 | -1.8 |
| Over-all rate of growth of GDP | 6.7 | 0.3 | -0.6 | 4.5 | 3.8 | 1.4 |

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

a/ Provisional estimate based on partial data.

b/ For fiscal year beginning 1 April.

yet the deficit contracted sharply in 1980, a year that saw a 3 per cent decline in aggregate output. 43/

The policy response to the latest inflationary burst appears to have had some success in limiting the extent of the acceleration in inflation rates. The rates of price increase, in fact, began to come down in the closing months of 1980. The weakness in labour markets and rising unemployment, which were partially policy-induced, may have been responsible for the moderation observed in wage settlements during 1979 and 1980. In many countries money wages rose less than consumer prices; in real terms, hourly earnings in manufacturing appear to have fallen slightly in 1980 after remaining practically unchanged in 1979.

43/ It should be noted, however, that deficits as a percentage of GNP have shown an upward long-run trend. Therefore, recent discretionary government action has only had the effect of arresting this trend. The extent to which these budget deficits had an inflationary impact depends on a large number of factors which may have varied from country to country. However, such large and increasing deficits have undoubtedly contributed to inflationary expectations.

These anti-inflationary policies, however, have also had immediate costs. Besides the losses in output arising from the contraction in demand - already documented in chapter II - there has been an increase in unemployment (see table III-6). Although the unemployment rate in the developed market economies as a whole rose during 1980, however, the increase was less steep than might have been expected from the slowdown in the over-all pace of economic growth. During the recession of 1974-1975 a drastic reduction in employment had occurred, and the subsequent hesitant recovery did not bring unemployment rates down to those prevailing before. Therefore, when the 1980 recession came, businesses had generally adjusted their labour forces to the more unfavourable economic situation and, although rates generally crept upward, a generalized and sharp increase did not take place. Indeed, in three of the major industrial countries, Canada, Italy and Japan, unemployment fluctuated around its level of the previous year. The sharpest increases in unemployment were seen in the United States and the United Kingdom. Strong increases in unemployment were also experienced by some of the smaller economies.

Table III-6. Major industrial countries: unemployment rates, a/ 1978-1980
(Percentage of labour force)

| | 1978 | 1979 | 1980 | December 1980 |
|------------------------------|------|------|---------------|---------------|
| Canada | 8.4 | 7.5 | 7.5 | 7.1 |
| France | 5.1 | 5.9 | 6.2 <u>b/</u> | 6.4 <u>c/</u> |
| Germany, Federal Republic of | 4.3 | 3.8 | 3.9 | 4.8 |
| Italy | 7.2 | 7.7 | 7.5 <u>b/</u> | 7.9 <u>c/</u> |
| Japan | 2.2 | 2.1 | 2.0 <u>b/</u> | 2.1 <u>c/</u> |
| United Kingdom | 6.1 | 5.7 | 7.4 | 9.3 |
| United States | 6.0 | 5.8 | 7.1 | 6.9 |

Source: United Nations, Monthly Bulletin of Statistics; and Organisation for Economic Co-operation and Development, Economic Outlook, No. 28 (December 1980).

a/ Owing to differences in methods of measurement, rates for different countries are not comparable.

b/ Estimate based on incomplete data.

c/ Latest available period.

The moderate over-all rise in unemployment rates in 1980 should not obscure the fact that the pattern of unemployment has been changing for the worse since the early 1970s, and that this trend continued into 1980. In most countries, the time that a person spends out of work has increased, as has the proportion of youths and prime-age workers in the total unemployed. Moreover, levels of unemployment are expected to remain high. The problem is aggravated by the enlargement in the number of young people entering the labour market over the next several years as a consequence of the late post-war acceleration in birth rates.

Over the next 12 to 24 months, while some slight amelioration of the pace of inflation appears probable, the dynamics of the inflationary process imply that the developed market economies are likely to continue to experience comparatively high rates of inflation, even in the context of limited economic growth and generally restrictive economic policies. Forecasts for the period 1981-1982, assuming no additional increase in the real price of oil, suggest only a slight deceleration in the rates of change of GDP deflators (see table III-7). Since the recovery is expected to be sluggish, pressures from the side of demand are unlikely. Given recent wage trends, lower rates of increase in nominal wage in the coming 18 months may be difficult to achieve, especially in the United States, where the drop in real wages has been particularly severe.

Policy dilemmas

The short-term outlook for the developed market economies is neither for any decided lessening of inflation nor for any notable acceleration of growth in output and employment. The consequence for the majority of developing countries is that they face the prospect of continued weakness in their terms of trade and in the volume of their exports. The intensified pressure on their balance of payments and their reduced capacity to import appear likely to persist.

In a growing number of developing countries, policy makers have become increasingly persuaded that the eventual easing of the external constraint on their economic growth will come primarily through changes in the productive structures of their own economies. Thus, while demand restraint measures are being implemented to lessen the pressure on the balance of payments and to moderate domestic price increases, medium-term plans designed to adjust productive structures are being introduced. Agricultural expansion programmes, energy development schemes and export promotion policies have been receiving increasing attention. However, such measures generally add to inflationary pressures in the shorter run and are thus in conflict with efforts to adhere rigorously to anti-inflationary policies. The provision of additional resources through bilateral assistance programmes, the World Bank and the International Monetary Fund for the recognized purpose of assisting countries, either directly or indirectly, in financing the investments required to effect adjustments in production structures could contribute significantly to lessening this dilemma.

Table III-7. Developed market economies: rates of change in GNP/GDP deflators, a/ by regional groups, 1978-1982
(Percentage)

| | 1978 | 1979 | 1980 <u>b/</u> | 1981 <u>c/</u> | 1982 <u>c/</u> |
|----------------------------|------|------|----------------|----------------|----------------|
| Developed market economies | 7.5 | 8.0 | 9.3 | 9.2 | 8.6 |
| Major industrial countries | 7.1 | 7.8 | 9.1 | 9.0 | 8.5 |
| Other countries | 9.8 | 8.8 | 10.1 | 10.2 | 9.2 |
| North America <u>d/</u> | 7.2 | 8.6 | 9.5 | 10.1 | 9.8 |
| Europe <u>e/</u> | 8.9 | 9.1 | 11.3 | 9.5 | 8.7 |
| Other countries <u>f/</u> | 4.8 | 3.6 | 3.8 | 6.7 | 5.9 |

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on International Monetary Fund, International Financial Statistics; Organisation of Economic Co-operation and Development, Economic Outlook, No. 28 (December 1980), p. 121; and forecasts of Project LINK.

a/ 1979 GNP/GDP weights and exchange rates.

b/ Preliminary.

c/ Forecast.

d/ Canada and the United States.

e/ Austria, Belgium, Denmark, Finland, France, Germany, Federal Republic of, Greece, Ireland, Italy, Norway, Portugal, Spain, Sweden and Switzerland.

f/ Australia, Japan, New Zealand and South Africa.

For the developed market economies, particularly those experiencing the most rapid price increases and the least growth over the last several years, more investment is also seen as an important condition for lessening inflation in the longer run. Because of insufficient confidence in the prospects for a return to vigorous economic growth - an insufficiency accentuated by the caution of demand management policies - real business investment increased little over the latter part of the 1970s. ^{44/} There were, as a consequence, insufficient additions to productive capacity in a number of industries, and any expansion in aggregate demand quickly gave rise to specific supply shortages and price increases. This tendency was aggravated by the fact that the substantial increase in energy costs rendered part of existing productive capacity uneconomic, so that it was withdrawn from use. Further, with the limited expansion in investment, the rate of increase in productivity declined. The growth of productivity accordingly contributed less to offsetting the effects of wage increases in raising costs per unit of output.

More generous tax provisions for business investment have been introduced, or are under consideration, in some of the developed market economies where investment has increased least. Such measures confront Governments with a certain dilemma since they entail a short-term loss of revenue as the cost of a longer-term gain in output. When a restrictive fiscal policy is being pursued as part of an anti-inflationary programme, however, the increased budget deficit implied by the loss in revenue appears inconsistent with public aims.

There is, however, a larger dilemma that must also be identified. The desired expansion in business investment is unlikely to take place so long as excess productive capacity in the economy is general and is expected to persist. In other words, the pursuit of restrictive demand management policies which consequentially maintain the under-utilization of capacity at relatively high levels into the indefinite future works against the expansion of business investment. It is true, of course, that restraint has to be exercised in demand management policies, not solely to prevent the emergence of excess aggregate demand but also to dampen down inflationary expectations. However, if heavy reliance is placed on these policies, it is likely that substantial under-utilization of capacity and high levels of unemployment will have to be maintained for an extended period, and the conditions will not be created for the encouragement of investment.

This difficulty arises primarily because of the central role which the wage-price spiral plays in the inflationary process of most developed market economies. The adjustment of wages to price increases and of prices to wage increases on an economy-wide basis is a long, evident process; it has persisted over many years during which levels of unemployment have not only fluctuated but have also exhibited a longer-term, upward trend. There is widespread linking of wages to changes in the cost of living, either through formal arrangements or on a de facto basis. Wage contracts often include clauses which allow for the adjustment of wages in the light of increases in the cost of living. Where wage negotiations relate to a single increase and not to a contract covering a future period, past increases in the cost of living are, none the less,

^{44/} See chap. II.

usually an important element in the wage settlement. Thus, the behaviour of wages commonly appears to be influenced more by the evolution of prices in the past than by expectations about the effects of current policies on future prices.

It is not only wages but numerous other incomes which may be closely linked to prices through some kind of indexation, formal or informal. Evidence, for example, from the United States suggests that the distribution of income by age group and income group, whether in nominal or real terms, showed virtually no change in the period over the mid-1970s when prices advanced strongly.

This argues for some form of incomes policy as a complement to demand management policies to permit simultaneously the control of inflation and the encouragement of expanding investment activity. While incomes policies are fraught with difficulties and weaknesses, it is hard to see the alternative to further experimentation with them. New approaches, such as the tax-based income proposal, merit careful analysis and discussion. Through some such means, it is hoped, a social consensus moderating the demands of different groups to protect or raise their incomes may emerge. A broadening of the discussion on incomes to embrace other related economic changes and needs, such as investment, productivity and adaptation to higher energy costs, may contribute to a better understanding of the issues and to the emergence of a consensus.

It is not only wages and prices which are inflexible downwards and which impart an upward momentum to prices. Some prices are periodically fixed by Governments, and these are often adjusted to compensate for higher costs or lower real incomes. Governments also closely regulate some markets for specific goods or services, and such regulation may sometimes have the effect of protecting less efficient producers from price competition. One particular, but very important, instance is the use of protective measures against competition from foreign imports. The maintenance of an open trading system and the eschewal of resort to measures protecting uncompetitive industries are significant anti-inflationary measures.

In conclusion, the lowering of the pace of inflation together with the restoration of some momentum to the growth of investment and output, appears to call for the pursuit of a combination of policy measures, both national and international. An important condition is the avoidance of increases in the price of petroleum that are both large and abrupt. Success in moderating inflation will rest, however, upon finding the suitable combination of measures in the developed market economies. It cannot be pretended that the particular balance among measures, or the most workable forms of particular measures, are easily discernible or widely agreed. This only stresses the need for more intensive discussion to widen understanding of the process, to clarify the courses of action socially most acceptable, and to foster the emergence of a consensus in support of effective action.

Chapter IV

INTERNATIONAL TRADE AND PAYMENTS

Increasing payments disequilibrium in the world economy

As anticipated in last year's Survey, ^{45/} the current account imbalances that emerged in 1979 worsened considerably in the course of 1980 (see table IV-1). The net energy-importing developing countries and the developed market economies experienced a substantial increase in their current account deficits, and the energy-exporting developing countries saw their balances continue to improve very significantly. The trade accounts of the centrally planned economies moved from near-balance to a small surplus, the product of a reduction in the deficits of China and the Eastern European countries and a continuing large surplus in the Soviet Union.

The changes in the pattern of current accounts in the market economies were caused largely by movements in the terms of trade. Reflecting the sharp increase in energy prices, the net energy-importing countries experienced a significant deterioration in their terms of trade and net energy-exporting countries, a large improvement. That the changes in current accounts were the product of price movements is clearly brought out by the fact that changes in trade volumes in the market economies ran counter to those in current accounts. In both the energy-importing developing countries and the developed market economies, the volume of exports rose at a substantially faster pace than the volume of imports. On the other hand, in the energy-exporting developing countries, export volumes actually contracted quite sharply, while import volumes rose strongly ^{46/} (see table IV-2).

Among the European centrally planned economies, trade developments differed as between the Eastern European countries and Union of Soviet Socialist Republics. In the first group of countries, efforts were made to increase exports and to reduce imports in order to limit as much as possible the growth in external indebtedness, and the volume of exports increased by about 3 per cent while imports stagnated. On the other hand, the Soviet Union - a net exporter of oil - experienced an improvement in its terms of trade, which was partly offset by a substantially faster growth in the volume of imports than in exports. In China, the decline in the trade deficit appears to have been due largely to import restraint coupled with some improvement in the terms of trade.

^{45/} World Economic Survey 1979-1980 (United Nations publication, Sales No. E.80.II.C.2), pp. 37-42.

^{46/} Measured in 1979 prices, the combined trade balance of the energy-importing developing countries improved by \$5 1/2 billion, that of the developed market economies by \$34 1/2 billion and the trade balance of the energy-exporting developing countries deteriorated by \$39 billion.

Table IV-1. Balance of payments on current account, a/
by country groups, 1978-1981

(Billions of United States dollars)

| | 1978 | 1979 | 1980 <u>b/</u> | 1981 <u>c/</u> |
|---------------------------------------|-------|-------|----------------|----------------|
| Developed market economies | 32.8 | -7.4 | -47.2 | -39 1/2 |
| Major industrial countries | 36.2 | 3.5 | -17.9 | -8 |
| Other countries | -3.5 | -10.9 | -29.3 | -31 1/2 |
| Developing countries <u>d/</u> | -30.5 | 15.4 | 35.0 | 37 1/2 |
| Capital surplus countries | 20.4 | 70.4 | 108.5 | 125 |
| Other net energy exporters | -22.1 | -6.8 | -1.5 | -4 |
| Net energy importers <u>d/</u> | -28.8 | -48.2 | -72.0 | -83 1/2 |
| Centrally planned economies <u>e/</u> | -5.8 | -0.1 | 3.4 | 5 1/2 |
| China | -0.8 | -1.9 | -0.6 | -1/2 |
| Eastern Europe | -6.6 | -5.1 | -3.9 | -4 |
| USSR | 1.6 | 7.0 | 7.9 | 10 |
| Residual balance <u>f/</u> | 3.5 | -7.9 | 8.8 | -3 1/2 |

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

a/ Excluding government transfers.

b/ Preliminary.

c/ Forecast.

d/ The data presented herein underestimate the deficit due to the exclusion of Cuba and the developing centrally planned economies of Asia where data series on which to base estimates were unavailable through 1980.

e/ 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.

Trade developments

In general, world trade did not provide an impetus to growth in the world economy in 1980. In line with the decline in the rate of growth of output throughout the world economy, the growth in world imports decelerated substantially from around 6 per cent in 1979 to about 1 1/2 per cent in 1980. The decline in the growth of imports affected all the major categories of goods. Apart from those countries that experienced improvements in their terms of trade and external positions - the energy-exporting developing countries and the Soviet Union - only a few countries were able to step up the growth of their imports. In the developed market economies, which account for 70 per cent of world imports, the volume of total imports did not rise at all because of recessionary conditions, a sharp decrease in oil imports and a reversal of the preceding year's rapid build-up of raw material inventories. In the energy-importing developing countries, lack of flexibility in international financial markets and rapidly rising current account deficits led to a continuation or intensification of stringent policies to contain imports. ^{47/}

The behaviour of the volume of exports also varied considerably among regions. Exports from energy-importing developing countries fared better than those from other country groups, mainly on account of rapidly growing exports to the energy-exporting countries. Import demand from the latter group of countries also appears to have significantly boosted the growth of exports from the developed market economies. The substantial contraction in the volume of exports from the oil-exporting developing countries reflected conservation measures in the developed market economies, effects of the Middle East conflict and decisions to reduce oil exports in some countries.

Trade and payments outlook

The slow growth anticipated for the world economy in 1981 will very likely give rise to sluggish growth in international trade. Export growth rates are expected to remain weak in 1981 in all country groups. However, in the energy-exporting countries, exports are unlikely to decline by as much as they did in 1980. The main source of additional import demand will again be located in the latter group of countries. Imports into the developed market economies are forecast to decline by almost 1 per cent, mainly due to the recession and to further reductions in energy consumption. The energy-importing developing countries will be compelled to continue to restrain the growth of their imports. Owing to supply problems, the centrally planned economies are likely to experience some further deceleration in the growth of their real exports. In Eastern Europe, serious balance of payments problems will probably continue to condition policies towards imports.

In 1982, some recovery in the growth of world trade may be expected as the developed market economies move out of recession. The volume of international trade of these countries may increase by about 5 per cent. As their economic recovery gains momentum, the demand for energy is likely to increase, and the volume of exports from the energy-exporting countries could be expected to rise. For the energy-importing developing countries as a group, growth in the volume of

^{47/} Policy measures undertaken through early 1980 were discussed in World Economic Survey 1979-1980, chap. VI.

Table IV-2. World trade: annual rates of change in volumes and prices, by country groups, 1976-1982

(Percentage)

| | 1976-1979 | 1978 | 1979 | 1980 <u>a/</u> | 1981 <u>b/</u> | 1982 <u>b/</u> |
|---------------------------------------|-----------|-------|------|----------------|----------------|----------------|
| <u>Volume of exports</u> | | | | | | |
| World | 6.7 | 5.1 | 6.0 | 2 | 1 3/4 | 5 |
| Developed market economies | 7.0 | 6.1 | 6.5 | 3 1/4 | 2 | 5 1/2 |
| Developing countries | 5.6 | 2.1 | 4.5 | -2 1/4 | 1 | 4 1/2 |
| Capital surplus countries | 1.8 | -3.9 | -2.1 | -11 | -4 | ... |
| Other net energy exporters | 6.2 | 3.4 | 7.8 | -2 1/2 | 2 | ... |
| Net energy importers | 8.9 | 7.6 | 8.8 | 5 | 4 | ... |
| Centrally planned economies <u>c/</u> | 7.0 | 5.5 | 5.6 | 3 | 2 | 2 |
| <u>Volume of imports</u> | | | | | | |
| World | 6.9 | 5.8 | 5.6 | 1 1/2 | 1 1/4 | 5 |
| Developed market economies | 7.4 | 5.4 | 7.3 | - | -3/4 | 4 1/2 |
| Developing countries | 6.0 | 6.3 | 1.5 | 6 1/2 | 7 1/2 | 8 |
| Capital surplus countries | 12.8 | 1.3 | 2.4 | 12 | 15 | ... |
| Other net energy exporters | 5.2 | 4.4 | -3.3 | 15 | 15 | ... |
| Net energy importers | 4.5 | 8.9 | 3.3 | 1 | 1 | ... |
| Centrally planned economies <u>c/</u> | 5.2 | 8.3 | 2.1 | 2 3/4 | 2 | 3 |
| <u>Unit value of exports</u> | | | | | | |
| Market economies | 9.9 | 10.1 | 19.2 | 20 1/4 | 11 3/4 | ... |
| Developed market economies | 9.2 | 13.2 | 15.5 | 13 1/2 | 10 | ... |
| Developing countries | 11.9 | 2.1 | 30.4 | 40 1/4 | 16 1/4 | ... |
| Capital surplus countries | 15.0 | 0.7 | 48.9 | 66 1/2 | 25 | ... |
| Other net energy exporters | 12.9 | 1.2 | 36.2 | 49 3/4 | 20 | ... |
| Net energy importers | 8.6 | 3.6 | 12.6 | 13 3/4 | 6 | ... |
| <u>Unit value of imports</u> | | | | | | |
| Market economies | 9.7 | 9.7 | 18.7 | 21 1/4 | 11 1/2 | ... |
| Developed market economies | 9.7 | 9.9 | 19.3 | 22 | 12 | ... |
| Developing countries | 9.1 | 9.0 | 16.7 | 18 3/4 | 10 1/4 | ... |
| Capital surplus countries | 8.5 | 12.0 | 13.6 | 13 1/2 | 9 | ... |
| Other net energy exporters | 9.0 | 11.4 | 14.9 | 14 | 9 | ... |
| Net energy importers | 9.3 | 6.9 | 18.6 | 23 | 12 | ... |
| <u>Terms of trade</u> | | | | | | |
| Developed market economies | -0.5 | 3.0 | -3.2 | -7 | -1 3/4 | ... |
| Developing countries | 2.6 | -6.3 | 11.7 | 18 | 5 1/2 | ... |
| Capital surplus countries | 6.0 | -10.1 | 31.1 | 46 3/4 | 14 3/4 | ... |
| Other net energy exporters | 3.6 | -9.1 | 18.6 | 31 1/2 | 10 | ... |
| Net energy importers | -0.7 | -3.1 | -5.1 | -7 1/2 | -5 1/4 | ... |

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

a/ Preliminary estimates.

c/ Centrally planned economies of Europe only.

b/ Forecast.

exports may also recover. But their terms of trade are likely to continue to deteriorate, and the constraint on the growth of imports would accordingly continue to be severe. In the centrally planned economies of Europe, conditions similar to those prevailing in 1981 are expected to continue to affect the evolution of exports and imports.

The major payments imbalances observed in the last two years are forecast to intensify still further in 1981. Despite sharp increases in their imports and continued declines in the volume of their exports due to decreases in oil exports - the energy-exporting developing countries are expected to experience a further rise in their combined current account surplus because of additional terms of trade gains. In the developed market economies, a substantial improvement in their real trade balances is expected to more than offset the effect of deteriorating terms of trade, and their current account should, therefore, improve although still remaining substantially in deficit.

By contrast to 1980, when the developed market economies absorbed a large share of the surpluses of the energy-exporting countries, the energy-importing developing countries will have to bear an increasing share of the deficits which arise from the large and growing surpluses of the energy-exporting countries in 1981. In spite of continued import restraint and inadequate economic growth, the current account deficits of the energy-importing developing countries are still expected to rise sharply, owing entirely to a further deterioration in their terms of trade. In 1981, the terms of trade of these countries are expected to be almost 20 per cent lower than in 1977. As a result, several of these countries will face very severe financial difficulties, and a few among them even a payments crisis.

As a percentage of total world exports, the current account surpluses of the countries which have a structural surplus grew from 4 per cent in 1975 to 5 1/2 per cent in 1980 and are likely to remain at the same level in 1981. This suggests that the process of accommodation of the world economy to these surpluses will now be considerably more difficult and protracted than after the first round of energy price adjustments. Moreover, energy prices are not likely to decrease in real terms as they did in 1975-1978 but will more probably continue to rise. Both the surpluses of the energy-exporting countries and the counterpart deficits of the energy-importing regions will tend to diminish much more gradually than after 1975. This structural character of payments imbalances implies that efforts to reduce deficits by means of policies that dampen the demand for imports will tend to shift the deficits to other countries and will only reduce the aggregate deficit of the energy-importing regions through a further slackening of growth in the world economy.

Price changes in international commodity markets

Developments in international commodity markets have largely shaped the changes discussed above. As already mentioned, sharp increases in energy prices were the main factor affecting movements in current account balances of the major groupings of market economies in 1980. There were also important fluctuations in the prices of primary commodities other than oil and in the prices of manufactures, and these tended to have widely divergent effects on different groups of countries. While most energy-importing developing countries were affected by worsening terms of trade, the developing countries which depend on tropical beverages or oil-seeds for their export earnings and tend to be importers of temperate-zone food-stuffs appear to have experienced the sharpest deterioration in their terms of trade, as the prices of the former commodities fell substantially while grain prices rose.

Primary commodity prices were under pressure over the course of 1980 (see table IV-3). The major exception was food. Due to supply problems, both grain and sugar prices were substantially above their 1979 levels. The soaring price of sugar was due to weather-induced declines in output in the Caribbean, in a number of other developing countries and in the USSR. Estimates for the major grain crops - wheat, maize and rice - for the 1980/81 season suggest that grain output will be largely unchanged, and stocks have fallen.

The largest price declines in 1980 were recorded by tropical beverages and vegetable oils and oil-seeds. The markets for all commodities in the first group - comprising coffee, cocoa and tea - continued to be in over-supply, resulting in downward pressures on prices. The pattern of price changes was quite different in the markets for vegetable oil-seeds and oils. Until mid-1980, the record crops of 1979/80 caused prices to drop sharply; however, prices rose by almost 15 per cent between June and December on estimates of substantially reduced crops for 1980/81.

Weak demand conditions were the main factors affecting the prices of industrial raw materials. The movement of raw material prices closely followed trends in output growth rates in the developed market economies. But speculation has also been important in the fluctuations of raw material prices over the last couple of years. A flight from currencies primarily into gold and silver but also into other commodities contributed to the price upswing that ended in early 1980. At that point, the rapid and sharp rise in interest rates appears to have encouraged liquidation of speculative positions in commodities and thus may have reinforced the market weakness caused by more fundamental supply-demand factors.

So far, prices of industrial raw materials have not fallen as much during the current recession as they did in 1974-1975. One reason is that at their peak in February 1980, the prices for industrial raw materials - when deflated by the prices of manufactures - were well below their highs in 1974. Another reason is clearly that this time, the recession has not been as deep. But perhaps more importantly, there has been little undesired accumulation of inventories, and large excess capacity has not developed. Producers appear to have moved more quickly than in 1974-1975 to cut production and avoid the accumulation of unwanted inventories. It is notable that, partly as a consequence of weak price trends and expectations of continued market softness, there has not been much world-wide investment in raw materials since the early 1970s. Therefore, despite the pronounced slowdown in demand during the course of 1980, the extent of excess capacity has been smaller than during the previous recession. While these weak investment trends have helped to sustain prices during the recession, they could also lead to an early exacerbation of inflation in the event of a strong recovery.

Table IV-3. Changes in the prices of internationally traded commodities, 1978-1981

(Percentage)

| | 1978 | 1979 | 1980 | 1980, January to December | 1981 <u>a/</u> |
|--|-------|------|-------|------------------------------|----------------|
| Non-oil primary commodities <u>b/</u> | -6.7 | 15.3 | 14.8 | -1.4 | 2 |
| Food | 8.2 | 15.2 | 63.2 | 33.6 | 7 |
| Tropical beverages | -28.3 | 3.5 | -5.9 | -21.7 | -8 |
| Vegetable oil-seeds and oils | 10.3 | 15.6 | -14.9 | -2.9 | 11 |
| Agricultural raw materials | 10.8 | 22.8 | 11.9 | -0.1 | 5 |
| Minerals, ores and metals | 6.7 | 28.8 | 13.3 | -11.6 | -1 |
| Crude petroleum <u>c/</u> | - | 46.1 | 63.9 | 16.7 | 25 |
| Manufactures exported by developed market economies <u>d/</u> | 14.7 | 14.4 | 10.5 | 6.7 <u>e/</u> | 10 |

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

a/ Forecast.

b/ The price indices which serve as a basis for the calculations of rates of change have been constructed on the basis of spot market quotations expressed in United States dollars. Individual commodities are weighed by their value in the exports of developing countries in 1975-1977. The corresponding per cent weights are: food, 23.4 (of which sugar, 9.2; grains, 6.6; others, 7.6); tropical beverages, 31.0 (of which coffee, 22.1; cocoa, 5.7; tea, 3.1); vegetable oil-seeds and oil, 7.0; agricultural raw materials, 18.3 (of which tropical timber, 6.1; cotton, 5.9; rubber, 4.6; others, 1.7); minerals, ores and metals, 20.3 (of which copper, 6.8; iron ore, 4.3; aluminium, 2.7; tin, 2.5; phosphate rock, 2.2; others, 1.8).

c/ Based on official price quotations by OPEC member countries, North Sea producers, Brunei, Canada, Malaysia, Mexico, Oman, the Syrian Arab Republic and the USSR.

d/ Based on unit values for manufactures exported by developed market economies.

e/ Fourth quarter of 1979 through fourth quarter of 1980.

During 1981, primary commodity prices, perhaps with the exception of oil-seeds, are expected to increase less than the prices of manufactures exported by the developed market economies. However, unsettled interest rates might still lead to significant short-term fluctuations in the prices of some primary commodities. Unless there are major crop failures, grain prices should stabilize this year. Over-supply is expected to continue to dampen the prices for tropical beverages. Given the weak output trends in the developed market economies, the prices for industrial raw materials should experience a further drop relative to the prices for manufactures.

The prices for manufactures exported by the developed market economies continued to rise during 1980, but not as rapidly as in 1978-1979. For the first time since 1976, prices actually declined by about 2 1/2 per cent in the fourth quarter of 1980. The recession may have had some effect in bringing down the rate of price increase. However, the major factor appears to have been the appreciation of the dollar, which was particularly strong in the last quarter of the year. ^{48/} Unless there are substantial movements of exchange rates vis-à-vis the dollar, in 1981, prices for manufactures are likely to rise in line with inflation trends in the developed market economies.

As shown in table IV-3, crude petroleum prices rose by over 60 per cent in 1980 on a year-on-year basis. Most of the increase, however, took place at the beginning of the year, since the increase between January and December was less than 17 per cent. In spite of the Middle East conflict, the market remained unexpectedly calm. The loss of exports from Iran and Iraq was partially made up by a number of other producers. In addition, temporary inventory drawdowns and declines in consumption contributed to market balance. Given the large volume of inventories, stock depletion could continue in the next few months before stocks are run down to levels which may trigger sharp price increases. ^{49/}

During 1981, oil prices may rise further but at a much slower pace than in the past two years. By February, official prices were already about 17 per cent higher than their average 1980 levels. Assuming no further increases in real oil prices, in dollar terms, prices would be 25 per cent higher in 1981 than in 1980.

The likely movements in international prices in 1981 have adverse implications for developing countries which are net importers of energy. The prices for primary commodities exported by these countries are generally not expected to keep pace with those for other internationally traded commodities, and the terms of trade of a broad group of developing countries will be correspondingly affected. For the net energy-importing countries as a whole, the commodity price movements forecast for 1981 yield a deterioration in the terms of trade of over 5 per cent.

^{48/} It should be noted that the unit value index from which the rates of change shown in table IV-3 were estimated is expressed in dollars. As the dollar appreciates against the currencies of the main exporters of manufactures, this tends to be reflected in a slower increase in the dollar prices of the manufactures exported by such countries.

^{49/} For a more complete discussion of oil market developments, see chap. II.

These likely developments, and particularly the significant short-term fluctuations in prices of primary commodities in 1979-1980, which were partly due to speculative movements, underline the importance of efforts to stabilize international prices. The Agreement establishing the Common Fund to help finance price stabilization schemes was adopted in June 1980. By March 1981, about a third of the countries required to make it enter into force, had signed the Agreement.

The payments situation in energy-importing developing countries

Severe deterioration in the external accounts

Despite the over-all decline in the expansion of world trade, the volume of exports from energy-importing developing countries appears to have expanded by about 5 per cent in 1980. While this rate is substantially higher than recorded by other country groups, it is none the less considerably less than achieved in previous years. According to preliminary information, exports to the developed market economies appear to have expanded by less than 2 per cent. By contrast, exports to the energy-exporting developing countries rose sharply, accounting for a large share of the over-all increase in export volume. The expansion of exports to the energy-exporting countries appears to have been broad-based, with participation from countries at different income levels and from different geographic areas. ^{50/} Thus the trend toward closer trade links between energy-importing and energy-exporting countries observed during the past few years appears to have been strengthened in 1980 and may have made an important contribution to the maintenance of export growth rates in the former group of countries.

However, this relatively favourable export performance in the context of a rapidly decelerating world economy was not reflected in an improvement in the current account deficit, which worsened by an estimated \$24 billion in 1980. The most important contributing factors were the deterioration in the terms of trade mainly on account of energy price movements and the increase in interest payments resulting from the rise in international interest rates. It is estimated that increases in the cost of energy imports and interest charges alone amounted to about \$25 billion in 1980. As a share of total merchandise exports, the oil bill and gross interest outflows rose from 31 per cent in 1978 to 45 per cent in 1980.

These very adverse movements in the prices of imported goods and services prevented imports from growing much in 1980. In order to expand imports by a meager 1 per cent, the energy-importing developing countries were forced to draw down their international reserves even though these were already at an unsatisfactory level at the beginning of the year. As a percentage of imports, reserves had declined from 37 per cent at the end of 1978 to 33 per cent at the end of 1979. During the course of 1980, they declined in nominal terms by \$3 1/2 billion, bringing the reserves-to-imports ratio down to 25 per cent, or the equivalent of three months' imports. The decline in the reserve-import ratio was widespread. ^{51/} Since the current account deficit is expected to worsen

^{50/} For example, Brazil, Kenya, Morocco, Pakistan, the Republic of Korea, Yugoslavia and Zaire.

^{51/} Of the 61 countries for which data were available for at least one month in the period October-December 1980, 28 countries recorded an absolute decline in reserves relative to December 1979.

substantially in 1981, reserves are not likely to recover and may, in fact, decline further. Even with unchanged reserves in nominal terms, they would continue to decline sharply relative to imports. For the group as a whole, they may not be sufficient to finance even 2 1/2 months of imports by the end of the year.

Financing the increased current account deficits and the role of the International Monetary Fund

Although information is still very preliminary, a major portion of the increase in the current account deficit appears to have been financed by inflows of loan capital on relatively short term. Official transfers and direct investment may have increased by about \$1 billion each, but in real terms there apparently was little change in these variables. The failure of official grants to contribute adequately to the financing of substantially enlarged deficits undoubtedly affected the capacity of developing countries, and particularly of the lower-income countries, to sustain the pace of economic expansion. Also, although considerable efforts were exerted by many countries to attract foreign investment, substantially increased flows were not expected before 1981.

There is evidence that the expansion of long-term and medium-term credit from the international capital markets slowed down considerably during 1980 and may have contributed little to finance the increase in the current account deficit. Available information suggests that net increases in syndicated borrowings from Euro-currency markets which among commercial bank lending carry the most favourable terms with regard to both interest rates and maturities, were at best unchanged, forcing developing countries to resort to more expensive and shorter-term sources of credit. After two years of vigorous expansion, gross international syndicated borrowing from Euro-currency markets and bond issues by energy-importing developing countries fell from \$22 billion in 1979 to \$17 billion in 1980. However, net over-all use of credit from international capital markets may have fared somewhat better. A substantial amount of advanced refinancing of Euro-currency loans occurred in 1979 when borrowing terms were seen to have become advantageous, thus increasing gross 1979 borrowings by more than might have been expected otherwise. In addition, it is thought that the public reporting of multi-bank lending may have been less complete in 1980 and that more unannounced private placements were made. Furthermore, non-syndicated loans from banks in individual capital market centres appear to have risen. Finally, credits obtained in 1979 appear to have been used in 1980, as indicated by the sharp decline in the ratio of undisbursed commitments to total medium-term and long-term international bank credits.

The reduced level of syndicated international bank credits resulted from changing conditions in the financial markets under which lending banks were demanding harder terms for credits which borrower countries were reluctant to accept. Lending banks had become more cautious owing to the deteriorated payments position of the major energy-importing borrowers, an uncertain short-term outlook, and increasing loan-equity ratios. Thus, while countries with rapidly increasing export revenues were still able to command favourable lending "spreads" ^{52/} in

^{52/} Interest on international bank loans is usually set as a fixed percentage "spread" above a periodically changed base interest rate, generally the six-month London Interbank Offered Rate for the currency of the loan.

1980 comparable to the low levels reached in 1979, the more heavily indebted energy-importing countries were being asked to accept increasingly wide loan spreads or larger "front-end" fees 53/ as well as shorter maturities.

Since 1978, the International Monetary Fund (IMF) has played a more important role than in the past in providing balance of payments financing to developing countries. It should be noted, though, that greater recourse to the Fund by developing countries, and particularly by the lower-income countries, was partly a reflection of the inadequate increase in concessionary aid. Total net access to Fund resources by energy-importing developing countries rose from \$0.4 billion in 1978 to \$3.2 billion in 1980. Overcoming what in earlier years had been seen as barriers resulting from conditionality norms, energy-importing developing countries increased their recourse to regular Fund resources and to the Extended Fund Facility from \$0.2 billion in 1978 to \$2.1 billion in 1980. An increase of over 100 per cent in net drawings also occurred in the newly liberalized Compensatory Financing Facility which had now become available as a result of adverse trends in export performance. Furthermore, there was also a significant increase in the flow of borrowing from the IMF Trust Fund, the facility with the most advantageous borrowing terms. 54/

Clearly anticipating continued payments financing difficulties, an increasing number of energy-importing developing countries also arranged very significantly expanded credit lines with IMF in 1980. The total value of stand-by and Extended Fund Facility agreements for those countries in effect at the end of 1980 was \$9.9 billion, as compared to \$1.5 billion at the end of 1978. As 1981 began, three quarters of those credit lines (a number of which had been arranged in the latter part of 1980) were as yet undrawn.

The increased use of IMF resources in 1980 and the further increase which will most likely take place in 1981, were made possible by a series of Fund policy changes effected in the last two years. Prominent among them was the adoption in March 1979 of a new set of guidelines for the conditionality attached to use of Fund credit. The basic thrust of the change was the formal recognition that adjustment of severe balance-of-payments problems required longer-term financing so as "to alleviate the effect of corrective measures on real incomes and to contribute to a distribution of the burden of adjustment within the economy that is socially and politically more acceptable". 55/ The guidelines also provide that due regard be paid to domestic social and political objectives in assisting countries in designing their adjustment programmes and that stand-by agreements, necessary for use of certain of the credits provided by the Fund, might be concluded for longer periods. Notwithstanding, the Fund may need to modify

53/ These are one-time charges imposed when a loan agreement is signed and fluctuate with the difficulty loan managers have in syndicating the loan.

54/ Trust Fund loans bear interest at 0.5 per cent per annum and are to be repaid in instalments from 6 to 10 years from the date of disbursement. Final disbursements from the Trust Fund were made early in 1981.

55/ International Monetary Fund, Annual Report 1979 (Washington, D.C., IMF, 1979), p. 63.

further its policies conditioning access to its resources to enable countries to sustain substantially larger deficits for periods long enough to permit structural adjustment without sacrificing economic growth.

Besides altering conditionality, the Fund has taken numerous steps to increase the ability of member countries to borrow from its various facilities. Since members' borrowing rights are generally defined in terms of multiples of Fund quotas, the implementation of the Seventh General Review of Quotas at the end of 1980, which raised quotas by an average of 50 per cent, increased borrowing ability as well as the size of reserve assets. Moreover, preparatory work on the Eighth General Review of Quotas was initiated in 1980. These increases in quotas will go some way toward enabling IMF to provide a more significant share of the balance of payments financing required by developing countries than in the past. 56/

In recognition of the need for expanded balance of payments financing, the Fund has adopted new policy guidelines to substantially enlarge borrowing limits. In August 1979, the quota limit for borrowing from the Compensatory Financing Facility was raised from 75 to 100 per cent, and the annual borrowing limit of 50 per cent of quotas was dropped. In September 1980, the Interim Committee endorsed the Executive Board's recommendation that the limit to annual assistance be set at 200 per cent of quota 57/ for a total of 600 per cent of quota over a three-year period. 58/

Another significant development has been the efforts of many of the energy-exporting developing countries to increase resource flows to other developing countries. During the second half of the 1970s, concessional financial flows from OPEC countries have been, on average, well above 1 per cent of their gross domestic product. In 1980 new policy initiatives were taken by these countries and other oil exporters to increase substantially financial resource flows in the medium term.

At the present moment, the current account deficit of the energy-importing developing countries is expected to grow by an additional \$11 to \$12 billion in 1981. Prospects are for a sluggish expansion of exports and a further and significant deterioration in the terms of trade. Furthermore, the medium-term prospects for the current account are clouded with uncertainties. Under these circumstances, developing countries may be less willing or able to resort to the temporary expedient of financing larger deficits by raising short-term credits and drawing from their international reserves. This means that access to longer-term financing, both from official and private sources, will have to increase substantially in 1981 even if only to maintain the level of real imports.

56/ In order to meet the sizable increases in lending that are expected in the near future, the Fund is also attempting to borrow \$7 billion to \$8 billion annually over the period 1981-1983. These efforts have already met with considerable success; Saudi Arabia alone has decided to lend IMF \$4.9 billion in each of the next two years.

57/ Excluding drawings under the compensatory and buffer stock financing facilities.

58/ After the adoption of the new quotas, however, a further revision was made in ceiling guidelines in early 1981, and members may now draw up to 150 per cent per annum of their new, larger quotas, for a limit of 450 per cent over three years. The net effect of the latter change is a further 12.5 per cent increase in the borrowing ceiling.

Large current account fluctuations in the developed market economies

As noted above, the combined current account of the developed market economies deteriorated by about \$40 1/2 billion in 1980, and the main factor account for the increased deficit was the sharp deterioration in the terms of trade. Export volume, in fact, increased at a faster pace than the volume of imports, and the surplus on services and private transfers declined by less than \$1 billion.

Perhaps the most important change in the pattern of current accounts among industrial countries since 1978 is the reversal of the relative positions of the United States, on the one hand, and of Japan, the Federal Republic of Germany, France and Italy, on the other. While the latter countries had growing surpluses during the recovery from the previous recession, the United States recorded large and growing deficits. As can be seen in table IV-4, beginning in 1979, the surpluses of Japan and the major continental European countries began to erode, and now they all are in significant deficit; the United States, on the other hand, has experienced a turn-around in its current account, and its former deficit position has become a small but growing surplus.

During 1980, the United States' current account surplus grew in spite of worsening terms of trade and a sharp increase in the value of net energy imports. It is estimated that, had net energy imports remained unchanged in volume terms, price increases would have caused their value to rise by over \$50 billion between 1978 and 1980. A sharp decline in the volume of energy imports, however, kept the increase to about two thirds of that magnitude. In 1980, a 21 per cent contraction in real energy imports was the major factor behind the fall in the over-all level of import volume of slightly more than 7 per cent. On the other hand, partly as a result of improved competitiveness, exports rose by almost 7 per cent in real terms. In addition to the improvement in the trade balance, a significant increase in net investment income from abroad contributed to the rise in the current account surplus.

The current accounts of Canada and the United Kingdom of Great Britain and Northern Ireland also improved in 1980. In both countries, the movement in the real trade balance was favourable, reflecting mainly weak domestic demand conditions. In addition, the Canadian terms of trade appear to have improved somewhat, and the terms of trade of the United Kingdom may have deteriorated only marginally.

In the major continental European countries and Japan, current accounts worsened considerably. Since these countries are heavily dependent on imported energy, their terms of trade were adversely affected by higher energy prices. In Japan, the current account deficit was greater than in 1979, but narrowed continually throughout the year, largely because of movements in the real trade balance; exports grew by over 19 per cent in real terms, while import volume declined by almost 6 per cent. In contrast to Japan, the current accounts of the major continental European countries worsened considerably as the year progressed. In these countries, the growth of export volume was substantially slower than in Japan, and imports rose in real terms. In addition, the deterioration of their terms of trade was aggravated by the depreciation of their currencies.

The smaller developed market economies were also affected by a sharp worsening in their terms of trade. In addition, the more buoyant state of domestic demand in

Table IV-4. Developed market economies: trade and current account balances, a/ 1978-1981
(Billions of United States dollars)

| | 1978 | 1979 | 1980 <u>b/</u> | 1981 <u>c/</u> |
|----------------------------------|-------|-------|----------------|----------------|
| Canada | | | | |
| Trade balance | 3.6 | 3.8 | 5.8 | 6 1/2 |
| Current account balance | -4.2 | -4.5 | -3.2 | -3 |
| France | | | | |
| Trade balance | 0.7 | -1.6 | -13.4 | -16 3/4 |
| Current account balance | 5.3 | 3.2 | -6.7 | -8 3/4 |
| Germany, Federal Republic of | | | | |
| Trade balance | 23.3 | 14.7 | 6.6 | 8 1/4 |
| Current account balance | 13.0 | -0.4 | -10.9 | -10 |
| Italy | | | | |
| Trade balance | 2.9 | -1.1 | -13.2 | -14 |
| Current account balance | 9.2 | 8.0 | -3.2 | -2 1/2 |
| Japan | | | | |
| Trade balance | 25.3 | 1.8 | -0.3 | 1 1/4 |
| Current account balance | 18.0 | -7.9 | -12.0 | -11 3/4 |
| United Kingdom | | | | |
| Trade balance | -3.0 | -7.1 | 0.4 | 3/4 |
| Current account balance | 4.5 | 1.0 | 7.9 | 8 |
| United States | | | | |
| Trade balance | -33.8 | -29.5 | -26.7 | -23 3/4 |
| Current account balance | -9.5 | 4.6 | 10.2 | 20 |
| Major industrial countries | | | | |
| Trade balance | 19.1 | -19.0 | -40.8 | -37 1/2 |
| Current account balance | 36.2 | 3.9 | -17.9 | -8 3/4 |
| Other developed market economies | | | | |
| Trade balance | -12.9 | -21.6 | -39.3 | -41 1/2 |
| Current account balance | -3.5 | -10.7 | -29.3 | -31 1/2 |
| Developed market economies | | | | |
| Trade balance | 6.1 | -40.5 | -80.1 | -79 |
| Current account balance | 32.8 | -6.8 | -47.2 | -39 1/4 |

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

a/ Excluding government transfers.

b/ Preliminary.

c/ Forecast.

these countries relative to their main trading partners appears to have prevented a significant improvement in real trade balances. As a consequence of these movements in trade prices and volumes, their combined current account deficit almost trebled in 1980.

The short-term prospects for the collective current account of the developed market economies are for some reduction in the deficit. All of the decline, however, will be due to a \$10 billion increase in the surplus of the United States. Further declines in energy and other categories of imports and larger net income payments from abroad account for the larger surplus.

Despite sluggish imports, further unfavourable movements in the terms of trade will cause the major industrial countries of continental Europe and Japan to remain in substantial deficit. In the case of Japan, export growth is also expected to decelerate considerably. ^{59/} The lagged effects of exchange rate appreciation on trade volumes should make themselves increasingly felt as 1981 progresses. On the other hand, exports from the major continental European countries, and especially from the Federal Republic of Germany, should increase at a somewhat faster pace when the effects of the currency depreciation of recent months begin to take hold.

The smaller developed market economies are expected to experience a further increase in their collective deficit. In fact, in 1981 these countries may account for over 80 per cent of the aggregate deficit of the developed market economies as a whole. Not only are their terms of trade expected to deteriorate, but changes in real balances may not be as favourable as for the major countries. The growth of exports to the larger industrial economies, their major trading partners, will be adversely affected by the recession there. Deficits of the magnitude forecast for 1981 imply that adjustment measures are very likely to be taken by a number of countries, thereby affecting output growth rates in the short term and medium term.

External adjustment efforts in the centrally planned economies

The policies underlying the national output and trade plans of the centrally planned economies of Eastern Europe and the USSR in 1980 were conditioned by two broad types of concerns. First, policymakers deliberately slowed down the pace of economic activity in an effort to adapt further to drastic shifts in world costs of energy and raw materials and to eliminate the supply and transportation bottle-necks that had been building up since the late 1970s. Concerns about the external balance were especially strong in the Eastern European economies, where compressing external deficits through import cutbacks and export promotion played a pivotal role in charting policies. Secondly, adverse effects on private consumption were to be minimized. Both sets of considerations, while already influential in plan formulation, played an even more significant role in plan implementation.

The improvement in the group's external balance of about \$2 billion in 1980 stemmed from a significant reduction in Eastern Europe's trade deficit and a larger

^{59/} This assumes that no spectacular recovery in the economies of the Persian Gulf would take place in 1981.

surplus for the USSR (see table IV-5). Their external balancing efforts were focused primarily on the developed market economies. Eastern Europe surpassed by a significant margin the amount by which deficits with developed market economies were compressed in 1979, and the USSR even recorded a small surplus. Against the backdrop of the group's slow output expansion and the recession in the developed market economies, the reduction in Eastern Europe's deficit with the latter countries was notable.

Table IV-5. Eastern Europe and the Union of Soviet Socialist Republics: trade balances, 1978-1980
(Billions of United States dollars)

| Country group | Eastern Europe | | | a/ | USSR | | | a/ |
|-----------------------------|----------------|------|------|----|------|------|------|----|
| | 1978 | 1979 | 1980 | | 1978 | 1979 | 1980 | |
| World | -6.6 | -5.1 | -3.9 | | 1.6 | 7.0 | 7.9 | |
| Centrally planned economies | -1.2 | -0.1 | -0.4 | | 0.7 | 3.4 | 4.9 | |
| Developed market economies | -6.4 | -5.4 | -4.2 | | -3.3 | -1.1 | 0.2 | |
| Developing countries | 1.0 | 0.4 | 0.6 | | 4.2 | 4.7 | 2.8 | |

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

a/ Preliminary estimates.

Growth in export and import volume for the group was modest - about 2 to 3 per cent - and it lagged well behind the rates observed in 1978-1979 (see table IV-2). However, these figures have to be interpreted in the light of at least three considerations. In the first place, the export growth rates for the group as a whole mask the significant growth in Eastern Europe's exports, especially to the market economies, and the strong import surge in the USSR. Second, the 5 to 6 per cent growth in Eastern Europe's exports to the market economies is a remarkable achievement in the light of the fact that the import demand of these economies expanded by only 1 1/2 per cent. Finally, it bears stressing that the increase in Eastern Europe's export volume was attained in spite of a variety of external and internal output constraints, including virtually stagnant real import levels and a reduction of 1 to 2 per cent in the volume of imports from outside the group.

In contrast to Eastern Europe's trade performance, the Union of Soviet Socialist Republics exports stagnated, and its imports expanded substantially without adversely affecting the trade balance. Especially in relations with the market economies, the USSR was able to increase its export revenue while reducing the volume of major exportables (including petroleum). Imports from outside the group, however, rose substantially - by about 11-12 per cent - in part to mitigate the effects of the poor 1979 harvest on domestic supplies. On the other hand, the volume of exports and imports in trade with other centrally planned economies increased by about 3 to 4 per cent.

In most of the Eastern European economies, export expansion with other areas took precedence over intra-group trade. In the case of Hungary and Poland, for example, the current value of intra-group exports even declined. The potential impact of output shortfalls on Polish exports to the market economies was cushioned by curtailing shipments to other centrally planned economies, especially the USSR, and the pace of industrial production in some of Poland's partner countries in Central Europe was adversely affected by delays or cancellation of shipments contracted for.

The 1980 trade environment was characterized by rather small movements in the terms of trade. Whereas the USSR registered another gain in its total terms of trade, owing to price increases for its fuels and raw materials, those of the Eastern European economies on balance changed only marginally. Import prices generally increased in 1980 faster than in the preceding year, and the same held true for Eastern European exports. On the other hand, due to comparatively modest year-over-year increases in the price of key export commodities (such as petroleum and gas products, most of which are exported under special price arrangements to other countries of the Council for Mutual Economic Assistance (CMEA)), USSR export prices increased less than in 1979.

As during most of the 1970s, price movements in intra-group trade differed markedly from those observed in trade with other countries. Intra-group export and import prices went up on the average by about 7 per cent in terms of transferable roubles, but price movements for fuels and industrial raw materials were substantially larger. Although the latter are the key export products of the USSR to the group, price changes were comparatively modest and, on the whole, the USSR experienced a terms of trade gain of less than 2 per cent. Substantially larger price changes took place in trade with the market economies: while Eastern Europe's terms of trade with the market economies were unchanged, those of the USSR improved by a sizable 5 per cent.

The comparatively minor shifts in intra-group trade imbalances could be easily accommodated within the framework of the institutional and other arrangements that regulate trade and payment flows among the CMEA members, although special measures were required to assist Poland both in its regional and extra-CMEA payments relations. As in the past few years, Eastern Europe's current account deficit with the market economies was financed by a combination of new borrowing in international capital markets, government-supported export credits of the supplier countries, direct supplier credits and gold sales, although the latter were markedly below their 1979 levels.

The combined net convertible currency debt of Eastern Europe and the Soviet Union (including the two CMEA banks), which in 1979 had passed the \$65 billion mark, probably increased by another \$5 billion to \$6 billion in 1980, ^{60/} all of which was concentrated in Eastern Europe. ^{61/} Total debt service continues to be substantial (from 20 to 90 per cent of current convertible currency earnings) and was exacerbated in 1980 by the high interest rates in world financial markets.

^{60/} During the first nine months of 1980, net liabilities to Western commercial banks, which constitute the bulk of the total convertible currency debt, increased by \$4.1 billion.

^{61/} Romania accounted for about 38 per cent of the increase.

The trade outlook for 1981 and 1982 differs only marginally from actual performance in 1980 inasmuch as most Eastern European economies are determined to restore gradually external equilibrium. As already evident from developments during the past two years, the margin for further deceleration in import growth by depleting inventories, substituting inputs and more effective input utilization has become exceedingly narrow. As a result, slowing down import growth for balance-of-payments reasons implies relatively modest output targets. Although all countries are planning to increase exports, particularly to the market economies, the climate for substantial gains is unfavourable. On the other hand, the Eastern European countries are likely to experience a further deterioration in their terms of trade, owing to the annual adjustment of intra-CMEA trade prices and because additional fuels and raw materials will have to be increasingly procured from world markets. In view of the constraints on output and anticipated shifts in the terms of trade, the Eastern European countries are likely to incur a deficit at least as large as in 1980. Although policies in these countries are aimed at further compressing deficits with market economies, sluggish output growth in combination with a modest expansion of demand for Eastern European exports on the part of the market economies render these policy objectives rather ambitious. As a result, the convertible currency debt burden is unlikely to shrink in the next two years for the Eastern European countries as a whole. On the other hand, intra-group imbalances are bound to deteriorate substantially for most Eastern European countries, the exact amount depending upon the size of the 1981 intra-CMEA price adjustments.

As in the past few years, external trade and payments considerations will continue to be less of a constraint for the USSR. Although the export volume of fuels and raw materials will probably rise only marginally, if at all, owing to supply constraints and rapidly growing domestic demand, the USSR can count on further gains in its terms of trade. Even under a scenario of relative price stability in the world market, the over-all trade surplus of the Soviet Union may well surpass \$10 billion in 1981. This reflects the fact that under the lagged price adjustment procedure used in intra-CMEA trade, the relative price of petroleum will continue to show a strong upward drift in this portion of Soviet trade. ^{62/} In fact, a full adjustment of intra-CMEA prices to the 1976-1980 world market average in 1981 is likely to impose a considerable strain on the trade and financing system of the region, which is geared to medium-term bilateral balancing. Since this would result in a much enlarged Soviet surplus in relation with Eastern Europe, new institutional arrangements may have to be found to bridge the financial gap until trade flows can be adjusted to balance at the new price levels.

Rising protectionist pressures

After some 30 years of general movement toward trade liberalization, the recent years have been characterized by more ambivalent actions and attitudes towards protection, particularly on the part of the major industrial countries. The 1970s witnessed the successful negotiations in the General Agreement on Tariffs

^{62/} Under the revised "Bucharest formula" procedure applied since 1975, intra-group foreign trade prices are renegotiated annually on the basis of a moving five-year average of world market prices. The price base for 1981 thus includes two years of the higher post-1978 oil price, as against only one year in the 1980 price base.

and Trade (GATT) of yet another round of tariff reductions. During the same period, however, recourse to non-tariff barriers increased. According to a recent study, about 40 per cent of all trade by market economies was subject to some sort of non-tariff restriction in 1974, and the share of such controlled trade has since raised the figure to over 55 per cent. The increase has occurred almost entirely in the field of manufactures - since a substantial part of trade in agricultural products was already managed by 1974 - and it was mainly the result of new barriers introduced by the industrial countries. 63/

The range of products subject to non-tariff restrictions has grown. To the list of traditional categories of protected goods - foods, textiles and clothing - must now be added footwear and leather goods, iron and steel, chemicals, shipbuilding and home electronics products. From the point of view of the developing countries, it is a matter of the greatest concern if their emergence as competitors in new manufacturing industries is soon followed by the erection of formidable barriers impeding their access to specific markets.

In order to circumvent current GATT regulations, in recent years quantitative restrictions such as "voluntary export restraints", "orderly marketing agreements" and "organized free trade" have been added to the traditional range of non-tariff barriers such as quotas, licensing and technical barriers to trade. The use of trigger prices or sliding tariff scales and the granting of subsidies to specific industries in the developed market economies are also distorting trade patterns in several activities in which developing countries have a comparative advantage. The negative effect of these barriers may be much stronger than is commonly assumed. Although in the short run they may have a relatively marginal effect on developing countries, in the longer run, the trade dynamics of these countries are considerably affected, and the process of change in the international division of labour is slowed down. Thus developing countries are prevented from realizing their full export potential.

During 1980, as the pace of economic activity slackened in the developed market economies and unemployment rose, protectionist pressures increased. Calls for protection and protectionist actions have actually affected, or are threatening to affect, trade both among developed market economies and between developed market economies and developing countries. The threat of protectionist measures on trade between developed market economies is of particular concern, since such measures carry the risk of retaliation and the rapid unraveling of the liberal trade order that has characterized the post-war period. Concern centres in particular on the bilateral trade relations between Japan, on the one hand, and the European Economic Community (EEC) and the United States, on the other. Increasing Japanese penetration of the markets of its major trading partners has given rise to calls for protection from both business and labour. The major industries affected by competition from Japanese exports are automobiles, colour television sets, other home electronics products and, more recently, machine tools and office machinery. The bulk of the Japanese export drive during 1980 took place in these industrial sectors. Moreover, these sectors are suffering from serious structural problems in both the United States and EEC. While structural adjustment is the long-term solution to the trade dispute between Japan and its industrial partners, the difficulties inherent in such a process are heightened during a time of weak over-all demand and rising unemployment.

63/ S. D. B. Page, The Management of International Trade (London, National Institute of Economic and Social Research, November 1979), pp. 11-14.

Concrete actions have also been taken against imports of manufactures from developing countries. Invoking the existence of export subsidies or the GATT anti-dumping code, during 1980 the United States imposed new countervailing duties on exports from five developing countries. ^{64/} In addition, some categories of non-traditional exports from five countries continued to be affected by duties imposed in previous years. ^{65/} In EEC, the number of "sensitive" products exported by developing countries subject to tariffs and quotas and of "semi-sensitive" ones subject to ceilings in the EEC General System of Preferences scheme increased from 59 and 136, respectively, in 1979 to 136 and 184, respectively, in 1980.

The main single event in the field of trade policies in 1980 was the entering into force of several of the agreements negotiated in the Tokyo Round of Multilateral Trade Negotiations. ^{66/} The first of eight yearly tariff cuts came into effect as well as the codes on subsidies and countervailing duties, dumping, technical barriers to trade, import licensing procedures, bovine meat, dairy products and trade in civil aircraft. In January 1981, the agreements on customs valuation and government procurement entered into force as well.

The codes aim to regulate certain practices that contravene the spirit if not the letter of GATT rules in these areas. By establishing unequivocal criteria, conditions and procedures under which legitimate action can be taken under GATT and by improving the surveillance mechanisms, it is hoped that the new instruments will deter such practices in the future. Although it is too soon to assess the over-all effectiveness of the codes in reshaping the basis of trade relations, there are some grounds for concern. For instance, in the United States the recent shift in emphasis from countervailing to anti-dumping trade actions can be explained, at least in part, by the weakening of the injury criterion in the revised anti-dumping code. In effect, only 7 countervailing actions were initiated in 1980, as against 17 in 1979; meanwhile, the number of anti-dumping actions increased from 10 to 35.

Of particular concern to developing countries is that no agreement was reached on the proposed text on safeguards, where some of the strongest clauses against protection were to be found. As a result of this lack of agreement, industrial countries continue to be able to circumvent GATT and impose import limitations on individual countries, usually in the form of "voluntary" export restraints whenever an exporter is successful in penetrating their markets.

Pressures for greater protectionist measures continue and may well intensify in 1981. The Multi-Fibre Agreement, which has successfully limited textile and clothing exports from developing countries over the past two decades, is due for renewal in 1981, and there are indications that the major importing countries may be seeking more stringent limits to developing country exports in order to accommodate more trade in textiles among industrial countries. More generally, until the industrial economies begin to show signs of an upturn in economic activity protectionist pressures from both management and labour are likely to remain strong.

^{64/} India, Israel, Mexico, Pakistan and the Republic of Korea.

^{65/} Argentina, Brazil, the Dominican Republic, the Republic of Korea and Yugoslavia.

^{66/} For a more comprehensive discussion, see General Agreement on Tariffs and Trade, The Tokyo Round of Multilateral Trade Negotiations, GATT/1979/3 (Geneva, April 1979) and Supplementary Report (Geneva, January 1980); and United Nations Conference on Trade and Development, "Assessment of the results of the multilateral trade negotiations" (TD/B/778 and Add.1, February 1980).

Chapter V

ADAPTATION IN DEVELOPING COUNTRIES: SELECTED ISSUES

Adaptation and the role of international finance

Since the mid-1970s, but particularly starting in 1978, the growth and development prospects of developing countries have been seriously affected by certain major international events. The upsurge of inflation in some of the main industrial countries beginning in the second half of 1978, the sharp increases in energy prices in 1979 and 1980, the large world-wide decline in industrial activity in the first half of 1980, and the instability in markets for food and certain raw materials have considerably altered international prices and trade flows. As a consequence, the gains from trade have been modified very substantially for individual countries. At the same time, for most countries external payments imbalances have intensified. These changes in the international environment have required and still require substantial adaptation of the economics of developing countries.

Capital-surplus countries are still confronted with two crucial issues: diversification of production structures and finding adequate outlets for their financial surpluses. In fact, efforts to diversify production structures have been only partly successful ^{67/} and their economies are still very dependent on a depletable resource. However, during 1979 and even more in 1980, significant advances were achieved regarding the second issue. Diversification of financial assets has progressed rapidly and financial institutions - some newly created with public and private sector ownership from surplus countries - have begun to play a role in the international market. In addition, the financial centres of Western Asia have themselves become a more significant part of the international financial system. Nevertheless, given the interconnexions between capital markets in an open world financial system, these new centres are still very much influenced by financial developments in main industrial countries.

In deficit countries, an essential ingredient of policies required to foster adaptation is increased efforts to mobilize the resources, particularly investible funds, required for the restructuring of domestic production. However, under present circumstances, there are certain factors that inhibit the capacity of developing countries to mobilize these resources. One of these is the sluggishness in the flow of external finance, particularly as regards funds at long term and with concessional interest rates. The pages that follow take up certain aspects

^{67/} It is true that in recent years surplus countries have made significant strides to improve their human and physical infrastructure and to diversify their economies. Nevertheless, since it is only during the last decade that these countries have had the resources to embark on accelerated multisectoral or comprehensive development programmes, much remains to be done. For example, the technological gap between these and industrial countries still remains very substantial in most areas.

of these two issues, namely, the policies followed by developing countries to expedite domestic adaptation and the requirements of external financing for a smooth adaptation process.

The adaptation of production structures

Faced with foreign exchange constraints, rapidly changing energy prices, continued instability in commodity export prices, and strong inflationary pressures from within and without, most deficit developing countries have had to adjust their economic policies, making difficult choices affecting the structure of output, over-all growth and income distribution. Although few developing countries have dramatically altered their national plans or development strategies, there have been significant changes in the planned level and structure of investment to be undertaken in the medium term. While the reorientation of policies having a bearing on the level and structure of investment differs considerably among countries, there are certain common - sometimes overlapping - features emerging in the new approaches. These include a downward revision of planned growth rates, a stronger emphasis on actions to relieve the foreign exchange constraint, an increased role for the market and a shift of investment patterns towards energy and agriculture.

The factors leading to downward revision in planned growth rates - particularly import constraints and decreasing public investment allocations as a result of the need for greater fiscal discipline - were already described in the World Economic Survey 1979-1980. ^{68/} In the past year, problems have intensified and an additional number of countries have had to slow down the rate of growth of investment. Moreover, what was until 1979 mostly a phenomenon affecting countries with a stagnant capacity to import ^{69/} has now become more pervasive owing to the widespread commitment to dampen inflation. Thus, certain developing countries as, for example, Brazil, Gabon, the Republic of Korea, the Syrian Arab Republic, Venezuela and Yugoslavia, have adopted a policy of "controlled" growth to ease inflationary pressures.

At the same time, in the face of current movements in international prices and uncertain economic outlook, developing countries have been concerned to ensure that they have the ability to make available the necessary imports of goods and services over the medium term and long term. Thus, most developing countries have paid increased attention to export activities since early 1979; ^{70/} and in 1980, policies to expand and diversify exports, both in terms of products and markets were reinforced and intensified. In addition, efforts are being made to speed the efficient substitution of domestic output for imports, particularly in the sectors based on natural resources.

In the short term, nevertheless, the more critical foreign-exchange situation has led to intensified import restraint in a number of countries. Some countries

^{68/} United Nations publication, Sales No. E.80.II.C.2, chap. VI.

^{69/} For example, Costa Rica, El Salvador, Jamaica, Kenya, Morocco, Senegal, the Sudan and Zaire.

^{70/} This phenomenon, which had already started in the mid-1970s, is also described in the World Economic Survey 1979-1980, chap. VI.

devalued, 71/ others resorted to different forms of import restrictions. But contrary to past experience, recent import restrictions have tended to be across the board rather than selective. In a sense, policies have been geared primarily to raise the relative cost in domestic prices of all imports - in some cases with the exception of food - rather than reducing or eliminating certain lines of imported goods.

The changed emphasis as regards techniques for reducing imports reflects a greater willingness to accord a major role to market forces in bringing about changes in the domestic economy. This tendency is also evident in other aspects of countries' policies. Prices for hydrocarbons have been adjusted swiftly to induce conservation, while in many countries measures have been taken to raise agricultural prices at the farm level to encourage output growth. And, as mentioned earlier, many Governments are according a greater role to foreign enterprises.

These tendencies have rarely been the result of explicit decisions in principle to place greater reliance on market mechanisms, but have rather emerged from pragmatic responses to present difficulties. Another factor is that in the present situation characterized by high levels of inflation, increased scarcity of foreign exchange and volatility of international prices and exchange rates, planning has become more difficult. Increased reliance on the market has been seen by many developing countries, therefore, as a way to make fuller use of their productive potential in areas or sectors in which it has become increasingly difficult for the Government to provide a more direct stimulus. 72/

There are two areas, however, in which market forces have been significantly reinforced by government policies: energy and agriculture. The reasons for increased attention to these two sectors are broadly similar. In the case of energy, higher international prices for hydrocarbons and their external payment implications, relative unpredictability of supplies in the medium term, 73/ and the clear recognition that dependence on imported petroleum might be risky in the long run, have led most developing countries to seek to become more self-reliant in energy. Thus, exploration and development of hydrocarbons have been emphasized, while new programmes have been launched to develop other domestic renewable and non-renewable sources of energy. In the case of agriculture, food price volatility in international markets and the possibility of regional - and even world - crises in the present decade have led many countries to reconsider the relative neglect of the agricultural sector. In a large number of countries, including Bangladesh, Brazil, India, Nicaragua, Senegal and Turkey, very significant additional efforts are being made to increase agricultural production as a way to improve the trade

71/ For example, Costa Rica, Israel, the Republic of Korea, Turkey, Yugoslavia and Zaire devalued very significantly in 1980 vis-à-vis the dollar.

72/ There are instances, however, in which the aim has been to curb the growth of the public sector or even to reduce its size considerably, as in Argentina, Brazil, Chile, Egypt and Venezuela.

73/ However, it must be pointed out that several oil exporters have given preferential treatment to other developing countries. Preference includes assured availability of supplies at official prices and long-term credits on favourable terms on petroleum purchases.

balance and dietary conditions. ^{74/} Moreover, in some countries, particularly those in which resource availability is increasing rapidly on account of energy exports, advances in the agricultural sector are seen as a crucial element in a strategy of balanced development with improved income distribution. ^{75/}

The external financial requirements of deficit countries

A smooth adaptation of production structures, and particularly the allocation of additional resources in investment programmes having a long gestation period - for example, energy development - require, in addition to increased domestic savings, increased flows of external resources on appropriate terms. Besides, under present economic conditions characterized by the volatility of prices in international markets, of interest rates and exchange rates, increased access to short-term and medium-term financing also plays an important role in a smooth adaptation process. The latter forms of financing are particularly necessary for those developing countries which, owing to international price volatility, have suffered sharp - although transitory - falls in their export prices or abrupt increases in their import bill, leading to increased current account deficits. ^{76/}

Among the deficit developing countries, there were some countries - the net energy exporters - whose current account deficit generally did not deteriorate in 1980. In several of these countries, the payments situation actually improved as increasing energy exports more than compensated for increases in import bills. For the group as a whole, in spite of still very significant deficits in some countries. ^{77/} the current account deficit declined considerably in 1980.

However, the general improvement in the current account position of these energy-exporting countries is expected to be a temporary phenomenon for a number of reasons. One is that the sharp increases in energy prices in 1979 and 1980 are not expected to be repeated to the same degree in subsequent years, thus tempering the terms of trade gains. Second, imports have grown at a very fast pace in most

^{74/} The growing importance attached to dietary conditions is also reflected in the increasing number of developing countries which have adopted national food strategies along the lines recommended by the World Food Council. See the report of the World Food Council on its sixth session (Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 19 (A/35/19)).

^{75/} For example, the recent re-orientation of economic policies in Algeria and Tunisia involves a strong emphasis on agriculture and rural development. Similarly, Mexico established the "Sistema alimentario mexicano" aimed at eradicating malnutrition and achieving food self-sufficiency by 1985.

^{76/} In this regard, an important development has been the recent decision of the Interim Committee of IMF to urge prompt consideration by the Executive Board of the provision of additional balance-of-payments support to assist low-income, food-deficit countries to meet increases in their food-import bills.

^{77/} For example, the current account deficit of Mexico exceeded \$US 6 billion in 1980 while the deficits of Algeria and Egypt were estimated to exceed \$US 1 billion, and the deficits of Ecuador and Tunisia were of about half that amount.

of these countries and new social and economic programmes suggest that a significant absorptive capacity exists and that rapid import increases will be maintained. Third, the considerable income growth and industrialization drive will tend to reduce the share of energy production available for export. The management problems associated with any widening in the deficit of these countries will be alleviated by the high credit-worthiness of these countries and the fact that the deficit is the result of rapid growth in both imports and GDP.

As explained in chapter IV, the current account deficits of energy-importing developing countries worsened considerably in 1980, owing primarily to the sharp deterioration that occurred in their terms of trade and the effects of recession in the developed market economies. Moreover, these deficits are not likely to decline in 1981 and may even rise further.

In evaluating the significance of these developments in terms of external financial requirements, it should be borne in mind that the persistence of current account deficits and even their increase are not a problem per se. The development process and efforts to adapt the structure of domestic production are importantly supported by capital from abroad, and as long as a deficit is sustainable in the long run, it makes sense for lenders and the individual country to realize such a deficit. Problems arise, however, when the deficit widens abruptly or when the particular means for financing the deficit changes in ways that raise questions as to whether the deficit can be sustained throughout the period required for adaptation. While some adjustment may be inevitable in such a case, 78/ there are none the less advantages in phasing that adjustment over a number of years.

The sluggishness of long-term financial flows

Recent developments in the external resource flows to developing countries have underscored the importance of the above considerations regarding development financing. There has been a marked change in the composition of external resources which finance the current account deficit of energy-importing countries. First, whereas official grants financed about one fifth of the deficit in 1976-1977, by 1980 they covered less than one eighth. 79/ Since 1977, there has also been a dramatic decline in the share of the deficit covered by net direct investment inflows. Indeed, in 1980 both of the above types of flow appear to have declined in real terms. The result of this process is that whereas non-debt-related flows accounted for about 34 per cent of the net financing of the current account deficit of energy-importing countries in 1978, they accounted for 27 per cent in 1979 and only 21 per cent in 1980 (see table V-1).

78/ The difficulties that accompany sudden increases in current account deficits and the consequent adjustment problems were one focus of attention in the World Economic Survey 1979-1980. The analysis therein remains germane today.

79/ For purposes of the present discussion, it was appropriate to separate grants from the debt-creating, albeit concessional, part of official development assistance (ODA). Nevertheless, it is unlikely that net over-all ODA receipts of the energy-importing developing countries rose by as much as the general increase in average import costs of this group of countries in 1980. This followed two years in which net ODA flows, increasing about 24 per cent in each year, did exceed the rise in import unit values (these increases exceeded the growth of ODA received by all developing countries since an increasing portion of ODA has been shifted to the energy-importing countries).

Table V-1. Financing the current account deficits of energy-importing developing countries, 1976-1980

(Billions of United States dollars)

| | 1976 | 1977 | 1978 | 1979 | 1980 <u>a/</u> | Percentage distribution in 1980 |
|--|-------|-------|-------|-------|----------------|---------------------------------|
| <u>Current account balance of energy-importing countries</u> . . | -21.4 | -21.2 | -28.8 | -48.2 | -72 | |
| Of which 56 countries . . . | -18.6 | -19.7 | -25.0 | -40.1 | -57 1/2 | 100 |
| <u>Net financing (56 countries)</u> | | | | | | |
| Official unrequited transfers | 3.7 | 4.0 | 4.4 | 5.8 | 6 1/2 | 11 |
| Direct investment | 2.8 | 3.5 | 4.1 | 5.1 | 6 | 10 |
| Portfolio and other long-term capital | 15.7 | 15.5 | 22.2 | 24.5 | 25 1/2 | 45 |
| Non-monetary authority short-term <u>c/</u> | 2.5 | 2.7 | 4.9 | 8.4 | 14 1/2 | 25 |
| Balance on capital account | 24.7 | 25.7 | 35.7 | 43.7 | 52 1/2 | 91 |
| Reserve-related finance <u>d/</u> . | 6.1 | 6.0 | 10.6 | 3.5 | -5 | 9 |

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

a/ Preliminary estimate based on incomplete information.

b/ The sample comprised 56 countries for which sufficiently detailed information was available through 1979: Argentina, Bahamas, Bangladesh, Barbados, Botswana, Brazil, Burma, Central African Republic, Chile, Colombia, Costa Rica, Cyprus, Democratic Yemen, Dominican Republic, El Salvador, Ethiopia, Fiji, Gambia, Ghana, Guatemala, Haiti, Honduras, Israel, Jamaica, Jordan, Kenya, Madagascar, Malawi, Malta, Mauritania, Mauritius, Morocco, Nepal, Nicaragua, Pakistan, Panama, Papua New Guinea, Paraguay, Philippines, Republic of Korea, Rwanda, Seychelles, Sierra Leone, Singapore, Somalia, Sri Lanka, Sudan, Suriname, Swaziland, Thailand, Turkey, Uganda, Uruguay, Yemen, Yugoslavia, Zambia.

c/ Includes errors and omissions.

d/ This includes increases (+) or decreases (-) in reserve assets and net inflows (-) or net repayments (+) of monetary authority borrowing (principally from IMF). It excludes financing through reserve creation (SDR allocations and other counterpart items).

The shift to flows that give rise to debt was accompanied also by changes in the composition of net external borrowing. The net flow of long-term capital to developing countries since the mid-1970s has been uneven. Over this period, the net flow of portfolio and other long-term capital to the energy-importing developing countries increased in terms of its ability to purchase imports in only one year, 1978. Present indications are that in 1980 there was little growth even in nominal terms in the net flow.

The reasons for the inadequate long-term flows in 1980 reside in the weak performance of their two major sources, official creditors and, particularly, private financial institutions. Net flows from official creditors - bilateral and multilateral institutions - which had been growing in nominal terms at an average annual rate of only about 7.5 per cent since 1975, are estimated to have grown at roughly double that rate in 1980. ^{80/} Nevertheless, the unit cost of the imports of energy-importing developing countries grew faster still. At the same time, there was an apparent decrease in the nominal net flows of officially-guaranteed borrowing from the private financial markets in 1980 (see table V-2). ^{81/}

Table V-2. Net flows of medium-term and long-term external debt capital ^{a/} to energy-importing developing countries, 1976-1980

(Billions of United States dollars)

| | 1976 | 1977 | 1978 | 1979 | 1980 ^{b/} |
|--|------|------|------|------|--------------------|
| Official creditors ^{c/} | 8.0 | 7.6 | 9.5 | 10.4 | 12 |
| Private financial institutions | 6.6 | 7.1 | 11.5 | 16.0 | 15 |
| Bonds | 1.0 | 1.1 | 1.7 | 0.7 | 0.5 |
| Private suppliers' credits and other | 0.8 | 1.1 | 2.3 | -0.3 | ... |
| Total, all lenders | 16.4 | 16.8 | 24.9 | 26.8 | ... |

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on World Bank, World Debt Tables and other sources.

^{a/} Public or publicly guaranteed debt owed to non-residents, repayable in foreign currency, goods or services, having an original or extended maturity in excess of one year.

^{b/} Preliminary estimates for the year based on partial information.

^{c/} Governments and international organizations.

^{80/} To a certain extent, this was due to increased financial co-operation among developing countries, to the first year of disbursements under the World Bank's structural adjustment lending programme and to more intensive promotion of official export credits by developed market economy countries, as well as to increased flows of official development assistance.

^{81/} It appears that at least some and possibly all of the retreat in the net flow of officially guaranteed borrowing was offset by higher non-guaranteed, private flows. Nevertheless, the ability of developing country enterprises to borrow without a government guarantee - although on the increase - is not yet very widespread.

The basic reason for the lack of advance in 1980 in net financial market flows, and a worrying portent for 1981, was the decline in syndicated Euro-currency credits (see table V-3). The decline occurred in spite of the fact that such credits have been a preferred vehicle for international commercial bank credit by borrowing countries. This is because it has been generally cheaper to raise large sums through a syndicate of banks than through a comparable series of individual bank loans. ^{82/}

In 1980, such loans maintained their favourable terms as compared with other forms of bank lending. However, for developing countries terms became more onerous. Although the average spread on large loans ^{83/} arranged for borrowers in developed market economies was reported to have been lower or about the same in each quarter of 1980 compared to the corresponding quarter of 1979, the average spread for developing countries, measured on the same basis, showed spreads exceeding the corresponding 1979 quarterly averages during the second half of 1980. Toward the end of 1980, developing country average spreads were roughly twice those paid by developed market economies. ^{84/}

Table V-3. Gross international borrowing by energy-importing developing countries and by all borrowers
(Billions of United States dollars)

| | 1976 | 1977 | 1978 | 1979 | 1980 |
|---|------|------|-------|-------|-------|
| <u>Syndicated Euro-currency credits</u> | | | | | |
| Energy-importing developing countries . . | 7.8 | 7.6 | 16.0 | 19.7 | 16.9 |
| World | 28.7 | 34.2 | 73.7 | 70.2 | 70.4 |
| <u>Foreign and international bonds</u> | | | | | |
| Energy-importing developing countries . . | 1.3 | 1.9 | 2.5 | 2.3 | 1.5 |
| World | 34.3 | 36.1 | 37.5 | 37.8 | 38.3 |
| <u>Total bonds and credits</u> | | | | | |
| Energy-importing developing countries . . | 9.2 | 9.6 | 18.5 | 22.0 | 18.4 |
| World | 63.0 | 70.3 | 111.2 | 108.0 | 108.7 |

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on World Bank Capital Markets System.

^{82/} This cost advantage has been reinforced by the fact that increasing competition from new lenders has in recent years lowered the cost of loan syndications.

^{83/} Weighted average of spreads above LIBOR on loans of at least \$US 50 million with a maturity exceeding three years, completed or signed during period (excluding tax-sparing loans).

^{84/} Organisation for Economic Co-operation and Development, Financial Market Trends, various issues.

Moreover, this increase in spreads for developing countries occurred at a time when there was a resurgence of interest rates in the Euro-currency market. Six-month Euro-dollar deposit rates, which had been around 12 per cent at the end of 1978, moved upward in late 1979 and then rose steeply in early 1980, reaching more than 19 per cent at the end of March. The rates fell back to around 10 per cent in mid-1980, but then rose again, exceeding 16 per cent by the end of the year.

These changes in interest costs no doubt help explain the fact that from 1978 to 1980 the total value of syndicated Euro-currency credits has fallen (albeit after more than doubling in 1978). ^{85/} Keeping in mind that these are gross lending figures which thus include refinancings (especially in 1978 for industrial countries and in 1979 for developing countries), it appears that the Euro-currency market is not continuing the dynamic growth of the middle 1970s.

As may be seen in table V-3, the stagnation in total Euro-currency credits has been echoed in the foreign and international bond markets. The steady growth in the share of bond issues of energy-importing countries from 3.8 per cent in 1976 to 6.7 per cent in 1978, was reversed in 1979 and in 1980 fell back to 4 per cent of the total, a decreasing share of a virtually unchanged total. Again, an advantageous form of long-term finance which can significantly help to meet balance-of-payments financing needs of developing countries is not offering prospects of growth.

Short-term financing

In the face of inadequate elasticity of the forms of finance discussed above, developing countries have been forced to make more extensive use of single bank borrowing at short and medium term and various forms of short-term finance. Indeed, whereas short-term flows accounted for about 10 per cent of net capital flows to energy-importing countries in 1976 and 1977, that ratio began to rise in 1978, reaching 19 per cent in 1979 and, apparently, almost 28 per cent in 1980. ^{86/} Each year this borrowing must either be retired, renewed again at short term, or converted into longer-term debt. Under present circumstances, the latter is the preferred alternative.

No doubt, short-term credit provides in many cases the flexibility that is required in the present situation. But a significant reliance on it poses certain problems. First, unless debt to be retired is offset by non-debt inflows (that is, official transfers or direct investment), a net reduction in debt entails a reduction in the current account deficit. As discussed in chapter IV, the expectation for 1981 is, instead, for an increased deficit. Secondly, although the relative importance of the various components of short-term capital are not all subject to measurement, some of the flows which may be playing a role are self-

^{85/} Nevertheless, figures in table V-3 exclude a different form of multibank lending (that is, club loans) which is becoming increasingly important and which offers the basic risk-sharing advantage of syndicated credits.

^{86/} Based on data for non-monetary authority short-term flows and the balance on capital account in table V-1.

limiting, 87/ and must therefore be replaced by other credit sources. Thirdly, short-term credits have tended to be more expensive than longer-term flows.

A further self-limiting source of external financing in 1980 was the use of official reserve assets. As may be seen in table V-1, from 1976 to 1978 about a fourth of net capital inflows in that group of countries served to finance the net accumulation of reserves. This effort to increase financial flexibility following the external difficulties of 1975 was propitious. In 1979, in spite of a large increase in net capital inflows, the pace of reserve accumulation dropped substantially. In 1980, it became necessary to draw substantially on accumulated reserves. As a result, by the end of 1980, in about half of these 56 countries reserves were not sufficient to cover even two months of 1980 imports.

Policies to increase private resource flows

Faced with the need for more rapidly expanding supplies of external finance and a bleak outlook for significant increases in official resource transfers from developed countries, 88/ a large number of developing countries have recently re-examined regulations governing foreign involvement in their domestic economies. This re-examination does not imply a return to past relationships. In fact, during the 1970s, developing countries have enhanced their institutional capabilities to deal with foreign involvement. This, in turn, has created a situation in a number of countries in which it was felt that greater foreign involvement would provide benefits to the host country and be consistent with present development objectives. Developing countries have also been re-evaluating the role of external financing of domestic entities. In some cases, the ensuing policies were part of longer-run strategies for adjustment of the structure of production and trade. In other cases, these steps were aimed, simply, at more effectively tapping potential sources of international finance.

In fact, since the mid-1970s but particularly in 1980, a large number of developing countries have made very considerable efforts to increase the inflow of private resources through a variety of approaches to enhance their over-all borrowing ability. Such approaches involve encouraging public enterprises and private firms - including transnational corporations operating in the country - to seek financial resources abroad, relaxation of constraints on foreign financial concerns attempting to enter or increasing their operations in domestic capital markets, recourse to new financial instruments to achieve a larger flow of portfolio investment and increased economic incentives to keep domestic capital at home and to attract flows from abroad, particularly through interest rate adjustments in the face of international interest rate developments.

87/ One such source is adjustments in the timing of payments for internationally traded goods, for example, between affiliates of a transnational corporation (that is, advancing dates of payment to developing country enterprises or lagging payment dates for imports by them). A second self-limiting source is outright payments arrears.

88/ As described in chapter IV, energy-exporting developing countries have under discussion a number of initiatives designed to increase substantially their financial flows to developing countries.

By way of example, Chile, the Philippines, Thailand and Venezuela took measures in 1980 to encourage or enhance the capability of corporations to borrow abroad; Argentina, India and Malaysia opened their capital markets to greater foreign participation, including that of countries in the Middle East; Singapore and Sri Lanka took steps to enhance or establish offshore financial markets, thereby promoting an international presence in their financial sector; Brazil, Jamaica, Mexico, Pakistan and the Republic of Korea have negotiated an increased variety of financial instruments in foreign capital markets, including some of a short-term nature. 89/

Because of cost considerations, some countries otherwise in a position to do so have not availed themselves of international capital markets to a significant extent. In the present situation, however, the ability to borrow substantial amounts, even on commercial terms, has come increasingly to be recognized as an opportunity that must be given close consideration. One country to do so in 1980 was India, which has arranged for a Euro-currency credit on the order of 10 times the size of its largest previous borrowing, the proceeds to be applied to an aluminium project. However, the new borrowing policy was not entered into lightly or without reservations. 40/

Efforts to facilitate direct investment

The effort by some countries to attract international banks to operate in domestic financial markets is but a special case of what appears to be a more general phenomenon. There is a renewed or enhanced interest in encouraging foreign firms to enter and undertake both manufacturing and, particularly, resource development activities in developing countries. To be sure, the concerns which led to attempts to establish an agreed code of conduct for transnational corporations continue to exist; and developing countries have expressed their strong interest in a successful conclusion of these negotiations. However, the current situation has induced developing countries to examine ways in which their policies might be made more attractive to foreign direct investors. As well as being a source of financing, some foreign investors are a potential channel for technology transfers and some can absorb locally-produced output into their own international distribution systems. Developing countries are entirely alert to their pressing needs in all these areas. 91/

89/ For example, bankers' acceptance credits, 180-day bank letters of credit and commercial paper.

90/ As the Indian Planning Commission stated in mid-1980, "The climate for concessional aid, both bilateral and multilateral, is not favourable. There is undoubtedly considerable excess liquidity in the international capital markets and if we have sound bankable projects it should be possible to mobilize moderate amounts by way of commercial borrowings. However, it must be emphasized that borrowing on commercial terms with relatively short maturities can be resorted to only if the projects yield a return higher than the interest cost of the debt. Moreover, international capital markets usually categorize countries according to country risks and ... the attitude of commercial bankers abroad could change suddenly ..." (Government of India, Planning Commission, "Sixth Five-Year Plan, 1980-1985, a Framework", para. 24).

91/ In addition, in a few countries there has been a growing dissatisfaction with the major domestic organizers of production, be they in State or private sectors, as regards their over-all efficiency and responsiveness to changing economic circumstances. In some cases, new domestic or foreign investors are seen as a potentially refreshing, competitive wind.

Thus, in a number of developing countries, general policy statements were made in 1980 in support of an increased role for direct foreign investors under current conditions. Furthermore, these statements were followed by specific proposals and commitments for implementation. For example, in order to reduce various uncertainties facing potential foreign investors, Indonesia specified more clearly its lists of investment priorities, while Ghana and Peru set out to rewrite and liberalize their investment laws, and Nigeria issued a set of investor guidelines which clarified the role of foreign partners. Similarly, the Ivory Coast began elaboration of a new foreign investment law whose publication was expected in 1981. A number of countries, including India, Indonesia and Thailand, indicated their willingness to reduce administrative delays and speed processing of investment applications, while Bangladesh announced enhanced flexibility in implementing its investment code.

Specific reductions in restrictions on foreign investment were also announced during 1980. India expanded permissible foreign equity participation in a number of sectors (including paper manufacture, fertilizers, petro-chemicals and hotels) and opened oil exploration to foreign investment through production-sharing arrangements. Similarly, Chile has decided to open new areas to private, risk-bearing oil exploration contracts in 1981. In Thailand and Turkey, almost all sectors were opened to foreign investment in 1980, including those traditionally in the public sector. In Tunisia, a proposal was under discussion early in 1981 under which coverage of a law granting special incentives to foreign manufacturing investors and joint ventures would be extended to export service industries. The Republic of Korea and Sri Lanka expanded the maximum allowable share of foreign ownership in local subsidiaries in certain sectors, while the former country also reduced the minimum investment foreign firms were required to make. Similarly, Venezuela announced that investors from outside the Andean Pact region could invest with reduced local participation provided they agreed to conversion to majority local ownership within 15 years or provided they exported at least 80 per cent of their production. In addition, a number of countries, particularly in the south of Asia, are extending the privileges granted to investors in export processing zones or are planning new zones.

Besides the above, in the new policy environment there are three distinctive features. First, pragmatism has become a leading factor in the current situation and developing countries are allowing foreign investment even in sectors that, because of their strategic importance, had previously been reserved only for public corporations. This is particularly true as regards hydro-carbons. Secondly, special efforts have been made in several countries to promote direct investment by other developing countries, particularly oil exporters. Indeed, there is an expanding presence of developing countries as suppliers of capital and as direct producers in a variety of forms of co-operative ventures meeting the institutional requirements of individual host countries and regional economic associations. Thirdly, several countries have undertaken an active role in recruiting foreign investors by establishing closer contacts with the business communities - and in some cases, with Governments - of other countries. 92/

92/ Apart from the traditional policy statements and communications through the information media, developing countries are increasingly sending well-prepared delegations, usually with representatives of both the Government and the private sector, to meet with the business communities of the more industrialized countries. For example, in 1980, Indonesia sent a 100-strong delegation to London and Paris to meet with the latter's business communities.

It is still too early to assess the results of the new policies to attract direct investment. Increased resource flows will start to materialize only gradually. Even then, many of the resulting projects will not mature for a number of years. But whatever the results in the medium term, it is clear that reliance on foreign investment is only a partial solution available to a limited number of countries.

