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## World Economy – Recovery Still on a Tightrope

The latest world economic summit in Bonn ended in customary style with a declaration of principle on economic policy. This contains a joint profession of support for a policy which endeavours to overcome slow economic growth and high unemployment via a patient improvement of the general framework for economic activity and not just a short-winded boost to demand. In view of the fact that most of the summit governments are more or less pursuing such an economic policy course already this fundamental consensus is more credible than during earlier summits. However, marked differences of opinion surface as soon as such basic commitments are to be translated into action, a fact exemplified by the attempt to translate the condemnation of protectionism into a further liberalisation of world trade.

The opening up of international markets and the intensification of the international division of labour were two of the major post-war driving forces behind economic growth and increasing prosperity. Today the world economy is again in need of this kind of impetus. The marked increase in overall production in industrialised countries, averaging 5 % in 1984, cannot disguise this fact, for this growth rate has already dropped by half since the middle of last year. This reflects the cooling-down of the boom in the US economy, which is partly due to normal cyclical fatigue and partly to shortcomings in implementing the supply-oriented strategy. Despite the massive tax cuts, the continued increase in public spending forced up real interest rates and the exchange rate. The pronounced expansion of demand in the USA, therefore, was particularly beneficial to foreign suppliers and the stimulation of the propensity to invest pursued via tax reduction was partially counteracted.

The continued faith in American economic policy, which promised to bring about stability and economic momentum at the same time, was confronted by its limits in spring this year, and the dollar exchange rate began to rectify the exaggerations. The American central bank contributed towards this process by allowing a more rapid increase in the money supply at the end of last year after it had become clear that the economy was slowing down. However, an overstepping of the announced monetary target range is not possible in the longer term without inducing a renewed flaring-up of inflationary expectations and jeopardising the "soft landing" of the dollar and the American economy. It also looks as if it will take some time before the Federal Reserve Board will be relieved by confidence-inspiring advances in consolidating public finances.

In view of this US scenario, the demand stimuli for the rest of the world will be substantially weaker than last year. On the other hand, the diminished strength of the dollar will provide many governments and central banks with greater scope in their economic-policy decisions. Above all, interest rates will at long last tend to fall. At the same time, there are signs of a further decrease in oil prices, which will favour incomes in oil-importing countries. This in turn will stimulate demand and production in Western Europe and Japan. Whether these new impulses will offset, or even overcompensate, the reduction of direct demand stimuli from the USA depends on the fundamental conditions of growth.

The upturn in business investments in Japan and also in Western Europe is an encouraging sign in this respect. This development has resulted to a certain degree from

cyclical processes triggered by the increase in exports to the USA. However, the general underlying forces of economic growth, which now play a key role, have also been strengthened following an overall improvement of business profitability in the wake of continuing stabilisation and wage restraint.

Excessive public consumption and income redistribution, however, which were two of the reasons for the sustained weakness of economic growth, have not as a rule been appreciably remedied and continue to impede the development of dynamic market economy forces. Supply conditions vary from one region or country to the next: they are much more favourable in Japan, for example, than in Western Europe, and more favourable in the Federal Republic of Germany and Britain than in France and Italy.

On the whole, the industrialised countries can expect the upward economic trend to continue, although the momentum will no longer be provided by a pace-setting US economy. However, a broadly based, moderate increase in production will signify a considerable improvement compared with the slow growth at the beginning of the eighties. At the same time, this will characterise the international economic framework for attempts to overcome adjustment problems in developing countries. A substantial reduction in their current account deficits in 1983 and 1984 was above all made possible by the import boom in the USA. This was an important basis for successful debt rescheduling negotiations. External stimuli enabled developed countries, albeit to an extremely varying degree, to get economic growth going again.

The need to consolidate their foreign trade positions still sets narrow limits to the strengthening of economic growth in many developing countries. The removal of the fundamental imbalances, which were accentuated by the oil price explosions since the mid-seventies, needs time. In this respect, there are considerable differences between individual developing countries when correcting past errors and adjusting the structure of their economies to the changes in the overall economic setting. However, wherever attempts were made to avoid these painful adjustments, which are often associated with a temporary reduction of the already low standard of living, it soon became clear that these processes are inevitable.

The industrialised countries cannot spare developing countries this structural adjustment. Debt rescheduling, which is usually associated with an even greater increase in outstanding debts, can only grant a respite. This can only be utilised by developing countries, however, if they have sufficient sales prospects on international markets. The emerging moderate growth in the industrialised countries is not enough; what is required is the opening up and keeping open of markets for goods from developing countries, in particular for their industrial products. The support repeatedly declared for free trade would be of little value if this aspect were to be ignored and efforts were to concentrate solely on the exchange between industrialised countries themselves. It is by no means a question of an altruistic act, since the smouldering debt crisis is a serious threat to the international financial system in its entirety.

Despite the recovery during the past few years the world economy is still doing a balancing act; risks and opportunities are not far apart. This particularly applies to the economic policy of the USA, which must rectify the internal and external misdevelopments which have occurred during the rapid economic upswing in the past two years, without triggering a new recession. This applies to an equal extent to Western Europe, where the short-term retardant effects of the essential adjustment and consolidation processes mean that the policy to improve supply conditions is being put to a severe test in the face of serious unemployment.

In such a difficult situation economic summits are also unable to provide patent remedies. However, they do remind us emphatically that no single country or group of countries can expect to resolve its problems at the expense of others.

*Günter Großer*