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## Political Measures to Stimulate World Trade

**In forecasting the world business trend for 1978 cautious optimism seems to be justified. Risk factors are the weakness of the Dollar and the partially still obstinately persisting expectations of further inflationary price increases.**

Regarding the world economic trend 1977 has been a year of disappointed expectations. Even as recently as at their economic summit conference in London last May the Western heads of government still believed to be able to confirm the planned growth targets: for the Western industrial countries altogether a 4½ % increase in the real gross national product was anticipated. These estimates were based on the expectation that during the remainder of 1977 production would continue to rise, albeit at a somewhat slower pace as the political measures taken in 1976 to stimulate the economy had by now lost their effectiveness. What actually happened was that in the second quarter of last year, at the very time the heads of government had their meeting in London, output ceased to grow in many countries while in several others it started even to recede.

In Western Europe in particular the summer months of the past year were marked by a pronounced economic slackness, and it was not until the autumn that in many countries signs of a certain revival in business activity began to become apparent. On an annual average Western Europe's GNP rose in real terms by a mere 2 %, and this mainly because 1977 was able to benefit from the orders which were still pending from the preceding year. In Japan current expansion also proceeded at a slower pace than had been expected. Overall, industrial output rose by about 5 % — a percentage increase which, although high by international comparison, is nonetheless low relative to Japan's long-term growth. Only in the USA did the growth rate with 5 % closely approach the expected level. In all the Western industrial countries together output rose by 3½ %, that is the increase stayed below the long expected rise by one percentage point.

### **Self-acceleration Fails to Materialise**

The most disappointing feature of the economic trend in the past year was the failure of the pump-priming measures introduced in 1976 "to take". Even in the USA business expansion apparently continued to depend on repeated fiscal stimuli. Other leading national economies, like Japan and

the Federal Republic of Germany, on the other hand, placing more reliance on the snowball effect of the measures already taken to strengthen the economy, decided only relatively late in favour of massive additional action. Besides, some of these additional steps were designed to become effective only in the medium term.

Cuts in public expenditure have in many cases contributed to the renewed recession, but they were not the decisive factor. Responsible for the failure of private investment to come forward to the necessary extent were other obstacles. Space forbids to deal in detail with the various obstacles which have been discussed for some time. A large part of these negative influences are however connected with the entrepreneurs' unsatisfactory profit expectations. Apparently, the improvement in yields which had occurred in the course of the recovery was generally speaking not strong enough to encourage new investments to the required extent. After all, until 1975 firms operating in many countries had been caught for quite a number of years in a profit squeeze which had become tighter year by year. This tendency was further accentuated by the oil-price explosion of 1973/74. To this increase of external costs, internal costs, i.e. notably wages, failed to react speedily and extensively enough.

Consequently, undesirable economic trends proved to be most numerous where the trade unions resisted most strongly the imperative need to adjust to the changed external situation and where the government more or less tolerated such an attitude. Thus national economies like France, Italy, Great Britain and Denmark relapsed relatively soon into considerable balance-of-payments difficulties and mounting inflationary fears. The result was that as early as the second half of 1976 they were forced to steer once again a restrictionist course. Contrary to expectations entertained in Western Europe — and particularly by its business community — these negative influences have in fact outweighed the positive impulses emanating from the economic upturn in the USA, and been a considerable obstacle in the way of an enduring recovery.

### **High Unemployment**

The halt in the economic recovery outside the USA weighed all the more heavily as at the beginning of the past year unemployment figures in most countries, after an upturn of only 1½ years, were still at, if not over, the levels of the recession. The only notable success in reducing unemployment was registered by the USA. Even there the unemployment ratio remained above the average level, due not least to structural reasons: continuing population growth and an increasing number of job-seekers. In many West European countries, too, an improvement in the employment situation is rendered more difficult by the demographically conditioned rise in the number of persons requiring jobs. During the recession of 1977 there has been a rise not only in the official unemployment figures but also in "hidden" unemployment. The extent of the latter is difficult to ascertain because almost all countries resorted to more or less comprehensive political measures which temporarily "relieve" the pressure on the labour market. It is due to these relief measures that in many cases a further rise in the official unemployment figures has been avoided in the second half year.

### **Damping Down the Rise in Prices**

Most of the countries affected by the recession have nevertheless succeeded in improving the preconditions for a new phase of recovery. This applies in particular to the price trend: In the second half of 1977 the upswing in consumer prices showed in most cases a marked slowing down.

Very marked was also the greater steadiness shown by the weak-currency countries Great Britain and Italy which a year earlier had been obliged to introduce certain restrictions; in the second half of 1977 prices in these countries increased at an appreciably slower pace. That the annual rate of increase in the cost of living in comparison with the previous year is still appreciably more than 10% is due to the big price increases which came into force by the spring of 1977 and were partially traceable to fiscal measures. In several other West European economies and in Japan price rises have likewise been less hectic. This was in no small measure due to a slowing down of nominal wage increases. In most countries real wages last year did not rise any further. In Great Britain they have in fact appreciably been reduced as a result of the government's incomes policy, and although the wage controls came to an end last August, there were so far no backlog effects.

Another stabilising factor was the fact that import costs largely ceased to exercise pressure on internal price levels. Prices on the international raw material markets, after reaching their highest

levels in April 1977, have since appreciably declined to the general benefit of all Western industrial countries. Moreover, by stabilising the foreign exchange value of their currencies several countries succeeded in escaping from the vicious circle of competitive currency depreciation and inflation. This applies above all to Great Britain and Italy, but also to France. These countries managed to achieve appreciable reductions in the current account deficits. Whereas the recovery in France and Italy was solely due to reductions in the internal demand, the decisive factor in Great Britain was the increasing flow of North Sea oil.

### **Foreign Trade Problems**

The balance-of-payments worries of the most important West European "problem countries" have become markedly less acute although in Denmark and Sweden the external position remained precarious notwithstanding last August's further devaluation and the recession. Generally speaking, the international exchange of goods and services has hardly made any progress towards equilibrium. The turmoils in the foreign exchange markets concerning the US Dollar and its recent heavy falls in value primarily reflect the strong rise in the US current account deficit during the past year and fears for the future which this deficit arouses.

The deficit is due not so much to the fact the USA is ahead of other countries as far as the business cycle is concerned. This argument may have some relevance in the case of the high deficits vis-à-vis Japan. Much more important, however, is the sharp increase in American oil imports which undermine the confidence in the Dollar. For the USA, being by far the largest Western economy which moreover has meanwhile become the world's most important oil importer, has so far failed to work out any politically binding strategy for the reduction of the oil deficit. The external problems add at the same time fuel to the protectionist agitation, thereby increasing the threat of a worldwide economic disintegration. Whether intentionally or not: By the problematical nature of their economic policy the Americans merely underline the urgent need, especially in a period of flexible exchange rates, for an internationally coordinated economic policy.

### **Stimulating Economic Policies**

After a self-sustaining expansion failed to develop, the industrial countries will in 1978 at first once again have to depend on political stimuli. Most clearly apparent are at present the endeavours made by the three leading national economies to stimulate demand. The continuing upturn in the USA for instance receives considerable impulses from the implementation of last year's economic policy programme; besides, new drastic cuts in

taxation are in the offing. Japan is speeding up the implementation of the decisions taken last autumn to boost the economy in response to foreign demands for a reduction of Japan's large current account surpluses. Finally, the West German Government's financial policy has been changed for the purpose of accelerating the process of economic recovery which last year was temporarily interrupted. But there are also clearly visible signs of expansionist tendencies in most other West European economies. The chances of the endeavours to boost the economy depend first and foremost on the degree of inertia of the downward forces which made themselves felt in the industrial countries in 1977. Would the starting position be roughly similar to that of 1974 before the recession, the measures as at present envisaged would certainly have to be regarded as insufficient. The present position is, however, essentially different from that in 1974 when the oil crisis shocked the world economy profoundly. The USA has been, and still is, in an upswing, and neither in Japan nor in Western Europe has there been an accumulation of a "recession potential" similar to that which existed in 1974; in contrast to other occasions when a boom was on the point of busting, there has this time been no overloading of capacity.

In view of the high supply elasticity, and with the expectation of the inflationary trends abating, there cannot have been much stockpiling during the recovery phase; this explains the smallness of the "corrective demand" for the purpose of adjusting to less optimistic expectations. Progress in curbing current account deficits and greater hopes that inflation can be held in check have not only made it possible for governments to reverse their economic policies but have also increased the real stimuli to output and employment. All this indicates that the traditional concept of the trade-cycle has ceased to be valid not only in the upward but also in the downward phase.

### Moderate Expansion

True, at the turn of the year 1977/78 the situation in different industrial countries varied considerably depending on the point they started from, the nature and the extent of the steps they had already taken and the framework conditions of stabilising policies. Consequently the forecasts for these countries also differ from one another. On the other hand there are many signs pointing to a certain convergence of the speed of overall economic expansion because it now looks as if most of the West European countries as well as Japan can count on a certain recovery of demand and output while in the USA the upswing process continues. All in all the Western industrial economies should be able, on average, to expand their GNP in 1978

by about 3½ % in real terms as compared with the preceding year. For Western Europe the production increase over 1977 will — due to the low level at the beginning of the year — probably amount to 2½ % only.

The measures now being taken to arrest the downward economic trend and the moderate revival of demand and production which is slowly becoming apparent also augurs well for world trade. Whereas in 1977 the exchange between the industrial countries accelerated the downward trend, mutual expansive stimuli can now be expected again. There should also be a further increase in demand from developing countries and especially from the OPEC-countries although at a slower rate. As for the state-trading countries, these are expected to show less resistance to buy abroad. All in all, world trade is expected to expand by over 5% in real terms. There should be a marked drop in the surpluses of the OPEC-countries. The current account deficit of the industrial countries will however remain extremely precarious because of its heavy concentration on the USA.

### Dollar-weakness as Risk Factor

The weak position of the Dollar which still is the world's most important currency, be it for trading or intervention purposes, constitutes a grave factor of uncertainty for the world economy. True, the experiences of the last few years have taught us not to pay too much attention to the short-term effects on world trade of fluctuations on the foreign exchange markets. But a fall in the value of the Dollar such as has occurred at the end of the past year has an immediate adverse effect on the profit expectations and the business climate in many export industries outside the USA. The ensuing gloom seriously risks to discourage new investments. It has moreover become apparent that a pronounced weakness of the Dollar encourages violations even of the basic rules of the "controlled floating" game. But the moment the impression should gain currency that employment problems are to be "exported" by foreign exchange manipulations, it will become impossible to hold the barriers against the, in any case, rising tide of protectionism. However, the prospect that in 1978 there will be no appreciable reduction in the US current account deficit does not necessarily mean a continued further decline in the Dollar value. The trend of the Dollar depends also on other factors, not least on the American monetary policy. If with the change in the leadership of the Federal Reserve system the prevailing feeling of uncertainty as to the future of the Dollar is dispelled and provided some progress is seen to be made in the direction of an energy-saving programme, there may even be a certain improvement in the Dollar.

## ECONOMIC TRENDS

### Further Stabilisation Indispensable

The Dollar problem is not the only risk factor that a faintly optimistic forecast for the world economy in 1978 has to take into account. The progress made in the past year towards a greater stability by many countries is as yet insufficiently consolidated. This applies notably to France, Great Britain and Italy, and that all the more as in those countries internal political factors strongly impinge on wage policy. Nor is it to be expected that in the USA price increases will remain at the same modest rate as in the second half of 1977 when they were temporarily halted by the favourable development in the food sector. On an average for the industrial countries the cost of living is expected to rise in 1978 by about 7.5% (with substantial variations from country to country) as against 8.5% in 1977. 7.5% is still considerably more than the average annual increase over a longer time span and this in spite of insufficient utilisation of available capacities and high unemployment. This reflects the obstinately persisting fear of further inflationary price rises implying the very real risk of distribution struggles flaring up again once the expansion has started to accelerate.

As long as this state of mind persists any classical method of giving a boost to the economy will be no more than temporarily successful; such meas-

ures alone will not suffice to restore confidence in the return of framework conditions regarding economic policy and external trade and payments which will last long enough to enable a return to a growth path which in the foreseeable future will lead back to full employment. As things are at present, it is a completely open question whether the economic policies pursued by various governments will succeed in bringing about anything more lasting than a brief expansion phase. Transition to a self-sustaining upturn in the world economy presupposes that in a greater number of important industrial countries the distribution struggles between the social groups die down. Only if present indications pointing to greater wage restraint turn out to be lasting, will it be reasonable to hope for a sustained resumption of the propensity to invest — an essential precondition for a restoration of high employment levels. The experience of the post-war years suggest that once the sales and profit expectations have improved sufficiently, the structural problems which have been piling up in the last few years are unlikely to be such formidable obstacles to growth as is often feared.

*Compiled by the Department on Business Cycles and Statistics of HWWA-Institut für Wirtschaftsforschung-Hamburg.*

### Indicators of the World Business Trends \*

	Real Gross National Product (increase over preceding year in %)				Consumer Prices (increase over preceding year in %)				Exchange rates <sup>1</sup> (change vis-à-vis preceding year in %)		Unemployment Ratios <sup>2</sup>	
	1966-1975 a	1976	1977 b	1978 c	1966-1975 a	1976	1977 b	1978 c	Dec. 1976	Dec. 1977	1976	1977 d
USA	2,2	6,0	5,0	4,0	5,8	5,8	6,5	6,0	2,5	-2,2	7,5	6,5
Canada	4,4	4,9	2,0	3,0	5,8	7,5	8,0	7,5	0,8	0,8	7,1	8,3
Japan	8,3	6,3	5,0	5,0	8,8	9,3	8,0	6,0	5,0	21,9	2,0	1,9
Western Europe <sup>3</sup>	3,7	4,2	2,0	2,5	6,8	10,5	11,0	9,0	.	.	4,3	5,1
Belgium	4,3	2,5	2,5	2,5	6,1	9,2	7,0	6,0	11,2	2,7	5,8	6,8
Federal Republic	3,3	5,7	2,5	3,0	4,4	4,5	4,0	4,0	15,1	7,9	4,1	4,0
Denmark	3,3	5,5	1,0	1,0	8,0	9,0	9,5	8,0	8,2	-4,0	6,1	7,4
Finland	4,8	0,4	0,0	2,0	8,7	14,4	13,0	10,0	4,6	-9,3	4,0	8,1
France	4,5	5,2	3,0	3,0	6,9	9,6	9,5	9,0	-8,0	0,1	4,2	4,8
Great Britain	2,2	2,1	0,5	2,5	9,3	16,5	16,0	11,0	-17,1	9,8	4,9	5,5
Italy	3,9	5,6	2,0	2,0	7,6	16,8	18,5	13,0	-20,8	-5,5	.	7,7
Netherlands	4,6	4,9	3,0	3,0	6,8	8,8	7,0	5,5	9,4	1,2	5,1	5,2
Norway	4,5	6,0	4,5	6,0	7,0	9,1	9,5	9,0	12,9	-1,8	1,1	0,9
Austria	4,4	5,2	3,5	1,5	5,6	7,3	5,5	5,0	11,0	4,1	2,0	1,9
Sweden	3,2	1,5	-2,5	0,0	6,2	10,3	11,0	10,0	8,9	-15,4	1,6	2,0
Switzerland	2,2	-1,3	3,0	3,0	5,6	1,7	1,5	1,5	12,1	13,6	0,8	0,5
Spain	5,7	2,1	3,0	1,0	8,8	17,7	25,0	25,0	-8,5	-19,3	5,0	5,2
OECD-countries total <sup>3</sup>	3,7	5,2	3,5	3,5	6,6	8,3	8,5	7,5	.	.	5,1	5,1

a Average annual change. b Estimated, rounded off to 0.5 percentage points. c Forecast. d September or October, respectively. <sup>1</sup> Weighted according to foreign trade shares in 1974. <sup>2</sup> Adjusted for seasonal variation, in % of the labour force. <sup>3</sup> Weighted according to GNP or private consumption in 1975, respectively; total of all indicated countries.

Source: OECD, EC, national statements, estimates by HWWA-Institute.

\* Decimal notations marked by commas.