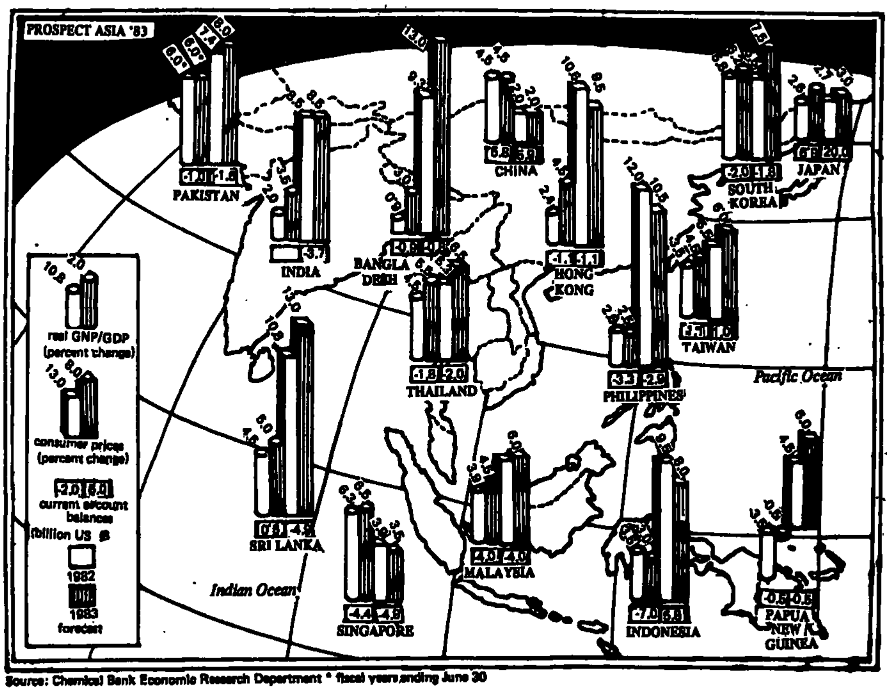


Source: Chemical Bank Economic Research Department * fiscal years ending June 30

THE WORLD ECONOMIC RECESSION

The world economy is in the midst of crisis. The recent summit gathering of leaders of either rich countries in Williamsburg or poor countries in New Delhi, or of both groups in Belgrade have apparently had little impact on the situation. At Williamsburg the representatives of the seven rich countries hardly gave much consideration to the problems of the poor world; with hardly a suggestion either of steps to reduce the debt burden of the Third World or about any form of global negotiations. At New Delhi, and earlier in Buenos Aires, the Group of 77 showed signs of hope in the dialogue to follow at UNCTAD in Belgrade. The rich world, particularly the present US administration however, is unable to view global economic problems in the same light that the poor world does and has disagreed specially on trade and compensatory financing for Third World countries' shortfalls in commodity earnings. They have also continued to resist suggestions for reforms in the western-dominated international economic system, which developing countries blame for many of their problems.

Since 1979 the global economy has been dominated by adverse developments, plunging it into the deepest recession of the past 50 years. The manifestations of the crisis have been observed for three consecutive years in the form of sharply lower rates of growth of output, the deflation of commodity prices, a decline in the volume of goods traded internationally and a resurgence of pressure for increased protectionism, high and rising interest rates and fluctuating exchange rates, increased difficulties in managing internal and external debt, sharply reduced rates of growth of capital formation, and cut backs in provision of official development assistance and in domestic social programmes. Of greatest concern is the fact that the crisis appears to have reduced social welfare in many countries, sometimes seriously, particularly in the developing world.

There were reports earlier this year that the signs of economic recovery evident in the US were finally reaching the countries of Western Europe. But economists in Europe are now beginning to show "a caution bordering on skepticism about early evidence that the three year long grueling recession was at last over", according to most recent reports. An European board of economists making a forecast for the major West European countries of West Germany, France, Italy, Britain, Belgium, Netherlands, Spain, Sweden and Switzerland, now predicted that growth in these countries will be only 1.5 per cent in 1983 and 2.5 per cent in 1984, while inflation will recede to 7.5 per cent this year from 9.7 per cent in 1982; but unemployment which stands at 10.7 per cent of the workforce or approximately 12 million people in the European community is not likely to decline; while estimates beofre the European Parliament indicates a doubling of this figure in the next five years. The outlook remains gloomy, says Hans Mast, a University of Zurich, lecturer and vice-president of Credit Swisse, because as he sees it the three major short-term economic problems of our time have not been resolved. In Mast's view, from Switzerland, the problems are (1) unemployment, which could rise to socially and politically dangerous levels; (2) the US $ 600 billion debt of developing nations, that is testing the stability of the international financial system; and (3) the trend toward worldwide trade protectionism. And although these were the obvious problems, he said, the fight yet seems to be against "an enemy who is no longer there. Inflation is no longer enemy No.1".

Pressures continue, however, to be kept up for a common approach to solving the closely intertwined problems of international debt, global unemployment and growing protectionism. Says Herbert Giersch, director of the University of Kiel's Institute for World Economics: "We need a vision. But where is that world leadership ?". Giersch's cry reflects the general feeling that "the chances of world recovery rest on a compromise in the clash between optimism and pessimism, between those who would push the frail expansion too fast and those who out of fear of new inflation, would stifle recovery."

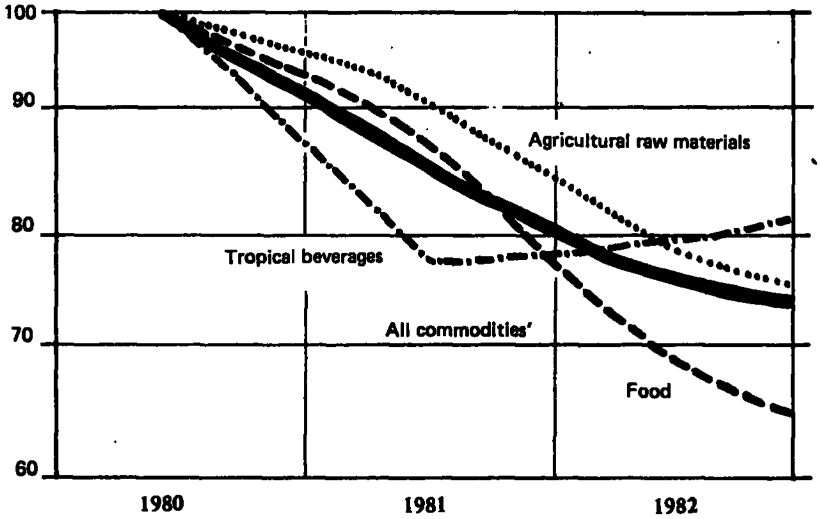
The roots of the current economic recession can be traced to the turmoil in the international economy since the late 1960's. In the 1967 recession from which industrialised countries were left out (particularly the US which avoided it through the Vietnam War) unemployment in the OECD industrial countries of North America, Western Europe, Japan, Australia and New Zealand, rose to five million. It then declined again until the recession of 1969–70, when their unemployment rose to ten million. Then unemployment declined again but only to eight million in the recovery of 1971–73 In the recession from 1973 to 1975 – the biggest post-war recession till the present one – unemployment in these countries rose to 15 million. In the then long recovery from mid–1975 to mid–1979 unemployment declined in the United States, but rose so much elsewhere in the industrialised countries, that total unemployment rose from 15 million to 17 million. That is where it stood at the beginning of the present recession though since then it has nearly doubled and by the end of 1982 the level of unemployment was over ·32 million. Unemployment thus rose in the OECD industrial countries from a post-war low figure to 5 million in 1967 and since has increased to over six times that figure today.

The recession of 1973–1975 had begun in the United States (in May–June 1973) when the first oil shock which came only during October 1973 (after the recession had begun), though this helped to deepen recession. The rate of inflation which was increasing from 1972 was also ultimately to be affected by this situation. The second oil price hike at the end of 1979 again came after the recession had begun – about June 1979 – only adding to the existing disorder. The trade, monetary and fiscal policies adapted more recently by the industrial nations as counter active measures to fight the growing economic recession also occupy a place of significance. During this period the growth performance of the seven major industrial nations, on which the global economy has depended much, has been disappointing; some countries experiencing zero or near zero real economic growth rates, while others have seen their economies decline in real terms as implied by their negative growth rates. Against this background, a slightly better economic performance beginning from the final quarter of 1982 led to renewed hopes that a recovery of the global economy was within sight.

Most recent reports indicate that the annual growth rate of the US Gross National Product for the first half of 1983 had moved upto 6.6 per cent and growth was likely to reach a comparative high 8 per cent annual rate, during the next quarter. The US administration was elated about these shinny figures, though some US economists contend that the speed with which the rebound has come can be unsettling. The pace, they feel, could eventually overheat the economy and spark off a new run-up in prices. This upturn, however, has still to be felt across the Atlantic and the situation here is not being viewed with the same optimism as in the US, as indicated in current prospects of the European economies. In its OUTLOOK for 1983 (published in July 1982) the OECD projected a growth of 2½ per cent, but has since modified its forecast to zero growth.

Indices of Primary Commodity Prices

(1980 = 100: in US dollar terms)



Index comprises spot prices of 30 primary commodities exported by primary producing countries.

Data: IMF, International Financial Statistics

It is evident that the global economy is in a long structural crisis of over-production that began in about 1967 with the beginnings of decline in the rate of profits and the growing level of recession. This feature was most apparent among the Western industrialised nations.

Background to the Crisis

After the end of World War 11, especially from the 1950's in Western Europe and the 60's in America, Western governments had apparently learnt how to avoid deep economic recessions. Under Keynesian economics they had "learnt" how to relax credit and stimulate demand by either cutting taxes or by increased Government spending or both. The post World War 11 period saw an increased prosperity in the Western World and a feeling existed that business cycles and depressions were basically a thing of the past. The consumer society and the new affluence was evident everywhere. The period also saw the increasing relative and sometimes absolute pauperisation of the Third World as terms of trade continued to turn against raw material producers; while producers of the industrialised nations continued to raise prices of their manufactured exports; leading to a virtual subsidising of the Western world economies by the Third World during the post war period.

As the economic crisis deepened in 1975 the conventional Keynesian economics was found to be increasingly inapplicable; while the Third World continued to make increasing demands for a larger share of the world's health.

The weighted average growth rate of the major seven industrial nations recorded a 5.2 per cent growth rate in 1972, a still higher growth rate of 6.3 percent in 1973. This growth performance had been principally a consequence of expansionary monetary policies and liberal fiscal policies pursued by the US and followed by other industrial nations. The continuing emphasis on such growth oriented policies led to the next inevitable development of raw material shortages.

Into this situation came the 1973 Arab Oil embargo and subsequent price explosion. The United States and other major industrial countries responded to the oil price hike through a reversal of expansionary policies, to restrictive monetary policies; with a view to containing the inflationary tendencies associated with the oil price hike and the increasing demand for other primary commodities. This course of action proved to be successful in reducing the adverse effects of the oil price hike to managable levels. With the recession under control by the end of 1975, the monetary policies became less restrictive and this again followed a gradual recovery of the global economy.

While the gradual shift to liberal monetary policy of industrial nations – from a restrictive to a moderately expansionary – played a role in the economic recovery since 1975, it also became the leading factor in initiating the process towards inflationary tendencies. These tendencies were stepped up sharply after 1979, as a result of pressures from the oil price hike on consumer prices. In the Western world the rate of inflation measured in terms of the consumer price indices rose from around 6 per cent in 1976 to 9.0 per cent in 1979 and to 11.9% in 1981. With the exception of Japan and West Germany, all other major industrial nations experienced two digit inflation in 1981. With rising inflation, the need for policy adjustments again surfaced. In contrast to the more dominant role of monetary policy in the past, a combination of restrictive monetary and protectionist trade policies signified the policy considerations after 1979. These policies proved to be more damaging to the world economy and to the developing nations in particular, than the size of the oil price increase itself.

Monetary Policy Adjustments

A restrictive monetary policy once again became an important policy instrument and it turned out to be the most restrictive monetary policy in recent times adopted by the USA, in particular, and also Britain, the Federal Republic of Germany, Japan and France. In the case of United States, the narrow money supply (M1) progressively declined from 8.3 per cent in 1978 to 2.3 per cent in 1981. The severity of the restrictive monetary policies of major industrial nations was more pronounced in the movements of broad money supply (M2).* In the third quarter of 1979 the broad money supply in the US turned abruptly negative in real terms, when adjusted for inflation, and remained negative during the next two years. As a consequence of this decline in money supply, consumer demand in basic sectors drastically fell, but this, as anticipated, followed a marked improvement in the rate of inflation. The weighted average for all industrial nations taken together declined from 11.9 per cent in 1980 to 8.8 per cent in 1982, and for the United States from 10.1 per cent in 1980 to 6.2 per cent in 1982.

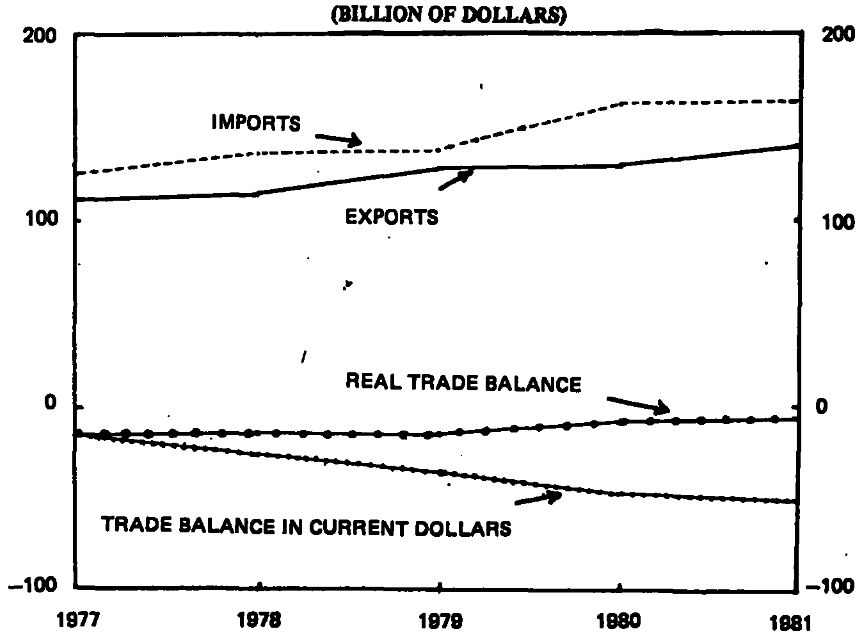
The impact of money supply contraction, in real terms, was further exacerbated by the rise in nominal interest rates of virtually all industrial nations. In the final quarter of 1978, the nominal interest rates of the major industrial nations remained at between 4.5 per cent in Japan to 15.0 per cent in Italy. By the end of 1981, nominal interest rates had risen proportionately to unprecedented levels ranging from 7.0 per cent in Japan to 22.5 per cent in Italy. The nominal interest rate in the United States reached a peak in the last quarter of 1980 at 20.2 per cent and since declined to about 18.0 per cent during the final quarter of 1982.

The rise in nominal interest rates, along with the declining inflation rates, produced sharply rising real interest rates. With the exceptions of Italy and perhaps the United Kingdom, real interest rates of all other industrial nations have remained positive since 1978. In 1981, all seven major industrial countries reported positive interest rates, ranging from 1.6 per cent in France to 9.8 per cent in the Federal Republic of Germany. The sharp rise in interest rates effected adversely credit sensitive activities such as consumer durables, housing and inventory accumulation which, in turn, constrained the real economic growth rates to historically low levels.

Trade Policy Adjustments

Another key element in the current economic recession is that of protectionism, which first emerged around 1977 and gradually strengthened as the recession progressed. This practice has been adopted by Japan and the Western industrial nations in particular, and to some extent by the socialist countries and also some developing nations. While the main objectives of protectionist policies of industrial nations was to safeguard domestic production from foreign competition, similar measures became important for socialist and developing nations in the face of their deteriorating balance of payments situations, as the world economic climate turned more and more unfavourable. Protectionism is essentially an act of putting up trade barriers, both direct and indirect, with a view to control and discourage imports and by the same token, to promote the utilization of domestic products and resources. A recent survey of the United Nations Conference on Trade and Development (UNCTAD) identified nearly 2,000 entries coming under various protectionist devices such as tariffs, restrictive business practices, price favouritism and quality standsrds. Of these , there are four protectionist agreements, introduced by the US and other Western industrial nations, with serious implications on world trade and two of these four agreements severely limit market access to developing country producers. They are: (a) tightening of the Multi-Fibre Arrangement, which governs most international trade in textiles

OIL IMPORTING DEVELOPING COUNTRIES TRADE BALANCE (BILLION OF DOLLARS)



* *M1, the basic supply, consists chiefly of currency and bank checking accounts. Broad monetary aggregate (M2) has been defined as the sum total of narrow money supply (M1) and quasi money (i.e. time and savings deposits of the private sector with commercial banks). The relationship between the broad monetary aggregate and the causal factors are expressed as follows: Board Monetary Aggregate(M2) = External Banking Assets (net) plus Domestic Credit minus other liabilities (net).*

and apparel products, and subsequent tightening of its bilateral agreements negotiated within that framework, and (b) introduction and subsequent tightening of import quotas for sugar.

The outcomes of these monetary and trade policies were immediately reflected in the upward movement in the exchange rates of *major currencies*, notably the US dollar. The value of the US dollar, as estimated by Bergeste has appreciated by an average of about 20 per cent, during the past two years, against the currencies of major trading partners of the US. For the developing nations, protectionism and higher exchange rates produced a double blow: expenditure on imports increased proportionately with the sharply rising exchange rates and revenue from exports substantially reduced with continuing emphasis on protectionism. These situations have required the developing nations to introduce measures to reduce imports in order to prevent the rapid erosion of their current account balances and acute foreign exchange shortages. But such contractive policies severly limited the ability to sustain the growth momentum of a large number of developing nations. In most cases economic growth performance reached zero or negative levels.

Policy Implications for Economic Growth

The continuing emphasis on protectionist policies has been denounced by almost all developing nations and international organizations, particularly the detrimental effects of these policies on the economies of developing nations. They have also been subject to equally strong criticisms from many others in the western world on the grounds that these very policies will further perpetuate economic stagnation in the industrial world. According to Weiderbaun, for instance, the protectionist policies have two major effects on the US economy: first, imports are reduced, and the trade deficit is initially narrowed, next, the value of the dollar is pushed up thus reducing the ability to export while making imports still chaaper so that the deficit eventually widens. The Secretary General of the OECD also expressed fears that "import restrictions by a country with an overvalued currency will only make things worse by reducing the flows of foreign exchange which would otherwise help to restore more appropriate exchange rates". These concerns are well justified in the context of economic growth performance of the world, as a whole. As illustrated in table 1 on page 7 a turning point in growth performance, for all nations in general, has taken place in 1979.

It is apparent that the current crisis of the world economy is not simply a cyclical phenomenon. It is primarily a consequence of underlying structural mal-adjustments in virtually all areas of the international economic system. Unfortunately the resulting global burden of adjustment has fallen disproportionately on the developing countries.

There is greater recognition today, in the developed countries, of the need to stimulate growth, but the measures being taken towards this end will be inadequate unless they provide for an expansion of the import possibilities of the developing countries. The developed countries have realised that they stand to suffer when productive capacities in developing countries are under-utilized. The industrialised countries have a large positive balance of trade from export of manufactures with the developing countries. But unless the 'South' exports to the 'North', it cannot in turn pay for the North's exports to the South.

The share of the Third World in Western exports increased very substantially during the 1970s. The Brandt Commission estimates that the United States for instance sells twice more goods to the Third World than it does to Europe, and four times those to Japan. Western Europe also sells three times more to the Third World than it does to America and twenty times those to Japan. And Japan sells nearly 50 per cent of its exports in the Third World, which has become absolutely crucial as an importer.

But insufficient financing and low export earnings have recently been forcing developing countries to close their markets to imports from the industralised nations. According to an UN economist "The recessions are feeding on each other. The collapse of the Third World will hurt the first world's recovery."

Industralised Nations

In the 1960's Western Europe, apart from Great Britain, was increasing its rate of productivity (output per input of labour) at twice the rate of the US. Meanwhile Japan was increasing its productivity at twice the rate of Western Europe, or nearly four times as fast as that of US. This higher rate of growth in productivity and competitiveness of Western Europe and Japan affected the position of the US in the 1970's. Beginning with the recession of 1973, however, the rate of productivity growth in all these economies slowed down markedly. The counter active measures adapted by the industralised nations produced a negative effect on their own economies. In 1977, the real GDP growth rate of the major industrial countries, for example, ranged from 5.4 percent in Japan to 1.3 percent in the United Kingdom, By 1980 a number of countries found difficult to compromise for a reasonable growth performance and despite a positive growth rate as a group, United Kingdom, and the United States reported negative growth rates, while Canada reported a zero growth rate. There were three countries with negative growth rates in 1981: Federal Republic of Germany (–0.4%), Italy (–1.0%), and United Kingdom (–2.7%). Growth performance in 1982 in the industrial nations marginally improved, while the United States growth rate has been estimated to be around –0.4 per cent. The slow down in growth performance was accompanied by a sharp rise in the unemployment rate bringing the total unemployed to historical levels of over 30 million. This in turn has affected the rate of economic growth via the transmission mechanism of its adverse effects on basic sectors such as building construction, consumer durables and automobile sales. Steel, automobiles, shipbuilding and petrochemicals became the four major crisis industries of the West.

The new upturn in the US economy in 1983 however, is now helping its industries as well. The US auto industry is reported to be one of the biggest gainers due to both domestic and world economic circumstances. Given the magnititude of the current unemployment problem of the industrial nations, it is estimated that a minimum of 4.5 per cent growth rate is required to bring down the rate to socially acceptable levels and to help revitalize the economies of industrial nations and also for them to regain their lost trade with the developing nations. It has been realised in many quarters that the industrial nations cannot reach this target of economic growth if they continue to place a greater emphasis on restrictive policies.

Centrally Planned Economies

The centrally planned economies have also suffered similar setbacks due to both domestic and world economic circumstances. Since 1979, partly due to declining external demand for their products and raw materials, their growth performance as a whole has been below planned targets.

Agricultural production in these countries has also lagged behind due to continued unfavourable weather conditions during several consecutive seasons, requiring imports to meet consumption shortfalls. Declining external demand, on the one hand, and adverse weather conditions, on the other, have substantially inhibited the expansion of capacities in fuel and raw material production, in transportation and in power generation. This also led to the introduction of additional austere measures to lower consumer demand to correspond with low output performance.

In the Soviet Union planned output and growth targets have had to be revised downward each year since 1979. The decline in world prices of oil and gold, as well as other commodities on which the Soviet Union depends for export earnings are having an adverse impact on the Soviet economy. In other socialist economies, such as Poland, the situation has been more serious. In 1979 production in Poland went down by 2 per cent, in 1980 it went down by 4 per cent, but in 1981 it went down by 14 per cent. Rumania, Czechoslovakia and Hungary have suffered balance of payments and debt crises and negative growth rates. Yugoslavia too has not escaped a major economic crisis.

China, which began its 'four modernisations' drive in 1976, planning increased investments and technology imports from the West, was obliged to cut back on its programme after 1979. The world economic environment was also not conducive to China's planned economic grwoth performance and during this period, its actual output was lower, between 2–3 points, than annual targets. China given its relatively high proportion of exports of primary products and raw materials required more difficult policy adjustments to keep up with declining export revenues, inducing unprecendented cutbacks in all spheres of its investment programme. Consequently, a sharp fall in employment generation surfaced along with the problem of absorption of the new labour force. To meet this challenge wide-ranging measures with a view to promote self-emplpyment, became new areas of policy concern and by 1983 these economic problems were more within control.

Developing Nations

The growth performance of some of the developing nations, during these recent years has not been all together disappointing despite the fact that the world economic recession had been extremely adverse to their economies. The annual GDP growth rates between 1977 and 1980 as a group, have been greater than the annual growth rates of Industrial nations. It is necessary however, to differentiate between the various categories of developing countries. the more successful contributing the larger share of GDP as a group. Nonetheless the difficulty of sustaining this performance in the absence of more favourahle policies on trade and finance is clearly manifested in the recent poor economic growth performance. The figures illustrate that the growth performance has been steadily declining from about 5.8 per cent in 1977 to about 2.2 per cent in 1981, indicating a more than 50 per cent decline over this period. (See table 1).

Table 1 Real Growth of Gross Domestic Product (GDP)
(Percentage change per year)

		1970–80	1977	1978	1979	1980	1981
(a)	**All Developing Regions**	5.6	5.8	5.2	4.8	5.0	2.2
	Africa South of the Sahara	3.7	2.9	3.4	1.5	2.8	2.2
	East Asia & Pacific	6.9	8.4	9.4	7.5	5.8	5.5
	Latin America & the Carribean	5.5	4.8	3.9	5.9	5.3	–0.4
	North Africa & the M/East	8.1	10.0	6.0	8.5	6.8	0.6
	South Asia	3.5	7.1	7.0	–3,1	6.6	5.9
	Southern Europe & other Mediterranian	5.1	4.0	4.1	2.5	1.2	2.4
(b)	**Industrial Nations**	3.3	3.8	4.0	3.5	1.4	1.2
	Canada		2.7	3.6	2.8	0.0	3.0
	France		2.8	3.8	3.3	1.7	0.8
	Germany		2.7	3.2	4.5	1.8	–0.4
	Italy		2.5	2.5	5.0	4.0	–1.0
	Japan		5.4	5.9	5.9	4.2	3.1
	UK		1.3	3.1	1.5	–1.4	–2.7
	USA		5.1	4.4	2.3	–0.2	2.0

The international environment facing developing countries has seldom been more unfavourable. The factor most influencing the sharp decline in their growth volumes has been the precipitous fall in the terms of trade of their principal exports (See diagram 1). Interest rates on non-concessional loans also kept rising to unprecedented levels; while there was stagnation in capital flows on concessional terms. The performance of primary commodity exports from developing countries is perhaps the most stark reflection of the adverse economic environment facing them. Prices of exports in both nominal and real terms fell sharply.

The declines in nominal prices in 1981 and early 1982 were characteristic of all major primary commodity groups. In the case of tropical beverages, vegetable oilseeds and oils, and minerals and metals these declines represented a continuation of trends established in 1980. For agricultural raw materials declines in nominal prices followed a period of price stagnation. With respect to food prices, a sharp decline followed a period of strongly rising prices reflecting mainly the near trebling of the price of sugar in 1980 because of supply shortfalls.

In retrospect, it can be seen that the highly unsatisfactory situation facing developing country primary exports during recent months has resulted from the existence of generally ample supploes in the presence of weak overall demand. Moreover, high interest rates have also tended to discourage stockbuilding and led in some cases to the need for a reduction in inventories, thus contributing to the weakening of commodity prices. The bleak situation facing primary commodity exports persisted in 1982. It is however, extremely difficult to determine with any degree of certainty the price levels at which trade will take place during the coming months.

The World Bank's annual report for 1982, summing up the situation states "the impact of the recession on their export earnings, as well as the effect of high interest rates on their debt burden and hence their capacity to borrow further, undermines their ability to sustain earlier levels of production". Such observations clearly signifies the current economic dilemma of developing nations, and given the greater dependability of their economies on industrial market economies, the extent to which protectionist policies of industrial nations can influence their economies via transmission mechanism seems clear.

Terms of Trade

In view of the adverse developments of trade and monetary policies on the economies of developing nations, the call for relaxation of such policies is readily understandable. Of all these, perhaps, the issue causing most widespread concern, among the vast majority of developing nations, is that of declining export revenues as international commodity markets for primary products continue to remain weak and continue to cause adverse movements in the terms of trade (See diagram1).In 1981, for example, prices of all major primary products declined, relative to 1980 prices ranging from —40.8 per cent for sugar to —9.6 per cent for tea. Price declines of such magnitudes within one year are certainly unbearable for most developing nations as these commodities assume an increasing proportion of their total export revenue and hence an importance in the overall structure of their economies. On the other hand, developing nations were required to pay increasing prices for their major imports, such as maize, rice and wheat. At the same time expenditure on oil imports kept taking up an increasing share of their export revenues, despite mea-

ASIA'S PROSPECTS IN 1983 MORE RESISTANCE THAN MOST OTHER REGIONS IN FIGHTING RECESSION SAYS MELVYN WESTLAKE

Asia will be the fastest growing economic region of the world this year. Although the growth rate for many countries in the region will still be quite low by past standards, a sluggish recovery from the 1982 trough of the recession is now seen by economic forecasters.

According to economists at Chemical Bank in the United States, output in Asia — including China but excluding other closed economies like Burma and Vietnam — will be around 3.5 per cent compared with 3 per cent last year. The region's developing countries will generally do better than the developed ones, expanding output by some 4 per cent on average (against 3.5 per cent in 1982), or 4.5 per cent if the figures are weighted to allow for the fact that the larger developing countries are likely to experience the fastest growth rates.

The predictions assume US growth of 2 per cent, but do not take fully into account the recent falls in oil prices. If the US economy expands faster than expected, resulting in greater purchases of Asian goods, or the oil price declines further. Asian economic growth could be faster overall than now projected. However, Indonesia and Malaysia would be adversely affected by lower oil prices.

By contrast, European gross domestic product is likely to increase by barely 1 per cent this year. The economies of Latin America will be stagnant or declining in many cases; and Africa is likely to show little progress.

Chemical Bank economists predict a growth of US $ 2-billion in Asia's gross national product this year (in real terms). Developing Asia alone will contribute around US $ 40-billion to world GNP — a little more than Western Europe. Among the developing countries of the region. Singapore is thought likely to do best, with a growth rate of around 6.5 per cent — while Papua New Guinea is expected to do least well, with a fall of 0.5 per cent in GNP forecast.

Inflation in the region is expected to be fairly stable this year. Prices are predicted to rise, on average, by around 7.5 per cent in the developing countries — about the same as last year, and in line with the average for the region's three developed countries — Japan, Australia and New Zealand, China, will again score top marks on this front, by keeping price increases down to 2 per cent.

The developing countries of Asia will again have a very substantial combined deficit on the current account of the balance of payments. The aggregate deficit worsened last year, but will only improve marginally this year, to almost US $ 23-billion, according to Chemical Bank. Only China and Taiwan will be in surplus. Some improvement in non-oil commodity prices is seen, but this will only be moderate.

Another factor constraining export earnings is likely to be protectionism, particularly in the US, which buys 22 per cent of Asia's exports.

Trade in Asia will probably continue to grow more rapidly than elsewhere say Chemical Bank economists. Last year the non-oil exporting developing countries in the region pushed up their volume of trade, in marked contrast to performance in the rest of the world.

The summary of forecasts covers 14 developing countries and Japan — the dominant economy in the region, accounting for about half of Asia's total GNP.

Japan: after recording its slowest growth for seven years in 1982, it is likely to experience modest recovery, according to the Paris-based Organisation for Economic Cooperation and Development. GNP expansion is projected at 3.5 per cent, compared with 2.5 per cent last year. However there is disagreement about the liekly size of Japan's trade surplus this year. The OECD expects the trade surplus to rise by US$3-billion, while Chemical Bank are predicting a much bigger rise of US $ 8-billion, to a total of US $ -28 billion. A surplus of this order would be certain to give rise to new trade frictions and possibly increased protectionist measures against Japanese exports.

China: one of the few countries that actually did better in 1982 than in the preceding year. According to Data Resources, a private analyst, output will grow still faster in 1983 at about 5 per cent. Other forecasters put growth rate at nearer the 1982 level of 4.5 per cent. Industrial output is predicted to expand by 8.8 per cent — a little more than in 1982 — and some modest improvement also seems likely in agriculture. Forecasts of its foreign trade position vary considerably, with projected trade surpluses ranging from US $ 1.3 billion to US $ 5.4-billion.

Taiwan: after a 17 per cent drop in exports last year, the level of overseas sales is likely to pick-up this year — rising by perhaps 10 per cent. This will help push GNP to around 4.5 per cent — compared with 3.5 per cent in 1982 — but still not sures to curtail domestic oil consumption. For instance, low income developing nations spent $ 1.8 billion in 1975 as their expenditure on oil imports on about 0.4 millions of barrels of oil per day. The expenditure almost doubled to $ 3.3 billion in 1980 although the volume imported declined by 25 per cent to 0.3 million barrels per day.

The magnitude of declining terms of trade is clearly manifested in estimates prepared by the UNCTAD taking the comparative export price indices for 1971 and 1981 of thirty primary products of developing nations and comparing them with import price indices of their major imports during the same period (See diagram) This computation shows that the terms of trade of developing nations was only a meagre 30 per cent in 1981, compared with that of a decade earlier in 1971. Between 1979–81, the terms of trade dropped by 19 per cent and in the case of developing nations in the South Asian region, the decline was still greater, around 2 per cent. The estimates further show that the non-oil developing nations as a whole suffered a trade loss, between 1971–81,

much more than half the average annual growth in the 1970s. Some forecasters put the likely 1983 rate at nearer 5.5 per cent. Conservative economic policies are likely to result in another current account surplus and stable inflation.

South Korea: Some modest improvement is expected this year in the growth rate, which dropped to under 6 per cent in 1982. Some economists predict a growth of 6.2 per cent this year, although more optimistic projections put it at 7.5 per cent This would be close to the 7.8 per cent average annual rate of expansion achieved during the middle and later 1970s. Exports, which increased by only 3 per cent last year, are predicted to rise by nearer 9 per cent this year. The rate of inflation seems likely to deteriorate to around 7.5 per cent.

Singapore: Output growth in 1982 was the highest in Asia and one of the best in the world. although, at just over 6 per cent. it was still some way below its past achievements. The range of projections for 1983 is, however, quite wide. Even the more optimistic forecasters have trimmed their predictions from an original 7.5 to 6.5 per cent and some put likely growth in the 2 per cent to 4 per cent range. Government construction projects and the island's service industries continue to be the main source of strength. Inflation is likely to drop to a respectable 3.5 per cent after 1982's 4 per cent.

Malaysia: a moderate pick-up is forecast after the fall of 1982. This year, growth is forecast at between 4 and 5 per cent compared with last year's 4 per cent and an annual average of some 7.5 per cent in the middle and later 1970s. Exports which declined in each of the last two years, are expected to rise 10 per cent, helped by higher demand and prices. Imports are also expected to rise. but by less than exports, producing some improvement in the current account deficit in spite of larger debt service.

Hong Kong: a modest recovery is expected after one of the biggest slumps for years. Growth in 1982 was a mere 2.4 per cent against 11 per cent the year before. Projections for 1983 put growth at around 4 to 4.5 per cent, but any revival is not expected before the second half of the year. The financial and service sectors are likely to be growth areas. Inflation decelerated substantially last year and it is expected to slow down further in 1983 to 9.5 per cent.

Thailand: modest improvements in commodity prices and slow recovery in the world economy could boost GDP growth from last year's 4.5 per cent to around 3.5 per cent this year. More than half its foreign exchange earnings come from agricultural exports, like rice, sugar and maize. A substantial drop in investment and lower profitability in the natural gas sector also took their toll last year. But inflation was slashed from over 12 per cent to under 6 per cent and should remain stable this year.

Philippines: this year is likely to see no real recovery, and the growth rate will remain at a depressed level of between 2.5 and 3 per cent, half the level of the 1970s. Poor foreign demand and falling prices for the country's main commodity crops – sugar and coconut products – reduced export earnings by 10 per cent in 1982. Although they are predicted to improve a little this year, export earnings will remain below the level of both 1980 and 1981. As imports may be largely unchanged, the current account deficit will fall.

Indonesia: world recession has slashed exports and output. Growth of GDP was halved last year, to around 2.5 to 4 per cent. The outlook for 1983 remains gloomy, with growth projections ranging from as little as 2 per cent up to about 4 per cent. The deficit on the current account worsened markedly last year. Although some forecasters expect to see an improvement in 1983, the deficit is still likely to remain quite substantial.

Papua New Guinea: GDP is expected to fall for the fourth consecutive year, although such a fall will be limited to around 0.5 per cent compared with 1982's drop of 3.5 per cent. The country has been hit by falling revenues from exports, accounting for 40 per cent of GDP. The gloomy medium-term outlook for copper prices causes concern. Though exports fell by 11 per cent in 1982, following a 15 per cent decline the previous year, 1983 will reverse part of this fall. Economists, however, believe that the longer term prospects are good.

India: hit by a poor monsoon, the economy performed relatively badly in the fiscal year ending in March 1983. Real GNP growth appears to have been only 2 per cent against roughly 5 per cent the previous year and the increase in industrial production nearly halved, to 4.5 per cent. In the coming year, growth should rise to around 3.5 per cent if the monsoon is normal. Foreign trade will continue to register a substantial deficit, but this deficit should be partly offset, by the inflow of remittances from Indian workers in the Middle East, although these inflows could be affected by construction cutbacks in the Gulf.

Pakistan: in spite of the world recession, the growth rate has held up quite well. At 6 per cent in 1982, it was still above the annual average rate of the 1970's although down from 6.6 per cent in 1981. The 1981 outcome is now expected to be about the same as for last year. Inflation may be reduced a little, although the current account deficit could show some further deterioration. After falling last year, imports and exports are projected to rise. The widening of the current account deficit in 1982 was largely due to a fall in Middle East remittances.

Bangladesh: after a very bad performance in 1982, some recovery seems on the cards this year. With growth at barely one per cent, and the population growing 2.7 per cent per annum, average per capita income fell last year. If output expands by the projected 3 per cent this year, per capita income should just broadly hold steady. But it will be necessary to get back to growth rates of 6 and 7 per cent if there is to be any chance of reducing poverty. Inflation, which was brought below 10 per cent in 1982, is expected to rise to 13 per cent.

Sri Lanka: a somewhat faster growth rate is expected, compared to last year's 4.5 per cent. An increase in output of about 5 per cent is thought likely by forecasters. Agriculture, accounting for 25 per cent of GDP, is expected to contribute to this improvement if weather conditions are reasonable; industry will benefit from an expansion in the world economy. Non-traditional manufacturing, such as electronics, are expanding rapidly. But little overall rise is expected in either exports or imports. Source: SOUTH, May 1983.

amounting to S 60.0 billion. The combined loss in 1980 and 1981 alone was around $ 22.00 billion and the joint total is equal to about 45 per cent of the combined net resource transfers to developing nations from multilateral, bilateral and other private sources in 1980 and 1981.

Declining terms of trade cause balance of payment problems which in turn cause stagnation in growth of the economies concerned. These three factors work in a vicious circle influencing each other. Furthermore, aid flows can be affected by a slowing down of growth in the aid giving industrialised countries, which in turn could further worsen the problems of the developing countries attempting to get out of their dependence on aid.

Current Account Balances

Declining terms of trade have been the principal cause of adverse developments in current balances experienced by developing nations since the early 1970's.

Table 2 traces the trends in current account balances in terms of major industrial groupings. The most striking feature is the inverse correlation between the trends.

Table 2 CURRENT ACCOUNT BALANCES ($ BILLION)

	1970	1977	1978	1979	1980	1981
Industrial Countries	12.1	– 5.7	29.8	–10.2	– 44.8	– 3
High-income Oil Exporters	2.8	33.0	18.6	57.3	103.3	76.1
Developing Countries	–10.9	–25.2	–45.4	–41.8	– 72.8	–109.7
Oil Importers	– 8.7	–19.7	–27.8	–46.9	– 71.1	– 80.4
Low Income	– 1.7	– 0.6	– 5.5	– 8.7	– 14.6	– 10.1
Middle income	– 7.0	–19.1	–22.3	–38.2	– 56.5	– 70.3
Oil Exporters	– 2.2	– 5.5	–17.6	– 5.1	– 1.7	– 29.3
Centrally Planned Economies	1.7	– 2.1	0.5	0.8	2.4	.9
Statistical Discrepancy	5.7	0.1	3.5	6.1	– 11.9	– 37.3

Source: World Bank Annual Reports, 1981 & 1982

in current account surpluses of high income oil exporters, and current account deficits of low income oil importing developing nations. While the oil exporting capital surplus nations accumulated a total current account surplus of more than $ 400 billion between 1970 and 1981, oil importing low and middle income nations kept the global current account in the balance with a counterpart deficit of around $ 380 billion during the same period, almost equal to the surplus. Of this accumulated deficit (between 1979 and 1981), oil importing developing nations accounted for approximately 20 per cent while the remainder came from oil importing middle income countries.

Despite three consecutive years of current account deficits, industrialially advanced nations have not been placed in a difficult situation since their accumulated reserves are substantially large. In the case of centrally planned economies, the developments in current account balances do not warrent special consideration; with a few exceptions such as Poland, where the country almost faced banktuptcy in 1981 but the situation has since been gradually easing. In other centrally planned countries, however, effective demand management policies helped, to keep current account balances within manageable limits, at the expense of low consumer demand and poor economic growth.

The Debt Problem

The growing interest in the external debt problem, the issue that has caused great alarm in the international banking system, and perhaps, the most widely discussed issue in international forums in recent times, is in turn a by-product of growing current account deficits of developing countries. It started with rising oil prices, augmented by declining terms of trade, followed by shrinking export revenues — the characteristics directly attributed to global economic recession — and sparked off through the recourse to borrowings from private sources for financing of current account deficits. With growing current account deficits of developing nations, financing requirements also grew by the same proportion; but the supply of financial flows from concessional sources did not grow by the same magnitude. The shortfall in financial requirements required borrowings from private sources including Euro Currency markets and commercial banking systems. As shown in tables 3 and 5 financial resources from private sources gradually assumed a significant proportion of the total outlay of resource requirements. The oil surpluses are now being recycled. but through the international banking system, which helped to increase indebtedness of more Third World countries with obligation to Western banks. In 1970, for example, private sources accounted for only about 15 percent of the total net financing requirements of developing nations, but in 1981, the net lending from private sources grew by almost ten-fold to account for 48 percent of their total requirements. The projected figure of $ 56 billion in 1982 accounts for almost 51 per cent indicating a continuation in this trend, at least in the short run. Between 1976 and 1979 the developing countries medium and long term debt rose by 25; and between 1979 and 1981 growth has been around 15 per cent. (See table 3, 4 and 5)

Although the debt problem of developing nations has been a subject of international concern for sometime, the problem surfaced at crisis level only in 1981 when Poland, with a debt $ 27 billion, declared bankruptcy, as it did not have the $ 2.5 billion required as service payments. Among others facing similar diffi-

Table 3 PUBLIC AND PRIVATE DEBT OF DEVELOPING COUNTRIES,1973–82

(in billions of U S dollars)

	1973	1975	1976	1977	1978	1979	1980	1981	1982*
Total debt	109.4	181.9	195.5	240.1	298.8	352.4	404.8	462.1	529.0
Total debt service	16.0	23.0	26.1	33.1	47.9	62.3	70.4	83.0	95.0
Low-income Africa	0.4	0.5	0.5	0.6	0.7	0.8	1.1	1.3	–
Low-income Asia	1.0	1.3	1.3	1.4	1.6	1.8	1.9	1.9	–
Middle-income Oil importers	9.7	14.0	15.4	18.8	27.9	34.6	40.6	49.8	–
Oil exporters	4.9	7.1	8.9	12.4	17.7	24.9	26.7	30.8	–

Source: World Bank, World Debt Tables.
indicates data not available.
**Estimates*

culties were the big borrowers, such as Mexico, Brazil, and Argentina (See table 6). By late 1982, fears and anxiety were building up, especially because of the exposure of commercial banks to these troubled countries, and as the Brandt Commission reported "the possibilities of a financial collapse, were openly being talked about". The situation became particularly distressing to the industrial nations with growing fears for them that this situation could perpetuate the recession and, perhaps, lead to a global depression.

All these major borrowers had taken substantial short and medium term loans from commercial Banks. By the end of 1980, a total of more than $ 162.0 billion was outstanding to commercial banks, and the US commercial bank's share of this was $ 130 billion. The Latin American countries where US interests were heavy were favoured by the US banks and received the particular attention of US banks. Mexico, Argentina and Brazil together owed $ 52 billion to US commercial banks, and accounted for about 76 per cent of their total loan portfolio to all Latin American countries. Commercial bank loans to developing nations further increased to $ 311 billion, out of an estimated total debt outstanding of $ 529 billion at the end of 1982, and four major borrowers – Argentina, Brazil, Mexico and South Korea – together accounted for $ 140 billion or 45 per cent of total commercial borrowings.

The substantial shift from official sources to private sources for funds, along with rising interest rates, has further exacerbated the debt burden of developing nations. This shift towards private sources means more short term loans and payments of market related interest rates, such as the Euro dollar interest rate. The average Euro dollar interest rate between 1972 and 1982 more than doubled, increasing from 5½ per cent to 13½ per cent. This compares with the marginal increase of average interest rate on official concessional loans from 4½ per cent to 5 per cent during the same period. Given an increasing share of borrowings from private sources, rising interest rates on private sources directly translate to higher borrowing costs to developing nations. It has been estimated that the developing nations together accounted for around $ 20–25 billion between 1979 and 1981 as additional interest payments.

The corresponding development of higher borrowing costs is reflected in the steady decline of net resource transfers to developing nations. For instance, net resource transfers to developing nations in 1978 accounted for $ 34.1 billion; in 1981 it declined to $ 10.0 billion, little more than 50 per cent of 1978 figure in current prices, despite an increase in gross disbursements from $ 82.2 billion to $ 93.3 billion during the same period. As the 1982 World Development Report points out "the heavier burden of repaying existing debt, along with the substantial drop in net real resource transfers to developing nations, has constrained trade choices of developing nations, and measureably complicated the management of domestic monetary policies, since credit–tightening measures were required to avoid capital flight".

Table 4 LONG–TERM DEBT RATIOS FOR NON–OIL DEVELOPING COUNTRIES, 1973–82

	1973	1975	1976	1977	1978	1979	1980	1981	1982
Ratio of external long-term debt to exports of goods and services*	88.7	97.7	102.6	104.9	111.2	101.9	92.9	103.2	109.1
Ratio of external long-term debt to GDP *	16.6	18.3	20.5	22.1	23.7	22.7	21.8	24.3	25.2
Debt service ratio**	14.0	14.0	13.9	14.0	17.3	18.1	16.3	21.0	22.3

Source: IMF, Occasional Paper No. 9 World Economic Outlook, 1982. Tables 31 and 33
**Ratio for year-end debt to exports or GDP for year indicated.*
***Payments–interest, amortization or both– as percentages of exports of goods and services.*

Table 5 NON–OIL DEVELOPING COUNTRIES: DISTRIBUTION OF DEBT BY CLASS OF CREDITOR, END OF YEAR, 1973–82'

(in per cent)

	1973	1975	1976	1977	1978	1979	1980	1981	1982
Total outstanding debt of non-oil developing countries	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
To official creditors	49.9	46.2	45.3	44.3	42.5	41.1	41.4	40.1	39.4
Governments	36.9	33.0	31.7	30.4	28.8	27.4	27.2	25.9	25.1
International institutions	13.0	13.2	13.6	13.9	13.7	14.2	14.2	14.2	14.3
To private creditors	50.1	53.7	54.7	55.7	57.5	58.9	58.6	59.9	60.6
Financial institutions	35.7	42.7	44.4	45.8	46.2	49.5	49.6	51.4	52.7
Other private creditors	14.4	11.0	10.3	10.0	11.3	9.4	9.0	8.5	7.9

Source: IMF Occasional Paper No.9 World Economic Outlook, 1982. Table 32
'Excludes data for the People's Republic of China prior to 1977.

Table 6 THE BIG BORROWERS

	Total debt		Borrowing from banks end–1981	1982 debt service as % of total exports	
	Total US $ bn.	Debt %	US $ billion	Interest	Principal
Mexico	80	27	56.9	37	92
Brazil	75	25	52.7	45	92
Argentina	37	13	24.8	44	77
South Korea	33	11	19.9	11	135
Venezuela	19	6	26.2	14	43
Yugoslavia	18	6	10.7	14	81
Philippines	16	5	10.2	18	32
Chile	15	5	10.5	40	74
Equador	7	2	4.5	30	76
Total	300	100	216.4		

Source: *Far Eastern Economic Review, Nov.5, 1982*

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What is more alarming, however, is the magnitude of resource transfers from developing nations for servicing external debts. The resource transfer for debt service (interest and capital payment) expressed as a percentage of Gross National Product from the non-oil developing countries shows that the ratio increased from about 22.7 in 1979 to 25.2 in 1982. As a percentage of exports of goods and services, the ratio markedly increased from 18.1 per cent in 1979 to 22.3 per cent in 1982. If the debt service concept is broadened to include all payments related to external debts, (i.e. interest on gross debt, maturing debt, amortization of medium and long term debt, and all short term debt) and expressed as a percentage of exports of goods and services, the ratio would have increased from 101.9 per cent in 1979 to 109.1 per cent in 1982, according to Morgan Guaranty estimates, and it ranged from about 18.5 per cent in Malaysia to 195 per cent in Zambia.

All developing nations do not equally share the debt burden although the implications will perhaps be more severely felt on oil importing developing nations, than the economies of large scale borrowers.

Of the total 99 low income and middle income nations and the centrally planned economies, only about 13 countries carried outstanding external debts of more than $ 10.0 billion, and, of these, 5 countries were in Latin America. These countries together accounted for more than 84 per cent of the total outstanding debts at the end of 1982. Brazil's external debt of $ 87.0 billion alone is more than the total outstanding debt of all the countries of South and South East Asia and the Pacific. In the event of large scale defaults by major borrowers, the limited access to concessional resources of the developing nations could be further tightened. The reason is that credit facilities from private sources would no longer be available to developing nations due to lack of confidence in them by commercial banks; and a probable development of this nature will be increased pressure on concessional funds from multilateral agencies, the only source available to most non-oil developing nations.

The year 1982 was marked by increasing strains in the international banking sector, reflecting the mounting payments difficulties of a number of important debtor countries and the growing reluctance of banks to expand their credit exposure in those countries. The continuing high level of real interest rates and the depressed volume and value of industrial countries' imports from the developing countries resulted in a serious deterioration in the external payments and debt position of a large number of debtor countries.

It is evident that the recession in industrial countries has had extremely unfavourable effects on the external positions of the developing countries, contributing to the emergence of these severe debt problems for a number of them.

The threat of large scale defaults appears to have somewhat subsided, at least temporarily. This does not mean that borrowers have agreed to settle their debts, or that there has been any apparent change in their ability to settle these huge debts. Rather, the situation has eased as a result of several rescue operations to bail out the likely defaulters in order to avoid possible world wide liquidity crisis. In early 1982, for example, the US government attempted rescue operations for Mexico and Brazil. A number of commercial banks also recently got involved in similar rescue operations, with debt rescheduling agreements with their clients. In most cases, however, rescheduling requires more than longer repayment periods; an increasing number of countries are seeking additional loans, frequently larger ones, for their economic survival. The banks are not in a position to turn down such requests, as the amounts at stake are quite substantial. Multilateral agencies such as the World Bank are also helping more and more countries with their debt servicing difficulties, but the amounts involved are relatively small compared with commercial bank rescheduling agreements.

Proposed Policy Action

The challenge posed by the cumulative developments of higher oil prices, declining export revenues, high interest rates and increasing indebtedness is beyong the reach of only domestic policy adjustments of the developing nations. Nonetheless, the major industrial nations, particularly the US, still argue that developing nations should find solutions through their own domestic policy adjustments