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World Economy Still Ailing

by Günter Großer, Günter Weinert, Hamburg*

1982 was yet another year of international economic disappointment. The frequently forecast gradual recovery of demand and production during the course of the second half of the year did not materialise. In fact, Western Europe once again experienced another pronounced downturn. However, at least in the majority of leading industrialised countries, the conditions for growth have definitely improved. Will 1983 bear witness to the turning of the recessionary tide?

For the first time in post-war history 1982 was a year in which the danger of a lasting depression was seriously discussed. A number of developing countries had reached, or gone beyond, the limits of their external borrowing capacity, their payments crisis causing a serious strain on the international financial system. This development seemed to corroborate such gloomy speculation.

Demand from developing countries, particularly from the OPEC member states, had been expected to level off. However, with export earnings declining considerably as a result of both falling exports of raw materials, especially oil, and the continuing decrease in prices for these products, and with interest costs rising, these countries in fact cut back their imports. At the same time, above all the European industrialised countries witnessed an even further drop in domestic demand, whilst in the USA and Japan the expected recovery did not take place. In most cases, private consumption had stagnated somewhat in the face of the depressed development of real disposable incomes. High interest rates and unfavourable prospects for sales and profits led firms to further cut back investments. A pessimistic mood once again overshadowed stockpiling behaviour.

The employment problem, already very serious at the start of 1982, worsened considerably as the year continued. The number of employed persons fell almost everywhere, whilst the demographically induced increase of employable persons continued. By the end of 1982, the USA and Western Europe's major industrialised countries were confronted by rates of unemployment ranging between 8 and 12 %. An ever increasing number of persons were working short-time.

Even in Japan and in some of the smaller Western European countries, where official unemployment levels were relatively low, the extent of hidden

underemployment has grown significantly. The domestic political pressure triggered off by the high unemployment became so powerful in some countries that protectionist trends rapidly gained ground. This is a fundamental difference to the recession following the first oil crisis, where governments of Western industrialised countries successfully managed to check such protectionist trends.

The continuing weak state of demand, production and employment in the industrialised countries reflects in particular the restrictive effects of stabilisation policies accompanied by a lack of price and wage flexibility. Against this background, the success achieved last year in curbing inflation becomes particularly important. Whereas the price of goods for private consumption at the start of 1982 had increased on average 9 % compared to the previous year in the industrialised countries, this figure had dropped to 6 % by the end of the year. The leading economies, the USA, Japan and the Federal Republic of Germany, exhibited an even lower level of price increase; the stabilisation success achieved by Britain is also commendable in this respect. On the other hand, a number of Western European countries still have to come to terms with the urgent problem of inflation. A case in question is Italy; yet France's resorting to government price and wage controls has also not managed to solve the problem.

On the whole there has been an unmistakable improvement in the overall economic framework in many industrialised countries during the past year, particularly following the world-wide substantial drop in interest rates since the middle of the year. This revived a process which had begun in autumn 1981, but was already flagging by the beginning of 1982, the main reason being developments in the USA. Up until mid-1982, there had been a lack of coordination between monetary and fiscal policies in the USA. The central bank stuck to its tight monetary course, whilst fiscal policy led to a rapid increase in budgetary deficits. This

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was mainly due to the fact that the stimulative effects of tax reductions, carried out or planned to become effective between autumn 1981 and mid-1983, were estimated far too optimistically. The result of tight money supply and uncertain financial markets was an exceedingly high level of real interest. The propensity to invest thus kept on declining, instead of recovering as intended. Foreign trade also suffered under the contractive effects: the rising external value of the dollar brought about a continuous reduction in the competitiveness of American producers both at home and abroad. Only after measures had been taken in the USA towards the middle of the year to limit budgetary deficits via tax increases and, above all, following the easing of monetary policy, did interest rates begin to fall substantially. During the final months of 1982 the dollar also found itself under pressure, probably as a result of the emerging strong deterioration on the American current account.

The changing trend on American financial markets was particularly important, since the high levels of interest in the USA had had a curbing effect on the world economy as a whole. Due to the tremendous strain of interest payments, for example, highly indebted developing countries were forced to resort to even stronger braking measures in an effort to consolidate their foreign payments position. What is more, the economic policy institutions in Western industrialised countries and in Japan were confronted by limited room for manoeuvre due to external pressures. For some considerable time many central banks only allowed a lower expansion of money supply than would have corresponded to a potential-oriented course. Even after the American central bank had departed from its restrictive course in mid-1982 and interest rates in the USA had fallen, there was only a gradual easing of monetary policy in other countries on account of the continuing strength of the dollar. These countries tried to avoid a depreciation against the – still strong – dollar so as not to delay the process of stabilisation. The appreciation of the dollar had, indeed, made it difficult to check the upsurge of prices in most Western European countries right up until the summer. It was only during the second half of the year that price increases clearly began to slow down in many countries. The easing of monetary policy was usually accompanied by less monetary restriction. In the face of falling price increases, real interest rates fell only slowly, however.

The reason for the fact that, even after the interest rate turnabout in the USA, it took time before many other countries eased up their policies of tight and expensive money was the lack of success in solving the adjustment

and stabilisation problems, which can be traced back to long before the oil-price explosion. In many cases hardly any advances were made with regard to corrective distributive adjustments between wages and profits. The adjustment of government spending to the lower growth path also left a great deal to be desired. Success in the consolidation of public finance, however, is almost always overshadowed by cyclically induced deficits. Taking into consideration that the consequences resulting from such fundamental misdevelopments still play such an important role, it is all the more astounding that the conditions for growth experienced a definite improvement, at least in the majority of leading industrialised countries, namely the USA, Japan, the Federal Republic of Germany and Britain.

Forecast Marked by Uncertainty

The current international economic situation is not purely the result of one of the usual cyclical downward phases but of a more fundamental crisis of readjustment and stabilisation. Any forecast of further developments, therefore, must extend beyond an assessment of the usual cyclical relationships and deal with the progress made in solving the basic problems facing growth in the industrialised countries. Furthermore, as a result of the long duration of the world-wide economic recession, self-enforcing elements have begun to take effect. This is particularly the case in the field of foreign trade and payments: the debt crisis facing in particular a growing number of developing countries and the expansion of protectionist tendencies in the industrialised countries are just some of the long recognised risks which have become so acute that, for this reason alone, forecasts of future developments are so uncertain.

The number of developing countries which, as typical debtor countries, after the long phase of high interest rates on international financial markets, the long-lasting bearish market for raw materials, and the curbing of imports by industrialised countries are no longer able to meet their payments obligations, is obviously still growing. This enhances the danger of placing too great a strain on the international banking system, which has also to come to terms with major defaults by state-trading countries and private companies in the industrialised countries themselves. The breaking of credit chains could shake the very roots of the world economy. Considering the fact that no one country could then escape the disastrous implications of such a collapse, there is sufficient reason to believe that cooperation between international institutions, governments, central and commercial banks will be increased and that matters can be prevented coming to

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a head. However, certain restrictive effects are inevitable, if only since the borrowing countries will not be able to avoid further import cuts.

The situation of debt-ridden developing countries is made even more difficult by the growing extent of protectionism in the industrialised countries. Pressured by growing unemployment, parliaments and governments more and more frequently adopt various kinds of measures aimed at securing sales of domestic products at the expense of foreign competitors. In doing so, the possibility of temporarily supporting employment in certain areas is usually overestimated, whilst the great probability of larger overall economic losses which are not so easy to calculate is disregarded. The most serious problem is the accompanying lasting deterioration of conditions for growth. After the continuing opening-up of national markets had for many decades been one of the most important growth impulses, the reciprocal escalation of protectionist barriers generally increases export risks, leading to growing strains on the propensity to invest. Nevertheless, a further intensification of protectionism is apparently to be expected. In many cases national economic short-sightedness will only be limited by the fear of direct retaliation.

In view of the continuing impact of world-wide retarding influences, the question arises as to whether last year's improvement in the overall economic

framework in the USA and a number of other industrialised countries will suffice to guarantee a recovery of demand and production. The first positive reactions to the drop in interest rates already became apparent last year in the housebuilding sector. This would back up the assumption that a continuing fall of interest rates would support, and finally stimulate, demand by investors and consumers. There is still considerable uncertainty as to exactly when, and to what extent, this will occur. However, there are signs that, encouraged by stock-cyclical factors, expansive influences will once again gain the upper hand during the course of 1983.

The prospects for a recovery of demand are definitely better in the USA than in other industrialised countries. Firstly, the fundamental economic misdevelopments were not so great to begin with; and secondly, the monetary easing-up and reduction of interest rates were particularly pronounced after inflationary expectations had been curbed, although the real interest level, probably mainly due to uncertainties of fiscal policy, still remains considerably higher than in earlier downward phases. An increase in demand in the USA would spread even more to the rest of the world since the competitiveness of non-American producers is high due to the considerable appreciation of the dollar during the past two years. Now, however, the dollar's position is beginning to be weakened, not least due to the

Economic Indicators

	Real Gross National Product (Year-on-year change in %)				Consumer Prices (Year-on-year change in %)				Exchange Rates ¹ (Change over 12 mths in %)		Unemployment Rate ²	
	1973-80 ^a	1981	1982 ^b	1983 ^b	1973-80 ^a	1981	1982 ^c	1983 ^b	Dec. 1981	Dec. 1982	1981	1982 ^d
USA	2.7	1.9	-1.5	1.0	8.8	10.4	6.0	4.5	8.8	10.8	7.2	10.8
Canada	3.4	3.1	-5.0	1.0	9.1	12.4	11.0	9.0	3.8	-1.8	7.6	12.6
Japan	4.4	2.9	2.5	1.5	9.9	4.9	3.0	3.5	1.1	-5.0	2.2	2.6
Western Europe ³	2.7	-0.4	0.0	0.0	11.4	11.2	9.6	7.8	-	-	7.8	9.6
Austria	3.2	0.0	0.5	0.5	6.5	6.8	5.5	4.0	2.2	3.7	2.2	3.7
Belgium	2.9	-1.9	-0.5	0.0	8.0	7.6	9.0	8.0	-2.8	-9.6	9.7	11.0
Denmark	1.9	-0.2	1.0	0.0	10.8	11.7	10.0	8.0	-3.0	-0.3	8.3	9.1
Finland	3.2	1.3	0.5	1.0	12.3	12.0	9.0	8.5	4.3	-4.3	5.3	6.4
France	3.2	0.2	1.0	-0.5	10.6	13.4	11.5	9.0	-6.8	-5.5	7.9	9.0
FR Germany	2.6	-0.2	-1.0	-0.5	5.0	5.9	5.5	4.0	2.4	7.2	4.8	7.7
Great Britain	1.7	-2.4	0.5	1.0	15.1	11.9	8.5	5.5	-7.1	-4.4	9.9	11.3
Ireland	3.8	1.1	1.0	1.0	14.9	20.4	17.5	13.0	-0.8	0.1	10.5	13.5
Italy	3.3	-0.2	-0.5	-1.0	16.2	19.5	16.5	15.5	-10.5	-2.6	8.4	9.2
Netherlands	2.6	-1.1	-1.0	0.0	7.2	6.7	6.0	4.0	1.4	5.7	7.3	11.5
Norway	4.6	0.8	0.0	0.5	8.8	13.6	11.5	10.0	5.7	-4.0	1.5	2.4
Spain	3.2	0.3	1.0	1.0	17.1	14.6	14.5	13.0	-5.6	-13.1	13.9	17.5
Sweden	2.0	-0.8	-1.5	0.0	9.9	12.1	8.5	8.5	-8.2	-14.1	2.5	4.1
Switzerland	0.6	2.7	-1.0	-0.5	4.6	6.5	5.5	4.5	15.3	-0.4	0.2	0.8
OECD Countries Total ³	3.0	1.1	-0.5	0.5	10.1	10.0	7.3	5.9	-	-	6.6	8.9

¹ External value of currencies weighted by share in international trade 1979. ² In % of total number at or available for work. ³ Total of listed countries weighted by real gross national product or private consumption in 1979 and numbers available for work in 1980 respectively. ^a Average year-on-year change. ^b Estimated or forecast; figures rounded to nearest 0.5 %. ^c Partly estimated and rounded to nearest 0.5 %. ^d Last available month; adjusted for seasonal variation.

emerging deterioration on the American current account. On the other hand, this change in tendency will help make sure that the monetary relaxation also continues outside of the USA, particularly in those countries which have made considerable progress regarding stabilisation.

Obstacles to Growth Still Great

However, there are still a number of large obstacles to growth. Whereas in Japan these are primarily of an external nature – Japan's exports, for example, are particularly affected by protectionist measures – in Western Europe domestic factors continue to play a decisive part. Above all, there has been little progress in correcting distributive relations in favour of profits to pave the way for a better growth climate. Via the close economic links such braking factors are also effective for Western European economies, which – as in the cases of the Federal Republic of Germany and Britain – have achieved considerable adjustment and stabilisation successes.

Even if the forecast gradual strengthening of expansive forces during the course of this year takes place – to begin with in the USA and later in Japan and Western Europe – it is not likely to prevent 1983's demand and production figures from being only slightly up on the previous year's results. In a number of Western European countries there will in fact be a decline, with the 1 % to 2 % growth rates expected for the USA and Japan representing the top of the growth scale. The continuing sluggish development of overall demand will, to begin with, still characterise foreign trade; only towards the end of the year will a stimulation be felt, caused in part by improved stockpiling behaviour. The slight impulses on the part of the industrialised countries will probably be counter-balanced by contractive influences from countries

exporting raw materials. Although the imports by oil-exporting countries can be expected to stabilise gradually following adjustment to unexpectedly low oil earnings, the external consolidation pressures will probably lead to a cutback in imports by many developing countries. Altogether, therefore, international trade in 1983 will once again, for the third year running, remain just under the level recorded for the previous year, albeit with a rising tendency throughout the year.

Despite continued improvement in the general economic framework – inflation will probably further decrease in almost all industrialised countries and interest rates will decline – 1983 can at best be expected to see a turn for the better. Substantial progress in overcoming the world-wide weakness of growth is not to be expected. It would seem that following the many years of economic misdevelopment demand now reveals a delayed reaction to positive impulses, partly as a result of the self-enforcing elements now in effect. This means that there is an overlapping of fundamental and cyclical factors of weakness in the world economy. In a situation of growing unemployment, economic policy is subject to ever-increasing pressure to effect appropriate countermeasures, without the scope for such measures having been increased significantly. In many cases, high government deficits, for example, force fiscal policy onto a consolidation course, even though in the short run this will have contractive effects. Monetary policy in the industrialised countries, however, will not be able to force the process of interest rate reduction following a return from restrictive to potential-oriented expansion without running the risk of rekindling inflationary expectations and thus giving rise to a new deterioration of conditions for growth: this would only delay, and not alleviate, the international adjustment and stabilisation problems.

HWWA Index of World Market Prices of Raw Materials¹
(1975=100)

Raw Materials and Groups of Materials	1981		1982					1983
	AA ²	December	AA ²	October	November	December	Dec. 30	Jan. 14
Total index	240.7	242.1	228.6	224.3	224.6	225.0	225.5	225.3
Total, excl. energy raw materials . . .	135.6	125.9	117.9	110.6	110.6	111.8	112.9	113.2
Food, tropical beverages	126.1	114.1	106.1	99.1	102.2	103.4	103.7	103.9
Industrial raw materials	142.7	134.8	126.4	119.3	117.1	118.2	119.9	120.3
Agricultural raw materials	146.4	134.2	127.1	115.3	113.3	114.3	115.3	115.2
Non-ferrous metals	165.3	151.8	134.9	131.4	128.5	128.7	131.5	135.0
Energy raw materials	302.1	309.9	293.4	290.7	291.1	291.1	291.2	290.8

¹ On dollar basis. - ² Annual Average. For the method of computation of the HWWA Index cf. INTERECONOMICS No. 5, 1980, p. 261 ff.