

Trade, Debt and Growth in Latin America

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TRADE, DEBT AND GROWTH IN LATIN AMERICA

by

Antonio Jorge
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Enrique P. Sanchez

PREFACE

The present book consists of the proceedings of the Conference on Latin American Trade and Economic Growth, sponsored by the Department of Economics at Florida International University and Wharton Econometrics Forecasting Associates. The event took place in the City of Miami, Florida, on March 7th and 8th 1983.

This work could be considered a sequel to the publication of the proceedings of a previous conference, sponsored by Florida International University's Department of Economics and the International Banking Center, on the closely related topic of the foreign debt and economic development of Latin America. In that book our main purpose was the examination of the external debt problem as it affected the region as a whole and certain individual countries in particular. What we now seek to accomplish is to explore the inter-relations of the foreign debt with the international trade of the area and its prospects for economic development.

It is becoming increasingly evident that the issues in question cannot be productively or realistically contemplated in isolation and much less resolved independently of one another. The interdependence of these variables has by now become inextricable and its consequent reverberations will decisively affect the working of the world economy. Now more than ever it is clear that the economic integration of the international trade, financial and monetary systems, is a reality. The well-being of developed and developing nations are dependent upon the outcome of their mutual interactions and the coordination of their policies.

In light of the above, it is highly important to emphasize the need of a vigorous recovery in the developed nations as a necessary condition for a resurgence of economic growth in the developing countries. Stimulating the linkages between both groups of countries is essential for the restoration of world trade and the health of the global economy. In turn, this conditions must be fulfilled in order to resume the orderly transfer of resources from debtor to creditor countries and thus satisfy outstanding debt obligations.

Recent events in the world economy may well be seen at a future point in time as a watershed. Structural changes in the international world system will concomitantly require new perceptions and more flexible and accommodative behavior by all parties involved. The increasing complexity of the system poses both grave risks of world disequilibria and also the opportunity to creatively resolve the manifold challenges confronting all nations.

Both the conference and the book have been made possible by the enthusiastic support and participation of the local and international banking and business communities. In a special manner, the editors would like to express their gratitude to Angel Fernandez Varela, Chairman of the Board of Consolidated Bank of Miami and Carlos Arbolea, Vice-Chairman of Barnett Bank of South Florida, for their financial generosity and personal support. We take this opportunity to recognize once again the persevering efforts of Robert Schwarzreich, a graduate student of economics at F.I.U., and Pat Egner, of Wharton Econometrics, who were an essential element in the editing of this manuscript. Finally, our special recognition of Lourdes Gonzalez-Novoa, who, not only was a key support in the organization of the conference, but also went through many hours of patient typing to get this book to press.

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BY WAY OF A BRIEF OVERVIEW

Antonio Jorge

There has been a stagnation in the volume of world trade evident during the course of this decade, while the growth of world production for the same period has also closely resembled the performance of trade. The declining trend in volume of world trade is clearly signified by the decrease in the average annual rate of advance of the volume of world exports between 1963-73 and 1973-81. While for the former periods it was 8.5 percent, for the latter it had been reduced to a much lower 3.5 percent.

In terms of value, world trade experienced a 1 percent contraction in 1981 relative to the preceding year, representing a total of \$2,000 billion. Likewise, 1982 was similarly disappointing in performance. The eighties have thus sharply contrasted with the buoyant seventies, characterized by a yearly average rate of growth of 20 percent. These recent changes, it should be noted, mainly reflected the decline in unit values expressed in dollars. These had diminished by about 1 percent in 1981, while they had increased by 14 percent annual average for the decennium of the seventies. As we know, previous to the present difficulties of the world economy, the tempo of world trade growth amply surpassed that of the global expansion in output, as has been the case for the last two and a half decades.

As for the distribution of trade between developed market economies and the group of less developed countries, a rough division of their relative shares in terms of world exports would assign from slightly over three-fifths to less than two-thirds of the total to the former and about 27 percent to the latter. Of this last figure, approximately 14 percent would correspond to oil-exporting developing countries, with the other developing countries accounting for the balance of 13 percent. It is also worth noting that although there has been a decrease in the eighties relative to the preceding decade in the intradeveloped countries' market for exports, it still absorbs about 70 percent of the total exports of these countries. In a related context, it should be pointed out that more than two-thirds of the developing countries' exports are destined to the markets of developed nations, with only a little above one-quarter of their total exports constituting trade among themselves.

Concerning the composition of world exports, it is of great importance to remember that, as of the end of the decade of the seventies, the proportion of manufactured products in the exports of developed countries was about 3/4 of the total. By contrast, primary products represented about the same proportion of the total exports of developing market economies. Nonetheless, developing countries have succeeded in expanding their participation in the market for manufactured goods imported by developed nations from 7 percent in 1970 to 13 percent in 1980. This advance has taken place while the imports of manufactures as a fraction of GNP in these nations increased from about 6 percent in 1970 to more than 9 percent in 1980. For such progress to take place, the less developed countries had to mount a sustained effort to increase their exports of manufactures (good among themselves), expanded at an annual average rate of 12 percent for the 1960s and 1970s. Still, the total value of this category of exports by developing nations amounted to approximately only 1.3 percent of the industrial countries GDP. Given that the rate of growth of market penetration by less developed countries of the markets for industrial goods of the developed nations advanced at an annual rate of 8 percent for the 1970's, in contrast to a mere 5 percent import penetration rate for all sources, there remains hope of a gradually improving position for less developed countries in these markets.

However, price developments have not, on an overall basis, favored developing countries. The prices of manufactured goods exported by developed countries went up from an index value of 100 in the base year 1975 to 150 in 1981. During the same period, the export prices of primary commodities (with the exception of crude petroleum)

advanced from 100 to 147. It should be pointed out that for the entire category of food commodities, the terminal value was only 139. Figures for 1982 seem to indicate that the performance of the overall index of prices for primary commodities may be still weaker for this period than it was in 1981, when it had already fallen 15 percent from its 1980 level. Most of the low income and many of the middle-income less developed countries were, and still are, affected by these price changes. Given the 325 percent price increase in crude petroleum from 1975 to 1981, the impact on the non-oil exporting developing countries has been a very severe one. Compounding the problems of the low-income members of the group of less developed countries is the fact that they account for only 2 percent of world exports.

As for Latin America, a brief review of some telling data will suffice to highlight some elements of its trade panorama. The tempo of the area's exports began to accelerate towards the middle of the 1960s. In fact, between 1970 and 1981, the value of exported goods increased at an average annual rate of 19 percent. It should be noted that due to a decline in the unit value of exports, there was a value decline in exports of 10 percent in 1982. These developments were accompanied by a process of export diversification. Sales of industrial goods have represented for certain years about 20 percent of the total value of exports. Also, the range of agricultural and other primary goods exported has widened considerably during this period.

There has been a concomitant evolution in the trend of Latin America's imports. Since the late sixties they have been expanding vigorously as the area's economies have become more open. In contrast to the strategy of the fifties and early sixties, the Latin nations are now striking a more balanced position between an inward-looking, import-substitution approach to development, and an outward-directed, international trade-static comparative-advantage-guided, growth pattern.

Just as in the case of exports, the value of imports for the area decreased by 19 percent in 1982. However, the main cause for this contraction stood in opposition to the origin of the decline in foreign sales. It was due in the main to a decrease of 16 percent in the quantum of imported goods. It should be kept in mind that this decline has adverse implications for the growth of the area, given the high proportion of intermediate and capital goods, as well as of fuel, in the total of imported goods.

As for the terms of trade relationship, it experienced a new deterioration of 6 percent in 1982, after the 7 percent loss suffered in 1981. In general, for those countries other than the exporters of oil, after a brief improvement of the terms of trade in 1972-73, these registered a level for the rest of the decade of the seventies much like that prevailing in the sixties, which in turn was itself lower than the corresponding relation during the decennium of the fifties.

Undoubtedly, Latin America's increasing participation in the international trade system has been marked by success. The figures amply demonstrate that the region has been able to establish itself in the world system and expand its level of involvement at a rapid pace. While this will greatly enhance the growth prospects of the area, facilitating its occurrence through the acquisition of international resources, it will also make Latin America more vulnerable to the fluctuations of the world economy. As a matter of fact, the unfavorable behavior of the economy in 1981 and 1982 is very much linked to developments in the international situation. This is not to deny that internal factors, especially in relation to fiscal and exchange rate policy were not of major importance in some countries, as political ones were of decisive influence in others. It only asserts that as the network of global interrelations becomes more intricate, exogenous variables will increasingly determine the constraints and upper limits to growth open to the region.

On the average, and abstracting from the sharp fluctuations in growth experienced by the area during the seventies and up to 1980, the GNP of Latin America expanded at an acceptable rate. On the average, the annual rate of growth of this indicator was 6 percent for the period in question, as was almost the case during the preceding decade of the sixties. In 1981 the rate of advance has decreased to 1.5 percent and during 1982 a

negative rate of growth close to 1 percent was registered. In general, the growth history of the area has been a fairly good one and compares favorably with the records of developing countries and other developing areas.

Meanwhile, the pace at which the region integrated with the international economy has been a rapid one indeed. As is well known, world trade has grown faster than world output. The former advanced at an annual rate of 5.1 percent from 1955 to 1980, and at an even faster tempo of 6.9 percent from 1965 to 1980. Latin America has moved to open its economy at a pace above that of the global economy.

The commerce of Central and South America with the world expanded by more than tenfold between 1963 and 1981. Latin America's trade with the developed countries accounts for two-thirds of its total international trade. Specifically, Central and South America's trade with North America increased by about tenfold for the previously cited period of 1963-81. Concurrently, intra-regional trade was augmented by fifteenfold. It is also of considerable interest to note that the trade of the area with developing countries, including its own intra-regional commerce, grew by more than seventeenfold for the indicated period.

In order for self-sustained development to continue to take place at rates comparable to those of the decades of the sixties and seventies, and for the area to meet its external debt obligations in an orderly fashion, Latin America's external trade must keep on growing at a good pace, intra-regional economic cooperation has to be reinvigorated, and an adequate flow and composition of financial resources has to be made available to the region.

Latin America's external debt has been accumulating at a 29 percent annual rate since 1977 and until 1981. Last year there was a drastic slowing of the growth pace to a modest 7 percent and the total figure for the debt reached \$274 billion. Meanwhile, the ratio of external debt service to the value of exports climbed from 20 percent in 1977 to almost 30 percent in 1981, and will certainly be still higher in 1982. During the last year, interest remittances absorbed 50 percent of the export earnings of Argentina, Brazil and Chile, and 44 percent of those of Mexico. Worse yet, the relation between debt service payments and new credits to the area, which was 48 percent in 1976, has ascended to 80 percent for 1980 and 1981. The meaning of this, of course, is that the flow of financial capital to the area has diminished considerably.

As an ever larger portion of the external debt has become short term (constituting approximately 80 percent of the total outstanding by 1981), and as it has grown increasingly concentrated in the hands of private banking institutions extending it on purely commercial terms, and which by their very nature are unable under the present circumstances to sustain the momentum of the lending spiral they helped to generate back in 1974-75, the Latin American debt situation has progressively turned bleaker. If we add to this the exceptionally high level of real interest holding at present, the unfavorable portfolio position of banks, the high risks and poor immediate prospects of debtor countries, the limited capability of international institutions to extend concessional credits in the amount (or for the purpose and time required), and last, but certainly not least in importance, both as direct cause and contributing condition to this scenario, the deep and prolonged world recession, we begin to fathom the gravity of the predicament in which the world system as a whole and the individual economies of developed and developing nations find themselves enmeshed.

The interesting, yet fearful aspect of the panorama facing developed and less developed, public as well as private institutions is that a positive sum game kind of solution is the only viable one. That is, either all parties to this situation cooperate in solving it, in which case all will benefit individually, or the outcome will not be favorable to any of the participants.

Clearly, Latin America needs both the access to the markets and the financial resources of developed countries which will enable it to maintain the developmental pace of the last two decades. Only under such conditions could the area hope to honor its debt

obligations to the rest of the world. The world economy has become too interdependent for any other formula to work.

The circumstances prevailing towards the middle of the seventies, when commercial banks were willing and able to help finance the deficit on the current account of the balance of payments of Latin American countries, have radically changed at present. An illustration of the situation now facing the area is given by the fact that during 1982 there was a 35 percent decrease in the net flow of capital resources accruing to the non oil-exporting countries of the area.

The double danger of protectionism gaining the upper hand in the international economy, and of the external flow of resources drying up, thus forcing a reduction in the high rates of capital formation typical of the area in the past, are very serious possibilities whose ominous consequences are obvious. Again, there is scant comfort in imagining that partial approaches to these multifaceted problems are possible. Only a profound rethinking of the global strategies, criteria and policies in the relations of developed and developing nations, as they operate in the context of both domestic and international, private and public institutions, offers any hope for the resolution of the world economy's crisis.

In the particular case of Latin America, continued access to the markets of developed countries, particularly those for manufactured goods, and renewed efforts to strengthen intra-regional trade are necessary conditions for the reestablishment of the economic health of the area. Concomitantly, the external flow of private and public funds to the area must be resumed if the wherewithal for these efforts is to be found at all.

It is now clear that export expansion, especially of manufactured goods, will prove vital to the continued development of the area. Parallel to this and in a complementary policy move, a much higher degree of regional cooperation and trade will also contribute to the expansion of markets and the rationalization of the resource allocation process, as well as enhance the efficiency of the area's national economies. In an expanding world economy, there is no reason for the share of exports of developing countries, among them the Latin American nations, not to continue expanding as it did during the last decade. The same applies to the proportion exported by developing countries of the manufactured goods consumed by developed nations, particularly when, as in the case of Latin America, the market penetration rate for these goods just remained stable during the seventies.

It would seem justified to conclude these notes by quoting, perhaps rather extensively, from some observations by this author and his colleague Jorge Salazar-Carillo, in a book recently edited by them in conjunction with Rene P. Higonnet.

There is enough reason to worry about the course of events in the short and medium run, considering the more than eightfold growth in Latin America's total public debt outstanding over the decade of the seventies. The fact should be kept in mind that the area contributes slightly more than half the total of service payments made on the developing countries' debt, while it holds about 35 percent of the total, of which more than 57 percent is held by private banks. Nonetheless, our final assessment should be an optimistic one, due to the simple reason that the area's developmental potential would amply justify it. In dealing with developmental processes one must keep in mind that they normally do not proceed along a smooth and perfectly divisible ascending path. Intelligent policy, even intelligent private decision making, has to take into account the discontinuities and indivisibilities which typify the evolution of development at various stages. What is of decisive importance is to realize that, in accordance with every reasonable estimate, the potential for continued growth exists and it is highly probable that it will historically materialize.

A renewed effort to increase the volume of exports should no doubt have a high priority in the policy package of Latin American nations. In this context, it is interesting to note that the annual rate of increase in this area's export of manufactures has been very high, at times greater than that of any other region, since the early seventies onwards. In spite of this observed growth, while Latin America accounts for half the industrial output of the developing countries, it contributes only a fifth of the exports of manufactures originating in these countries. The policy of export promotion requires urgent attention because of another factor which greatly influences the external accounts of the area. Preliminary data for 1980 seem to indicate that about 30 percent of the foreign exchange earning of oil-importing countries went to pay for their oil imports. As recently as 1978 the corresponding figure was only 21 percent.

Latin America is not only the most economically developed region of the Third World, but also the one with the brightest prospects in the short and medium term for high and sustained growth. Under the most reasonable alternative scenarios that could be postulated at the time of this printing as a basis for forecasting the evolution of the area's economy, one would be led to conclude that both its potential and the probabilities for its realization are highly favorable, in absolute terms and also in terms relative to the prospects of other regions.

In the subject of our concern, and given the present specific traits of the debt situation, in the less developed countries in general and Latin America in particular, expectations and misperceptions have a greater weight than usual in molding future realities. As a result, we may also quite insensibly fall prey to the famous fallacy well known to all beginners in the field of economics: Post Hoc, Ergo Propter Hoc. If the flow of resources or its accompanying conditions are such as to curtail or hinder the normal servicing of the debt and the developmental process itself, this will tend to bring about the very results which are often feared by the more pessimistic observers. In that case, their inclination will be to attribute the experienced reality to the operation of some inevitable forces that predetermined the outcome itself rather than to the very same policies which are adopted in order to forestall its occurrence.¹

¹Foreign Debt and Latin American Economic Development, (New York: Pergamon Press, 1982), pp. 19, 29.

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PERSPECTIVES ON LATIN AMERICA AND THE WORLD ECONOMIC OUTLOOK*

by F. Gerard Adams

Developments in 1982 have been disappointing to the many who expected that the world economy would pull out of stagnation. While on a worldwide basis recovery is not yet a reality, in the United States an economic turnaround is under way, and the other industrial countries should show some improvement as the year progresses. Prospects are still deteriorating in some developing countries, particularly in Latin America, where the burden of huge debts and debt service are impacting on economic and social development. But we are hopeful that recovery in the industrial world will serve to get the world economy through its current period of crisis.

More than ever the world's economic blocks are interrelated. The industrial economies, with the United States in the lead, are pulling themselves up by their own bootstraps. The developing economies are greatly dependent on the economic recovery of the industrial world as a market for their primary products and for their burgeoning manufacturing output. In turn the industrial countries rely heavily on markets in the LDCs, as is amply demonstrated by the relationship between the United States and Latin America or by the connection between Japan and the Pacific Basin.

The situation of the world economy is greatly complicated at this point by past and present movements of petroleum prices and by the overwhelming burden of debt which some countries have accumulated. Consequently, in addition to an appraisal of the "most probable" path of economic developments, it is important to consider the risks associated with world financial problems. It goes almost without saying that these risks are particularly associated with the situation in Latin America, and the threatened world financial crisis.

World Economic Situation

From a worldwide perspective, 1982 was a year of growth recession. Growth declined to 0.3 percent worldwide and for the industrial countries it averaged near zero. This meant sharp declines for some countries, the United States for example, and stagnation or only very modest growth for others like Japan, Germany, and the United Kingdom. In the less developed countries, growth also slowed radically with significant declines in both the oil-exporting and the oil-importing LDCs. The centrally planned block also showed a slowdown to less than half its desired growth rate.

The recession has resulted in the most serious buildup of unemployment since the Great Depression, with unemployment rates in excess of 10 percent in the United States and the United Kingdom and with total OECD unemployment now above the 30 million mark. But there has been some positive payoff, though at high cost. Inflation rates are down worldwide, except in Latin America, to more bearable level. Equally significant is the substantial decline in interest rates as a result of change of monetary policy in the United States. The impact is not only on the domestic economy through improvement in prospects for investment, particularly in housing, but there is also significant international impact. There has been some easing of the over valuation of the U.S. dollar and some relief for the interest burden of the debtor countries. Prospects for 1983 and beyond are somewhat more optimistic.

Though signs of improvement are still very modest, recovery appears to be on the

* This paper is based on forecasts prepared by the World Economic Service and the Latin American Service of Wharton Econometrics, Philadelphia, Pa. Wharton Econometrics has just completed extensive studies of a world financial crisis.

horizon at last. In the United States strength in housing and autos and the end of a huge inventory rundown have set the stage for recovery. The United States alone cannot act as the "locomotive" for the world economy, but with lower interest rates and falling petroleum prices other industrial countries should soon also show some gains. Wharton Econometrics forecasts a gradual turnaround of the world economy with modest growth in 1983 and beyond. The recovery will be sluggish at an annual rate of 2-3 percent for the world as a whole—lower than the 4 percent per year of the recovery of the mid-1970s. The growth of world markets for primary products and manufactures should provide a welcome boost for the LDCs as well in 1983 and 1984.

A brief tour through the major world regions will highlight the prospects for 1983 and beyond.

Industrial Countries

The industrial countries continue to suffer from unemployment and stagnant demand. The easing of inflation has made it possible to lower interest rates and to turn policies somewhat more in the direction of international stimulus. The United States is on the threshold of an economic turnaround. The inventory cycle appears to be reaching its end. Consumer purchases of automobiles and other goods have begun to pick up. Housing is making a much improved showing, with housing starts of 1.7 million in January. While the financial community is still concerned about the potential impact of large continued deficits on financial markets, the fundamental policy problem of the Reagan Administration appears to be somewhat closer to resolution. On one hand, the supply-siders have pushed for the large income tax cuts which account in part for the deficits in the \$200 billion range. On the other side were the monetarists, who had sought to reduce inflation through control of the money supply. It has been six months now since the Federal Reserve signaled an easing of its tight monetary guidelines. Interest rates have dropped sharply, but have not declined further recently in view of fears that the Federal Reserve will be forced to reassert its control over the money supply as deficits increase. Much depends consequently on a willingness of the Congress to compromise by going at least part way toward improved budgetary balance. If that occurs, further easing of interest rates, particularly on the long end of the yield curve, is likely. In any case, substantial improvement in economic activity is expected, with GNP in 1983 2.4 percent higher than the comparable 1982 figure.

Other industrial countries are behind in the cycle. Some recovery is expected in Japan and Canada, and the Western European recovery is likely to come later. Germany has produced a discouraging pessimistic forecast of growth of less than 1 percent, after three years of slump. France, which has had to rein in its economy after excessive expansion in the first years of the socialist government, is likely to show no growth at all in 1983 and only modest expansion thereafter. Italy, too, will show unfavorable results in 1983. The United Kingdom, on the other hand, will show a slight pickup this year and next, some 1.7 percent, but the upturn will not be enough to bring down the record unemployment near 11 percent. Japan's growth rate will continue in the 2.5-3 percent level for the next couple of years, well below its average rate of the 1970s. And that assumes that exports, which are slumping, will not be affected too much more by slowing world demand and by rising protectionist barriers. All in all, the situation of the industrial economies remains stagnant, though a recovery in the United States, lower worldwide interest rates and inflation, and perhaps a gradual decline in oil prices may provide an upward boost later in 1983 and on into 1984.

Non-Oil-Exporting Developing Countries

The situation of the LDCs, particularly the non-oil-exporting developing countries, continues to be threatened by the prolonged recession in the industrial world. With export receipts growing slowly and high service payments on foreign debt, many developing countries have been forced to reassess their growth prospects. We will be discussing the situation of the Latin American countries at this conference. They are, of course, the outstanding example of difficulties, though they are not the only example. In Africa conditions have long been disastrous. Even the new industrial countries of the Pacific Basin, which heretofore appeared to be immune to the world slowdown, are being affected.

The heavy debt burdens are having serious repercussions. The hope that some of these problems would be eased through rapid increases in exports has faded as markets in the industrial world are closing because of economic stagnation or because of protectionism, and other developing countries simply lack the financial resources to increase their purchases. To deal with debt obligations, we will see Latin American growth being cut back to negative figures. But the imbalances on current account are so large that even heroic actions on trade will not offset them. Debt restructuring just barely accomplished in Mexico is becoming necessary in almost all Latin America.

The Oil Producers

The decline in energy demand as a result of the economic slowdown and as a result of conservation has had particular impact on the oil producers. As these pages are being written we are at a decision point in the controversy within OPEC with respect to the price of oil. Excess supply is forcing a downward erosion of prices, though it is not yet clear how far the adjustment will be allowed to go. In any case the surplus of available crude supply suggests that even with some recovery of the world economy and an end to inventory decumulation, crude oil price will not strengthen significantly for some time. The oil-producing countries are coming into a slowdown associated with weakness in the sales of their principal export, and some of them are having severe difficulties. Many producers—Nigeria, Indonesia, Libya, Venezuela—have seen their earnings diminish to the point where they can no longer meet their external obligations and carry on their development plans.

Centrally Planned Economies

In the centrally planned economies the sources of the difficulty are somewhat different, though the slowdown is nonetheless just as real. Production targets in industry and agriculture have not been met. The policy situation is only the most glaring example. Declines in oil export volumes, declines in export prices, insufficient short-term credits, and debt service burdens, in some cases, combine to force a reduction in imports of capital goods. This lowers chances for gains in productivity and, with slow labor force growth, reduces already sluggish prospects for growth.

World Financial Crisis

The risks to the world economy are almost as serious and immediate today as at any time in the postwar period. The events observed in world financial markets since mid-1982 correspond closely to what we have seen in our simulation studies as a "crunch" case. The picture can be summarized as follows: Many major borrowing countries have encountered balance of payments and debt servicing problems. The commercial bank lenders have sought to reduce their exposure in international debt markets. Numerous countries, among them the major debtor countries in Latin America, have asked for