WORLD RECESSION AND GLOBAL INTERDEPENDENCE

EFFECTS ON EMPLOYMENT, POVERTY AND POLICY FORMATION IN DEVELOPING COUNTRIES

International Labour Office Geneva

WORLD RECESSION AND GLOBAL INTERDEPENDENCE

EFFECTS ON EMPLOYMENT, POVERTY AND POLICY FORMATION IN DEVELOPING COUNTRIES

International Labour Office Geneva

ISBN 92-2-105608-2 (limp cover)
ISBN 92-2-105609-0 (hard cover)

First published 1987

ILO publications can be obtained through major booksellers or ILO local offices in many countries, or direct from ILO Publications, International Labour Office, CH-1211 Geneva 22, Switzerland. A catalogue or list of new publications will be sent free of charge from the above address.

Printed in Switzerland STA

WORLD RECESSION **AND GLOBAL INTERDEPENDENCE**

EFFECTS ON EMPLOYMENT, POVERTY AND POLICY FORMATION IN DEVELOPING COUNTRIES

PREFACE

Since 1980 economic growth and the creation of new jobs have been fragile world-wide. While there is evidence to show how this slump has affected various developing regions, the impact on different socio-economic groups within these countries has received far less attention. This is partly because few data are available for such analysis and partly because international attention rarely trickles down to the poorest groups.[1]

Conscious of this neglect, a group of high-level experts convened by the Director-General of the International Labour Office suggested that "the ILO has to remain vigilant to the distributional impact of policies pursued by the industrial countries and to the disproportionate burden on the poor resulting from the short-term stabilisation policies that developing countries are often compelled to follow".[2]

Before this, at a meeting of the chiefs of the ILO's Regional Employment Teams in late 1982, the World Employment Programme of the ILO had decided to launch a joint research project between the Regional Teams and the Headquarters component of the World Employment Programme on this issue and in particular on the weight of the burden on the poor in developing countries. This study, which was edited at Headquarters, is the first outcome of that joint research.

The Regional Employment Teams are the following: PREALC (Programa Regional del Empleo para América Latina y el Caribe) in Santiago, Chile; ARTEP (Asian Regional Team for Employment Promotion) in Bangkok, Thailand; JASPA (Jobs and Skills Programme for Africa) in Addis Ababa, Ethiopia; and SATEP (Southern African Team for Employment Promotion) in Lusaka, Zambia.

J. P. Martin
Director
Employment and Development Department

Notes

[1] Some exceptions are World Bank: *World development report, 1980* (Washington, DC, IBRD, 1980), and UNICEF: *The state of the world's children* (New York, UNICEF, 1984).

[2] ILO: *Employment and poverty in a troubled world: Report of a meeting of high-level experts on employment* (Geneva, ILO, 1985).

List of abbreviations

ADB	Asian Development Bank
ARTEP	Asian Regional Team for Employment Promotion
ASEAN	Association of South-East Asian Countries
CMEA	Council for Mutual Economic Assistance
DAC	Development Assistance Committee (of the OECD)
EEC	European Economic Community
GDCF	Gross domestic capital formation
GDP	Gross domestic product
GNP	Gross national product
IDA	International Development Association
ILO	International Labour Office
IMF	International Monetary Fund
JASPA	Jobs and Skills Programme for Africa
LDC	Less developed country
NIC	Newly industrialising country or area
ODA	Official development assistance
OECD	Organisation for Economic Cooperation and Development
PREALC	Programa Regional del Emplo para América Latina y el Caribe
SATEP	Southern African Team for Employment Promotion
SITC	Standard international trade classification
UNCTAD	United Nations Conference on Trade and Development

CONTENTS

List of tables

DEPRESSION AND ADJUSTMENT 1

INTRODUCTION

Both OECD countries and the developing world have experienced extreme economic changes over the last decade. These have included economic stagnation and drought in many parts of Africa, vastly increased purchasing power derived from oil and other fuels, the growing role of the newly industrialising countries in East Asia and of such countries as Brazil in world trade in manufacturing, the expansion of commercial bank lending to sovereign borrowers, massive policy shifts in the major OECD countries, together with the emergence of debilitating long-term unemployment, and surplus capacity in many traditional industries. Rapid adjustment has been required throughout, whether to reduced imports, to a changed labour market, to higher petroleum prices or to reduced capital flows. All economic actors have had to adjust, whether governments, entrepreneurs or workers.

Most adjustment has been far from spontaneous even though, since the balance of payments must balance, it may appear to have been so. Furthermore, pessimists claim that it is impossible for output and employment growth rates to return to the point they had reached in the late 1960s. However, there must be exceptions. Thus the East Asian NICs adjusted quickly to overcome the setbacks they faced (but in 1985 seemed to be having difficulty in restoring their early rhythm of growth), while the growth paths of China and India have apparently been little affected by oil price rises and other upheavals in the world economy. Furthermore, one form of adjustment can and does cause another. Reflation by OECD countries in the mid-1970s did nothing to reduce inflation and had little impact on investment. Further and less pleasant adjustment measures were left until the early 1980s.

The object of this study is to assess the impact of the post-1979 depression in OECD countries on the developing world. Certainly deflation pursued in 1979-80 after the second oil price rise often subsequently cut the growth rates of OECD countries severely, and directly and indirectly threatened growth and welfare in the developing world.

This study begins by looking at the OECD countries and describes how the depression developed. It also describes how employment and real wages in particular behaved during the period. It should, however, be noted that it is not the intention of this chapter to explain why growth rates fell and inflation increased. Different schools of economic thought have their own explanations. For the purposes of this study it is important to single out the features of recent economic growth in OECD countries which appear to have had the most significant effect on the developing countries.

Even including high-income oil exporters, the combined GDP of the developing world is less than one-half that of the OECD countries (although their population is 5.5 times as large). Fast growth in the OECD countries is not an absolute prerequisite for growth in developing countries but ensuring a steady rate of growth of imports generally is; and successful transactions with OECD countries are a major means of achieving this. The hypothesis of this study, therefore, is that developing countries' exports to OECD countries, and their borrowings, private investment, aid and other current transfers from OECD countries, have been affected by OECD growth rates and instability which in their turn have affected the welfare of the developing countries. In their turn the developing countries have taken measures which have relieved or intensified the first round of effects and have affected the inter-personal and inter-sectoral distribution of the burden of adjustment. The second chapter looks precisely at the means of transmission of the depression and later chapters concentrate on separate regions.

This study sheds light on the extent to which slow growth in developing countries is due to the crisis in the industrialised countries, and on whether developing countries should alter their policies for the coming decade, given that the growth expectations of the industrialised countries remain low. Arthur Lewis in his well-known Nobel prize lecture, as well as in other publications, has argued that North-South linkages are characterised by interdependence: "When the beat is faster the terms of trade are expected to be more favourable to the LDCs".[1] Further arguing that growth in the industrialised countries will be weak for years to come, he calls for a redirection of developing countries' exports away from developed countries towards other developing countries. Others, however, argue that the straight two-way link of Lewis's thesis (faster growth in North — faster growth in the South and slower growth in the North — slower growth in the South) are ill founded.

THE DEPRESSION IN INDUSTRIALISED COUNTRIES

The present economic setbacks in the industrialised world, which in employment terms still constitute a crisis, can be traced to a number of factors. The starting point often taken to analyse the crisis is the first major oil price increase in the last quarter of 1973. Subsequently, the industrialised countries experienced a serious drop in GDP growth. However, even before the oil price increase, inflation in the industrialised countries was creeping gradually upwards after the post-Korean War boom from an average level of about 2.3 per cent in the 1950s to about 3 per cent in the 1960s, reaching 5.9 per cent in 1970-72 and 8 per cent in 1973. Two reasons can be given for the acceleration in inflation before 1973. The first is the spurt in wage increases in many industrial countries in 1968-70, following a period of large productivity increases. This phenomenon was of less importance in the United States. However, price increases in 1969-70 in the United States were associated with increased government expenditure as a consequence of additional financing for the Viet Nam war. The system of fixed exchange rates, based on the dollar, ensured the propagation of this inflation to other countries. The breakdown of the fixed exchange rate system in early 1973 could well be explained by the desire of other Western countries to allow their currencies to appreciate against the dollar and reduce inflation. Floating exchange rates were also welcomed by those who thought that countries had been following over-severe budgetary and monetary policies in order to defend their exchange rate. Subsequently, many governments allowed themselves high budget deficits financed through monetary expansion. Any gain in insulation from the United States' inflation may thus have been eroded.

The 1973-74 oil price increase caused a sharp decrease in economic growth in the Western industrialised countries. In 1974 GDP grew by only 0.7 per cent and in 1975 its growth was negative. For the whole 1973-79 period the United States, the European Communities (EEC) and Japan all faced a sharp decrease in the growth of real GDP compared with the previous decade. Japan's decrease was the largest, but the EEC became the slowest growing group, halving its growth rate. Of the major components of national product, growth of gross fixed capital formation showed the largest deceleration.

The consequences of this slow-down for unemployment, especially in 1974-75, were not as great as initially feared. In Europe, where the average labour force growth was less than in the United States and Japan, more jobs were created in the tertiary sector. In the United States, where the rate of unemployment had for some time been higher than in Europe, and where the labour force grew faster, unemployment increased more. The percentage of additional jobs created was, however, much larger than in Europe. Although unemployment in Europe increased only to a limited extent, its character changed. The duration of unemployment became longer and especially the weaker groups — such as the unskilled, women and youth — were harder hit. The percentage of unemployed looking for work for more than a year doubled in most European countries between 1973 and 1979. The situation deteriorated faster for youth. In 1979, youth unemployment had increased to such an extent that it was at least twice as difficult for youth to find employment as for adults.

On the external side, adjustment after the first oil crisis was rapid. Through lower growth, through a decrease in imports and through energy-saving measures, the industrialised countries had, by 1978, managed to close their current account deficit, which just after the oil price increase had stood at US$30,000-40,000 million. On the surface, the situation in 1979 did not look so pessimistic, but investment was still low, inflation had not decreased and industrial restructuring, especially in Europe, was very slow.

Then in late 1979 oil prices began rising again and by the end of 1980 they were approximately 2.5 times their average 1978 level. Simultaneously, however, the political mood changed in Europe and the United States, and many countries started to embark on rather stringent fiscal and monetary policies with a view to containing inflation. Within a short time, this resulted in an increase in interest rates and, combined with the transfer of income from oil importers to oil exporters, in decreased GNP growth coupled with a dramatic increase in unemployment. World trade stagnated in 1981 and declined in 1982. The general deflationary climate forced those industrial countries which had hoped to follow more expansionary policies also to deflate or to face unsupportably large deficits on their current account balances. More recently, however, budget deficits in the United States have had a reflationary impact on that economy and through trade linkages also on other economies. Unfortunately, this reflationary action with its large requirements for capital inflows was not part of an overall policy package.

SOME SPECIFIC ASPECTS OF THE RECESSION IN OECD COUNTRIES

Looking at the United States, Japan and the four major countries of the EEC in more detail, and using the indicators given in table 1, it is clear that there was considerable disparity in the performance of these countries over the decade 1974-83; GDP per capita grew in fact at a low rate of only 0.9 per cent annually in the United Kingdom and at a rate of 2.7 per cent in Japan.

Considerable disparity is also noticeable between those variables which give a crude indication of changes in standards of living, namely: real wages, real private consumption expenditure per capita and real GDP per capita. In two countries, Japan and the United States, the growth of real wages over the decade (negative in the United States) was less than the growth of private expenditure, and that in turn was less than the growth of GDP. This suggests that non-wage incomes have increased and income taxes have decreased, leading to greater disparity between relative incomes. In France and Italy the opposite progression occurred, real wages rose most, private expenditure next and GDP last. This could be partly explained by increased taxes and transfer payments, on which, however, no comparable figures are available. It could be argued that the impact of slow growth on standards of living was less in those countries. In Canada and the Federal Republic of Germany the growth of all three variables was similar but private expenditure rose most, GDP next and real wages last, that is, there was pressure on real wages but not in ways that would also reduce average standards of living. Finally, the United Kingdom shows a real-wage increase which is the third highest in the group and an increase in private expenditure which is lower than the GDP increase, which again is the lowest of the group. Thus, average real standards of living hardly rose, although they must have fallen for the large group of unemployed.

In the United States, the major periods of real-wage compression were 1974-75 and 1979-81. Japan followed the pattern of the United States but with only two instances of negative real-wage growth. The Federal Republic of Germany entered a period of depressed real-wage growth only in 1980. In contrast again, real-wage growth in France never fell below 1 per cent and in Italy did so only in 1983. Apart from apparently aberrant behaviour in 1977-78, real-wage growth in the United Kingdom also fell below the 1 per cent level only in 1980.

In all countries unemployment rates were far higher (generally around double, although over four times in the United Kingdom) in 1983 than in 1973. The effect of the 1974-75 slow-down was to raise unemployment rates substantially (by around three percentage points) in the Federal Republic of Germany, the United Kingdom and the United States. In Japan the impact was proportionately as great. In the United States they had nearly fallen to their 1974 level by 1979. The fall in the Federal Republic of Germany was not so great but extended to 1980. Japan saw no subsequent fall and the increase in 1981-83 built on a historically high base. In France and Italy unemployment continued to rise throughout the period despite favourable GDP growth in 1976-79. Finally, in the United Kingdom there was a slight fall, in 1977-79, associated with the improvements in output.

The final variable considered is the ratio of the "compensation of employees" to GDP (i.e., more or less, the wage share in national

Table 1. Selected indicators in OECD countries, 1973-84 (annual changes in real variables)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
United States												
Real wages	1.2	−2.4	−0.4	2.1	2.7	0.8	−2.5	−4.3	−0.2	1.0	−0.1	−0.2
Private consumption expenditure per capita	3.2	−1.8	0.1	4.5	3.5	2.7	−0.5	−2.9	0.9	0.9	3.5	4.7
GDP per capita	4.7	−1.4	−1.5	4.1	4.4	3.9	1.7	−0.8	2.3	−2.9	2.7	6.0
Consumer prices, % increase	6.2	11.0	9.1	5.8	6.5	7.7	11.3	13.5	10.4	6.1	3.2	4.3
Government deficit, % GDP	0.6	0.8	5.0	3.3	2.7	2.1	1.2	2.7	2.5	4.3	5.8	5.0
Real interest rates	0.8	−2.8	−1.0	2.1	1.2	0.9	−1.9	−2.1	3.3	6.8	8.1	5.3
Unemployment (standardised), %	4.8	5.5	8.3	7.6	6.9	6.0	5.8	7.0	7.5	9.5	9.5	7.5
Surplus current transactions, % GDP	0.5	0.3	1.2	0.3	−0.7	−0.7	−0.1	0.2	0.2	−0.2	−1.0	...
Compensation of employees, % GDP	61.7	62.6	61.4	61.7	61.7	62.2	61.7	62.0	61.3	62.0	...	...
Italy												
Real wages	12.5	2.4	8.2	3.8	7.2	3.3	2.8	1.1	4.2	0.7	−0.2	0.6
Private consumption expenditure per capita	7.1	3.5	−1.6	3.9	−0.4	2.1	3.9	4.0	0.8	−0.1	−1.1	1.4
GDP per capita	5.3	3.5	−4.3	5.2	1.3	2.1	4.5	3.5	−0.3	−0.7	−1.6	2.0
Consumer prices, % increase	10.8	19.1	17.0	16.8	17.0	12.1	14.8	21.2	17.8	16.6	14.6	10.8
Government deficit, % GDP	9.7	8.8	13.2	9.4	9.0	14.6	11.1	11.0	13.2	15.4	16.5	...
Real interest rates	−9.8	0.0	3.0	−9.7	−2.0	1.5	−0.6	−5.1	2.8	4.4	3.3	4.2
Unemployment (standardised), %	6.2	5.3	5.8	6.6	7.0	7.1	7.5	7.4	8.3	8.9	9.7	10.2
Surplus current transactions, % GDP	−1.8	−4.7	−0.2	−1.5	1.1	2.4	1.7	−2.5	−2.3	−1.6	0.1	...
Compensation of employees, % GDP	52.6	53.2	57.2	55.9	56.6	...	55.1	54.2	56.5	55.8	...	...
France												
Real wages	6.7	4.9	4.9	4.1	3.0	3.6	2.1	1.3	1.0	3.0	1.5	0.8
Private consumption expenditure per capita	4.6	2.1	2.3	4.9	1.5	2.6	2.9	0.8	1.0	2.0	0.6	−0.1