WORLD ECONOMIC INTERDEPENDENCE and the evolving north-south relationship

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PARIS 1983

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPPEMENT

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Publié en français sous le titre:

L'INTERDÉPENDANCE ÉCONOMIQUE MONDIALE
ET
L'ÉVOLUTION DES RELATIONS NORD-SUD

This paper is based on analytical work undertaken by the OECD Secretariat for consideration by the Group on North-South Economic Issues. It draws on many areas of expertise in the Organisation and seeks to establish the major elements in the interaction between developed and developing countries, taking a longer term structural view and looking at the linkages between problems and issues as well as between countries and groups of countries. The paper is published under the responsibility of the Secretary-General, and does not necessarily reflect the views of Member governments.

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Chapter I

INTRODUCTION

The last decade has witnessed a sharpened awareness of world economic interdependence and, in particular, of the intensified economic and financial interrelationships between industrial and developing countries. This reflects the economic shocks of the oil price rises, the emergence of the more advanced developing countries as a new dynamic element in world economic growth and, more generally, a growing appreciation of the global impact of many economic, political and strategic issues which might previously have been seen in a narrower ambit. These questions have been brought into even sharper focus more recently by the pervasive influence of slow growth in world output, trade and employment and associated protectionist pressures and by the critical conjunction for many developing countries of high real interest rates and sharply depressed commodity prices leading to acute strains on their financial structure.

A specific North-South optique is often inadequate in addressing global interdependence issues. Industrialised as well as developing countries can be exporters of primary products, and borrowers as well as lenders of capital, and all countries have shared interests and responsibilities in the effective functioning of the world economy as a whole. Nevertheless, global interdependence contains important specific North-South dimensions which must be understood and effectively addressed. Particularly striking examples of specific North-South interdependence relationships are the complex linkages in the areas of debt, trade and finance, the evolution of trade relationships and the energy balance:

- The acute debt and adjustment problems of a number of developing countries are a dramatic manifestation of the complex interrelationships between developing country adjustment policies, their access to finance and to OECD markets, and the level of economic activity and employment in the OECD countries.

- The resolution of international trade problems will call for fuller integration of developing countries into the world trading system with policy implications for all trade partners. Further rapid expansion of trade between industrial and developing countries is critical as a spur to productivity and growth. Inexorable population growth in developing countries, largely concentrated on the urban centres, will increase industrialisation and export pressures with major implications for international trade.

- Given their increasing proportion of world energy demand, the ability of developing countries, with international co-operation, to strengthen their energy production and to use it more effectively will be an important element in efforts to reduce the risk of renewed international energy market imbalances and of recurring threats to sustained growth in the world economy.

Chapter II

SALIENT FEATURES OF THE INTERDEPENDENT WORLD ECONOMY AND THE EVOLVING NORTH-SOUTH RELATIONSHIP

The internationalisation of the world economy is one of the most significant events of the post-war period. General yardsticks such as trade/GNP ratios or the magnitude of current account balances or capital movements provide a measure of the increasing interdependence over this period and of the parallels with the evolution of the world economy in the century before the 1914-1945 period of world economic disintegration. As in that earlier period of growing interdependence, there has been a marked impact of technological change - which, more recently, may have contributed to an acceleration in the process of economic internationalisation. The revolutionary development of technology in transportation and communication has made markets in different countries interdependent to an even larger extent than previously. As a result, trade and financial flows between countries have become even more sensitive to changes in relative prices. Another new feature is the internationalisation of entrepreneurship and technology and the emergence of the transnational corporation. This development also has been facilitated by technological progress in transportation and communication over large distances, which has made it possible to operate global organisations efficiently. All of these new factors mean that positive or negative developments in the world economy are likely to take place much more quickly than hitherto and to affect a much larger proportion of the world's population. And the much larger number of independent states which emerged from the process of decolonisation has added a new degree of complexity into the world situation.

The market-based multilateral trade and payments system has provided the framework for widespread and unprecedented increases in productivity and living standards in developed and in a growing number of developing countries. (The comparative performance of various country groups as reflected in selected economic and social indicators is shown in Tables 1-4 in the Statistical Annex).

Trade between developed and developing countries with its mutual benefits has been a most dynamic and positive feature in the world economy. Rapidly rising international investment has contributed to spreading modern technology and managerial capacity. The international financial system has been a major instrument in channelling world savings into productive investment in developing countries.

As a result of their progressive integration into the world economy, economic, social and demographic trends in developing countries are now having a major impact on world economic and financial affairs.

The crucial importance for the developing countries of dynamic and sound economies in the industrial countries is evident enough. However, it is important to understand that this relation is no longer as one-sided as it was once considered to be. Intensified economic interchange and improved co-operation with developing countries have become much more vital to the efforts of developed countries to resume stable growth - by opening expanding markets for industries and agriculture, by contributing through competitive imports to improvements in productivity and the curbing of inflation, and by providing access to essential industrial materials and energy. It was a major conclusion of the Interfutures Study of 1979 that the longer-run prospects for the industrialised countries are substantially better in scenarios in which the developing countries progress harmoniously and that it is in the interest of developed countries to co-operate with and support such progress.

The interdependent world economy gives rise to opportunities for joint gains in economic welfare at the same time as it increases vulnerabilities. The more the world economy depends upon complex linkages not just between countries, but between the various key markets, the more vulnerable it becomes to disjunctions, rigidities and natural or political shocks in component markets and individual nations.

The more national economies are integrated in the world economy the more they are vulnerable to changes which occur abroad. While benefits from participation in the world economy are wide-spread, the capacity of national economies to benefit from the opportunities of the open system and to absorb external shocks has differed both among industrial and developing countries, depending on such factors as resource endowments and factor mobility as well as the responsiveness of economic policies.

Insufficient diversification of export products and trading partners and their often relatively low degree of national socio-economic integration limits the resilience of the poorer economies.

Interdependence thus gives rise to problems of common concern to both developed and developing countries, which include:

- the need to pursue policies which effectively re-establish the conditions for sustained non-inflationary recovery and satisfactory levels of employment;

- the accumulating dangers to the preservation of the open multilateral trading system arising from the persistence of slow growth of output and employment and from difficulties in domestic and international adjustment processes;

- the build-up of large international assets and indebtedness in a complex and interdependent world financial system;

- instability in oil markets and the longer-term energy balance;

- instability in agricultural markets together with inadequate agricultural performance and problems of food security in many developing countries;

- instability of commodity markets and related problems concerning the adequacy and reliability of raw materials supplies;

- the degradation of environmental systems in particular regions;

- the population explosion in developing countries;

- major migration flows with potential for creating social and political instability.

Prominent among the list of fundamental concerns must also rank the basic question of the ability of the international community to address the problems of world poverty and, more generally, to deal with the problems arising from the co-existence, within an integrated world economy, of partners at very different degrees of economic strength and vulnerability. Unless effective answers to these challenges are evolved, there is the prospect in the long-term, of a number of economically non-viable developing countries emerging, with large populations and urban agglomerations, heavily dependent on external sources for their energy and food supplies, but lacking the financial capacity to afford these basic needs. The human suffering and the critical social, political and environmental dislocation which this would entail are clearly evident. The response to this challenge will depend essentially on the pursuit of sound domestic policies in developing countries, supported and facilitated by international co-operation and external assistance.

Chapter III

MAIN ELEMENTS OF THE RECENT EVOLUTION OF THE NORTH-SOUTH RELATIONSHIP IN THE INTERDEPENDENT WORLD ECONOMY

a) The Emergence of New Actors and the Growing Diversity of National Economies

An important phenomenon of the post-war period has been the emergence of new dynamic actors on the world economic scene. Among the advanced economies, Japan is the outstanding example. However, there have also been, from the mid-Sixties onwards, some remarkable economic performances among the developing countries. The Newly Industrialising Countries(1) provide the clearest examples, and some of these countries bear witness to the fact that the development of a world market economy and critical national policy choices can render less constraining such factors as size, resource endowments and location as determinants of economic performance. But in addition there is a wide range of other relatively advanced middle-income developing countries with progressively more integrated national economies and rapidly evolving physical and institutional infrastructures. These countries have together also injected an important new source of dynamism into the world economy.

In many of the low-income developing countries encouraging progress has been made towards laying the foundations for more sustained and accelerated economic and social development, even though this has not been reflected yet in their economic growth performance. The low-income countries, which account for a large share of the world population, achieved a greater improvement in life expectancy, school attendance and literacy than the middle-income countries, albeit starting from lower

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1. OECD, The Impact of the Newly-Industrialising Countries on Production and Trade in Manufactures, 1979 and update, 1981.

levels. (See Table 4). However, the attainment of a broadly educated and healthy population, of physical infrastructure, of productive equipment and of socio-economic institutions which encourage and reward entrepreneurship and savings is a difficult and lengthy process. While there is progress towards this end in some of these countries, for the most part they remain largely dependent on a narrow range of commodity exports (in some cases on just one or two commodities) and on the flow of external assistance. These countries are thus greatly exposed to the world economic cycle. The mineral-based economies in particular have suffered from lagging investment and new economic and technological developments in the industrial economies. A further important phenomenon is the existence of some sixty very small countries and territories each with populations of less than one million. Often landlocked or island-based, they each present special development problems.
Finally, the Least Developed Countries are an internationally recognised group of the poorest developing countries. The international community has accepted the need for a range of special actions for these countries(2).

The two very large developing countries, India and China, although active in international trade and finance and in international affairs generally, have remained self-sufficient to an important degree. Although both of these nations still represent the largest concentration of poverty and will continue for some time to face major development problems, they have achieved, in their own special terms and circumstances, a significant measure of economic progress on the basis of quite different economic systems. Currently, both India and China are pursuing a higher degree of involvement in the world economy on a careful, step-by-step basis.

The oil price shocks of the last decade have effected quite dramatic shifts in the international distribution of real income and markedly increased diversity among countries as a result of uneven distribution of oil reserves and differing capacities for adjustment. Countries with important oil reserves, regardless of their degree of economic advancement, have experienced large increases in real income (see Table 1) but have also been confronted with serious problems of economic and social adjustment. The management of these problems has not been an easy task and there have been widely varying degrees of success in facing-up to them. The difficulties of

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2. The United Nations Conference on the Least Developed Countries (Paris, September 1981), agreed on a "Substantial New Programme of Action for the 1980s for the Least Developed Countries".

achieving a satisfactorily integrated national economy and society are not easily resolved. Lately, these difficulties have taken a new turn with the erosion of oil revenues and the emergence of lender resistance to borrowing by some "high-absorber" oil exporters. In the face of a stable or even falling real price, particular adjustment problems may arise for a number of oil producers. The analytical distinction between oil and non-oil developing countries is now much more blurred than it was in the 1970s. Non-OPEC developing countries (once clearly identified as the oil-importers among developing countries) are now, as a group, rather small net importers of oil - some countries having expanded production, some having become even net oil exporters. Some of the so-called high absorber oil exporters are now facing a similar financial situation to that of many oil-importing developing countries.

While the overall level of integration of the Eastern European countries with the world economy remains somewhat marginal when measured as a share of global trade and payments, the links tend to focus on a number of highly important areas, including energy, technology, finance and food. The involvement of the Eastern bloc countries in the world market economy has been characterised by a series of uneven advances and retreats. Trade between Eastern European countries and developing countries which is generally conducted in isolation from the world market economy through bilateral compensation on the basis of clearing accounts, represented a small share in the total trade of developing countries during the last decade. CMEA countries' international aid is almost exclusively concentrated on a few communist developing countries.

b) Rapid Post-War Growth

In stark contrast with the experience after the First World War, economic recovery after 1945 was a major success. From 1955 to 1980 world output tripled in real terms as growth proceeded at rates never previously witnessed. Despite rapid population growth, world real income per capita doubled. (See Table 1).

The economic situation of developing countries as a group has improved markedly over the past three decades as developments in the world economy have been more favourable to their growth than before. Even during the last decade of difficult adjustment, the momentum of growth has been sustained until recently as has the increased integration of all but the poorest developing countries in the world market economy.

The post-war recovery era must however be regarded as having two distinct periods in terms of the economic patterns exhibited. From the mid-1960s onwards, the patterns have been very different and not easily anticipated. The charts and tables in the Statistical Annex provide a short reference to the major trends. One obvious fact is that economic cycles have reappeared. These cycles have been to a large extent endogenous to the major industrial economies, generated by the interaction of economic trends and policy actions, although it is also true that external shocks have been a most important additional influence on the course and the size of the more recent cycles. A major question is whether cycles of this amplitude are likely to be a persisting feature of the world economy in the next decade.

c) <u>The Last Decade: Oil-Price Shocks, the Massive Transfer of Real Resources to Developing Countries and the Problems of World Economic Adjustment</u>

One of the most fundamental economic facts of the last decade was the massive redirection of world savings flows to developing countries in the wake of the oil price shocks. These countries largely absorbed the additional world savings arising from the vastly increased surpluses of the OPEC "low absorbers". (See Table 5). Quantitatively, most of these flows went to the more advanced developing countries and, by and large, were effectively utilized. Investment and, in most cases, domestic savings continued to rise. Historically respectable rates of economic growth were maintained until the advent of three years of sustained disinflation in the OECD area required developing countries to cut imports and slow growth.

The large transfer of real savings to developing countries over the last decade has had as its necessary counterpart a fast growth of financial flows. As perceived at the time of the first oil price shock, the problem of global macro-economic management was to ensure that unspent oil receipts were lent to oil importers and thus that adequate demand was "pumped back" into the world economy to compensate for the deflationary impact of the oil surplus: the "recycling" problem. Since the oil-surplus countries had neither the institutional capacity nor the readiness to assume the risks inherent in the financing of deficits of oil-importing countries, financial intermediation, principally effected through private institutions of the major industrialised countries, played a major role by facilitating the "recycling" of deposits from the oil-surplus countries into loans to oil-importing countries.

"Recycling" after the <u>first oil-price shock</u> was accomplished with the financial position of developing countries suffering only a relatively small deterioration, partly because of the effects of inflation on debt and