

FEATURES

The Current World Economic Scene and its Impact on Developing Countries

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The impact of the recession in the Western world is being felt by every country, though in varying degrees. This paper and the following one discuss its effects particularly on the developing countries.

Dr. Warnasena Rasaputram, Governor of the Central Bank of Ceylon, analyses the situation in a wide ranging discussion of the world economic scene in this paper. What is required, he states: is a concerted and co-ordinated effort by all countries, by harmonising the conflicting objectives of the day, so that developing countries can work as partners in development. He maintains that the adjustment process itself has to be a global one and any attempt to go alone by any single country will only confuse the issues. This paper was presented by him at the Regent School of Economics, Kuala Lumpur, at the end of November 1982.

The world economic situation not only continues to be gloomy but also indicates that the prospects for early recovery are getting bleaker. There is an economic crisis in almost every sphere of economic activity. Growth rates of developed countries are not only low but are likely to remain low. There are no convincing signs that their average output rise of 1½ percent will improve significantly in the next year. The per capita output of the developing world declined. World trade was adversely affected by inflation, exchange rate and interest rate volatility, slow growth and stagnant demand. Stagnation in world trade may enter a third successive year. Deflation of commodity prices posed a serious threat to the stability of incomes of developing countries. Demand for primary products continues to remain weak. High levels of unemployment tend to encourage the building up of a wall of protectionism. In fact there was a decline in the volume of imports by the developed countries by nearly 2 percent each year for the last three years.

The present economic situation is plagued by two big problems—unemployment and inflation. OECD countries have nearly 28½ million people or 8 percent of the work force unemployed. In the United States the unemployment rate as a percent of work force reached 13½ percent while in France it reached nearly 15½ percent. There is however, one silver lining around these dark clouds. The inflation rate has slowed down. In the advanced countries the rate of inflation has been brought down to single digit figure. But the question arises whether this deceleration is merely a product of the recession or something more lasting.

The developing countries particularly of South East Asia showed satisfactory rates of growth despite stubborn economic difficulties. Their terms of trade however, deteriorated further by nearly 11 percent and a few countries experienced declines of as much as 30 percent in three years. Unemployment remains high, according to an estimate made by the UNCTAD. Growth rate of GDP must rise by more than 6 percent if the unemployment situation is not allowed to deteriorate from its current situation. Acute foreign exchange shortages continued to reduce the availability of goods and services causing severe hardship to all sectors of the economy. Projections of economic growth for developing economies for the next 3 years show a dismal picture. Sharp increases in oil prices coupled with recession in the developed countries had resulted in severe balance of payments difficulties for the Third World countries. In fact the high oil prices together with a weak demand for their exports and higher imports of capital goods particularly those connected with raising energy supplies caused a balance of deficit of nearly \$100 billion in each of the years since 1979. The current account deficits of most non oil developing countries are in the region of 11-13 percent of GDP. As we are aware, anything more than 5 percent of GDP will undoubtedly cause severe financing problems and debt service burdens. The debt burden of some countries had skyrocketed to levels that are unprecedented. The rising interest rates added a further burden. It is estimated that 1 percent rise in interest rates of Euro dollars would raise the debt servicing burden by \$2 billion. Take the case of Mexico. In 1981 it had a debt service ratio

of 60 percent followed closely by Brazil with 58 percent. Of the ASEAN countries the debt service ratio is highest for Philippines with 24 percent, followed by Thailand 17 percent, Indonesia 12 percent and Malaysia 5 percent. There was an urgent need to have more investments to raise supplies and reduce the heavy dependence on imported energy which ranged between 30 and 72 percent of exports in a few countries. There can, therefore, be a continuation of the deficits into 1984 while possibilities of financing these deficits over a long period within the context of the current economic scene appears to be limited.

The socialist countries have had their share of trouble. China moved to modernise its economy. Certain structural problems caused a reduction in the planned rate of increase in national income of the East European socialist block.

There was however, a determined effort by all the countries concerned to meet the current challenge in the context of ever changing needs and priorities. There is an awareness not confined to Third World countries alone, that the existing configuration of economic forces is unjust, inequitable and inefficient. The developing countries have only been able to let off their steam in international fora about the inertia and inactivity of the developed countries to make concerted efforts to reach a solution to the existing problems despite their being aware of them. The disappointment about the inability to solve pressing economic issues has now gone beyond the stage of showing impatience.

Before I come to a discussion of world recovery through international economic co-operation, let me point out some of the effects that the current economic issues have on developing countries.

Despite bold attempts made by developing countries to adjust their economies they are obstructed by imported inflation. The control of inflation is given the highest priorities by most countries of the world. However, the solutions attempted by them may not be well balanced. It is accepted that inflation cannot be tackled except through action over a broad range of economic policies including monetary policy, fiscal policy, balance of payments policies and other economic policies that will raise supplies. Under the influence of monetarism the developed countries have given too much of emphasis to monetary issues. Another reason that may have allowed an excessive burden to fall on monetary policy may be the fact that it is a vital instrument in the hands of the Central Bank alone which had taken timely corrective action but not fully

supported by fiscal policies of the Government. The ultimate result is an increase in interest rates causing a higher debt servicing burden to the developing economies. It is recognised that large budget deficits, low savings and inefficient financial management have nullified the efforts made by resolute restrictive monetary policies. The fiscal policies of most developed countries are expansionary. Fiscal deficit of developed countries in 1981 was nearly 4 percent of GDP. The general fear that reductions in budget deficits will reduce domestic activity seems to deter Governments from accepting bold policies. This type of thinking is found in all parts of the world. A temporary slow down of economic activity in unavoidable if pressures on inflation and balance of payments are to be reduced. Instead they react by trying to safeguard existing industries whilst maintaining the level of employment in import competing industries. Thus the protectionist tendencies in the developed countries had been on the increase.

During World War II, the developing countries were compelled to substitute a few imported items due to supply shortages. Some of these industries were started under inefficient conditions and could not stand the flood of goods from developed countries soon after the war. However, with the breakdown

among industrialised countries and such trade was mostly in competitive goods. According to estimates made by the Overseas Development Council barriers to exports of manufactured goods from developing countries are removed, they alone can raise export-earnings by as much as \$25 billion. But there is a significant rise in protectionism in recent years. Motivated by short term political considerations, the developed countries move towards increasing protectionism has had serious adverse effects on the economies of the developing countries.

A rise in protectionism compounds the difficulty of finding long term solutions. Protectionist measures get entrenched and vested interests grow around them and prevent their removal thus causing higher costs to the economy. Though imports from developing countries are insignificant and seemingly minor, the developed countries make a fuss about its influence due to regional and political factors. The developing countries, on the other hand, which still specialise over a narrow range of products, find their export incomes heavily eroded. This will naturally have a serious adverse effect on economic growth at home and on the budget through lower revenues. They are unable to expand their exports and export production. In an inter-

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of the world economy and the emergence of an international economy with independent states trying to manage their economies, there developed a trend towards diversification of their exports. With the help of multinationals, some developing countries have made great strides in diversifying their exports, though this diversification is still not very significant. They have been able to break into a small and insignificant portion of the markets of the industrial world. There is no cause to get alarmed with increasing imports into developed countries, but the cry has been raised that such uncontrolled imports would ruin some of the industries in certain regions of these countries. The fear has arisen mainly because developing countries have been extending their manufactured exports to the developed countries at a very rapid rate of nearly 25 percent per annum. But when other western countries competed on equal terms, such a cry was not raised. On the other hand much of the increase in world trade in the past had been

dependent world their heavy dependence on exports has thus resulted in a lowering of real income as a consequence of direct action taken by the developed countries. Obviously exports of these products will not have the same growth momentum once they have been denied access or granted limited access to their products. They have to make further efforts in looking for new markets. But export promotion is an expensive item in the budgets of these countries. Some countries have even entered into long term debt based on export projections. Once the markets are closed the reopening of integrated markets like those in the United States, will be most difficult and expensive.

Monopolistic practices can often depress prices of third world exports; the efficient functioning of a free market mechanism for Third World Commodities is often challenged. The importation of essential commodities is dependent on export incomes. Serious disruption of export incomes will compel the

Third World countries to move their resources away from export products, a decision that may lead to the maldistribution of resources. The countries that import Third World Commodities have a responsibility to assist in the stabilisation of export incomes of the developing world, either individually, regionally or through multilateral institutions. Regional schemes such as STABEX for compensatory export shortfalls of developing countries are working well, but are inadequate. The

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need to compensate such export shortfalls is well recognised by the IMF and its facility is widely used. What is required is a more liberalised Compensatory Financing Facility to take into account real export losses, the condition of the most seriously affected countries, the size and nature of the loss due to protectionism and the need to compensate for the permanent loss of markets. Discussions on this subject at various forums such as the North South Dialogue had been inconclusive, but the Third World countries would expect some lead from a country like the United States towards the adoption of a more positive approach to assist the developing countries.

Lowering of real incomes both due to protectionism and recession has given rise to a huge debt problem for the developing countries. Interest rates, it was mentioned had gone up mainly because of the inability of the developed countries to control inflation. It is only now we see a breakthrough in the fight against inflation. However, inflationary expectations have not been reduced by the same degree. Whatever the outcome on economic activity this may have, it is necessary for the developed countries to pursue more restrictive budgetary policies so that the interest rates may decline to satisfactory levels without relaxing the tight monetary policies that are being pursued. This will not only help the developed countries themselves to come out of the present economic morass but also the developing countries to forge ahead with their development plans and a reduction in their debt servicing burden. The debt of the non oil developing countries can be further divided into debt of the middle income countries and debt of the low income countries. In 1974 the debt of the low income countries was nearly half that of middle income countries. It was earlier believed

that since the middle income countries have the potential for generating and maintaining continued economic growth, their debt problem was not likely to cause serious concern. But events have proved otherwise. The recycling of surplus funds by the banks was done little too well. Between 1976 and 1979 the medium and long term debt of all developing countries rose by 25 percent per year. Between 1979 and 1981 growth has been around 15 percent. But the total debt will grow further and it is projected to be in the region of \$954 billion in 1986. The debt service burden is however, expected to decline from 24 percent in 1982 to 20 percent in 1986. Even though there is a slower growth in the total debt, the low income countries will not be in a position to accelerate their growth and help the adjustment of the balance of payments position without outside help. These countries have experienced balance of payments deficits in the region of \$100 billion per year for the last three years. To restore economic health whilst achieving a satisfactory rate of growth, these countries must receive concessionary aid with longer terms of maturity. In several international forums these countries have demanded implementation of debt relief measures to get them out of the morass of an ever deepening debt situation. At the North South Dialogue and subsequently at UNCTAD, low income developing countries demanded immediate debt relief measures including the cancellation of that portion of the debt arising from official development assistance, rescheduling of all debts and the establishment of a consultative mechanism, that would lead more or less to automaticity in debt rescheduling. Though the middle income countries do not favour such drastic action for fear of adverse reaction from the private capital market, the present situation (where the debt rescheduling will help the bankers and the world economy) these suggestions should receive greater attention from the developed countries.

Today the financial world is in disarray. Monetary crises have not been overcome; financial relationships are at the point of disruption and money in general has run into a maelstrom. Some problems of development have been so aggravated that they are further away from being solved. The income gap instead of narrowing down is seen to be widening. The gap between the rich and poor countries will increase from \$4070 in 1965 to \$6540 in 1985 and to \$8812 in the year 2000. However, a series of bold initiatives that have taken place in the past, encourages us to believe that these economic events deeply marked by collective malaise in economic

relationships can be overcome through collective efforts.

It is well accepted that the growth rates of industrialised countries will have an impact on trade, income, output and the balance of payments of developing countries. However, there are certain disadvantages arising when high growth oriented developing countries are heavily dependent on developed economies. The demand for oil and capital goods by the developing countries will put them in the red with regard to balance of payments. If there is stagnation in growth of developed economies, this will cause balance of payments to deteriorate further and will be accompanied by a worsening of terms of trade. The expected aid flows will be adversely affected because of slow growth in industrialised countries. Obviously the financing requirements cannot be fully met and will pose severe problems in the context of imperfect capital markets that are heavily loaded against poor developing countries.

Thus, there does not seem to be any long term solution that is in sight except to increase intra-

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In the short run there is no escape from being dependant on aid flows, capital flows and high growth rates of developed countries as it is not possible to reduce the propensity to import in the short run. On the other hand it is possible to effect substantial reduction in the collective import propensity of developing countries, in respect to developed country imports in the long run by a well designed scheme of trading among themselves.

Since the objective of achieving collective self reliance cannot be realised in the near term, there is a strong case for international assistance not only to help the developing countries but also to assist the developed countries. Apart from the reverse flow arising from aid to developing countries the industrial countries would increase the efficiency in the use of resources and in the allocation of resources on a global scale. The allocation of world capital stock will not only improve efficiency but also work towards minimising the effects and possibilities of world recession and or inflation. An UNCTAD study has indicated that if the Third World countries increase their growth rate

by 3 percentage points, it will lead to an increase in the growth rate of the developed economies by 1 percentage point. We are quite aware of the current global imbalance which if allowed to grow, will cause further imbalances of a serious structural nature. For the sake of efficiency and equity, there is an urgent need to encourage the transfer of resources to stimulate a more balanced and sustainable growth. Any recovery of the industrial countries and acceleration of their growth without an equal stimulus to the growth of the Third World countries would rekindle inflation and cause serious imbalances. Continuing deterioration of the inequitous distribution of income will one day result in a situation where developed countries will be surrounded by a massive population of undernourished, underdeveloped peoples of the Third World just the same way South Africa is surrounded by Black Africa. It is therefore essential to take the initiative to transfer resources in a well meaning manner, to reduce the existing inequalities, by raising the efficiency in the use of resources of the Third World. Structural bottlenecks that hamper the achievement of a higher level of economic activity will have to be removed by a well designed and timely programme of action. The Arusha Declaration of the Group of 77 is important and relevant in the context of today's economic scene. This declaration of 1979 observed that "the extent and persistence of considerable underutilization of resources leading to unemployment in the developed world should no longer be seen as an exceptionally prolonged through to the business cycle with a more or less automatic recovery to follow. This situation inhibits an effective international adjustment process. What would be required to restore full employment is a new impulse on a historic scale comparable for example with the transfer of resources to Europe for post-war reconstruction". The Pearson Committee emphasised this need and this was re-emphasised by the Brandt Committee. Despite these declarations and recommendations, the developed countries are hesitant to support a massive transfer of resources even in the short term. Except for the front runners like Netherlands, Sweden and Norway, the ratio of official development assistance (ODA) as percent of Gross National Product (GNP) has increased only slightly from .35 percent in 1979 to 0.37 percent in 1981. There was, how-

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ever, a decline in the total resource flow from 1.17 percent of GNP in 1979 to 1.04 percent in 1980. The reluctance on the part of the developed countries, particularly at a time of recession is a result of a lack of political will and the reluctance on their part to increase any further assistance for fear of generating inflation. This same argument has been used against a fresh allocation of SDRs. There has been a decline in the share of SDRs in international liquidity in recent years. The inflation argument cannot be maintained under such a declining ratio. There is no evidence to suggest that economic expansion in developed countries prompted by expansion of domestic demand is less inflationary than a transfer of resources to developing countries either through SDR creation or development assistance. Such arguments are not only misleading but lead to misallocation of resources and building up of rigidities. The growth of unemployment in the developed countries had reached unprecedented levels and would create uncertainty about the in-

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come generation aspect in the future. Labour, in their concern for security and a permanent income could push costs to a point that would enhance inflationary pressures

All these merely indicate lack of concerted effort among the developed countries and even a strong political leadership to surmount the pressures of various lobbies of these countries and effectively respond to the call of the Third World. The efforts they have taken so far are only based on self interest and not on enlightened self interest. Why did the North so far accept the fact that the needs of the Third World have a major role to play to restore economic health of all the countries?

The industrialized countries began to take an interest in the economic development of the Third World countries only after the communist countries became an effective threat to the economic dominance of the North. The emergence of China as a superpower in Asia, and the Korean War, made the North con-

scious of the need to protect their interests. If one looks at the record of multi-lateral institutions engaged purely in reconstruction and development, one notes that during the first few years of the World Bank's existence, it loaned only to industrialised countries. It diverted its attention to the developing countries after the Korean boom but mainly to develop the infrastructure that would normally help the export oriented agricultural and mineral sectors. It is only very recently that it began to get interested in the development of rural areas and raising of the standard of living of the poorest of the poor. Assistance both from the World Bank and the IMF had risen substantially between 1979 and 1981. But projections of World Bank lending indicate that it will not grow as fast as in the past. It is most unfortunate that at this time there is an unwillingness by the developed countries to raise the resources of multilateral organisations. This has not only restricted their flexibility of operations, but also reduced the

ability of the developing countries to make both short term and structural adjustments. The widening of the gap between developed and developing countries will ultimately lead to social and economic injustices that will threaten the security of the world. Revolutionary changes in the policies of the world are required to change the fortunes of the developing countries to levels that can be considered as tolerable, let alone to be satisfactory.

The phrase "time for action" has been often repeated at various international forums. But action taken so far has been insignificant compared to the magnitude of the problem. In a world of conflicting objectives, political factors must necessarily take precedence. However, care should be taken not to give rise to further complexities or to by-pass the deep rooted problems, or else the harmonisation of development policies towards the attainment of the desired goals not only becomes difficult and imperfect but also unattainable in the context of the existing political environment.

We are now looking for better instruments and better ways and means of overcoming the misery of

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the poor countries. Collective self reliance alone cannot be considered a rapid way of developing the economies in an interdependent world. They have to be supported and assisted by the developed countries. We have seen the collapse of the mercantilist era and of the world economic order which existed since Bretton Woods. What is required now is the establishment of a new international economic order. Third World countries are demanding a comprehensive reform of the international monetary system. They are demanding a greater share in the decision making process. They feel frustrated when the decisions of development lending institutions like the World Bank are on a vote heavily weighted against the Third World. Similarly IMF is considered a rich mans club primarily to develop monetary relationships to give security and stability to developed countries. The IMF has not only hardened its conditionality clauses, but refused to increase the conditional liquidity position (SDR). The institutions that have been borne out of one set of circumstances are seldom capable of adapting themselves to a new set of attitudes and needs. The only way the Third World can hope for a greater share of the gains of their own production and trade is by widening their spheres of influence, particularly in the decision making process, rather than have decisions made for them.

The Non-alignment move arose from a desire for self-preservation and self-advancement. In recent years it has veered away from political issues into economic issues especially after the Lusaka meeting. Consistently economic declarations emphasised the need for collective self-reliance for the attainment and distribution of benefits arising out of economic development. The general dissatisfaction with the policies pursued by the developed countries in regulating the international monetary system, with only a scant respect for the ideas and aspirations of the developing countries, would make them move away into finding solutions in their own way. What is required is a concerted and co-ordinated effort by all countries, by harmonising the conflicting objectives of the day, so that developing countries can work as partners in development.

A solution must have a lasting impact on the attitudes and psychology of the people. It has to be worked not only within existing political and social conditions and the value system but also taken into the possible changes that can be foreseen. This requires a new approach and a new scenario towards global economic development. The ideals and aspi-

rations of the younger generations will have to be given adequate weightage. Economic problems affect the youth of the developing countries most while in the developed countries they are faced with a different set of problems. But in all cases the youth are seeking to establish peace through methods that may be different. Youth does not tolerate extremes of wealth and poverty and openly favour have-nots against the haves. Equity in the distribution of income is one of the objectives through which they aim at increasing efficiency of workers, raising dignity of labour, preventing unfair competition, exploitation and all types of privileges. Youth are frustrated as employment opportunities are limited. What is therefore required is a new look at the strategies of development, and a new look at the methods of achieving the ultimate goal. Any exhibition in the form of "emperors new clothes" will not only alienate the younger generations but will make them lose confidence in the methods. Apart from pressing for timely corrective action to restore world economic health and stability, there should be an acceptance of the urgent need to reform the existing system on a time bound programme of action.

Let me conclude my remarks by saying that the world economic malaise may be on a Kondratieff 50 year cycle but the instruments available for correcting this can be applied successfully only within the context of an interdependent world. The adjustment process itself has to be a global one and any attempt to go alone by any single country will only confuse the issues. Concerted efforts on demand management policies together with supply policies need to be defined, evaluated, identified, discussed, accepted and implemented. The bleak economic future before us cannot be solved by resorting to abstract expressions of political and economic semantics.