

Foreign News Review

High U S Dollar Interest Rates Hurt Rest of the World

The outlook for the developed Western economies will remain gloomy for a longer time than expected. The semi annual report by the Organisation for Economic Co-operation and Development (representing the 24 OECD countries) has emphasised that the recovery it forecast for mid 1981 will be delayed. "The timing of the West's economic upturn which in December's report was forecast for the first half of this year, has been delayed by six months or more." The implications of this continuing recessionary trend are bound to be felt not only in the West but among the countries of the developing world as well.

The OECD report which surveys prospects for the next 18 months indicates that the picture has turned out to be less buoyant than suggested by the Organisation in December last year. It foresees that when the recovery gets under way it will be "modest" and accompanied by inflation and unemployment "which are too high, yet hard to reduce." In the six months ended in June, the report notes, the dollar's effective exchange rate has increased 21 percent against the Deutsche mark, 24 percent against the French franc, 19 percent against the British pound and the Swiss franc, and 27 percent against the lira. This lost purchasing power, in dollar terms, should add about 1.1 percent to the basic rate of inflation in Europe this year and a further 2.2 percentage points next year, the report states.

In analyzing why exchange rates have moved so sharply, the report notes: "There does not seem to be any simple, systematic explanation for recent exchange rate developments." The usual main determinants — monetary conditions, interest rate differentials, current-account developments and relative price performance — have not played their usual role.

The question of the high interest rates policy of the United States which has become a controversial issue among OECD members has hardly been referred to. The European members have made repeated calls for less reliance by the U.S. on a tight monetary policy. The basic argument as to whether the long fight against inflation needs to be replaced with a programme to stimulate employment is largely avoided in the report, which sees no early

easing of the tight monetary policy. As a result, domestic demand, especially in Europe, "is expected to be muted" and unemployment, already at post-war records, will continue to climb. The big question being asked is whether the social pressures stemming from such high rates of joblessness — youth unemployment in Britain, France and Italy are seen at over 20 percent — will force government officials to abandon the current strategy of fighting inflation for a policy aimed at boosting employment.

What the developing countries will have to guard against, however, is that the OECD hopes that Europe's recovery will be fueled by a recovery in exports which would have been the result of the exchange rate changes making the prices of those goods very competitive on world markets.

For instance, West Germany's volume of exports is forecast to soar 10.7 percent next year against an increase of imports of only 2.7 percent. As a result, Bonn's current-account deficit is seen shrinking from the \$17 billion forecast for this year to \$5.25 billion next year and Germany's industrial production is expected to increase 2.7 percent following this year's forecast decline of 1/4 percent.

For the OECD countries as a group, the outlook for employment is poor, given the fall in the level of economic activity. With the labour force growing at a rate of 1 to 1 1/4 percent a year, unemployment is expected to continue to rise. The OECD has warned that the numbers unemployed in the 24 member states taken together could reach 25.5 million by mid-1982, an increase of over 10 percent since the end of 1980. If so, the unemployment rate for the OECD area would reach the historically high level of 7.5 percent of the working population.

In West Germany, by the end of June this year, unemployment had topped 1.1 million, its worst figure for almost 30 years. In Britain prospects were even more gloomy. The unemployment total had reached the highest in 50 years — by mid-July the number of adults out of work had reached 2.85 million, the equivalent of 10.7 percent of Britain's work force; and fears were being expressed that by the end of July the overall total would reach 3 million.

How seriously have these high US dollar interest rates affected the developing countries? One estimate states

"each percentage point that interest rates go up costs Third World debtors to the commercial markets another US \$1 billion".

"For countries like Zaire or Pakistan, every percentage point that the interest rates go up represents an extra US \$10 million in debt servicing costs. For a major borrower like South Korea, interest rate servicing cost US \$140 million for each percentage point. A record borrower like Brazil will have to borrow an extra US \$500 million in order to meet its interest rate commitments during the rest of 1981".

"At current prices, Zaire, has to match the increase in its exports point by point with the rise in interest rates. Last year, the African copper producer exported 461,191 metric tonnes. With an external "floating interest rate debt" of more than US \$ 1 billion, each percentage point costs the Zaireans above US \$10 million which at current prices means more than 5,000 tonnes of copper".

"Malaysia fares even worse. In 1980 the country exported 69,000 tonnes of tin. At current prices it would have to increase its tin exports by more than 2 percent in order to face the increased interest rate bill".

However, suppliers themselves are caught in a painful dilemma: any attempt to raise income by increasing exports merely floods the market and depresses prices. The producers of a particular commodity are trapped by the direct link between maintaining prices and controlling supply: as the latter is increased, the former falls.

In fact the situation builds upon itself. As interest rates rise, the recession gets deeper and the prices for both mineral and agricultural raw materials fall. The price of tin is reported to have dropped 26 percent during the last 12 months; rubber 14 per cent during the same period, and copper, in US dollar terms, showed a decrease of 6.83 per cent during the last six months.

If Third World treasuries want to keep up with their interest payments they have to increase their exports, but to an already depressed market.

In Sri Lanka the Minister of Finance expressed his apprehension over the situation when in an important statement in Parliament, he referred to its impact on our development programme (which is presented in the form of a 'rolling plan') and he hoped that our plans.

"will survive the new shock of the strengthened dollar which is proving an equally great shock for Third World countries, like ourselves, as the oil shocks of the last three years".