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RECENT TRENDS IN WORLD TRADE

(Résumé of main points)

Note by the Secretariat

Addendum

The present note summarizes the main points contained in the introductory chapter of the secretariat report on International Trade 1976/77 which was recently distributed to the Group as document CG.18/W/19.

1. MAIN TRENDS IN INTERNATIONAL TRADE

Following a 2 per cent decline in 1975, world production increased 7 per cent in 1976, a somewhat higher rate than the yearly average in the decade preceding the recession. Renewed growth in industrial countries was in 1976 due essentially to a 4½ per cent rise in private consumption, substantial restocking, and an 11 per cent rise in export volume. In general, the recovery was more pronounced in production than in employment.

Average inflation in industrial countries continued to decline in 1976, falling to 8 per cent from 11 per cent in 1975 and 13 per cent in 1974. The currencies of Germany and Switzerland, which had the lowest inflation rates, appreciated by 12 and 8 per cent, respectively, while those of the United Kingdom and Italy, which had inflation rates approximating 17 per cent, both depreciated by about 18 per cent.

The value of world trade is estimated to have approached \$1,000 billion in 1976, an increase of about 13 per cent compared with 1975; volume was up 11 per cent following a decline of 4 per cent the year before.

The major current account developments were a substantial decline in the surplus of industrial countries, associated with their economic recovery, and a modest improvement in the current account for developing countries, which mainly reflected a

large increase in their merchandise exports and only a marginal increase in their imports. The resulting substantial improvement of their trade balance was, however, almost wholly offset by increased payments on the service account.

The immediate outlook

Developments thus far in 1977 indicate a continuation of the slow-down in the pace of the economic recovery in industrial countries. This trend was particularly evident in Western Europe and Japan where industrial production has been virtually unchanged since the beginning of the year. In the United States, in contrast, industrial production has continued to increase rapidly. Because of the added uncertainty surrounding forecasts of economic activity during the remainder of the year, estimates of the increase in world trade for 1977 are very tentative. Subject to this qualification, it seems probable that the increase in the volume of world trade for the year as a whole will be in the vicinity of 6 per cent.

2. LONGER-TERM DEVELOPMENTS IN INDUSTRIAL COUNTRIES

While it may not be surprising that employment and output levels in the manufacturing sector in industrial areas suffered a sharp setback in 1974/75, given that sector's susceptibility to cyclical swings in demand, it is interesting that many of the developments between 1973 and 1976 are in several respects only an accentuation of trends observable since the late 1960s:

- The anti-inflationary policies adopted by most governments in 1969-1970 achieved an abrupt deceleration in a hitherto rapid growth. Manufacturing production in industrial areas had expanded by 6.5 per cent on average between 1960 and 1969, but declined to 4.7 per cent between 1969 and 1973. In the subsequent period ending in 1976 there was hardly any increase.

- Similarly, the growth of industrial countries' consolidated real GNP declined in 1969-73 compared with the earlier period, before dropping more sharply in 1973-76.

- Manufacturing employment, which had been increasing its share in total employment between 1960 and 1969, suffered a sharp decline in growth and in its share in the period 1969 to 1973, before declining in absolute terms in the three years ending 1976. Throughout the period 1960 to 1976 employment in services in all industrial countries expanded continuously, whereas agricultural employment steadily declined.

- Moreover, total unemployment, which had declined between 1960 and 1969, has been steadily increasing since 1970, except for a pause during the 1973 boom when it was still one fifth higher than at any preceding cyclical peak in the post-war period.

Developments in foreign trade in manufactured products broadly conform to the trends in production and employment. The comparative advantage of the industrial countries appears to be most pronounced in the relatively research and skill-intensive sectors such as engineering and chemicals. An important feature is the growth of demand from developing countries (mainly oil-exporting) for industrial exports between 1973 and 1975, which played an important part in sustaining production and employment in the industrial countries in this period.

3. CURRENT PROBLEMS AND POLICIES IN PERSPECTIVE

Three different kinds of change, or factors making for change, can be discerned in the developments recounted above. The first is a secular change, which is not directly attributable to policy. Second, there are the medium-term developments involving the policy response to the more basic secular changes. Recent economic disturbances such as the 1971-73 realignment of exchange rates, the 1973-74 petroleum crisis, and the subsequent cyclical fluctuations constitute the third category.

The secular change has, in turn, three components. One is demographic, consisting of a long-term decline of population growth, and of the underlying labour force growth, in developed countries. The second consists of changes in the distribution of employment between the agricultural, industrial and services sectors, where service employment continues to grow, industrial employment is beginning to stagnate, and agricultural employment continues to decline. These developments require compensating adjustment if a previously established rate of income growth is to be maintained. For example, a recently completed study includes the following observation among its major findings:

"The aggregate stability, or decline, of the industrial labour force underlines the crucial rôle of resource mobility between manufacturing branches. The shift of labour from the old, traditional industries to the new and technologically advanced ones, appears to be an essential prerequisite for future growth."

The third element of the secular change is at work outside the industrial countries. It consists of the progress of industrialization in the developing countries and of its impact on the pattern of comparative advantage within the manufacturing sector in the industrial countries.

For a number of reasons changes in industrial structure proceed more easily when the manufacturing sector is expanded than when manufacturing employment is stagnant or declining. In the latter case, expansion of some industries implies an absolute decline of employment in others. In that situation, structural change tends to generate more "frictional" unemployment, as workers leave the

lower productivity industries, but have a more limited choice of jobs in the higher-productivity industries. These problems would be minimized if wage differentials were allowed to widen between the low and high productivity industries and between low and high skill labour. Instead, the resistance to such a development in recent years has put upward pressure on the entire wage structure since 1969 pushing real wage growth ahead of productivity and leading to a growing competitive disadvantage of lower-productivity industries and, in turn, increased import penetration and growing protectionist pressures.

This was the setting when the third set of factors appeared. The pre-existing problems discussed above have clearly been intertwined with the more recent disturbances, particularly the inflationary expansion followed by the steep recession. That is, the pre-existing problems made the recession worse, and their own solution has been made more difficult by the prevailing high levels of unemployment.

Investment uncertainty

Uncertainty about future inflation rates is likely to lead domestic investors to favour investments with short-run payoffs and, in consequence, to reduce the longer-term investment activity which is needed to effect the basic structural changes. Additional uncertainty concerning both the stability of international credit relations and the stability of the rules that have governed post-war trade compounds the difficulty of solving these domestic problems. The adjustment problem confronting those countries with large current account deficits and/or large accumulations of foreign debt creates uncertainty for investors, as alternative solutions have different implications for the potential relative profitability of investment projects. The large current account imbalances also affect investment by lending additional strength to sectoral claims for protection. A continuous flow of headline speculation about a possible trade war does not create a propitious investment climate.

Spread of protectionist pressures

The spread of protectionist pressures may prove to be the most important current development in international economic policies. These pressures, which have greatly strengthened since 1973, are largely the reaction of a stagnating manufacturing sector in industrial countries to the continued growth in imports. The willingness of so many governments to give effect to these demands, however, is a contradiction of their stated policy objective of promoting economic growth. Further, it may be suggested that it directly accentuates the resistance to adjustment which contributed to the last recession.

A contradiction also exists, in view of the large and rapidly rising indebtedness of certain developing countries, between the concern about the stability of international financial structures, and the restrictive commercial policies. If international financial stability is to be maintained, at least in the sense that regular debt service can continue, trade channels must not only remain open, they must be enlarged.

Conclusion

Proliferating trade restrictions are an official endorsement of an unwillingness to adjust that is weakening the recovery and growth capacity of the industrial economies in two mutually reinforcing ways. The restrictions act directly on the production process, tying resources to relatively less productive uses and thus restricting the expansion of the more productive and dynamic industries. At the same time, increasing protectionism generates economic uncertainty by placing the system of agreed trade rules in doubt. Such uncertainty is inhibiting investment at a time when additional investment is crucial both as a stimulus to aggregate demand and as a vehicle for effecting structural adjustments. Without a basic change in the present trend of international trade policy, that is, without a clear return to more liberal trade practices, accompanied by the necessary adjustment measures - the stage would appear to be set for a further cumulation of economic difficulties.