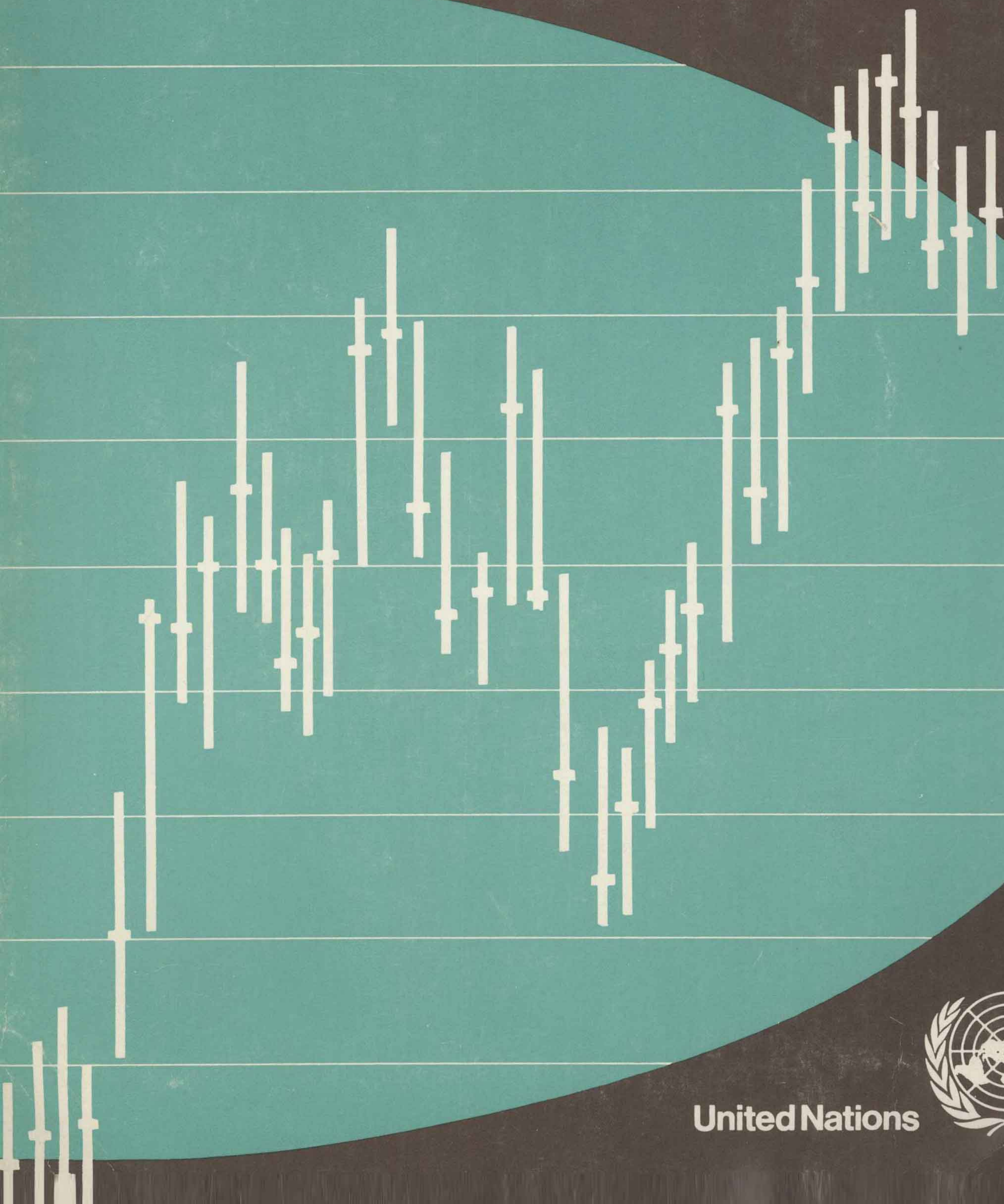
World Economic Survey

1979-1980 Current Trends in the World Economy



United Nations

Department of International Economic and Social Affairs

WORLD ECONOMIC SURVEY 1979-1980

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PREFACE

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

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

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

Explanatory notes

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

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

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

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

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

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

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

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

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

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

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

The following abbreviations have been used:

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

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

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

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

CONTENTS

CONTENTS (continued)

Annexes

List of tables

SUMMARY

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

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

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

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

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

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

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

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

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

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

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

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

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

Economic expansion slowed sharply in the centrally planned economies in 1979. In the European centrally planned economies, a trend of several years' standing was exacerbated by unusually unfavourable climatic conditions, and growth declined to less than 2 per cent, the lowest rate recorded in the post-war period. Apart from reduced agricultural output, this decline reflected a tight labour supply situation and difficulties stemming from imbalances in the transport, raw material and energy sectors. In the more trade-dependent countries of Eastern Europe, deteriorating terms of trade and policy decisions to curtail external deficits led to import constraints, which in a number of countries affected production supplies. In China, the growth of output decelerated after a period of recovery from the natural disasters and political upheavals of the mid 1970s.

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

/Chapter III. The accelerating pace of inflation/

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

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

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

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

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

The rate of increase in the volume of world trade in 1979 was between 6 and 7 per cent, slightly above that of 1978. Trade in manufactures grew at the same pace as in the previous year. The factors that shaped the acceleration in the volume of trade - large food imports necessitated by adverse weather conditions in certain regions and the decision of a few countries to build stocks of industrial inputs - were largely of a short-term nature.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Chapter I

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

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

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

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

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

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