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PROSPECTS FOR INTERNATIONAL TRADE

Main Conclusions of GATT Study for 1983-1984 Published

Developments in the world economy over the past eighteen months, and prospects for the future, are analyzed each year in the GATT secretariat report International Trade. This press release reproduces the complete text of the first chapter of the latest report, International Trade 1983/84. The full report, which is based on information available to mid-August 1984, will be published shortly.[1]

The main aspects of the recovery in the world economy are summarized in the first part of this press release. The second part considers some reasons why the current recovery has failed to spread internationally to the same extent as previous post-war recoveries. The role of trade policy in this process, in particular the fragmentation of the world market caused by discriminatory protection, is examined in the third part.

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[1] International Trade 1983/84 will be available in October in English, French and Spanish language editions, and may be ordered from the GATT secretariat or through book sellers at a price of 30 Swiss francs.

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PROSPECTS FOR INTERNATIONAL TRADE

1. MAIN DEVELOPMENTS IN 1983/84

More than eighteen months after the most protracted post-war recession bottomed out, the recovery of the world economy remains highly differentiated internationally. North America, notably the United States, experienced an unexpectedly strong expansion of production, with apparently no sacrifices thus far of the post-1980 gains on the inflation front. With the benefit of improved conditions on the markets for their exports and/or supported by favourable weather, some developing countries in South-East Asia and South Asia recently exhibited a satisfactory economic performance, adding brighter spots to the world economic scene. But in Western Europe and, to a lesser degree, Japan, the growth of production has thus far fallen short of the standards achieved in past recoveries. In the Eastern trading area, too, the recovery has been moderate and in many parts of the developing world, notably in Africa and in Latin America, economic activity remains depressed. Unemployment continues to be a serious problem, particularly in Western Europe and most developing countries. In the first half of 1984, the volume of world trade was running 9 per cent above the first half of 1983, a rate of growth well above that of world output.

Macroeconomic developments

World production[1] recovered by around 3 per cent in 1983, more than regaining the ground lost in 1982 when world output fell 2 per cent (Table 1). This resulted almost entirely from an estimated 4 per cent increase in manufacturing production, the largest gain since 1979. After two years of reasonably strong growth, agricultural production stagnated in 1983. Despite reduced production of fuels, there was a marginal increase in overall mining output, the first year-over-year increase since 1979.

TABLE 1. - GROWTH OF WORLD PRODUCTION AND TRADE, 1963-1983

(Average annual percentage change in volume)

	1963-73	1973-83	1979	1980	1981	1982	1983
PRODUCTION							
All commodities	6	2	4	1	1	-2	3
Agriculture	2½	2	1	-	3½	2	0
Mining	5½	½	4½	-1½	-3	-3½	½
Manufacturing	7	2½	5	1½	½	-2	4
EXPORTS							
Total	8½	3	6	1½	0	-2	2
Agricultural products	4	3½	7	5	3	1	1
Minerals[a]	7	-2½	5	-6	-12	-7	-1
Manufactures	11	4½	5	5	3½	-1½	4½

[a]Including fuels and non-ferrous metals.

Note: For sources and methods, see Appendix (not published with this press release).

[1]In this section production refers to the combined output of agriculture, mining and manufacturing, that is, it excludes services and construction.

Gains in mining and manufacturing production in the industrial countries, coupled with an estimated 6 per cent decline in agricultural production (led by a 20 per cent decline in United States agricultural output), resulted in a net gain of 2½ per cent in total production in 1983. In the developing countries, production was up an estimated 3 per cent last year, as gains in agricultural and manufacturing production outweighed a 2 per cent decline in mining output. Increases in production in all three sectors - agriculture, mining and manufacturing - combined to raise output in the Eastern trading area by an estimated 3½ per cent.

In 1983, both private consumption and fixed capital formation contributed to the growth of production in the United States. By contrast, in most other industrial countries (with the exception of the Federal Republic of Germany and the United Kingdom) and in several developing countries, it was external demand which was the main, often the only, stimulus to output. This external stimulus originated mainly in the United States.

Whereas total employment recovered by 1 per cent in North America and continued to grow in Japan, it fell by a further 2 per cent in Western Europe, where the total decrease has amounted to 5 per cent since 1979-1980. The fall in employment in manufacturing in the industrial countries was pronounced; even in the United States, in the first half of 1984, employment was still below its level of 1980-1981. In Western Europe, Australia and Canada, not to speak of the bulk of the developing countries, unemployment rates have remained high despite the recovery. In Australia the rate is about four times, in Western Europe about three times, and in Canada about twice as high as in the early 1970s. Even in the United States, where almost five million additional jobs have been created since the fourth quarter of 1982, the unemployment rate has not come down to its traditional level.[1]

The rise of consumer prices continued to slow down in the industrial countries during 1983. On average, the annual increase amounted to less than 5½ per cent, substantially below the average rate of the 1970s, although still exceeding that of the 1960s. In several industrial countries, however, inflation rates in 1983 were similar to those in the 1960s (the United States, the Federal Republic of Germany, United Kingdom, Austria, the Netherlands, and Switzerland), or lower (Japan). In the first half of 1984, inflation in the industrial countries was running at about the same level as in 1983. In the developing countries, especially in the Western hemisphere, inflation accelerated in 1983 and in the first half of 1984.

The 4 per cent appreciation of the effective (trade-weighted) exchange rate of the US dollar in 1983 was less than half the size of the appreciations in the two preceding years; however, by June 1984 the dollar's

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[1] It should be noted that, for many industrial countries, the statistical picture of employment, or production, is likely to underestimate current actual performance relative to that of the early 1970s. First, because of more generous unemployment benefits, more generous re-training allowances, changes in the age and sex composition of the labour force and the like there has been a structural increase in long-term unemployment. Second, empirical research of the underground economy suggests that there has been an increase in unrecorded employment in the industrial countries as a long-term trend.

effective exchange rate had appreciated by more than 5 per cent relative to its average level in 1983. Among the other countries whose effective exchange rates appreciated in 1983 were Japan (9½ per cent), Switzerland (5 per cent) and the Federal Republic of Germany (4½ per cent); of these three countries, only Japan's effective exchange rate continued to appreciate in 1984 relative to the average level in 1983.

The US dollar's real effective exchange rate (that is, the effective exchange adjusted for inflation differentials) appreciated in 1983 by 2½ per cent, as did the yen's real exchange rate. In June 1984 the dollar's real exchange rate was 3 per cent above the average level in 1983, while the yen was up 1 per cent. Canada, Italy and Switzerland also experienced appreciations of their real effective exchange rates in 1983, while the countries reporting depreciations included Australia, France, the United Kingdom, Spain and Sweden. Figures for June 1984 show a further appreciation of the real exchange rate of the Italian lira and a further depreciation of the pound sterling.[1]

World trade

The volume of world trade recovered by about 2 per cent in 1983, regaining the level of 1980-81. For the fourth consecutive year, trade in minerals declined, led by an 8 per cent decline in the volume of crude petroleum exports (which brought trade in crude petroleum and products to the lowest level since 1970). Trade in agricultural products rose in volume by 1 per cent, matching the 1982 increase; this was far below the average rates of growth recorded in the 1960s and the 1970s, and reflected the fact that the volume of exports of several food products and agricultural raw materials declined sharply in 1983. World trade in manufactured products, after declining in 1982, recovered by more than 4 per cent in 1983 in volume terms (but by only ½ per cent in dollar value). Exports of manufactures from developing countries are estimated to have increased by 9 per cent in value, a gain of approximately $10 billion. Due largely to the strong demand from the United States the value of developing countries' exports of manufactures to the industrial countries increased by 15 per cent.

As a result of the continued appreciation of the dollar in 1983, many export prices declined when expressed in dollars. The overall export price decline was large enough to more than offset the 2 per cent increase in the volume of trade, causing the dollar value of world trade to decline by 2 per cent in 1983, to a little more than $1,800 billion (the third consecutive annual decline in dollar value).

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[1]The exchange rate data are taken from the July 1984 issue of World Financial Markets (Morgan Guaranty Trust Company of New York). The adjustment for inflation differentials uses wholesale price indices for non-food manufactures.

A combination of sharply lower fuel prices and an estimated 8 per cent decline in export volume caused the export earnings of the traditional oil-exporting developing countries to decline by about 17 per cent. There was a 1 per cent decline in the value of exports from the industrial countries, whereas those from the non-oil developing countries and from the Eastern trading area rose by 2½ per cent and 4½ per cent, respectively. The volume increases ranged between 2½ per cent (industrial countries) and 5 per cent (non-oil developing countries).

It is estimated that the terms of trade of the industrial countries, which had improved by about ½ per cent in 1982, improved by an additional 2 per cent in 1983. The terms of trade of the oil-exporting developing countries, which had improved by about ½ per cent in 1982, deteriorated by an estimated 1½ per cent in 1983, whereas the deterioration of the terms of trade of the oil-importing developing countries, which was particularly substantial in 1981 and 1982, continued in 1983, but was reduced to about ½ per cent.

The share of the traditional oil-exporting developing countries in the total value of world exports has fallen continuously from 15 per cent in 1980 to 10 per cent in 1983 (Table 2). The counterpart of this decline were increases in the shares of industrial countries, the non-oil developing countries and the Eastern trading area; in the case of the non-oil developing countries, the increase brought their share of world exports back to its 1963 level.

TABLE 2. - REGIONAL COMPOSITION OF WORLD TRADE, 1963-1983

(Percentage shares in world exports (X) and imports (M))

		1963	1973	1979	1980	1981	1982	1983
Industrial areas	X	64	68	63	61	61	61½	62
	M	64½	69½	67	66	63	63	63½
Traditional oil-exporting developing countries	X	6	7½	13	15	14	12	10
	M	3	3½	6	6½	8	8½	7½
Other developing countries	X	14½	12	12½	13	13½	14	14½
	M	18	14½	16	16½	17½	17½	17½
Eastern trading area	X	12	10	9½	9	9½	10½	11
	M	11½	10	9	8½	8½	9	10

Source: Calculated from world export matrix, Appendix Table A3 (not published with this press release).

In the last quarter of 1983 there was a sharp acceleration in the value and volume of world trade, which seems to have continued to expand at a similar pace in the first months of 1984. The annual change in world trade depends on (a) changes in the value and volume of each country's trade and, since these have to be expressed in a single currency, (b) exchange rates.

Allowing for the uncertainty on all these points, the growth in world trade in 1984 can be expected to be in the range of 5 to 7 per cent in dollar value, implying perhaps a somewhat larger increase in volume.

Merchandise trade balances

After contracting by $25 billion in 1982, the combined trade deficit of the industrial countries (f.o.b-f.o.b.), rose by $3½ billion in 1983. This resulted from a further decline of their deficit with the traditional oil-exporting developing countries being more than offset by the disappearance of their surplus on trade with other developing countries. While the trade deficit of the United States is estimated to have increased by $26 billion (f.o.b-f.o.b.), the other industrial countries are estimated to have increased their combined trade surplus from about $12 billion in 1982 to $34 billion in 1983.

Despite a substantial decrease in their imports, the trade surplus of the traditional oil-exporting developing countries declined again in 1983. The reduction in the trade deficit of the non-oil developing countries in 1983 was the result of an increase in exports, and a decrease in imports, of roughly the same magnitude. In contrast, the 1982 reduction in the deficit was due entirely to reduced imports.

The trade surplus of the Eastern trading area, which had increased substantially in 1982, expanded further, despite a 5 per cent increase in imports (the first increase since 1980). The virtual disappearance of the combined trade deficit of Australia, New Zealand and South Africa was entirely due to a fall in imports.

2. ANALYSIS OF RECENT ECONOMIC DEVELOPMENTS

Trade and recovery

The most striking feature of the current recovery has been the weak response of the world economy to the vigorous boom in the United States. On earlier occasions, increased export earnings due to an initial recovery-induced rise of imports into the United States spread recovery from country to country. The expectation of additional orders from abroad triggered a worldwide wave of trade-related investment, which ignited recoveries in Western Europe and elsewhere outside the United States.[1] The upturns of economic activity in an increasing number of countries fuelled the growth of world trade and the growth of investment in a mutually re-inforcing process. Little of this process is observable to date.

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[1]For example, during the first five quarters of the 1975 recovery industrial production increased at an annual rate of 11.3 per cent in the United States (the trough of industrial production occurred in the first quarter of 1975), of 13.2 per cent in Japan (the trough occurred at the same time as in the United States), and of 8.8 per cent in OECD-Europe (the trough occurred in the third quarter of 1975). During the first five quarters of the present recovery (the troughs of industrial production for all regions occurred in the fourth quarter of 1982), the respective growth rates of industrial production were 14.3 per cent for the United States, 9.6 per cent for Japan and 4.3 per cent for OECD-Europe.

The weak international transmission of the recovery is all the more noteworthy because of the unusually large increase in imports into the United States. During the first five quarters of the recovery, these imports increased by nearly 35 per cent in value, which was more than during the recoveries of the 1960s and 1970s (Table 3). To be sure, not all countries participated in this growth of U.S. imports. In sharp contrast to the 1975 recovery, exports to the United States from oil-exporting countries of the Near East and a number of other oil- or raw material-exporting countries, mainly in Africa, declined in the current recovery. In the case of Japan, Western Europe, Canada, Latin America, South East Asia and the Eastern trading area, however, the increase in exports to the United States was larger in 1983 than in 1975 (Table 4). Yet these increases failed to stimulate domestic output to the same extent as in 1975. These observations suggest that a lack of trade-related investment lies at the heart of the weak response of the world economy to the boom in the United States, rather than an insufficient initial ignition from trade.

TABLE 3. - GROWTH OF UNITED STATES EXPORTS AND IMPORTS OVER THE FIRST FIVE QUARTERS OF THE RECOVERIES BETWEEN THE YEARS 1960 AND 1984

(Percentage change)

Recovery	1960/IV to 1962/I	1970/IV to 1972/I	1975/I to 1976/II	1982/IV to 1984/I
United States imports[a]				
Value	13.4	30.8	15.2	34.4
Volume	..	21.7	21.5	40.8
United States exports[a]				
Value	2.9	11.5	6.2	10.8
Volume	..	5.7	3.0	6.6

[a]Seasonally adjusted; the trade coverage of value and volume series is not strictly comparable.

Source: US Department of Commerce, US Exports and Imports 1923-1968; US Merchandise Trade, Exports and Imports 1965-1976; Survey of Current Business; Highlights of US Export and Import Trade.

TABLE 4.- GROWTH AND STRUCTURE OF THE UNITED STATES IMPORTS AND EXPORTS BY TRADING REGION, 1975/I-1976/II and 1982/IV-1984/I

(Changes and shares in percentages)

	Growth of U.S. imports (c.i.f.)[a]		Share in U.S. imports 1984/I	Growth of U.S. exports (f.a.s.)[a]		Share in U.S. exports 1984/I
	1975/I to 1976/II	1982/IV to 1984/I		1975/I to 1976/II	1982/IV to 1984/I	
World	15.2	34.4	100	6.2	10.8	100
Canada	26.0	43.4	19.4	17.1	49.0	21.7
Japan	14.9	48.3	16.3	1.1	4.6	10.5
European Communities	-9.0	33.3	18.4	1.2	1.8	21.5
Other industrial countries[b]	7.0	41.4	6.6	-0.3	21.8	9.2
Near East Asia	35.7	-2.1	2.6	25.9	-20.8	5.5
South East Asian developing countries	39.6	50.1	15.0	2.8	6.8	10.8
Latin America	9.3	23.4	13.4	-5.3	12.0	11.8
Other developing countries[c]	13.5	-3.5	6.7	-6.6	-17.6	6.0
Eastern trading area	5.6	62.3	1.6	63.8	41.0	3.0

[a]Seasonally adjusted.

[b]Excluding the Republic of South Africa.

[c]Including the Republic of South Africa.

Source: U.S. Department of Commerce, Highlights of U.S. Export and Import Trade.

Outside the United States, with very few exceptions, investment activity has indeed remained moderate. The expanding demand for exports has been mainly satisfied from existing capacity, which means that longer-term profit expectations were not improved to a point where there would result a widespread acceleration of business investment for capacity expansion.

In search for an explanation, high interest rates are the conventional answer. But, at least as far as the industrial countries other than the United States are concerned, this can only be a minor part of the explanation. The United States economy, with even higher interest rates than those prevailing in Europe and Japan, has a strong investment boom, as had Western European economies, in particular that of the Federal Republic of Germany, during the high interest rate phase of the 1950s. In considering investment incentives, it is more fruitful to look at such factors as business uncertainty, structural rigidities, and the weak response of raw material prices to the recovery.

General business uncertainty

By past standards, general business uncertainty has remained high in many countries during the present recovery. There has been the unsettled international debt issue; there has been concern as to the future course of monetary and fiscal policies in the major countries and their effects on exchange rates; and, last but not least, there is the increasing unpredictability of trade policy. As a result, private consumers and investors have become not only more cautious, but also highly sensitive to day-to-day changes, even such minor fluctuations as would have been ignored in the more robust recoveries of the past. For example, sporadic, perhaps transitory, rises in the rate of inflation in the United States, Japan and some smaller West European countries have repeatedly fed inflationary expectations and affected capital markets. Economists estimate that inflation fears have contributed to a more than two and a half percentage point increase of nominal long-term interest rates, from an already high level, in the United States and Canada between April 1983 (their most recent trough) and June 1984.

But it is important to note that an increase in uncertainty can reduce the amount of profitable investment and job creation without becoming visible in, or working through, a rise of interest rates. At the same time that an increase in uncertainty tends to drive up interest rates, it also tends to reduce the demand for credit because it adversely affects the expected returns from investment. Interest rates may rise, remain unchanged, or even decline, depending on the relative strength of the simultaneous reduction of the demand for and the supply of credit. Whatever its effect on interest rates, the unambiguous result of an increase in uncertainty, however, is reduced investment and, hence, reduced economic activity and reduced job creation.

In recent months the continued success on the inflation front has reduced somewhat the uncertainty about the conduct of macroeconomic policy, and as international inflation differentials in the industrial countries converge toward a lower level, exchange rate fluctuations can be expected to narrow. In the area of trade policy, in contrast, the developments have been in the opposite direction and the level of uncertainty correspondingly greater.

Structural rigidities

A trade stimulus is unlikely to trigger a major rise of investment and economic activity where it meets deep-rooted economic inflexibility. In such an environment expectations are highly conservative. Investors perceive external stimuli as singular events, not as the harbinger of a general improvement in profit conditions. The internal transmission mechanism of external stimuli is poorly lubricated; more technically, all the multipliers and accelerators of economic activity are low. Western Europe is a case in point.

A number of recent studies indicate that, on balance, Western European economies have reacted less flexibly than the United States to the economic shocks and the challenges of the 1970s and early 1980s.[1] Major factors in the relative resilience of the United States economy include the multiple opportunities to specialize in a large integrated market; greater responsiveness of the pattern of labour costs to the pattern of productivity change across occupations, industries and regions (and in particular in private services); a lowering of the tax burden, in particular with respect to marginal tax rates on income, including investment; abundant scope for new activities, enlarged by deregulation; and an elastic supply of risk capital through an efficient, innovative capital market, nurturing new ventures.

Various European governments have, on their side, taken steps to increase the flexibility of their economies. So far the success of such measures has been limited, partly because the change of policy perception is of recent origin and translating new perceptions into policies takes time. In all countries, efforts at major policy changes meet with natural inertia. Also, institutional barriers to change have been relatively high from the outset, and markets have remained fragmented. In other words, government efforts to increase structural flexibility have been handicapped by the fact that many past policies created impediments to adjustment that have become deeply embedded in public attitudes and expectations. Against this background it is not surprising that the United States recovery, along with favourable exchange rates, has had such a limited effect on Europe's unemployment rate and overall economic performance. That poor performance, in turn, has partly contributed to the fact that the United States recovery hardly spilled over to the developing countries in the Mediterranean and in Sub-Saharan Africa, which have traditionally strong trade links to Western Europe.

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[1] See, for example, J.D. Sachs, "Real Wages and Unemployment in the OECD Countries", Brookings Papers on Economic Activity 1-1983; M. Emerson, "The European Stagflation Disease" in M. Emerson (editor), Europe's Stagflation (Oxford University Press) 1984; A. Fox, "Employment Trends in Britain and the USA", Barclay's Review, May 1984; and B. Balassa, "The Economic Consequences of Social Policies in the Industrial Countries", Weltwirtschaftliches Archiv, Band 120, Heft 2, 1984.

Uncertain market access

But there is more to it. Notwithstanding a number of encouraging signs, including the announced advance implementation of the Tokyo Round tariff cuts on the part of the industrial countries, trade policy does not yet provide for the stable conditions needed to buttress investors' confidence. In Europe and North America, market access has been further tightened, or become more uncertain, in such sectors as agriculture, consumer electronics, automobiles, textiles, clothing, copper and steel. While the protection of domestic industries continues to be directed mainly against suppliers from Japan and the more advanced developing countries, transatlantic trade frictions, for example in agriculture and steel, have intensified as well. Pending anti-dumping and countervailing duty cases add significantly to trade uncertainty.

Where trade policy discipline deteriorates to a point at which protection becomes easily available to almost any industry anywhere, it would be clearly imprudent to invest in an expansion of export capacity. Thus the resulting uncertainty comes to bear on the expected returns from investment, lowering the world-wide volume of investment activities, including investment in production facilities, human capital, research and development, distribution networks and marketing. Not only is the overall level of investment lower, but the pattern is altered in the direction of lower productivity investments in the import-competing and non-traded goods sector. Sooner or later, the results depress overall economic performance and circumscribe the potential growth of trade at a later stage. It is not by chance that investment activity has remained subdued even in relatively flexible, export-oriented economies such as Japan or those South-East Asian developing countries which recently benefitted from an even steeper increase of their imports into the United States than Western Europe (Table 4).

Debt, trade, and investment

Trade uncertainty has obvious adverse effects on the investment climate in the heavily indebted developing countries. At the prevailing level of real rates of interest, their difficulties must increase unless they can achieve a higher degree of economic efficiency. This calls for a more efficient structure of investment, notably an increase of the share of investment going into efficient industries in the tradeables sector. With insecure access to export markets, the incentives for such endeavour, however, must remain weak.

In the indebted countries, the growing burden of debt service drew on export earnings which otherwise could have fuelled the demand for investment. As analyzed in two prior reports[1], the heavily indebted countries, notably the traditional customers of the United States in Latin America, responded to their payments difficulties generally by curtailing their imports rather than by expanding their exports.[2] In fact, the sharp 1982 contraction of the

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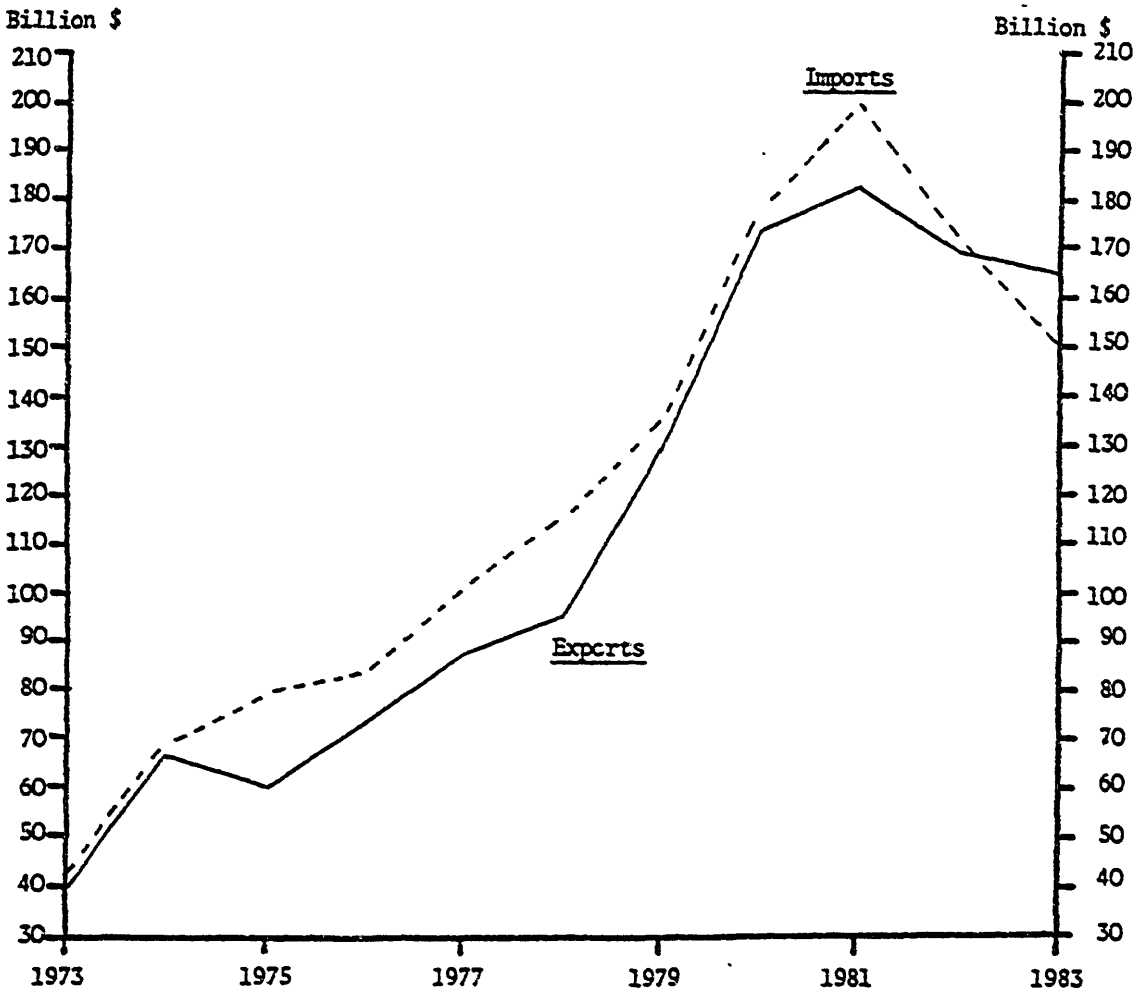
[1]See International Trade 1982/83, pp. 6-8 and GATT Press Release GATT/1358 of 18 May 1984.

[2]The Eastern trading area, also suffering from recession and problems of debt service, cut back imports as well.

combined imports of the sixteen indebted countries previously analyzed continued at about the same rate in 1983 (Chart 1). As a result, the combined imports of these countries were by about one-quarter down from their 1981 peak.

CHART 1. - DEVELOPMENT OF COMBINED MERCHANDISE TRADE IN SIXTEEN INDEBTED COUNTRIES, 1973-1983



Source: Appendix Table A4 (not published with this Press Release).

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The combined exports of the sixteen indebted countries contracted despite the recovery in the industrial countries in 1983. The decline was, however, less pronounced than in 1982 when exports had fallen by 7 per cent under the impact of the worldwide recession. This development differs markedly from the experience of the 1975-76 recovery. At that time, the combined exports of the same sixteen countries grew rapidly, after the recession-induced fall in 1975, to a level which exceeded that of the years preceding the recession. Major factors behind the unfavourable recent development include a weak response of raw material markets to the recovery in the industrial countries, the uncertain access to the markets for manufactures in the industrial countries, and the adverse effects of the cut-back of imports by the indebted countries on their export performance.

As the combined imports of the sixteen indebted countries fell distinctly more steeply in 1983 than their exports, the already reduced combined merchandise trade deficit of 1982 of these countries, turned into a sizeable surplus ($13 billion) in 1983, for the first time in more than three decades (except for a negligible surplus in 1965).[1]

Information for 1984 is still scarce. Perhaps the most important observation is that, for an increasing number of countries, the process of export contraction is finally coming to an end (Peru being a notable exception, mainly because of exceptionally adverse weather conditions). In fact, countries such as Brazil, Mexico, the Republic of Korea or Turkey are currently experiencing a rapid growth of their export earnings, brightening, at the same time, investment prospects. Trade policy changes in creditor and debtor countries could support this process.

Weak markets for food, energy and raw materials

Being strong only in North America, moderate in Japan and weak in Western Europe, the recovery failed to have a strong impact on the markets for primary commodities, with respect to quantities as well as to prices (Table 5). While food and raw material prices, an important factor for the export earnings of many developing countries, have partly recovered from

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[1]As can only be expected, developments among the sixteen indebted countries were far from uniform. In contrast to the overall development in 1983, imports or exports expanded in some countries (Thailand, Egypt, the Republic of Korea and Turkey in declining order of import growth; Republic of Korea, Brazil, Chile and Argentina in declining order of export growth). The merchandise trade balance (f.o.b-c.i.f.) of one-half of the countries remained in deficit (Egypt, Thailand, Turkey, the Philippines, Yugoslavia, Colombia, Republic of Korea and Morocco in declining order of the absolute size of the deficit); six countries continued to be in merchandise trade surplus (Mexico, Venezuela, Indonesia, Argentina, Nigeria and Chile in declining order of the absolute size of the surplus). Brazil and Peru turned their 1982 merchandise trade deficit into surpluses, in the case of Brazil in a sizeable one (just over $5 billion). But it is interesting to note that only four out of the sixteen countries experienced a significant deterioration of their merchandise trade balance in 1983, either via a reduced surplus (Indonesia) or an increased deficit (Thailand, Egypt and Turkey).

their 1982 trough, they have generally remained well below the 1980 level. Moreover, the rise of raw material prices decelerated over the last twelve months, or, as in the cases of sugar, tin, copper and rubber, it was only temporary, followed by a new decline. Oil prices have also fallen from their historical peak in 1981, to a level well below that of 1980. A fall in the prices for their exports is particularly worrisome for the heavily indebted developing countries because declining export prices reduce export earnings and thus increase the burden of high nominal interest rates.

TABLE 5.- WORLD EXPORTS OF PRIMARY COMMODITIES

(Billion dollars and indices 1980=100)

Commodity groups	1980 Billion dollars	Indices 1980=100	1979	1980	1981	1982	1983
Food[a]	183.02	Value index	85	100	104	96	94
		Volume index	103	100	115	123	124
Tropical beverages[b]	19.55	Value index	99	100	72	73	73
		Volume index	94	100	89	94	88
Oil seeds and oils[c]	20.83	Value index	98	100	101	91	93
		Volume index	88	100	106	115	101
Raw materials[d]	76.92	Value index	90	100	90	81	81
		Volume index	99	100	99	97	95
Ores and non-ferrous metals[e]	95.53	Value index	75	100	82	72	74
		Volume index	86	100	85	80	84
Fuels[f]	472.00	Value index	70	100	100	90	81
		Volume index	119	100	91	85	86

[a]SITC 0+1 (less 071, 072, 074).

[b]SITC 071, 072, 074.

[c]SITC 22+4.

[d]SITC 2 (less 22, 27, 28).

[e]SITC 27, 28, 68.

[f]SITC 3.

Sources: GATT, Appendix Table A28 (not published with this Press Release). Current values have been deflated by UNSO export price indices.

The explanation of the weak response of commodity markets to the recovery includes weak demand from industrial countries due to the moderate growth of production outside North America, as well as the high interest rates which put an additional brake on the usual replenishment of raw material stocks during the early phases of recovery. In addition, for those commodities which are not priced in dollars, the appreciation of the dollar had the effect of reducing export earnings measured in dollars.

But in part at least, the weak response of raw material and oil markets also reflects changes of a structural nature. First, the large price increases of the 1970s, in particular for oil but also for a number of raw materials, triggered saving and substitution processes with respect to energy and raw materials which continued after the second oil price shock. At the same time, energy and raw material supply from new sources increased, exerting further downward pressure on prices. Second, in the United States, as well as in other industrial countries, the present recovery is characterized by a further shift of the economic structures towards service activities which are generally below average in energy and raw material intensity; in fact, in the United States the net gain of jobs mentioned above is entirely due to employment expansion in services.[1] Third, the dynamic modern manufacturing sector (microelectronics, industrial robots, biotechnology, optical fibres, laser technology, and so forth) uses relatively little energy and raw materials, while the application of the new technologies supports the saving and substitution processes just mentioned.

Increasing demand for energy and raw materials from developing countries could make up for some of the structural slowdown in the growth of demand from the industrial countries. But up to the present the import demand from developing countries has been neither sufficient to reverse the long-term trend of a declining share of food and raw materials in world trade, nor has it specially benefitted the supply of these commodities from developing countries (Table 6).

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[1]The trend towards an increasing weight of services in the pattern of production and employment is a feature common to all high-income countries. It reflects relatively high income elasticities of demand for many services as well as the redressment of supply towards more sophisticated economic structures, including a better internal division of labour between hardware and software production. As such, the increasing service content of production is not confined to an intersectoral reallocation of resources but occurs within manufacturing firms as well.

TABLE 6.- WORLD TRADE IN FOOD, RAW MATERIALS AND FUELS, 1963-1983

(Shares, in percentages)

	1963	1973	1979	1980	1981	1982	1983
A) Food, beverages, oil seeds and oils[a]							
1. Food as a percentage of world trade	20	15	12	11	11	11	11
2. Share of world imports of food purchased by developing countries	19	18	23	26	28	26	27
of which: supplied by developing countries	32	19	25	28	28	29	30
B) Raw materials, ores and non ferrous metals[b]							
1. Raw materials as a percentage of world trade	16	12	9	9	7	7	7
2. Share of world imports of raw materials purchased by developing countries	10	11	14	14	16	16	16
of which: supplied by developing countries	39	46	40	37	35	35	35
C) Fuels[c]							
1. Fuels as a percentage of world trade	10	11	20	24	24	23	21
2. Share of world imports of fuels purchased by developing countries	20	15	16	17	19	21	21
of which: supplied by developing countries	81	88	87	88	86	84	83

[a]SITC 0+1+4+22.

[b]SITC 2 (less 22)+68.

[c]SITC 3.

Source: GATT, Appendix Table A28 (not published with this Press Release).

Given slack energy and raw material markets, in many developing countries there has been little incentive to prepare for an upswing by strongly engaging in investment which would show up in the order books of West European, North American or Japanese suppliers of machinery and equipment, or capital goods at large, and then would generate spill-overs to other economic activities and other countries.

Misperceptions and risks

Bright longer-term prospects for world trade could trigger a major boost of trade related investment in the world economy, the main channel through which recoveries spread internationally. The outlook for such a development is called into question however, by the widely held view that, in the remainder of 1984 and beyond, the recovery will slow down in North America and Japan and is unlikely to gain correspondingly more strength in Western Europe.

But this view overlooks the crucial point that the future course of economic developments depends very much on the nature of economic policies, that is, on the expectations which policy actions (and non-actions) create on the part of private households and business. Long-term business confidence has still to be restored. This difficult task would be eased if governments recognized that economic development has to be perceived in a cyclical context. Stabilization policies are likely to produce the most efficient results if their emphasis is on furthering the economies' flexibility, and on stabilizing medium- and long-term expectations with respect to the monetary and trading environment. Yet the process of confidence building can be frustrated by conflicting signals, for example when governments impose new import restrictions, or enforce new international market sharing arrangements on trading partners, soon after having publicly pledged themselves to resist protectionism.

A determined effort of the major countries to roll back protectionist forces could support and prolong the recovery, domestically and abroad. While enlarging the scope for the heavily indebted developing countries to earn foreign exchange for debt service, such an initiative would instantaneously strengthen the confidence in the international financial system and thus alleviate one form of present uncertainty. Determined resistance to protectionist pressures would also reduce the danger that profits earned behind protectionist walls become rapidly translated into wage claims and that temporary protection thus becomes permanent. By opening up new profitable investment opportunities and by furthering investment security, in particular with respect to trade-related investment, firm commitment to liberal trade policies would translate the enhanced flexibility into additional production and employment, in debtor and creditor countries alike.

On the other hand, while inducing a waste of capital and weakening the growth potential of the economy, increased import restrictions would do nothing to reduce current account deficits - in the United States or in the heavily indebted developing countries - because such restrictions quickly become an implicit tax on exports.[1] Focusing on symptoms rather than the causes has never been a basis for a successful therapy.

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[1] See, International Trade 1981/82, pp. 15-18.

An interesting question is whether the weak response of the European and Japanese economies with respect to the United States recovery implies the possibility that these regions will be insensitive to an eventual recession in the United States.

A number of considerations speak against such a hypothesis. First, the fact that the response was weak does not, of course, mean that there was no response.[1] Second, a recession in the United States would adversely affect the export earnings of developing countries whether they are engaged in trade of oil, raw materials or manufactures. As a consequence, Japanese and Western Europe suppliers would suffer from deteriorating export prospects with respect to these countries, on top of the difficulties they would encounter on the United States market. Third, to the extent that the weak response of Western Europe to the United States boom reflects the effects of relatively pervasive structural rigidities, this relationship is unlikely to operate symmetrically in case of a United States recession. In other words, rigidities limit output growth in an export-led recovery, but not the depth of a recession, let alone its duration.

With regard to the medium- and long-term objectives of stabilization policy, that is, looking beyond the present recovery, there is a need for measures which remove uncertainties and raise the economies' efficiency so that the real rate of interest and the growth rate of output converge in a way which allows for a higher level of employment. Once this is achieved there would be little reason to attempt, by way of policy intervention, to constantly "fine tune" capacity utilization at a high level. By now there is considerable evidence that efforts of short-term stabilization are likely to become frustrated by the many lags and potential errors involved. Moreover, the history of the 1960s and 1970s confers the lesson that even where such attempts work in the short-run, the recurrent stimulation of the economies increase rather than decrease cyclical fluctuations. Moderate cyclical upswings and downswings are a natural feature of decentralised economic systems, and the downswings serve a function, notably that of signalling dead ends, accelerating learning processes, streamlining production processes, freeing resources for new activities, and so forth. Such periodic fluctuations in output are the price for a healthy economic system, including a high average level of productive employment, in the medium term.

3. OUTSTANDING POLICY PROBLEMS

The preceding analysis covers all the main features of the current economic picture: differences in the speed and form of recovery between countries and continents, trade and its relation to investment, debt, interest rates and the various forms of uncertainty reflected in both interest rates and investment behaviour. It would be a fair summary of it to say that it describes a world economy functioning in a highly fragmented fashion. Thus restoring a more integrated world economy is the main task of economic policy, national and international. This concluding section explores the importance to each nation of an international economy functioning as an integrated system, and what makes it function in that manner.

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[1] See Chapter III in the present report (not published with this press release).

The process by which each economy develops can be most generally described as a continuous reallocation of capital and labour toward uses and employments promising a higher social yield. Much of the current economic comment, for example, is concerned with differences in "adjustment capacity", or "structural flexibility", between individual economies. These notions clearly refer to the ease or speed with which that reallocation proceeds.

In every economy the social yield of resources (as against private profitability of their use) depends to an important extent on economic developments abroad creating further opportunities for international specialization. When we speak of a fragmentation of the world economy, we mean that "communication" between different economies is poor. There is inadequate information in each about investment opportunities with a higher social yield, often coupled with inadequate incentives or even disincentives to act on that information, and/or other objective difficulties in the way of such action. The "excessive level of economic uncertainty" usually mentioned in this context refers to a state of affairs in which the relation between private and social profitability of economic projects has become disturbed and uncertain, usually in consequence of such imperfect transmission of information and incentives between economies.

The price system is essentially an information processing mechanism and uncertainty can be defined as lack of adequate information. It is international trade in a stable, liberal framework - in conjunction with international monetary arrangements providing for free convertibility of the major currencies - that connects national price systems into an international one. Changes in the relative prices formed in an international market where many producers can compete on equal terms, transmit promptly throughout the world economy information about shortages and surpluses incipient in any part of it. Since these prices reflect expectations of a large number of informed market participants, they often anticipate the real changes - the actual emergence of a scarcity or a surplus in a market - and thus already reduce their magnitude. At any rate, the relative price changes provide a timely signal for all the firms on which the real change will most directly impinge, to start planning their adjustment moves.[1]

Only the existence of a relatively unimpaired international price system makes it possible for rational individual economic decisions to be efficient from the social viewpoint as well. The international price system can thus be seen as an indispensable collective good; it directs national economic

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[1] It is correct to talk about an "oil price shock" of the 1970s, when the magnitude and suddenness of the relative price change created serious adjustment difficulties. In a more competitive market, an incipient shortage would have called forth a more gradual price increase and a smoother adjustment. Nonetheless, adjustment in the energy field proceeded rapidly in those countries which did not try to shield domestic users from the price increase. It is to be emphasized that this was only a particularly dramatic instance of the kind of changes that are occurring all the time.

development, and safeguards its continuity in a world in which particular resources tend to become more scarce and substitutes have to be found in time.

Even when the price system is impaired in its functioning to the present degree, individual economic agents can still make decisions that are rational (efficient) from the viewpoint of their own interests. At the limit, in the absence of any relevant information, tossing a coin would be a rational way of making a decision. In that situation, however, it will be clearly impossible to maintain the congruence of private and social rationality of individual economic decisions. If there is to be "adjustment" in the sense of structural changes which permit a self-sustaining (albeit cyclical) growth, therefore, a rehabilitation of the international price system is a necessary condition of it.

How can such a rehabilitation begin? Let us note that the rise of protection in the last 10 or 15 years has predominantly taken the form of quantitative restrictions, in particular restrictions made effective through export restraints. In consequence, in a large number of important sectors of the world economy (enumerated in International Trade 1982/83, p. 20) the price mechanism is no longer allowed to reflect true scarcity values, and thus functions only most imperfectly.[1] Being bilaterally applied, these arrangements are discriminatory by definition; and being in present circumstances relatively easy to obtain, they represent the central problem of the international trading system, making for a cumulative deterioration. As they proliferate, the international price system is less and less able to coordinate investment decisions within and between national economies. Scarce investment capital is increasingly frittered away in projects with inherently low and progressively lower social yield, the relatively high-risk innovative investment being correspondingly inhibited. It is important to note that protection could never have risen to its present levels if it had not been possible for governments to implement protective measures in a discriminatory way.

When discrimination in international trade becomes acceptable, the general level of protection cannot but rise. Indeed, there is no way of maintaining an international trade system, in the full sense of the word referring to regularity, orderliness and predictability, without the most-favoured nation commitment. Non-discrimination is the conditio sine qua non: the one necessary and sufficient system-forming condition. It has been

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[1] There is little sense in trying to quantify the degree of impairment; most attempts at "measurement" would be likely to understate the degree of damage already done. Quantitative restrictions, especially in the form of export restraint, seldom cover a whole product category of international trade. To take automobiles as an example, the larger part of world trade in this product is conducted under perfectly liberal conditions. Indeed only two particular trade flows in this area are quantitatively restrained: those from Japan to North America and from Japan to Europe. Once exports from the lowest cost source are restrained, however, all trade in that particular product category is conducted at distorted prices.

so little discussed in recent years that it appears necessary to recapitulate the several functions which the MFN commitment serves and through which it constitutes a trading system:

(i) From the economic viewpoint it ensures that each country accepting it will satisfy its total import needs from the most efficient sources of supply. Or, to put it slightly differently, it ensures that a given level of protection of domestic producers is achieved at the minimum cost for both the protecting country and the rest of the world. Thus, when practised generally, it will set up a tendency for the production of goods and tradeable services to take place according to comparative advantage. This tendency is a major element of labour productivity growth, and thus real wage growth, in all countries participating in the system.

(ii) From the trade policy viewpoint, the commitment protects the value of bilateral concessions. By protecting against such impairment of previous concessions through discrimination between different sources of supply, the MFN commitment "spreads security around", makes a multilateral system out of what are essentially bilateral bargains.

(iii) From the international-political viewpoint the commitment mobilizes the power of the large countries behind the main interest and aspiration of the small ones, which is to be treated equally. In this respect, it represents the only way to realize the ideal of sovereign equality of nations which is the foundation of international law. In more practical terms, the commitment guarantees the access of newcomers into international markets.

(iv) From the domestic-political viewpoint the commitment makes for straightforward, explicitly discussed and thus well-reasoned politics of national interest. In the protecting country the costs of non-discriminatory protection are generally more visible; the political discussion about it is thus adequately informed and less receptive to appeals to xenophobia. While trade restrictions always create vested interests in the importing country, discriminatory restrictions (especially those made effective through export restraints) tend, in addition, to create vested interests on the export side as well, and thus become much more difficult to remove. The MFN commitment avoids this special cost which, in systemic terms, is very large. An additional, non-negligible, national advantage is the simplicity of administration of non-discriminatory protection.

(v) Ultimately, the unconditional MFN commitment is of a constitutional significance. Given that protection cannot benefit an economy - a society - at large, there cannot be any rationally defensible, let alone scientific, consistently applicable methods and criteria for deciding which industry needs or deserves protection as against any other, and how much protection is needed or deserved. These are therefore pure value decisions and as such should be made by representative assemblies. Legislatures cannot, however, conduct foreign trade policy in the difficult world of many sovereignties and constantly shifting comparative advantage; that could easily claim all their attention with no time for other business. They

must therefore delegate considerable decision making powers in this area to the executive branch. Yet in view of the fact that no substantive, consistently applicable criteria can be articulated to guide such decisions, the delegated discretion would be most difficult to control. Historically, therefore, the MFN requirement served, in the domestic constitutional context, as the proper standard of delegation - the safe constraint on the delegated discretionary powers the executive branch needs to conduct trade policy (and foreign economic policy in general) in a situation of pervasive economic interdependence of nations.

The decline in trade policy discipline, and the consequent proliferation of conflicts, has led to proposals for a new round of trade negotiations. At this stage, it is especially important to bear in mind these system-forming functions of the MFN commitment. The agenda of a possible trade negotiation is generally thought of in terms of such different problems plaguing the international trade system as: issues directly affecting developing countries, safeguards, voluntary export restraints, subsidies, agriculture and so forth. The possibility is being explored of applying the GATT rules and methods in several new areas of international economic transactions. Each of these is considered to be a separate problem with an ideal solution of its own, though national positions on what the ideal solution might be, continue to differ. Nonetheless, it is believed that in one general negotiation it might be possible to trade off national concessions on particular issues and thus to arrive at a "balanced package" which, while not containing ideal solutions, would still be an improvement on the status quo.

The present state of trade policy does indeed call for an overall appraisal and joint action if an international market - capable of securing compatibility, and thus profitability, of investment decisions in all participating economies - is to be restored. It is also true that the technical aspects of the different issues, such as those identified in the previous paragraph, require expert attention. The technical aspects must not, however, be allowed to overshadow the central concern that it is the system that has to strengthened, and that underlying all the issues enumerated above is the basic problem of discrimination. Thus solutions in each of the different areas must conform to the objective of strengthening the multilateral trading system. The technical work on the individual issues must be inspired by the recognition by Contracting Parties of the true nature of the system's present weakness. To this end, the Contracting Parties, and in particular the major trading countries, would have to indicate in some binding manner their willingness to return to the non-discriminatory trading system embodied in the General Agreement.

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