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World Economy Still in the Doldrums

World economic growth has fallen off considerably in recent years. Annual average growth in world output has gone down from almost 4% in the latter half of the eighties to 1½% between 1990 and 1992. The main contributors to the slowdown have been the industrial countries, in which a weakness of economic activity has been the dominant trend since mid-1990: altogether, the utilization of production capacity has kept declining and unemployment has gone up by nearly a third to an average 8% of the total labour force. The growth optimism fuelled by the foregoing prolonged upswing in the world economy has therefore received a sharp setback, in particular as the forecasts still hold no promise of a rapid recovery.

All the same, the world economy today presents quite a varied picture. A number of newly industrializing countries have managed to break away from the general weakness and sustain strong economic growth; this is particularly true of the four Asian "tigers" and China. The countries in transition from centrally planned to market economies, however, are still in serious difficulties; especially in the CIS, production and employment are still in steep decline. The economies in the major industrial countries are also moving in contrary directions: whereas the forces for growth in the USA have finally gained the upper hand since last autumn, the downswing in Japan and western Europe has gained momentum. These divergences in trend patterns reflect major differences in structural conditions and in economic policy, which also determine the prospects for future economic development.

It is still difficult to quantify the retarding influence of the structural constraints in the financial sector, which stem in many cases from the excessive debts run up by businesses and private households in the eighties. Although the resultant reticence to lend and to borrow has diminished noticeably in the USA, the pace of economic recovery is likely to continue to be impeded by this factor. The outlook for Japan is similar, although the slight recovery on the stock exchange does indicate that problems of indebtedness are no longer having quite such a negative effect on the climate in the business and banking sectors. In western Europe, such adverse developments are concentrated on the United Kingdom and Scandinavia, where recessionary trends already started three years ago for just this reason. In most other countries, such factors of influence do not play any particular role in the current weakening of economic activity.

The efforts of businesses, not least of banks, and of private households to consolidate their finances have brought about a process of debt deflation. By remedying previous undesirable developments, this will ultimately improve the conditions for growth in the economies concerned. In the short term, however, it reduces demand and hampers the effectiveness of stimulant measures. The US Federal Reserve has been the first to learn this: its stimulation efforts over years only started to take noticeable effect after a long delay. For the same reason, in Japan, too, a tangible stimulus to the economy from the monetary relaxation begun two years ago will only start to make itself felt in the course of this year. Monetary policy faces fewer such impediments in most western European countries. Gradual monetary relaxation did not begin here, however, until last autumn. The

drops in interest rates have kept within relatively narrow bounds so far, primarily because the Bundesbank only departed from its strict course late on and in small steps due to the stabilization and distribution problems in Germany – which were not least a result of unification – thus only slowly enlarging the scope in other countries for the lowering of interest rates. Many of these countries have so far been unable, however, to lower their rates to German levels because their economic policies have not sufficiently gained the confidence of the financial markets and because – unlike the United Kingdom in particular – they want to avoid devaluing their currency if possible.

Low utilization of overall capacity and high unemployment curb government revenue and increase government spending, which is why public deficits have risen substantially in most industrial countries, from an average 2% of gross domestic product in 1990 to some 4.5% in 1993. This reaction has a stabilizing effect on income and demand and due to its automatic decline in the course of a recovery of economic activity, it will not require any corrective measures later. In many cases, though, cyclical deficits now come together with a structural deficit which was not reduced even during the upswing, and they add up to magnitudes which are threatening to disconcert the financial markets and curb the lowering of interest rates. For this reason, consolidation measures are announced in many countries despite the continuing weakness of economic activity. Owing to the continually precarious economic situation, fiscal policy, in particular in western Europe, is walking a tightrope. In the USA, too, weighing up short and medium-term needs is difficult in the face of the large budget deficit. This is why the new President has so far failed to get his plans to support expansive forces in the short term by additional government spending through Congress. Only in Japan, where the general government financial balance – including social security – still shows a surplus, does demand stimulus currently enjoy clear priority in fiscal policy.

As the structural impediments stemming from the debt problems are receding, having evidently passed their climax, future developments in the industrial countries will again be increasingly determined by general economic policy. Apart from exceptions like Japan, fiscal policy will play a minor role, as it will not usually generate any tangible stimulus which goes beyond the built-in stabilizers. Rather, the key role will be played by monetary policy. Its impulses can be all the more effective in real terms as prices almost everywhere are only rising slowly now and inflationary expectations have largely been contained. Altogether, there is reason to assume that following the USA, the downswing in Japan and western Europe will bottom out in the course of this year. But it will not be until 1994 that there will be a general, world-wide upward trend in demand and production. Utilization of capacity and employment will then start to revive gradually.

In particular in western Europe, the economic trends in individual countries will be influenced by adjustments to the large changes in currency relationships since last autumn. The outcome will finally depend on how prices and wages react in the countries concerned. In the short term, however, there will as a rule be a certain shift in net exports in favour of the devaluing countries and at the expense of those whose currencies have gained in value. The direct economic effects will thus differ, but the correction of outdated exchange rates basically has a generally salutary effect on conditions for growth.

With the cyclical recovery of demand and production, the structural impediments stemming from the indebtedness of enterprises and private households and from high budget deficits are bound to appear less important again, but progress must be made here well beyond the immediate cyclical improvement in order to better the conditions for sustained growth. It is also crucial that the Uruguay Round reach a positive outcome. This will have less of a short-term effect on developments in world trade than is often assumed, but the prospects of a lasting intensification of the international division of labour, which has contributed so decisively over recent decades to raising productivity and prosperity, would be a major incentive for investors and hence boost forces for world economic growth.

Günter Großer