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PART A

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PART A

Chancellor's (Howe) papers:  
JUMBO COUNCIL ON SOCIAL  
AND ECONOMIC AFFAIRS  
JUNE 1981

Disposal Directions : 25 Years

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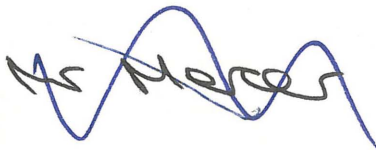
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April 6, 1981

To: Members of the Executive Board  
From: The Secretary  
Subject: World Economic Outlook - General Survey

The attached memorandum presenting a "General Survey" on the World Economic Outlook has been scheduled for Executive Board discussion on Friday, May 1, 1981 and Monday, May 4, 1981, together with the papers on the Situation of the Non-Oil Developing Countries (ID/81/3, 4/3/81), the Situation of the Oil Exporting Countries (ID/81/4, 3/30/81), and the Developments in Trade Policy (ID/81/5, 3/26/81 and Cor. 1, 3/31/81). Other papers in this series will be issued shortly.

As with previous papers on the world economic outlook, this document is being given limited distribution.



Att: (1)

PAPER  
ON  
WORLD  
ECONOMIC  
OUTLOOK



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April 6, 1981

World Economic Outlook--General Survey 1/

I. Introduction

The purpose of the current project on the World Economic Outlook is to provide a comprehensive picture of the international economic situation and outlook on the eve of the Interim Committee meeting in Libreville. This introductory section describes the project, outlines the present paper, and sets forth the main assumptions that have been utilized in preparation of the new projections.

Scope and nature of the project.--Staff work on this WEO project has entailed (1) a full-scale interdepartmental forecasting exercise (to be distinguished from one employing short-cut methods, as in the "General Survey", ID/80/7, issued last August), and (2) the preparation of seven papers. The project has had the benefit of consultations with a number of member countries, including special consultations with the United States, the Federal Republic of Germany, and Canada. These consultations, as usual, have proved valuable and have influenced both the statistical work and the analyses in many places even though explicit references to them may not be made.

The six papers other than the present "General Survey" (ID/81/1) cover the following subjects: "Situation of the Industrial Countries" (ID/81/2); "Situation of the Non-Oil Developing Countries" (ID/81/3); "Situation of the Oil Exporting Countries" (ID/81/4); "Developments in Trade Policy" (ID/81/5); "The World Oil Situation" (ID/81/6); and "Statistical Tables and Technical Notes" (ID/81/7). Some of the statistical tables provided in ID/81/7, it may be noted, are also included in the other papers for the convenience of readers.

An important new feature of the World Economic Outlook is the incorporation of the People's Republic of China into the statistical series, beginning with 1977. Also noteworthy is the work under way to extend the WEO's statistical coverage to nonmember Eastern European countries and the U.S.S.R.; the intention is to bring these countries more fully and explicitly within the framework of the WEO statistics in the outlook project of early 1982, drawing on the work embodied in a note presented in ID/81/7 and on further work to be done in the course of the coming year.

Content of the present paper.--This "General Survey" contains five main sections. After the present Introduction, the second section provides a short summary of the current international economic situation

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1/ Prepared by the Research Department in collaboration with the Area Departments and with the Exchange and Trade Relations and Fiscal Affairs Departments.



and of the prospects through 1982. The third section focuses briefly on two key issues of economic policy: "stagflation" in the industrial countries, and global adjustment and financing. Then, in the fourth section, the results of some medium-term "scenarios" are presented--scenarios which consider how the world economy might evolve over the period through 1985 on the basis of differing sets of assumptions, and which give particular attention in this context to the non-oil developing countries. The final section of the paper sets forth some topics as a suggested basis for discussion by the Executive Directors.

Key assumptions in the short-term projections.--As usual, the current staff projections for 1981 and 1982 are based on the assumption of "present policies"; for a few countries, this has been interpreted to encompass certain policy adaptations or changes that seem likely to occur even though they have not been announced by the authorities. It was also assumed, as a working hypothesis, that the average exchange rates of a recent period (January 1981) will prevail throughout the rest of 1981 and 1982. Another working hypothesis for present purposes is that changes in the average price of oil extending beyond the first quarter of 1981 (through 1982) will parallel changes in import prices of the oil exporting countries--that is, that the "real" price of oil will remain unchanged. This type of assumption, which is the standard one used by the Fund and other international agencies for the purposes of making short-term statistical projections, remains tenuous because of the uncertainty with respect to major aspects of the world oil market.

The character of the projections is substantially affected by the assumptions just noted. In addition, the statistical quality of the projections is subject to various uncertainties and difficulties, as noted in a still-relevant brief discussion on page 2 of the staff's May 1980 published report on the World Economic Outlook.

## II. Profile of Current Situation and Short-Term Prospects

Drawing on three of the background papers (ID/81/2-4), this "profile" first presents highlights of the current and prospective situation for the industrial countries and for each of the two broad groups of developing countries: the oil exporting group and the non-oil group. The section concludes with some observations intended to portray a broad picture of the economic situation on a global basis.

### 1. Industrial countries

The following review for the industrial countries touches on three subjects: financial policies in the major countries, prices and output, and external position.

Financial policies.--The evolution of the world economy is bound to be conditioned importantly by the monetary and fiscal policies pursued by the major industrial countries in dealing with the present



difficult problem of "stagflation." In response to mounting inflationary pressures, these policies turned increasingly restrictive during 1979 and 1980. Despite low or negative rates of growth, accompanied by worsening unemployment, this stance is generally being maintained in early 1981.

For the seven major industrial countries as a group, rates of monetary expansion (in terms of either M1 or M2) showed a clear deceleration from the end of 1978 to the end of 1980. On the basis of announced targets, this shift toward restraint carried over into early 1981; during the remainder of the year, rates of monetary expansion are expected to be lower than during 1980 for the United States and Canada but to show mixed tendencies in the other industrial countries.

The combination of monetary restraint and severe inflation has led to a rapid increase in interest rates, which currently may be viewed as relatively high in both real and nominal terms. Although some easing from the very high rates prevailing in the first quarter of 1981 is implicit in the staff projections, interest rates for the whole of 1981 are not expected to be very different, on average, from those of 1980, particularly with respect to longer maturities. A striking element of the general picture has been the rapid rise (and sharp fluctuation) of interest rates in the United States--which, together with a markedly stronger dollar, has had the side effect of constraining the policy options of other countries.

With respect to fiscal policy, the federal deficit in the United States increased markedly in 1980 (in part because of the weakening of the economy), thereby reversing the steady movement from 1975 to 1979 toward lower deficits relative to GNP. In nearly all the other industrial countries surveyed by the staff (see ID/81/7, Appendix A), some reduction of fiscal stimulus was achieved last year. For 1981, budgetary plans indicate a widespread, more pronounced shift toward restraint.

In large part, this posture of restraint reflects the acute concern that is felt in many countries about the actual size of public sector deficits. Initially swollen by the 1974-75 recession, these deficits in 1980 remained in most cases at least as high in relation to GNP as they were in 1976.

The stance of financial policies in industrial countries--viewed across countries, as above--is discussed more fully in ID/81/2, Section I-1. The individual country notes presented in the Appendix to ID/81/2--describing economic policies in the context of recent and projected developments--may also be of interest in this regard.

Prices and output.--The restraining influence of financial policies, together with the passing of the upsurge in oil prices during 1979 and early 1980, has led to some slowing of inflation in the industrial world. On average, increases in consumer prices decelerated from annual rates of about 13 1/2 per cent during the first two quarters of 1980 to rates of some 10 per cent during the last two quarters. On a year-over-year



basis, the increase in consumer prices for the industrial countries as a group is projected to decline from 12 per cent in 1980 to 9 1/2 per cent in 1981, and then to less than 8 per cent in 1982. The increase in GNP deflators--a better measure of underlying inflationary pressures--is also expected to moderate, but less markedly. Thus, the combined deflator for the industrial countries, after accelerating to 8 3/4 per cent in 1980, would remain at that high rate in 1981; it would then subside to 7 1/2 per cent in 1982. (See appended Table 1.) However, even achievement of the 7 1/2 per cent rate in 1982--predicated on continuing restraint in financial policies, unchanged prices of oil in real terms, weakness of other commodity prices, and widespread underutilization of resources--would still leave inflation in the industrial world, on average, as high as it had been several years earlier, following the sharp decline in inflation from late 1974 to the first part of 1976. In each of the years 1976-79, price increases for the whole group of industrial countries--as measured by GNP deflators--averaged about 7 1/2 per cent.

As shown in Table 1, rates of inflation differ widely among the industrial countries. (See also Table 3 of ID/81/7, which lists the smaller countries as well.) However, staff projections indicate that the pattern of differentials recorded for 1980 will change little in 1981-82. The only major exception is the United Kingdom, for which the effects of restrictive financial policies and of the large appreciation of sterling are expected to lead to a reduction in the increase of the GNP deflator from 19 per cent in 1980 to 10 1/2 per cent in 1981, and to 9 per cent in 1982.

When attention is turned from prices to real activity, a development of central importance is that the overall growth of real GNP in the industrial countries slowed from an annual average of 4 per cent in the 1976-79 period to 1 1/2 per cent in 1980, and is expected to amount to less than 1 per cent in 1981. Recovery in 1982 is expected to be modest, with real GNP in the industrial world projected to rise by only a little over 2 per cent from 1981. The overall rate of unemployment in the industrial world, already as high in 1980 as it was during the international recession of 1974-75, would rise further in 1981-82.

The very low average growth rates for 1980-81, together with the limited recovery projected for 1982, are indicative of widespread economic sluggishness in the industrial world. Nevertheless, the timing and magnitude of the shortfalls in growth of real GNP are found to vary considerably across countries. This point is obvious from analysis of national accounts data for individual countries on a quarterly or semi-annual basis, but it is also evident in the annual figures contained in appended Table 1 and, for more countries, in Table 1 of ID/81/7.

The developments indicated for Japan are clearly exceptional. The growth of real GNP in Japan amounted to as much as 6 per cent in 1978 and 1979, and to 5 1/2 per cent in 1980; it is projected to ease off to 4 per cent in 1981 but to return to 5 1/2 per cent in 1982. The seeming insulation of Japan's real output from the international slowdown is explained in large degree by the strength of the Japanese foreign

balance. In real terms, the increase of aggregate domestic demand in Japan dropped from 7 per cent in 1978 and 1979 to 1 1/2 per cent in 1980; it is projected to recover somewhat in 1981 and 1982, and to be accompanied by a continuing positive contribution to real GNP growth from the foreign sector (though smaller than in 1980).

The outlook for the United States warrants special comment. Although there is general agreement that real growth in 1981 will be modest, the staff is envisaging for 1982 a weaker economic situation than many private forecasters. Moreover, the staff's projection of an increase of about 1 1/2 per cent in real GNP for 1982 implies significantly more weakness in real and nominal GNP growth than the forecast published by the Administration in the context of its program for economic recovery. It may be noted that the staff is in substantial agreement with the Administration in anticipating a noticeable decline in the rate of price increase from 1980 to 1982. Even allowing for such progress on the inflation front, however, the staff is of the view that the monetary policy that has been announced is unlikely to permit an expansion of nominal demand that would allow output growth to be very strong in 1982. Of course, if expectations about inflation were to turn around fairly quickly, the recovery of output could be more robust. Indeed, over the medium term, the combination of restraint on aggregate demand and incentives for capital formation that characterize the Administration's program could set the stage for sustained growth in an environment of decelerating inflation. But in the near term, because of the existing cost-price pressures and the entrenchment of inflationary expectations, visible progress on inflation is likely to involve a significant degree of slack in product and labor markets.

External position.--As pointed out in earlier WEO papers, the pattern of current account balances among industrial countries improved--became more even--during the course of 1978 and continued to improve in 1979. This development was a very timely one. By and large, it strengthened the capacity of the international payments system to withstand the impact of the increase in oil prices during 1979 and 1980. Primarily because of that increase, the combined current account balance of the industrial countries (including official transfers) swung from a surplus of \$13 billion in 1978 to a deficit of \$31 billion in 1979, and then to a deficit of \$70 billion in 1980. (See Table 7.)

The change in the pattern of current account balances in the industrial world from 1978 to 1980 was centered to a large extent in the three largest countries. The biggest negative shifts in these balances occurred in the two countries--Japan and the Federal Republic of Germany--which had the largest surpluses in 1978; and the current account of the United States, which was in sizable deficit in 1978, moved into approximate balance in 1980.

The combined current account deficit of the industrial countries is expected to fall from the extraordinarily high figure of \$70 billion in 1980 to \$44 billion in 1981, with little further change indicated for



1982. However, this projected fall is concentrated among the seven major countries; the combined deficit of the smaller industrial countries (not including Norway and Switzerland, which have relatively strong current accounts) is projected to remain at the very high 1980 level of about \$31 billion in 1981--four times as high as the deficit incurred by these same countries in 1978. The financing of these greatly enlarged deficits is not expected to be a real problem, but in certain countries external debt will reach a level where service payments absorb a sizable share of foreign exchange receipts. Substantial adjustment is called for in a number of the smaller industrial countries over the medium term, and in some of them the need is becoming urgent.

The main exchange rate development in the course of 1980 and early 1981 was the weakening of the currencies of EMS participants. From end-December 1979 to end-March 1981, the EMS currencies (excluding the lira) lost about 18 per cent of their values vis-à-vis the U.S. dollar and the pound sterling, and about 28 per cent vis-à-vis the yen. After fluctuating markedly during 1980, the U.S. dollar was particularly strong in early 1981. From end-December 1980 to end-March 1981, the effective exchange rate of the U.S. dollar increased by about 5 per cent. Exchange rates within the EMS were relatively stable over the past 15 months; there was one currency realignment, involving a 6 per cent devaluation of the central rate of the lira in March 1981. However, intervention by EMS members in both dollars and EMS currencies was at times substantial.

Some important characteristics of the present system of managed floating exchange rates among major currencies or currency blocs continued to be apparent in 1980 and early 1981, namely: (i) a tendency for exchange rates to respond markedly to current account developments expected to be persistent; and (ii) a high sensitivity of exchange rates to changes in uncovered interest rate differentials.

The role of the current account in influencing exchange rates was striking in the period under discussion. For example, the sharp deterioration of the current account positions of the EMS countries relative to other major industrial countries seems to account primarily for the downward movement in the exchange rates of the EMS currencies since early 1980. Particularly important in that context was a gradual realization that the factors behind the change in the pattern of relative external positions against the EMS countries are likely to persist over the next few years. It is possible, although of course difficult to prove, that current account developments have resulted in some exchange rate "overshooting" because private market participants were not fully able to discount properly the transitory J-curve effects. The sharp appreciation of the pound sterling in real terms over the past three years--in excess of 50 per cent--is clearly attributable in large degree to current account developments and prospects related to North Sea oil and the deep U.K. recession.

Interest rate developments had a pronounced impact on exchange rates during 1980 and early 1981, although changes in interest rate differentials

tended to be transitory and thus to lead to only transitory movements of exchange rates. In the United States, in particular, interest rates fluctuated widely and were responsible for marked variations in the external value of the U.S. dollar. The short-term relation between the uncovered interest-rate differential and the exchange rate was quite pronounced in the case of the Federal Republic of Germany. At the same time, it must be noted that this differential was about the same in the first quarter of 1981 as in the first quarter of 1980, and thus cannot be considered a factor behind the major change in the exchange rate, which was even larger in real than in nominal terms, that occurred between these two periods. (See Section II-2 of ID/81/2, with accompanying charts.)

## 2. Oil exporting countries

Following the second round of large oil price increases from 1978 to 1980 (amounting to about 140 per cent), the combined current account surplus of the oil exporting countries went up from \$3 billion in 1978 to \$69 billion in 1979, and then to an estimated \$112 billion in 1980 (roughly equivalent in real terms to the surplus of \$68 billion recorded for 1974). (See Table 8.) With the expectation that the demand for oil from these countries will remain considerably below the levels of the recent past (1977-79), and on the standard working assumption that real oil prices will be unchanged during the forecast period, the combined current account surplus is projected to decline to about \$100 billion in 1981 and to some \$90 billion in 1982.

The rise in the oil exporting countries' current account surplus from 1978 to 1980 reflected a major gain in their terms of trade. With account taken both of the increase in oil prices and of the concurrent increase in import prices, the terms of trade of the oil exporting countries improved by about 28 per cent in 1979 and 42 per cent in 1980; over the two years, the improvement came to more than 80 per cent. (See Table 5.)

There has been a general tendency among the oil exporting countries toward relaxation of financial policies since late 1979. Nevertheless, the shift toward more expansionary policies has been much less pronounced so far than was the case after the 1973-74 oil price increases. The more cautious policy stance this time reflects to a large extent the intention of the authorities to avoid a recurrence of the earlier experience with excess demand pressures and the acceleration of inflation (Table 3), as well as to reduce the social strains associated with rapid development. In most countries of the oil exporting group, the apparent desire of the authorities to opt for a more gradual and balanced approach to economic development than previously is coupled with the objective of continuing the process of diversification of their economies. Growing realization that such diversification presents difficult choices, and that the risks of misallocation of resources are high, has contributed to a more cautious approach to spending, as well as to an increasing desire for conservation of oil reserves in some countries.



### 3. Non-oil developing countries

For many of the non-oil developing countries, the past two years have been a period of mounting economic difficulties. Some of the major difficulties have come from a generally unfavorable external environment. Growth in the international purchasing power of export earnings for most non-oil developing countries has been slowed by a subnormal expansion of export volume (due to recession-weakened demand in the industrial world) and by a deterioration in the terms of trade (reflecting particularly the increase in oil prices, as well as the cyclical situation). Despite a very substantial increase in external borrowing and a considerable reduction in the real value of their official reserves, the expansion in volume of imports in these countries has fallen off sharply.

The combined current account deficit of the non-oil developing countries rose from \$38 billion in 1978 to \$58 billion in 1979, and to an estimated \$80 billion in 1980; it is now expected to reach \$97 billion in 1981. (See Table 6; Table 10 shows current account balances as a percentage of GDP and of merchandise exports, by analytic subgroups, for the years 1973-81.) The figures for 1980 and 1981 are both considerably higher than the staff estimates presented to the Interim Committee (in ICMS/Doc/80/12) by the Managing Director last September (\$72 billion and \$80 billion, respectively).

Tentative staff projections for 1982 suggest a small further increase in the overall current account deficit of the non-oil LDCs to \$100 billion. This increase, however, would be concentrated among the dozen members of the group that are net exporters of oil, reflecting their exceptional access to international credit markets. For the main group of net oil importers, the aggregate deficit is expected to remain in 1982 at about the same level (almost \$85 billion) as that projected for 1981.

Financing of the enlarged deficit in 1980 required not only a substantial rise in net external borrowing, but also a virtual cessation of reserve accumulation (tantamount to a significant reduction of reserves in real terms). A further sharp increase in external borrowing is projected for 1981. As discussed in ID/81/3, the pattern of this projected borrowing raises questions about the sustainability of some of the inflows that are projected to finance the current account deficit of the non-oil developing countries in 1981. (Tables 11 and 12 give the financing picture for 1980 and 1981 against the background of estimates for prior years beginning with 1973.)

The recent increase in the current account deficit of the non-oil LDCs has reflected large increments in oil import bills. For the great majority of these countries (the ones that are net importers of oil), the cumulative increase in the oil trade deficit from 1978 to 1981 is estimated at nearly \$55 billion, an amount equivalent to the whole of the increase in the current account deficit. Over this period, a positive swing of some \$12 billion in the non-oil trade balance would be counter-balanced

by an increase in net payments for services, attributable in large degree to rising interest payments associated with enlarged external debt and higher interest rates. (See Table 9 in ID/81/3.)

Despite the severity of external financing problems and the difficulty of maintaining an adequate inflow of imports in real terms, the non-oil developing countries as a group have managed to sustain their real-GDP growth rates fairly well. The staff estimate of their average growth rate for the three years 1979-81 is a little less than 5 per cent, about 1 percentage point below the average for nonrecession years of the decade ended with 1978. (See Table 2.) For the net importers of oil in the group, the corresponding difference is about 1 1/2 percentage points. Against a background of continuing population growth at some 2 1/2 per cent per annum, such a curtailment of annual output expansion implies a significant slowing of per capita gains in real terms.

The record of the non-oil developing countries with respect to inflation is considerably worse than their growth performance. Because of the prevalence of accommodating financial policies (as borne out in a survey of Area Department staff judgments, described in ID/81/3), as well as the higher costs of imported goods, consumer prices in the non-oil developing countries have risen steeply. Measured on a weighted average basis, this advance in 1980 reached 33 per cent; the rate excluding China was 39 per cent, half again as high as the 1974-78 average and four times as high as the average for 1967-72. In terms of the median rate of increase, the situation is less unfavorable but still quite disturbing.

In any analysis of the current and prospective situation of the non-oil LDCs, it is clearly important to work with disaggregations of the figures for the entire group--an approach that the papers in this and earlier WEO series have sought to encourage through the presentation of breakdowns by analytical subgroups and by regions. Such breakdowns reveal significant differences among these countries with respect to both past developments and current positions. One such difference concerns the plight of the low income subgroup--which, inter alia, is found to have the worst economic growth rate for the period 1979-81 (appended Table 2); a growth in volume of imports averaging only 1 1/2 per cent a year over the period (Table 4, ID/81/3); severe financial difficulties that led to an actual reduction of reserves in 1980, and are expected to do so again in 1981; an exceedingly high ratio of external debt to export earnings (Table 13); and, not surprisingly, a very heavy dependence on official creditors and donors.

#### 4. Global picture

The foregoing "profile" has revealed a picture of the world economy broadly similar to that discussed by the Executive Board last September, just prior to the meetings of the Interim Committee and the Board of

Governors. Thus, inflation must still be characterized as a severe worldwide problem. Slow (or, in some countries, negative) growth remains a key feature of the international situation and outlook. Growth in the volume of world trade slumped to a very low rate of 1 1/2 per cent in 1980, and is projected to remain at that level in 1981 (Table 4). Most of the large imbalances in external current account positions that developed in 1979 and 1980 are not expected to recede very markedly in the next year or two; indeed, the projections give rise to added concern about the external difficulties of non-oil developing countries and about the emerging problems of a number of the smaller industrial countries. Reflecting mainly the conditions of weak demand and high unemployment in many of the industrial countries, the danger of protectionism still looms.

The statistical picture provided by the staff last September in ICMS/Doc/88/12 has not, in general, changed substantially. Growth of real GNP in the industrial countries as a group is still estimated at around 1 per cent for both 1980 and 1981. Inflation in the industrial countries for these two years--as measured by GNP deflators--is still shown to be in the neighborhood of 9 per cent. The estimated magnitude of the oil exporters' surplus has not changed very much; but, among the oil importing groups of countries, one very significant revision has occurred--namely, the upward revision in the combined current account deficit of the non-oil LDCs. This revision, based mainly on the availability of more trade and payments data for 1980, serves to reinforce the September 1980 analysis of the non-oil LDCs' external situation, rather than to alter its character. Also perhaps contributing to a relative pessimism of the staff's latest projections is the moderateness of the expected recovery of real GNP in the industrial countries from 1981 to 1982, accompanied by only a modest decline in the high rate of inflation.

All in all, the picture of the world economy provided in the current WEO exercise is at least as "grim" (last year's characterization) as that of six months ago. It is a picture of large and widespread economic imbalances both among broad groups of countries and within most individual countries. Clearly, the situation continues to present major policy challenges--for the Fund, as well as for its member countries--and to call for a maximum degree of international cooperation in dealing with them.

Trade policy is an important area in which such cooperation is urgently needed. The staff paper on developments in trade policy <sup>1/</sup> confirms the recent increase in pressures for protection, but notes that the record of industrial countries in resisting protectionist pressures in the 1970s was generally good; in particular, across-the-board trade restrictions were avoided. At the same time, selective trade measures of recent years have not been relaxed, and in some instances have been tightened.

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<sup>1/</sup> "World Economic Outlook--Developments in Trade Policy," ID/81/5, 3/26/81. See also "Developments in Trade Policy in Industrial Countries: Background Paper," SM/81/69, 3/30/81.



In the period ahead, the continuing weakness of the economies of the industrial countries, combined with the persistence of demands for protection of specific sectors from import competition, could make it increasingly difficult to deflect pressures for new trade restrictions or internal measures having trade-restrictive effects. A significant recent advance in international cooperation in the trade policy field is the strengthened framework of rules emerging from the Multilateral Trade Negotiations. Moreover, the dangers of protectionist policies--including their counterproductive effects on domestic anti-inflationary and economic growth objectives--are being increasingly recognized. However, without accelerated adjustment in economically weak sectors, it may be more difficult to resist further slippages into protectionist practices.

Thus, the present situation calls for increased vigilance and maximum prudence in government actions. If bilateral or sector-specific restrictions or restraint arrangements are allowed to proliferate, or if the new trade rules are not applied in an outward-looking, generally liberal manner, the consequences for the growth of world trade--as well as for the export and development prospects of the developing countries and their participation in the multilateral trading system--could be very serious.

Any picture of the world economy, however brief, should also take account of developments in the field of energy. Here, some clear progress has been made, and the developments of the past year or two are more encouraging.

Early data indicate a 3-4 per cent decline in energy consumption by the industrial countries in 1980. Although this decline reflected in part cyclical weakness, energy consumption in 1980 was actually lower than in 1973, despite a 19 per cent growth of real GNP since then. Another promising development has been the emergence in recent years of more rapid substitution of non-oil energy sources for oil. Consumption of non-oil energy is estimated to have risen by 9 per cent from 1978 to 1980, compared with a 2 per cent decline in the consumption of oil.

These developments both reflect and support the policy that has now been adopted in most industrial countries of allowing a full pass-through of oil price increases so as to encourage conservation of energy and substitution of alternative energy sources for oil. The recent oil-price decontrol measures in the United States are a further contribution to this policy. The doubling of the real price of energy in industrial countries that has taken place since 1973 is serving as a strong incentive for energy savings. Further, the recent emergence of relatively large price increases for petroleum derivatives (such prices having now increased by 2 1/2 times in real terms since 1973) has promoted substitution of non-oil energy sources for oil, and has been accompanied by improving supply conditions for these sources.

Nevertheless, the uncertainties to be faced in the medium term regarding the supply/demand balance in the energy and oil markets are considerable. A combination of declining oil consumption, rising production of

oil outside the oil exporting countries, a comfortable inventory position, sluggish demand in the industrial countries, and high level of output by Saudi Arabia are reflected at present in a situation of relative softness in the world oil market. (See ID/81/6.) However, past events have demonstrated how rapidly market conditions can change.

Some special considerations continue to be relevant to the issue of energy policies in the non-oil developing countries. Present and foreseeable balance of payments difficulties in this group of countries make development of their considerable indigenous energy sources a matter of urgent priority. While increased investment in energy projects in these countries may not for a time materially affect the global situation in view of the present scale of operations and long lead-times, it is important from the point of view of adjustment and development in the countries themselves. Such investment would imply, of course, an enlargement of external borrowing requirements in the short or medium term.

### III. Key Issues of Policy

#### 1. "Stagflation" in the industrial countries

For most of the period since 1973, the industrial countries have experienced historically high rates of both inflation and unemployment, combined with relatively slow growth of productivity. It is by now widely recognized that this situation of "stagflation" is a very serious one; some of the factors behind it are general, but others differ from country to country. No easy solution is in view. On the contrary, the policy alternatives open to national authorities are likely to require not only considerable skill and determination, but also sacrifices by the public, over a period of years. Nevertheless, certain alternatives appear to be more promising than others, and these will be discussed following a brief review of stagflation.

From the mid-1960s onward, inflationary tendencies became apparent in many industrial countries. The causes of these pressures included excessive fiscal deficits and rates of monetary expansion, as well as the effects of structural factors related to a decline in the degree of competition in both labor and goods markets. An example of these latter factors was the ability of workers in industries with relatively high rates of productivity growth to obtain relatively high wage increases, with workers in other industries then often successful in catching up, especially during periods when the authorities' policy stance accommodated such cost-push factors via measures aimed at maintaining high levels of employment.

It was only after 1973, however, that the present problem of stagflation became fully apparent. To a large extent, this problem can be traced to an unwillingness by both private economic agents and national authorities to accept fully the consequences of various supply-side developments. These developments included mainly:

a. The increase in the price of oil. The price of oil in real terms declined from the mid-1950s until the early 1970s; it then tripled in 1973-74 and doubled from 1978 to the first quarter of 1981. The two waves of steep increase in the price of imported oil led to sharp declines in the foreign terms of trade of the industrial countries, inducing a real transfer of unprecedented magnitude to the oil exporting countries.

b. The decline in the rate of growth of productivity. While the causes of the decline in the rate of growth of real output per employed worker that took place in most, although not all, industrial countries during the 1970s are not clearly discernible, a number of separate factors can be singled out: (i) the various effects of the shift to less energy-intensive processes and products necessitated by the steep rise in energy prices; (ii) the major shift in income distribution in favor of wage earners that took place in the late 1960s and early 1970s in many European countries--which may have been one of the factors responsible for a sharp fall in the average ratio of fixed capital formation to GNP; (iii) the fact that a significant portion of business investment during the 1970s, particularly in the United States, was not directed at raising productivity, but rather at meeting the increased public demand for pollution abatement and the enhancement of occupational health and safety; and (iv) the continued expansion of the services sector as a proportion of GNP, inasmuch as productivity growth in this sector tends to be relatively low.

c. Problems of industrial structure. Rapid changes in the composition of world demand and in the comparative economic advantage of various countries have left many industrial countries with a structure of production seriously out of line with the structure of demand. Well known examples are provided by the developments that have occurred in shipbuilding, steel, and textiles, as well as the differences among countries with respect to the endowment of energy sources. Structural changes are of course not new, but they seem to have been particularly great in the 1970s and to have contributed to structural unemployment.

d. Labor market developments. Changes occurring in the labor markets also played a key role in both the weakness of productivity growth and the high rates of unemployment that were experienced during the 1970s. Labor force growth in the industrial countries was generally rapid throughout the decade, and this was accompanied by remarkable shifts in participation rates (notably the increased participation by adult women) and by an influx of inexperienced and relatively less skilled workers into the labor market, raising measured unemployment rates and further depressing productivity gains.

The implications of such supply-side developments were a lower rate of growth of real per capita income and a higher average rate of unemployment. It is clear, however, that these developments did not necessarily imply rates of inflation or unemployment as high as those which have been observed since 1973. Stagflation has also been a result of the way in which private economic agents and national authorities have reacted to the changes of the 1970s.

Conditions of imperfect competition in the goods and labor markets have been sufficiently extensive in most industrial countries to allow private



economic agents to resist strongly any decrease in the rate of growth of their real incomes. An extreme example is provided by those countries where practically all labor incomes and social transfers are indexed to the cost of living--a mechanism that obviously contributes to inflation in any period of marked decline in the external terms of trade. Even in other countries, however, implicit forms of indexation have often had similar results.

The policy reactions of national authorities have also in many cases led to adverse effects on prices and employment. For one thing, failures to adjust domestic prices of energy products to world market levels, coupled with changing regulations concerning the exploitation of coal and nuclear energy, have delayed needed increases in energy supply and affected the cost position of oil substitutes. Similarly, concern about safety and the environment has often been translated into regulations that, in practice, have added considerably to costs and prices. At a time when the growth rate of real per capita income was already declining, many governments decided to maintain or even accelerate the expansion of government services and transfers. It is difficult to assess how much the increased tax burden required to finance government activity may have adversely affected private sector incentives to work, save, and invest in productive capital, but the effect may have been sizable. As to the necessary restructuring of economies, a few national authorities (such as the Japanese) have encouraged the adjustment process, but the usual pattern has been one in which the authorities delayed this process by subsidizing declining industries at the cost of an increase in the public sector deficit. Government intervention in the labor markets, however desirable from a social or political standpoint, has in many cases been a contributing factor to inflation and unemployment. For example, improvement and extension of unemployment compensation benefits have reduced the private opportunity cost of unemployment in some countries, possibly accounting for at least part of the rise in structural unemployment rates. In a number of countries, subsidies have been given to firms to keep redundant workers, thus impairing productivity. All in all, it seems clear that the degree of rigidity and inflexibility--however difficult to measure--increased markedly in the economies of many industrial countries in the course of the 1970s.

By far the most disappointing results of national economic policy have occurred in the area of demand management. A few industrial countries (notably the Federal Republic of Germany and Switzerland) appropriately shifted toward monetary restraint as early as 1973 and 1974, and then maintained it for several years. Most countries either reversed a shift toward restrictiveness rather quickly or avoided making such a shift for several years. From late 1975 onward, the larger industrial countries attempted to implement monetary policies on a "gradualist" basis. Several countries announced quantitative targets for the growth of domestic monetary aggregates in the context of programs intended to decelerate inflation gradually so as to minimize the adverse effects of monetary restraint on real output and employment. However, considerable slippage took place in the monetary targeting approach. Indeed, over the period from 1976 to 1980, monetary targets were frequently missed and there was little evidence of a sustained

deceleration of monetary growth in most industrial countries. Since the early 1970s, there has been sufficient monetary restrictiveness on occasion to initiate temporarily depressive or dampening effects on output, but the ensuing gains in terms of reduced inflation have proved to be small.

As regards fiscal policy, the efforts of industrial countries to shift toward greater restraint were often hampered by the existence of large public-sector expenditure programs which had expanded as a result of the extension of social and other government services during the 1960s and 1970s, and which could not easily be reduced to meet the objective of inflation control. As a result of these difficulties, public sector deficits have persisted. Indeed, declines in real economic activity in several countries have tended to increase public sector borrowing requirements. Thus, the recent period of ineffective monetary targeting, combined with sizable fiscal deficits, has also involved considerable variability in both nominal and real interest rates. Furthermore, the failure to bring public spending under firmer control--and the widespread belief that fiscal deficits are likely to be financed by monetary creation--has been an important factor in the persistence of inflationary expectations even in the face of continued weakness in real activity.

The foregoing cursory review does not, of course, break new ground; it is primarily intended for the purpose of recalling and underscoring the fact that the origins of stagflation in the industrial countries are both complex and deep-rooted--the result of a number of diverse and important developments extending over a lengthy period. In most of these countries, inflationary expectations are by now deeply imbedded in the economic system, indexation schemes and other mechanisms that protect economic agents from the effects of inflation at the cost of perpetuating its existence are widespread, and the degree of public confidence in the ability of the authorities to control inflation is at a low ebb. Despite the fact that the policy approach will have to differ among countries, some of the crucial elements of these policies are easily defined, although it may not be easy to implement them.

First, it is now widely acknowledged that inflation is unlikely to be moderated in the industrial countries unless there is a reduction in their rates of growth of aggregate nominal demand--a reduction sufficiently marked and prolonged to break inflationary expectations. This objective requires continued restraint on the growth of monetary aggregates, a reduction of fiscal deficits, and perhaps a leveling-off of the ratio of government expenditure to GNP. The control of nominal demand, however, can only be one of the elements of an integrated policy approach. Under present conditions, a reduction of the growth rate of nominal demand--in the absence of supporting measures--could have a further adverse impact on employment, investment, and productivity growth, and this, in turn, would increase the gap between what individuals expect the growth of their real income to be and what economic conditions allow. Inflation might decline, but the costs in terms of output could be large, and it is not clear that inflation would not rise again as soon as economic activity picked up. The dilemma is that, on the one hand, a policy of marked reduction in the growth of nominal demand may not affect expectations for a period of years while, on the other hand, it may not be politically feasible to maintain it for a prolonged period if most of its impact is on output rather than on prices.



The adverse impact on output and employment may be alleviated by placing greater emphasis on supply-side policies. Some of these policies should be designed to increase the incentives of the private sector to save and invest, thereby increasing the growth of real aggregate supply relative to nominal demand and reducing inflationary pressures. Such supply-side measures might include changes in the structure of taxes and reductions in the levels of taxes and government expenditures, so as to stimulate work and saving; changes in depreciation rules; less onerous regulation of private sector economic activity; and manpower training and other labor market policies designed to reduce structural unemployment. Other policies should aim at the difficult task of removing barriers that have been erected, sometimes by the authorities themselves, against the free play of market forces in the goods and labor markets. Certainly, supply-side policies such as these represent a step in the right direction; the question is whether they will be introduced on a wide scale, and whether their effects will be sufficiently great or quick-acting to have a marked impact on stagflation in the industrial world within the next two or three years.

One of the most useful supply-side achievements would be a further reduction in the dependence of industrial countries on imported oil. The demand for imported oil corresponding to a high level of economic activity in industrial countries should not exceed the maximum effective or desired production levels of the oil exporting countries in order to counter the risk of another large and abrupt increase in oil prices that would markedly worsen the stagflation problem of industrial countries and have serious consequences for non-oil developing countries as well. While the maintenance of domestic prices in line with world market levels is crucial in that context, other government actions may also have a useful role to play. It is important that unnecessary regulations, or the uncertainty concerning possible changes in regulations, not hinder the development of domestic energy sources. In countries where part of the energy sector is under direct government control, adequate public investment is an important factor. In other countries, the authorities may sometimes find it necessary to participate in the development of new sources of energy that require substantial research programs, long lead-times, and very large-scale projects.

Another aspect of the solution lies in the use of incomes policy. Such a policy is now frequently identified with the setting of wages and prices through controls or other administrative means, often without a supporting program of restraint on aggregate demand. Several experiences along these lines in the mid-1970s failed, bringing incomes policy into a certain disrepute. There are, however, more flexible forms of incomes policy--varying among countries according to their political and social environment--that may have a useful role to play in the fight against stagflation. In a few European countries, for example, the authorities have been directly involved with industry and labor in a process of negotiation in which efforts are made to relate the growth of real wages to the average economy-wide gain in productivity corrected for changes in the terms of trade. An even better example is provided by Japan, where a common perception shared by representatives of government, industry, and labor seems to have evolved and to have helped to achieve a relatively low rate of inflation (only 2 per cent in



1980, in terms of the GNP deflator), without recourse to a severe credit squeeze and despite a large public sector deficit. Clearly, the political and social circumstances of Japan may not apply to other countries, but Japan's success may serve to indicate the direction in which other countries will have to move if they are to get out of the present stagflationary morass.

## 2. Global adjustment and financing

The issues of external adjustment and financing to be faced in the next few years are no less formidable than the internal adjustment issues considered above. A comprehensive discussion of external issues was included in the published World Economic Outlook report of May 1980 (see mainly Chapter III), but it may be useful to review certain aspects in the light of two factors that, although already noticeable last year, have become more marked since then: namely, the sharp increase in real interest rates and the weakness of economic growth in industrial countries.

### a. Global adjustment issues

Global adjustment presents two major problems. The first is the now familiar issue of imbalances between the oil exporting and oil importing groups of countries. The other problem, perhaps not so widely known, is that which exists within the large group of oil importing countries, principally between the industrial world and the non-oil developing world.

The prospects for adjustment between oil exporting and oil importing countries remain as worrisome as they were last year. The oil exporting countries have continued to expand rapidly, but the probable limits on the absorptive capacity of these countries over the next few years are becoming more and more apparent (as discussed in Section 2 of ID/81/4).

The substantial increase in the level of real interest rates that occurred during 1980-81, particularly on U.S. dollar-denominated assets, may have greatly increased the magnitude of the transfer of real resources from oil importing to oil exporting countries that ultimately will be necessary to restore a better pattern of current account balances. As has long been recognized, unanticipated inflation lowers the debt burden of the debtor by reducing the transfer of real resources that is needed to make interest and amortization payments. Over the period 1974-79, the average annual rate of return on short-term funds in the United States or on U.S. dollar deposits in the Eurocurrency markets was only 6 1/2 to 7 per cent, while the average annual increase of import prices for oil exporting countries, in terms of the U.S. dollar, was about 12 1/2 per cent. The ex post real interest rate was only moderately less negative for short-term deposits denominated in other currencies. From the end of 1979 to the end of March 1981, however, the interest rate on short-term deposits denominated in U.S. dollars averaged about 12 to 14 per cent, while the rate of increase of import prices for oil exporting countries, in terms of the U.S. dollar, may have been on the order of 7 per cent. If, as seems likely, interest rates in financial markets continue to exceed rates of inflation, the growth of investment income should

contribute, along with less expansionary policies, to maintenance by the oil exporting countries of a combined current account surplus that would still amount to some \$50 billion (in current prices) in 1985, even without any further increase in the real price of oil.

Given the uncertainties surrounding the evolution of demand and supply in the world oil market, the possibility of further increases in the real price of oil cannot be discounted. If the real price of oil were to increase by about 5 per cent a year from now to 1985, the combined current account surplus of the oil exporting countries could be maintained at more than \$100 billion a year. The global adjustment and financing problems would in this case become much more formidable. In order to prevent a deterioration in the balance between the demand for and supply of oil, and thus to help avoid a further marked rise in its price, energy demand must be constrained, and energy supply increased, in the oil importing countries. As discussed above in Section II-4, there has been a significant reduction in world demand for oil in recent years, but much more is needed. Although the oil supply situation should be favorable in 1981, and possibly in 1982, the situation could then change rapidly in the event of a marked recovery of economic activity in the industrial world without new measures having been taken to reduce the current dependence of many countries on oil. Because of this and other possible developments that could trigger an upsurge in oil prices, the need to reduce the demand for oil and to increase the supply of alternative sources of energy continues to be crucial.

Adjustment problems among the various groups of oil importing countries may be even more difficult to solve than those between oil exporting and oil importing countries. The primary source of concern is with the weak external positions of two subgroups of non-oil developing countries--the low income countries and the "other" net oil importers, which together comprise nearly two thirds of the Fund's membership. <sup>1/</sup> These groups have been faced with two major problems over the past several years. (i) They do not produce the kinds of goods in demand by oil exporting countries and, therefore, cannot offset very much of their rising import bill by additional exports to these countries. (ii) They typically export primary commodities for which world demand has recently been weak. Despite such external problems, these two subgroups of developing countries have on the whole managed to sustain economic growth without excessive increases in their ratios of debt or debt service payments to exports of goods and services, although serious difficulties have emerged in a number of individual countries.

As one looks ahead, however, there is cause for real concern. First, it is important to note that, while these two groups of developing countries have achieved a measure of adjustment by reducing the ratio between the growth of import volume and of real GDP, by far the major reason why their debt situation remained generally manageable at the end of 1980 was the

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<sup>1/</sup> For countries classified in these groups, see Table 2. The People's Republic of China is not included in the group of low income countries for purposes of the analysis in the present section.

large negative real interest rates which they had experienced in the past several years. During 1974-79, the group of low income countries had an average nominal interest rate of 2 1/2 per cent on its debt, while its export prices grew at an average rate of 13 per cent. The real interest rate for the "other" net oil importers taken as a group was only slightly less negative; their nominal interest rate was 5 1/2 per cent, while the growth of their export prices averaged about 15 per cent. In addition to the low ex post real interest rates on U.S. dollar-denominated assets in the world financial markets during 1974-79, an important reason for the low cost of debt service for these two groups of countries--apart from the fact that so much of the debt had been incurred in earlier years at lower prices and interest rates--was that a large part of their financing was provided at concessionary rates. With the big increase in real interest rates that occurred in world financial markets in 1980/81 (and which may persist over the next few years), and with the gradual change in the structure of debt commitments that has been taking place toward debt contracted at market-related interest rates (particularly for the group of "other" net oil importers), the size of the real debt-service burden of these two groups is bound to grow more rapidly than in the past. This would be true even if their current account deficits, excluding investment income, were not to be larger than in the period 1974-79. In fact, however, their deficits in 1980 were already larger, and they are projected to reach still higher levels in 1981 and 1982.

These severe external adjustment problems raise the issue of the role of the exchange rate in non-oil developing countries. <sup>1/</sup> It is often contended that such countries which rely primarily on the export of primary products are faced with a price-inelastic world demand for their products, and therefore have nothing to gain by devaluing. This view can hardly be considered valid. Many of the primary products exported by developing countries compete with goods produced in the industrial world so that the price elasticity of demand for these products is not negligible in the medium term. Further, many primary producing countries already export agro-business products and manufactures, or will have the potential to do so over the next few years. These exports, while not large initially, could in the long run become extremely important for the development of their economies and the resolution of their external adjustment problems.

On the import side, the relation between the growth rates of imports and gross domestic product should not be taken as given. In many cases, there is need for a change in development strategy, away from import-intensive activities and toward activities with high domestic value-added and good export potential. Such a change in growth strategy requires that economic agents in the countries concerned be given the right information as to the price of foreign exchange in real terms. In this context, it is usually far better to allocate imports through the price mechanism by exchange devaluation than by quotas or restrictions that often mask the real price of foreign exchange. For all these reasons, it is a matter of concern that the average real exchange rates of the two subgroups of non-oil

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<sup>1/</sup> The following paragraphs are, in the main, drawn from "The Review of the Implementation of the Fund's Surveillance Over Members' Exchange Rate Policies" (SM/81/54, 3/11/81).

developing countries under discussion have tended to rise in recent years because of a reluctance on the part of many of these countries to adjust their exchange rates.

This is certainly not to say that exchange rate actions alone can solve the external adjustment problems of developing countries. First, exchange rate adjustment will need to be supported by structural actions on the part of the authorities. One frequent requirement is to change the pricing and procurement policies of marketing boards; these policies have a major impact on producers' incentives, and have often been oriented toward the protection of the urban population to the detriment of agricultural producers. Systems of import taxation and export subsidies may also have to be modified. Further, many investment decisions are made in the public sector, and it is important that these reflect economic returns. Second, there is also a need to support an exchange rate action by adequate demand management policies. A devaluation is not a substitute for demand management policies that will keep the growth of aggregate demand within the bounds of available noninflationary financing.

In the final analysis, however, it must be recognized that the chances for successful adjustment by non-oil developing countries will be small if they do not receive the cooperation of industrial countries. Developing countries cannot expand their exports, particularly their emerging exports of agro-business products and manufactures, if the industrial countries use protective measures against them. The needed structural adjustment of their economies will also require time, even if all the right policies are implemented. Thus, financing will be required for a number of years in support of adjustment programs. Direct investment in developing countries by industrial and oil exporting countries has a crucial role to play in that context. In the case of the low income countries, it is also clear that the financing should come to a large extent on concessionary terms.

The foregoing analysis has focused on the groups of low income countries and "other" net oil importers because they may encounter the most serious adjustment problems in the next few years. However, two other groups of oil importing countries--the developing countries classified as major exporters of manufactures and the smaller industrial countries--also face difficult adjustment problems. The causes of these problems are basically the same as those faced by the two groups of developing countries discussed above, namely, sluggish economic growth in the major industrial countries, the increase in the real price of oil, and, more recently, the increase in real interest rates in world financial markets (a factor of special importance in view of the particularly high proportion of their debt being contracted at market-related interest rates). In a number of countries among the LDC exporters of manufactures and the smaller industrial countries, adjustment problems have been exacerbated by expansionary financial policies, reflecting mainly excessive fiscal deficits, and by marked distortions in the structure of domestic prices, often associated with overvalued exchange rates. Subsidies to inefficient enterprises have also contributed to the problems by causing high import growth and low growth of GDP and exports. In contrast to the situation of countries at a lower stage of economic development, however, most of the countries in these two groups should find it easier to adapt their economic structures to changing external conditions.



In brief, as far as the non-oil developing countries are concerned, the conclusion reached in the May 1980 World Economic Outlook that it could be a serious mistake to place excessive reliance on financing rather than adjustment, in the belief that external conditions might soon improve, is even more relevant now. The same conclusion applies to a number of the smaller industrial countries that are seriously affected, among other factors, by the increase in real interest rates.

b. Global financing issues

In contrast to the views expressed by many bankers and observers of the private financial markets at the beginning of 1980, the capacity of the private financial markets to channel funds to deficit countries does not seem so far to have become a significant constraint on the flow of such funds. The prospects for channeling of funds to deficit countries during the rest of 1981 also seem favorable. Nevertheless, two problems that were discussed in the May 1980 World Economic Outlook are still present.

The first problem relates to the potential mobility of the huge amount of net external assets that have been accumulated by the oil exporting countries. Most of these funds are still invested in short- and medium-term financial instruments, such as government securities and deposits in the major international banks both on- and off-shore, although the proportion of the total invested in longer-term instruments has tended to increase gradually. Such predominance of relatively liquid investments tends to increase the potential for both stabilizing and destabilizing capital flows. The oil exporting countries have avoided shifts in existing assets on any significant scale, with the shifts that have occurred being accounted for mainly by new placements. But a further increase in the proportion of funds invested in longer-term instruments would help to stabilize the pattern of placements among debtor countries.

The second kind of problem concerns the financing of the current account deficits of non-oil developing countries. In this case, it also appears that the disquiet expressed by many bankers and observers of the private financial markets at the beginning of 1980 was to some extent overdone. But if one looks ahead to the next few years, there is still a clear danger that funds available to non-oil developing countries which at present have access to the international capital markets may become more constrained. There are several reasons for this. On the side of the banks, there may be a tendency to move away from the assumption of foreign risks. The major international banks already have a sizable portfolio of loans to non-oil developing countries; and, because of prudential considerations, there is less scope for expansion of such loans than there was several years ago. Also, the greater variability of interest rates during the past year may have exposed banks to some increase in risks, although probably to a lesser degree in international lending, where interest rates on loans are adjusted at frequent intervals, than in domestic lending. At the same time as the banks may want to decrease the riskiness of their foreign positions, many non-oil developing countries may, as discussed below in Section IV, experience over the next few years a marked increase in external adjustment problems and, therefore, difficulty in maintaining their credit standing.

If the deficits of non-oil LDCs continue at their present magnitude or increase, prudential considerations may eventually lead to some curtailment in the flow of private credit. The countries most likely to be affected would be those with a large foreign debt and inadequate adjustment policies, as well as the smaller, less diversified countries whose adjustment problems are in some cases quite severe. In the event of such difficulties, lending at concessionary rates through international agencies, such as the Fund, coupled with appropriate adjustment programs, may have to play an even greater role than at present if adjustment is to proceed in an orderly manner.

Financing of a greater part of the current account deficits of non-oil developing countries by oil exporting countries, directly through bilateral loans or indirectly through international lending agencies, could play a positive role in helping to ease global financing problems. According to the estimates in Table 9, the flow of loans and grants from the oil exporting countries directly to other developing countries rose to \$10 billion in 1980, compared with \$7-8 billion annually for the previous several years, and it is to be hoped that the flow may rise further in the period ahead. In addition, a very sizable and important new contribution to the current account financing of non-oil developing countries is now in prospect because of the borrowing arrangement under which Saudi Arabia has agreed to lend SDR 4 billion to the Fund in each of the first two years of the arrangement, with an intention on the part of the authorities to enter into a further commitment for the third year if their balance of payments and reserve position so permits. The funds thus supplied will bolster the Fund's ability to supply needed financing for countries in the process of making essential economic adjustments.

#### IV. Medium-Term Scenarios

The August 1980 WEO report (ID/80/7) discussed the probable consequences of a premature relaxation of demand management policies in industrial countries, as well as those of perseverance with the present policy stance, against the background of illustrative "scenarios" developed by the staff to explore alternative ways in which the world economic situation might develop over the first half of the 1980s. The principal focus of that analysis was on the industrial countries, and its principal message was that top priority should continue to be given to the containment of inflation, with supply-side measures used to relax the energy constraint and, more generally, to foster productive investment and labor mobility. This message is, if anything, even more relevant and valid at present.

The work presented below is to a large extent an extension and elaboration of the previous scenario analysis. This time, the focus is on medium-term prospects for the external positions and growth rates of the four analytical subgroups of non-oil developing countries. <sup>1/</sup> The main quantitative

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<sup>1/</sup> The countries included in these subgroups are defined in appended Table 2. For the low income subgroup, India and the People's Republic of China have been excluded as far as the present section is concerned, because their balance of payments and external debt developments would dominate too much the developments for other countries in the group.

results of the scenarios are presented in Tables 14 and 15. The estimates involved are an aid to exposition but, of course, are rather crude and should not be taken too literally. Their only value is to illustrate the orders of magnitude of the principal variables.

Two medium-term scenarios were quantified for the world economy on the basis of assumptions regarding the size of foreign aid flows, the degree of trade restriction in the industrial countries, and the level of real interest rates in world financial markets, and on alternative possibilities with respect to (i) rates of growth and inflation in the industrial countries, and (ii) the real price of oil and the evolution of the surplus of the oil exporting countries. Both scenarios assume a continuation of "stagflation" problems in industrial countries, although to a markedly differing degree; they also assume the implementation of firm external adjustment measures by developing as well as industrial countries.

Consideration was given to a third scenario based on assumptions for the industrial countries of a substantial improvement in inflationary expectations and marked progress on the supply side, leading to a rapid decline of inflation and higher rates of growth of the order of 4 to 5 per cent per annum. As one would expect, under these conditions the outlook for the non-oil developing countries would improve substantially and financing problems would be mitigated, certainly at the level of the subgroups treated here. Such a highly desirable scenario does not, unfortunately, seem very plausible at the present stage. It has not been developed in this paper but could be presented and analyzed on a further occasion.

A fourth scenario was also considered. This did not assume adjustment measures on the part of the non-oil LDCs and, as might be expected, produced financing implications that were completely infeasible.

The first scenario, referred to as Scenario A, is based on moderate rates of economic growth and gradually declining rates of inflation in industrial countries, along with constant oil prices in real terms. It is predicated upon the assumption that the industrial countries persist in the implementation of policies designed to bring about a significant reduction, over time, in the growth of nominal demand, and that they are moderately successful in reducing the impact of their restrictive demand management policies on output through the use of supply-side measures and incomes policies. It also assumes that energy policies of industrial countries lead to a further reduction in the dependence on imported oil. Scenario B is more pessimistic, assuming a worsening of stagflation in the industrial world, with lower growth, persistent high inflation, and further increases in the real price of oil. This second scenario could come about because of several possible types of development. The industrial countries could fail to limit the impact of their restrictive demand management on output. They could also decide on an early shift from restrictive to expansionary demand management policies. A sharp upturn in rates of growth might ensue during 1982-83, but inflation would flare up again. The most likely result would be a shift back to restrictive demand management policies, severely depressing the average rate of economic growth during

the 1984-85 period. The industrial countries could also fail to pursue effective energy policies, contributing to a further increase in the real price of oil. This increase would be particularly likely if there were to be a strong 1982-83 upturn and a surge of inflation.

For both scenarios, the assumptions regarding official development assistance, trade restrictions, and real interest rates are the same. The projections for official development assistance (ODA), which are more pessimistic than those prepared by the World Bank last year (see World Development Report, 1980), assume that such assistance will show no growth in real terms from 1980 to 1985. Trade restrictiveness of the industrial countries toward the exports of the non-oil developing countries is considered to remain about the same as it is now throughout the medium-term projection period. Real interest rates for new loans extended by private institutions in world financial markets (paralleling, say, the three-month LIBO rate) are assumed to be about 2 per cent per annum.

Growth rates for the industrial countries as a group are assumed to be about half a percentage point higher for the 1983-85 period in Scenario A, and half a point lower in Scenario B, than they were over the 1974-79 period. Specifically, the average annual rate of growth of real GNP assumed for the 1983-85 period under Scenario A is 3 1/4 per cent, and under Scenario B it is 2 1/4 per cent. The growth rate of 3 1/4 per cent for Scenario A may seem low by comparison with the 4 per cent average rate of growth experienced by the industrial countries in the recovery period 1976-79. It should be noted, however, that (i) Scenario A assumes that countries effectively reduce the growth rate of aggregate nominal demand--something which they did not do during 1976-79; (ii) inflationary expectations are now more deeply imbedded in the economic system; and (iii) a number of European countries, particularly EMS participants, are now faced by difficult problems of external adjustment that may constrain their possibilities for economic growth for some time to come.

Both scenarios incorporate the staff projections for 1981 and 1982 shown in appended Table 1 and, therefore, would entail an increase in economic slack, including a rise in the average unemployment rate for industrial countries of perhaps 1-1 1/2 percentage points from 1980 to 1982. Scenario A would not offer a prospect of much decline in economic slack and unemployment over the next three years. Scenario B would imply a further increase in economic slack throughout the 1983-85 period, with an increase in the average unemployment rate of possibly 1-2 percentage points. The rate of inflation in the industrial countries, measured in terms of GNP deflators, would decline from about 9 per cent in 1980 and 1981 to 6 1/2-7 per cent in 1985 under Scenario A. Despite its lower average rate of growth, Scenario B assumes a less favorable price performance; the rate of inflation remains at 8 1/2 per cent throughout 1983-85.

Although it is not possible to predict the implications of the output and inflation developments assumed in Scenario A for oil prices, conditions of the kind implied in that scenario might be consistent with an assumption that the real price of oil would remain more or less constant at its early-1981 level. For the more pessimistic scenario, a 5 per cent real increase



per annum is assumed throughout the period 1983-85. This figure was chosen mainly for the purpose of illustration. The evolution of the current account position of the oil exporting countries under the two scenarios follows directly from the assumptions regarding the real price of oil and the rate of interest, plus the view that the fiscal policies of these countries will not become unduly expansionary. The current account balance of the oil exporting countries is estimated to decline from \$90 billion in 1982 to \$50 billion by 1985 under the assumptions of Scenario A, but to rise somewhat to \$95 billion in 1985 under Scenario B.

Two complementary approaches were used to develop the medium-term projections. The first approach relied on econometric analysis of behavioral relationships explaining imports, exports, and the terms of trade for the four analytical subgroups of non-oil developing countries. Parameters derived from this analysis can be used to project possible future outcomes, assuming there are no further structural changes over the projection period. The second approach relied on a detailed survey of the major countries within each of the analytical subgroups of non-oil developing countries. Country experts in the Area Departments were asked to develop medium-term projections of output, trade flows and prices, and the balance of payments on the basis of the assumptions underlying the two scenarios, taking into account their own assessment of the adjustment policies most likely to be implemented by the country under consideration.

In the econometric approach, import propensities (the percentage change in the volume of imports due to the percentage change in real GDP) were estimated and tested for structural change. The growth of exports was explained by different factors for the various subgroups. Export growth of the net oil exporters and the major exporters of manufactures is less sensitive to medium-term changes in the level of economic activity in the industrial countries than export growth of the other two subgroups of oil importing developing countries. The market shares of the first two subgroups are small relative to the dominant suppliers of oil and manufactures in world markets; their medium-term export growth, therefore, is determined more by domestic supply conditions than by the growth of demand in the industrial countries. Export growth of the net oil exporters is mainly influenced by the rate of exploitation of their oil resources. Export growth of the major exporters of manufactures is explained primarily by the growth of manufacturing capacity, and to a lesser extent by the level of economic activity in the industrial world and the level of imports in other developing countries. On the other hand, exports of the low income countries and other oil importers tend to be complementary to output in industrial countries and, not surprisingly, the growth of foreign demand was the main determinant of export growth for these two subgroups. Movements in the terms of trade for each of the analytical subgroups were explained by the level of economic activity in the industrial countries and by changes in the price of oil.

Information received from the survey of Area Departments was used in several ways. It was aggregated into the four analytical subgroups, and the relationships of the sample groups to the aggregate groups were

assessed in order to project developments for the aggregate groups on the basis of the survey data. The more comprehensive information available from the survey regarding the financing of projected current account deficits and the adjustment policies followed by individual countries provided a basis for reconciling projections based purely on the econometric projections, which did not take into account possible structural change due to adjustment policies, and those based on the survey data, which in some cases diverged significantly from historical patterns. On the whole, this process of reconciling the two approaches worked out well.

The basic assumption underlying both scenarios is that the external adjustment policies followed at present by the various countries would continue to be implemented and in many cases would be strengthened further. This assumption is particularly crucial in the case of those developing countries that are net oil importers. The non-oil developing countries that are major exporters of manufactures are assumed to be able to continue to increase their market shares substantially because of continued expansion of their manufacturing capacity and strong export price competitiveness, while maintaining the lower import propensities that they have experienced since 1974.

Even more extensive adjustment measures are assumed for the low income countries and the "other" net oil importers, the two subgroups that export mostly primary products to the industrial countries. The country surveys showed that a high proportion of countries in these two subgroups were expected to pursue various strategies to reduce imports and increase exports, including the dismantling of price controls to increase incentives for investment and production, especially in the energy and agricultural sectors; promotion of exports of manufactures where possible; and improvement or maintenance of competitiveness through real exchange rate changes. As a result, these two subgroups are projected to have higher rates of growth in their export volumes than the normal historical relationships between growth in industrial countries and growth of their exports would suggest. On the import side, the rate of growth in volume is projected to be less rapid than that of real GNP, a tendency already in evidence during the 1973-80 period, but not in preceding years.

Part of the adjustment is also expected to come from changes in rates of economic growth. For the three subgroups of net oil importers in Scenario A, the growth rates estimated (on the basis of individual-country assessments) to be feasible for 1983-85 turned out to be quite similar to those for 1973-80, a period when there was already some decline in growth rates by comparison with the pre-1973 period. In Scenario B, the rates of growth of these three subgroups were estimated to be about 1 percentage point less than in Scenario A, both because the volume of their exports would grow less rapidly and because balance of payments financing constraints would oblige them to use more restrictive demand management policies. The growth rates of Scenario B would imply no growth in real per capita income for the low income countries, and only modest growth of 1-2 per cent per annum for the "other" net oil importers and the major exporters of manufactures.

In contrast, the non-oil developing countries classified as net oil exporters should be able to sustain their rates of economic growth at about 6 1/2 per cent per annum--about the same rate as during 1978-80--under both scenarios.

The main results of Scenario A may be summarized as follows:

(i) The current account deficit of the non-oil developing countries would continue to increase, reaching \$140 billion in 1985, or about 18 per cent of their exports of goods and services, while the industrial countries would go back to their traditional surplus position and the oil exporting countries would remain with a large but much reduced surplus. (See Table 14.) The three subgroups of developing countries that are net oil importers would experience a decline from the current levels of their deficits in relation to exports of goods and services. Their deficits would, nevertheless, remain large by comparison with historical norms.

(ii) Net external borrowing would have to increase markedly for the four subgroups of non-oil developing countries because of their increasing current account deficits, and because of the limits that they would face in using non-debt financing (that is, official transfers, SDR allocations, and direct investment) and reduction in reserve assets. Net external borrowing is estimated nearly to double from 1980 to 1985 for the net oil exporters, the major exporters of manufactures, and the low income countries, and to increase by about 50 per cent for the "other" net oil importers. There would be no major financing problems for the net oil exporters, but problems might be faced by the other three groups. In the case of the low income countries, the bulk of the financing would still have to come from official sources in the form of long-term capital at concessionary rates. For the major exporters of manufactures and the "other" net oil importers, the bulk of the borrowing would be expected to come from private sources at market-related interest rates.

(iii) The debt picture would remain satisfactory for the net oil exporters and the major exporters of manufactures, but it would continue to worsen for the low income countries and the "other" net oil importers. (See Table 15.) The debt service ratio for the low income countries would nearly double by 1985, from an already historically high level in 1980. This development reflects in large part the assumption with respect to no growth of ODA in real terms, and shows how precarious the situation of these countries may become if this assumption is validated by the facts. The debt service ratio would also increase significantly for the "other" net oil importers, in part because the average interest rate on their debt would remain at a much higher level than during the 1970s in view of the higher financing costs of both the new debt and the debt accumulated during the 1970s that would have to be "rolled over." These two subgroups would also experience a further marked decrease in their ratios of gross external reserves (with gold valued at SDR 35 per ounce) to imports of goods and services. For the low income countries, reserves would fall below the value of one month's imports.

(iv) The wide diversity existing in the external positions of countries within each subgroup would, if anything, tend to increase by 1985, with the weak countries becoming weaker and the strong countries stronger; thus, for example, the average debt service ratios of about 20-30 per cent shown in Table 15 for Scenario A include much higher ratios for a substantial number of countries. This tendency toward more diversity in external positions would occur despite the adjustment programs envisaged. A major reason for this is that the persistence of interest rates at levels much higher than during the 1970s would tend to lead to substantial increases in the outflow of investment income from countries with large external debt levels and, therefore, to further increases in their current account deficits. Thus, even though the financing prospects for the subgroups are viewed as manageable, a number of countries would face uncertain prospects in that context. If these financing problems could not be solved, the countries involved would be obliged to accept lower growth rates than those envisaged in the present scenario.

The implications of Scenario A are not favorable, particularly for the developing countries that are net oil importers, but the implications of Scenario B are even worse. Under the latter scenario, the current account surplus for the group of major oil exporting countries would hardly decline from its high level for 1981. The developing countries that are net oil importers, on the other hand, would have a deficit of more than \$130 billion by 1985, or as high a proportion of their exports of goods and services as in 1981. This would occur despite the sharply reduced growth rates assumed for these countries. The deficit of the low income subgroup would not be much higher in Scenario B than in Scenario A, but this is because the deficit of that group in Scenario A is already judged to be at the upper limit of what could be financed, so that a further worsening of the external conditions could only lead to a reduction in the rate of economic growth. For the major exporters of manufactures and the "other" net oil importers, the debt burdens would also become so large in relation to slowly growing exports that financing difficulties could become widespread. Most of the differences in the results for non-oil LDCs shown by the two scenarios are attributed to differences in the assumed rates of growth for industrial countries, although the difference in the assumptions with respect to the real price of oil is also important.

In sum, the medium-term prospects for the low income developing countries and the developing countries classified as "other" net oil importers are, to say the least, disturbing. Even if, as assumed in Scenario A, the industrial countries persist in the implementation of policies designed to bring about a significant reduction, over time, in the growth of aggregate nominal demand and are successful in limiting the effects of these policies on output, the low income countries and the "other" net oil importers will face difficult adjustment and financing problems over the medium term. They will incur major increases in their debt service ratios even if they are successful, as assumed here, in implementing comprehensive adjustment programs. In the absence of adjustment measures, they would soon find themselves in a position where their deficits could not be financed. With the adverse developments for the industrial countries that are envisaged in Scenario B, the medium-term prospects for these two subgroups of developing



countries would become critical. In particular, it is uncertain whether the low income countries could even maintain rates of economic growth that would prevent outright declines in per capita real income. Prospects for the developing countries that are major exporters of manufactures are somewhat more favorable, at least under Scenario A, although their need for firm adjustment policies is clear.

The two scenarios would also have widely differing implications for the second half of the 1980s. With Scenario A, one could envisage that by the mid-1980s an environment conducive to sustained long-run growth in the industrial countries would have been restored. With a more rapid expansion of their exports, the developing countries that are net oil importers could then sustain the high debt burden accumulated in the first half of the 1980s. For Scenario B, however, a further period of low growth rates in industrial countries could be envisaged for 1986-90, and in this case it is difficult to see how these developing countries could sustain their debt burden. A further reduction of their growth rates would then become unavoidable.

V. Topics for Discussion

This "General Survey" has endeavored to assemble a wide range of statistical and analytical material on the world economy, pertaining to its current situation, to its prospects for 1981 and 1982, and to "scenarios" of its possible evolution over the medium term to 1985. Within this broad framework, Executive Directors will doubtless find many things in the paper on which to comment. But, without intending to provide an exhaustive list, the staff would suggest that Directors give particular attention to the following topics in the formulation of their remarks--keeping in mind the implications for the role of the Fund in such key areas as payments adjustment and financing, and surveillance over members' exchange rate policies.

1. "Stagflation" in the industrial countries.--This fundamental problem has been discussed in Section III-1; also relevant to its consideration are the staff projections for 1981-82 and the assumptions about the industrial countries incorporated in the first of the medium-term scenarios. One immediate question is whether Directors would agree with the staff view--more or less explicit in the material presented--that stagflation in the industrial countries is apt to prove a stubborn problem extending over a number of years, if only because of the strength of inflationary expectations, and will call for significant reductions in the rate of growth of nominal demand, more effective implementation of various supply-side measures, and the use of incomes policy (wherever feasible) along the lines indicated in Section III-1.

2. Problems of adjustment and financing in the non-oil LDCs.--The severity of these problems differs markedly among various subgroups of non-oil developing countries, being most pronounced among the low income countries and among those middle income countries (in the "other" category) that are exporters of primary products. With this important aspect in mind, Directors may wish to react to the staff view that the range of

adjustment and financing problems for developing countries now seems even more formidable in light of the various findings in the current WEO project. Among these findings are the higher level of deficits now seen for 1980 and 1981 as a result of the statistical revisions mentioned earlier; the strains in the pattern of external financing evident in the estimates for 1980-82; the clearly accommodating (unduly expansionary) character of present financial policies in many countries; the reluctance of many countries to adjust their exchange rates; and various considerations emerging from the study of medium-term scenarios, especially the need for external adjustment and, notwithstanding such adjustment, the likelihood of a deterioration in external debt positions over the next five years. The problems of the non-oil LDCs in the medium term are of such magnitude as to call for international action in the fields of ODA and capital flows.

3. Variability of exchange rates.--The magnitude and speed of changes in exchange rates for major currencies during 1980 and early 1981 raise a number of questions. One of these relates to the possible use of monetary policy to foster a greater degree of short-run stability of exchange rates. Here, a point of fundamental significance is that the first priority of monetary policy at the present time must be to counter inflationary pressures, and in that context it is crucial that the authorities be seen to maintain a firm strategy of reducing their monetary growth rates over time. To allow an upward deviation from longer-run monetary targets for the sake of limiting an exchange rate appreciation could send a wrong signal to private market participants. In present circumstances, therefore, it would seem that a certain degree of short-term variability of exchange rates has to be accepted, even with allowance for an appropriate use of intervention. Nonetheless, there remains a question of the extent to which, and under what conditions, sharp fluctuations in interest rates may be unavoidable in the conduct of a sound and responsible monetary policy. In any event, it would seem desirable for the authorities to keep an eye on exchange rates in running their monetary policies in the short run and, to the extent compatible with domestic objectives, to prevent the exchange rate from going "too far" and having major external repercussions. (The nature of Directors' comments on exchange rate issues such as these will depend, at least to some extent, on what will have been covered in the prior Board discussion of the staff paper on "Review of Implementation of the Fund's Surveillance Over Members' Exchange Rate Policies," SM/81/54.)

4. Direction of trade policy.--Executive Directors may wish to give their views on whether there is significant danger of protectionism in the period immediately ahead, and to discuss the outlook for resisting protectionist pressures in the countries they represent. They may also wish to comment on whether the Fund, in its role of promoting international adjustment, should become more active in encouraging countries to reduce restrictions or avoid recourse to them, and whether it should pay more attention to trade policy issues in the regular Article IV consultations.

Table 1. Industrial Countries: Changes in Output and Prices, 1962-82 <sup>1/</sup>  
(In per cent)

	Average 1962-72 <sup>2/</sup>	From Preceding Year									
		1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
<u>Real GNP</u>											
Canada	5.5	7.5	3.6	1.2	5.5	2.2	3.4	2.7	0.1	1.6	1.4
United States	4.0	5.8	-0.6	-1.1	5.4	5.5	4.8	3.2	-0.2	1.0	1.3
Japan	10.4	10.0	-0.3	1.4	6.5	5.4	6.0	5.9	5.4	4.0	5.4
France <sup>3/</sup>	5.5	5.4	3.2	0.2	5.2	2.8	3.6	3.2	1.6	0.8	2.4
Germany	4.5	4.9	0.5	-1.8	5.2	2.8	3.6	4.5	1.8	-1.0	2.2
Italy <sup>3/</sup>	4.8	6.9	4.2	-3.5	5.9	1.9	2.6	5.0	4.0	-1.0	2.0
United Kingdom <sup>3/</sup>	2.9	7.3	-1.8	-0.5	3.3	1.6	3.8	1.8	-2.1	-2.8	1.0
Other countries <sup>4/</sup>	4.9	5.4	3.5	-0.1	3.6	1.5	2.3	2.8	1.6	0.9	1.8
All industrial countries	4.8	6.3	0.4	-0.6	5.2	3.9	4.1	3.7	1.4	0.9	2.2
Of which:											
Seven largest countries <sup>5/</sup>	4.8	6.4	0.3	-0.7	5.4	4.3	4.5	3.8	1.4	0.9	2.3
European countries	4.5	5.8	2.0	-1.1	4.6	2.2	3.1	3.4	1.4	-0.5	1.8
<u>GNP deflator</u>											
Canada	3.6	9.1	15.3	10.8	9.5	7.0	6.4	10.3	10.5	9.5	8.3
United States	3.6	5.7	8.7	9.3	5.2	5.8	7.3	8.5	9.0	9.6	7.7
Japan	5.0	10.0	20.0	8.6	4.8	5.5	4.0	2.0	1.9	4.4	4.0
France <sup>3/</sup>	4.8	7.8	11.1	13.4	9.9	9.0	9.5	10.4	10.5	10.7	9.1
Germany	4.0	6.0	6.8	6.7	3.2	3.8	3.9	3.9	5.0	5.0	4.0
Italy <sup>3/</sup>	5.1	11.7	18.3	17.4	18.0	19.1	14.0	15.2	20.4	17.6	16.5
United Kingdom <sup>3/</sup>	5.2	6.7	14.9	27.2	14.3	13.9	10.7	14.6	18.8	10.6	8.9
Other countries <sup>4/</sup>	5.6	9.4	12.2	13.0	10.3	10.1	9.0	7.5	9.0	8.9	8.6
All industrial countries	4.1	7.4	12.0	11.3	7.5	7.6	7.4	7.7	8.7	8.7	7.5
Of which:											
Seven largest countries <sup>5/</sup>	4.0	7.0	11.6	11.0	6.9	7.1	7.1	7.8	8.7	8.7	7.3
European countries	5.0	8.2	11.6	13.7	9.7	9.8	8.6	8.6	10.7	9.4	8.4

Note: Both in this table and in the companion tables, the projections are based on several broad assumptions or working hypotheses: (1) that average exchange rates for January 1981 will prevail in subsequent months through 1982; (2) that "present" policies of national authorities will be maintained through 1982; and (3) that the price of oil will remain unchanged in real terms as of the first quarter of 1981.

<sup>1/</sup> Composites for the country groups are averages of percentage changes for individual countries weighted by the average U.S. dollar value of their respective GNPs over the previous three years.

<sup>2/</sup> Compound annual rates of change.

<sup>3/</sup> GDP at market prices.

<sup>4/</sup> Comprise Australia, Austria, Belgium, Denmark, Finland, Iceland, Ireland, Luxembourg, the Netherlands, New Zealand, Norway, Spain, Sweden, and Switzerland.

<sup>5/</sup> As listed separately above.

Table 2. Developing Countries: Changes in Output, 1967-81<sup>1/</sup>

(In per cent)

	Average <sup>2/</sup> 1967-72 <sup>2/</sup>	From Preceding Year								
		1973	1974	1975	1976	1977	1978	1979	1980	1981
Oil exporting countries <sup>3/</sup>	9.0	10.7	8.0	-0.3	12.3	5.9	1.9	2.2	-2.9	0.8
Oil sector	...	13.2	-1.0	-11.1	13.5	1.8	-4.2	2.8	-12.6	-6.4
Other sectors	...	9.7	12.3	12.4	11.3	8.9	6.0	1.8	4.0	6.8
Non-oil developing countries <sup>3/</sup>	...	...	...	...	...	5.3	6.5	5.1	4.3	5.0
Excluding China, People's Republic of	5.9	6.6	5.7	4.0	5.6	4.9	5.6	4.8	4.2	5.1
By Area:										
Africa	4.9	3.9	6.7	2.0	4.7	1.9	2.3	2.8	4.0	4.5
Asia	...	...	...	...	...	7.1	9.6	4.8	4.1	5.3
Excl. China, People's Rep. of	4.6	6.0	4.2	6.0	6.6	6.5	8.1	3.4	3.5	5.8
Europe	6.2	5.7	4.0	4.4	7.1	5.2	5.3	4.5	2.0	3.1
Middle East	7.5	5.3	3.3	4.2	3.1	5.0	7.8	5.8	4.7	5.5
Western Hemisphere	7.2	8.3	7.3	2.9	4.9	4.4	4.7	6.5	5.7	5.4
By Analytical Group; <sup>4/</sup>										
Net oil exporters <sup>4/</sup>	6.1	7.7	6.2	5.2	4.9	3.2	5.8	7.0	6.7	6.8
Net oil importers	...	...	...	...	...	5.6	6.6	4.9	4.0	4.7
Excl. China, People's Rep. of	5.8	6.4	5.5	3.7	5.8	5.1	5.5	4.5	3.8	4.7
Major exporters of manufactures <sup>5/</sup>	8.2	9.7	6.6	3.2	6.5	5.1	5.2	6.5	4.5	4.8
Low income countries <sup>6/</sup>	...	...	...	...	...	6.4	8.7	3.3	3.7	4.7
Excl. China, People's Rep. of	3.5	3.2	3.2	5.9	3.7	5.0	5.8	-0.2	2.4	4.9
Other net oil importers	5.4	4.0	6.0	2.8	6.5	5.3	5.8	4.3	3.4	4.3

<sup>1/</sup> Data in this table cover all Fund members except those listed in Table 1, together with a few territories for which balance of payments statistics are readily available. The figures are averages of percentage changes in real GDP for individual countries weighted by the average U.S. dollar value of GDPs over the previous three years.

<sup>2/</sup> Compound annual rates of change.

<sup>3/</sup> These groups, and each of the regional subgroups of non-oil developing countries, conform to the classification now used in the International Financial Statistics.

<sup>4/</sup> Comprise Bahrain, Bolivia, Congo, Ecuador, Egypt, Gabon, Malaysia, Mexico, Peru, Syrian Arab Republic, Trinidad and Tobago, and Tunisia.

<sup>5/</sup> Include Argentina, Brazil, Greece, Hong Kong, Israel, Korea, Portugal, Singapore, South Africa, and Yugoslavia.

<sup>6/</sup> Comprise 40 countries whose per capita GDP, as estimated by the World Bank, did not exceed the equivalent of US\$350 in 1978.



Table 3. Developing Countries: Changes in Consumer Prices, 1967-81<sup>1/</sup>

(In per cent)

	Average <sup>2/</sup> 1967-72 <sup>2/</sup>	From Preceding Year								
		1973	1974	1975	1976	1977	1978	1979	1980	1981
Oil Exporting Countries (weighted average <sup>3/</sup> )	8.0	11.3	17.0	18.8	16.8	15.5	10.2	10.8	13.6	12.9
Non-oil Developing Countries										
Weighted Average	...	...	...	...	...	23.3	19.3	24.1	33.1	28.6
Excluding China, People's Republic of	9.3	21.7	27.6	27.5	24.2	27.4	23.5	28.6	38.7	34.1
Arithmetic Average <sup>4/</sup>	6.0	17.2	25.2	21.7	17.5	18.1	14.3	18.5	22.6	17.4
Median <sup>4/</sup>	4.3	10.4	18.4	15.4	10.0	11.8	9.9	12.2	15.0	12.4
<u>By Area:</u>										
Weighted Averages <sup>3/</sup>										
Africa	4.6	9.8	15.4	15.5	15.0	19.9	15.5	20.6	23.0	19.9
Asia	...	...	...	...	...	5.2	2.5	6.4	11.8	7.1
Excluding China, People's Republic of	6.7	19.5	28.8	10.6	0.5	6.8	5.2	9.5	16.2	11.8
Europe	6.2	12.8	17.9	15.0	12.3	16.2	21.2	27.2	39.9	22.7
Middle East	4.2	12.7	22.2	21.9	18.7	19.0	20.9	24.2	48.3	35.0
Western Hemisphere	15.4	32.2	35.2	52.0	55.1	51.1	42.1	48.9	60.7	60.8
Medians										
Africa	4.3	9.4	16.4	16.0	10.7	14.6	10.5	11.9	14.0	11.0
Asia <sup>4/</sup>	4.1	14.0	24.3	10.5	6.2	7.6	6.0	8.2	14.4	10.0
Europe	3.8	12.9	16.2	13.4	11.6	12.2	12.5	19.0	16.6	18.0
Middle East	4.4	17.1	20.1	14.1	14.1	14.3	10.8	12.1	18.2	12.5
Western Hemisphere	4.5	12.9	19.5	17.0	9.7	11.4	10.7	17.5	19.5	16.0
<u>By Analytical Group:</u>										
Weighted Averages <sup>3/</sup>										
Net Oil Exporters	4.1	11.1	20.5	14.6	15.0	22.4	17.9	16.4	24.2	24.0
Net Oil Importers	...	...	...	...	...	23.5	19.5	25.3	34.5	29.3
Excluding China, People's Republic of	10.2	23.8	29.0	30.1	26.3	28.5	24.5	30.9	41.4	36.1
Major Exporters of Manufactures	14.1	20.8	24.9	41.9	47.7	40.7	36.1	43.9	56.5	56.4
Low Income Countries	...	...	...	...	...	6.5	2.5	7.5	12.1	7.5
Excl. China, People's Rep. of	6.9	20.1	29.1	12.2	0.2	11.6	7.5	13.3	19.3	14.7
Other Net Oil Importers	8.6	33.3	37.0	26.4	17.1	20.9	19.2	23.6	32.6	19.4
Medians										
Net Oil Exporters	3.8	11.2	18.7	15.5	10.5	12.1	11.0	9.9	16.0	15.0
Net Oil Importers <sup>4/</sup>	4.3	10.3	18.4	15.3	9.9	11.6	9.5	12.2	15.0	12.4
Major Exporters of Manufactures	6.4	18.2	24.3	15.2	13.3	12.2	14.4	19.0	25.0	18.9
Low Income Countries <sup>4/</sup>	4.3	10.0	17.9	18.9	8.5	11.6	9.4	11.0	13.6	11.0
Other Net Oil Importers	3.9	10.6	18.4	13.3	9.7	11.5	9.4	12.6	16.5	12.0

1/ For classification of countries in groups shown here, see Table 2.

2/ Compound annual rates of change.

3/ Geometric averages of country indices, weighted by the average U.S. dollar value of GDPs over the previous three years.

4/ Excludes the People's Republic of China.

Table 4. World Trade Summary, 1962-82<sup>1/</sup>  
(Percentage Changes)<sup>2/</sup>

	Average 1962-72 <sup>3/</sup>	Change From Preceding Year									
		1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
World Trade <sup>4/</sup>											
Volume	8½	12½	5	-4	11	5	5½	6½	1½	1½	4½
Unit Value (U.S. Dollar Terms)	3	22½	39	8½	1½	8½	10	18	20	7	7½
(SDR Terms)	2	11½	38	7½	7	7½	2½	14½	19	10	7½
Volume of Trade											
Exports											
Industrial Countries	13½	6½	-4	10½	10½	5	6	7	4	1½	4
Developing Countries											
Oil exporting countries	9	13	-1	-11½	14½	--	-3½	3	-13	-7	3
Non-oil developing countries	7	10	1½	½	14	4	11	9	8	7½	8
Imports											
Industrial Countries	9	12	½	-8	14	4	5½	8	-1	-½	3½
Developing Countries											
Oil exporting countries	8½	20½	38½	41½	20½	14½	5	-12	16	16½	14½
Non-oil developing countries	6	14	7½	-4	2½	6½	8	11	5	5	6½
Unit Value of Trade in SDR Terms <sup>5/</sup>											
Exports											
Industrial Countries	2½	9½	23½	10	5½	6½	5½	12	12½	8½	7½
Developing Countries											
Oil exporting countries	2½	27½	202	4	11½	8½	-6½	41	57½	20	7½
Non-oil developing countries	1½	20½	35	-2	9½	13	-3	14	16½	10½	7½
Imports											
Industrial Countries	2	11½	40	8	6½	8	2½	15½	20½	9	7½
Developing Countries											
Oil exporting countries	2	12½	27	10	5½	8	5	10½	11	8½	7½
Non-oil developing countries	1½	13	45	7½	7	6	3	14½	20	13½	7½

1/ The data for 1977 and later years include estimates for the People's Republic of China and are therefore not entirely comparable to those for prior years, for which that country is not included.

2/ Figures are rounded to the nearest half of 1 percentage point.

3/ Compound annual rates of change.

4/ Averages based on data for the three groups of countries shown separately and on partly estimated data for other countries (mainly comprising the Union of Soviet Socialist Republics and other nonmember countries of Eastern Europe).

5/ For years prior to 1970, an imputed value of US\$1.00 has been assigned to the SDR.

Table 5. Terms of Trade Developments, 1962-82<sup>1/</sup>  
(Percentage Changes)<sup>2/</sup>

	Average 1962-72 <sup>3/</sup>	Changes From Preceding Year									
		1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Industrial Countries	--	-1½	-11½	2	-1	-1	3	-3	-6½	-½	--
Developing Countries											
Oil exporting countries	½	13½	138½	-5½	5½	½	-11	28	42	10½	--
Non-oil developing countries	-½	6½	-7	-9	2	6½	-5½	-½	-3	-2½	--
Reference: World Trade Prices (in U.S. dollars) for major commodity groups <sup>4/</sup>											
A. Manufactures	3	17½	22	12½	--	9	14½	14½	11	5	7
B. Oil <sup>5/</sup>	3	40½	226	5½	6	9½	--	48	62	17½	7
C. Non-oil Primary Commodities (Market Prices)	2½	54	27½	-18	13½	20½	-4½	16½	9½	-2½	7½

<sup>1/</sup> Based on foreign trade unit values except where indicated. The data for 1977 and later years include estimates for the People's Republic of China and are therefore not entirely comparable to those for prior years, for which that country is not included.

<sup>2/</sup> Figures are rounded to the nearest half of 1 percentage point.

<sup>3/</sup> Compound annual rates of change.

<sup>4/</sup> As represented, respectively, by: (a) the United Nations' export unit value index for the manufactures of the developed countries; (b) the oil export unit values of the oil exporting countries; and (c) the International Financial Statistics index of market quotations for non-oil primary commodities.

<sup>5/</sup> For the working hypothesis underlying the projections for 1981 and 1982, see "Note" to Table 1.

Table 6. Payments Balances on Current Account, 1973-82<sup>1/</sup>

(In billions of U.S. dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981 <sup>2/</sup>	1982 <sup>2/</sup>
Industrial Countries	19.3	-12.4	17.1	-2.1	-5.5	29.8	-11.3	-46.5	-21½	-15½
Canada	--	-1.6	-4.7	-4.0	-4.0	-4.1	-4.5	-1.6	-3	-2
United States	9.9	7.6	21.2	7.5	-11.3	-11.1	2.8	4.6	14½	13
Japan	0.1	-4.5	-0.4	4.0	11.2	18.0	-7.9	-9.5	-3	--
France	-0.1	-4.9	1.0	-4.9	-1.6	5.2	2.9	-5.9	-4½	-2½
Germany	7.1	13.0	7.7	7.7	8.5	13.3	0.7	-7.7	-5	-2
Italy	-2.2	-7.4	-0.2	-2.5	3.1	7.8	6.1	-9.5	-7½	-6½
United Kingdom	-1.2	-7.2	-2.9	-0.6	1.5	4.5	0.7	10.4	15	9½
Other Industrial Countries	5.8	-7.4	-4.7	-9.3	-12.8	-3.8	-12.2	-27.5	-27½	-25
Developing Countries										
Oil Exporting Countries	6.6	67.8	35.0	40.0	31.1	3.3	69.2	112.0	100	90
Non-oil Developing Countries	...	...	...	...	-28.6	-37.5	-57.6	-80.1	-97	-100
Excluding China, People's Rep. of	-11.5	-36.8	-46.5	-32.9	-29.6	-37.1	-56.1	-78.9	-96½	...
By Analytical Group:										
Net oil exporters	-2.6	-5.1	-10.0	-7.8	-6.8	-7.6	-8.0	-9.7	-13	-17½
Net oil importers	...	...	...	...	-21.8	-29.9	-49.7	-70.4	-83½	-83
Excluding China, People's Rep. of	-8.9	-31.7	-36.5	-25.1	-22.8	-29.5	-48.2	-69.2	-83½	...
Major Exporters of Manufactures	-3.7	-19.2	-19.5	-12.3	-8.1	-9.9	-21.7	-31.5	-39	...
Low income countries	...	...	...	...	-2.4	-7.1	-11.0	-14.9	-16½	...
Excl. China, People's Rep. of	-4.0	-7.5	-7.6	-4.2	-3.4	-6.7	-9.5	-13.7	-16	...
Other net oil importers	-1.2	-5.0	-9.4	-8.6	-11.3	-13.0	-16.9	-24.0	-28	...
By Area:										
Africa <sup>3/</sup>	-1.9	-3.2	-6.6	-6.1	-6.5	-8.7	-9.3	-11.3	-13	...
Asia	...	...	...	...	-0.7	-5.8	-14.1	-22.5	-26	...
Excluding China, People's Rep. of	-2.5	-9.8	-9.0	-3.5	-1.7	-5.4	-12.6	-21.3	-25½	...
Europe	0.3	-4.3	-4.7	-4.1	-7.6	-5.2	-8.5	-10.1	-11	...
Middle East	-2.6	-4.5	-7.0	-5.4	-5.2	-6.3	-8.3	-7.0	-8½	...
Western Hemisphere	-4.7	-13.4	-16.6	-11.9	-9.1	-12.9	-20.9	-33.1	-38	...
Total <sup>4/</sup>	14.4	18.6	5.6	5.0	-3.0	-4.4	0.3	-14.6	-18½	-25½

<sup>1/</sup> Goods, services, and private transfers. For classification of countries in groups shown here, see Tables 1 and 2.

<sup>2/</sup> Figures are rounded to the nearest \$0.5 billion.

<sup>3/</sup> Excluding South Africa.

<sup>4/</sup> Reflects errors, omissions, and asymmetries in reported balance of payments statistics, plus balance of listed groups with other countries (mainly the Union of Soviet Socialist Republics and other nonmember countries of Eastern Europe and, for years prior to 1977, the People's Republic of China).



Table 7. Industrial Countries: Balances on Current Account, Including Official Transfers, 1973-82<sup>1/</sup>

(In billions of U.S. dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981 <sup>2/</sup>	1982 <sup>2/</sup>
Industrial Countries	12.3	-24.4	6.0	-13.2	-18.4	13.3	-31.0	-69.4	-44	-40
Canada	0.1	-1.5	-4.7	-3.9	-4.1	-4.4	-4.4	-1.3	-2½	-1½
United States	8.0	2.1	18.3	4.4	-14.1	-14.3	-0.7	0.1	10½	9½
Japan	-0.1	-4.7	-0.7	3.7	10.9	17.6	-8.7	-10.8	-4½	-2
France	-0.7	-6.1	-0.1	-6.0	-3.0	3.7	1.2	-7.4	-6½	-4
Germany	4.6	10.3	4.0	3.9	4.2	8.7	-5.5	-15.5	-13	-10½
Italy	-2.6	-8.0	-0.5	-2.8	2.5	6.4	5.2	-9.9	-8	-7½
United Kingdom	-2.1	-7.9	-3.7	-2.0	-0.5	1.2	-3.7	5.6	11	5
Other Countries <sup>3/</sup>	5.1	-8.6	-6.6	-10.6	-14.4	-5.6	-14.3	-30.2	-30½	-28½

<sup>1/</sup> The balances shown in this table cover goods, services, and all (private and official) current transfers.

<sup>2/</sup> Figures are rounded to the nearest \$0.5 billion.

<sup>3/</sup> For list of countries covered, see Table 1, footnote 4.

Table 8. Oil Exporting Countries: Summary of Current Account, 1973-81 <sup>1/</sup>

(In billions of U.S. dollars, except as indicated)

	1973	1974	1975	1976	1977	1978	1979	1980	1981
Exports, f.o.b.	39.0	117.9	109.6	133.3	146.4	141.6	212.6	292.9	319.6
Oil exports	34.8	112.0	103.6	126.0	137.9	131.9	199.1	277.4	301.3
Other exports	4.2	5.9	6.0	7.3	8.5	9.7	13.5	15.5	18.3
Imports, f.o.b.	-20.2	-35.8	-56.2	-68.0	-84.9	-100.5	-101.1	-131.3	-162.0
Balance on merchandise trade	18.8	82.1	53.4	65.3	61.5	41.1	111.5	161.6	157.6
Net services and private transfers	-12.2	-14.3	-18.4	-25.3	-30.4	-37.8	-42.3	-49.6	-57.6
Receipts	4.3	8.8	12.1	14.5	18.0	21.1	24.8	33.8	42.5
Payments	-16.5	-23.1	-30.5	-39.8	-48.4	-58.9	-67.1	-83.4	-100.1
Balance on current account	6.6	67.8	35.0	40.0	31.1	3.3	69.2	112.0	100.0
Six "surplus" countries <sup>2/</sup>	6.7	43.3	30.8	36.3	32.9	18.8	56.7	103.0	...
Other oil exporters <sup>3/</sup>	-0.1	24.5	4.2	3.7	-1.8	-15.5	12.5	9.0	...
Memorandum:									
Oil export volume (billion bbls)	10.82	10.68	9.38	10.73	10.75	10.27	10.48	9.00	8.34
Average oil export price (US\$bbl)	3.22	10.49	11.05	11.74	12.83	12.84	19.00	30.82	36.15
Annual percentage changes	40.6	225.8	5.3	6.2	9.3	0.1	48.0	62.2	17.3

<sup>1/</sup> For the estimated disposition of the current account surplus, see Table 9.<sup>2/</sup> Defined to include the six countries which have had a current account surplus each year in the 1970s. These are Iraq, Kuwait, Libya, Qatar, Saudi Arabia, and the United Arab Emirates.<sup>3/</sup> Iran, Oman, Venezuela, Nigeria, Algeria, and Indonesia.

Table 9. Oil Exporting Countries: Estimated Disposition of the Current Account Surplus, 1974-80

(In billions of U.S. dollars)

	1974	1975	1976	1977	1978	1979	1980	Total 1974-80
Current account surplus <u>1/</u>	68	35	40	31	3	69	112	358
Plus: Oil sector capital transactions <u>2/</u> (outflow -)	-12	1	-6	-1	2	-9	1	-24
Net borrowing <u>3/</u>	2	3	8	10	15	10	7	55
Equals: Cash surplus available for disposition	58	39	42	40	20	70	120	389
Disposition of net cash inflows:								
1. Placements in industrial countries and in Eurocurrency markets (net)	49	29	33	32	14	63	109	329
a. Bank deposits	30	11	13	13	5	40	48	160
Direct placements	7	2	1	2	2	7	6	27
Eurocurrency deposits	23	9	12	11	3	33	42	133
b. Short-term government securities <u>4/</u>	8	--	-2	-1	-1	4	3	11
c. Other capital flows <u>5/</u>	11	18	22	20	10	19	58	158
2. IMF and IBRD <u>6/</u>	4	3	2	--	-1	-1	1	8
3. Flow of funds to developing countries <u>7/</u>	5	7	7	8	7	8	10	52

1/ As shown in Table 8.

2/ Comprise: (1) changes in accounts receivable or imputed credits arising from timing differences between oil exports and receipts of payments for them; and (2) compensation payments to oil companies for full or partial nationalization of oil facilities, together with other changes in direct investment capital of such oil companies.

3/ Total net external borrowing by the public and private sectors (including banks). Includes small amounts of official transfer receipts, inward non-oil direct investment capital, and other miscellaneous capital (e.g., changes in short-term liabilities and positions under bilateral payments agreements).

4/ Mainly placements in Treasury bills in the United States and the United Kingdom.

5/ Includes net acquisitions of long-term government securities, corporate stocks and bonds, bilateral lending (mainly to governments), real estate and other direct investments, and prepayments for imports. Also includes relatively small amounts of placements in non-Fund members as well as statistical discrepancies.

6/ Includes investments in the IMF oil facility and supplementary financing facility together with other changes in the reserve position in the Fund and direct purchase of IBRD bonds.

7/ Includes bilateral grants and loans as well as contributions and capital subscriptions to regional and international development agencies (other than IMF and IBRD). Also includes relatively small amounts of other capital flows to developing countries. Estimates are based on highly uncertain information.

Table 10. Non-Oil Developing Countries:<sup>1/</sup> Current Account Balances  
as Percentage of GDP and of Merchandise Imports, 1973-81

	1973	1974	1975	1976	1977	1978	1979	1980	1981
	----- As percentage of GDP -----								
Weighted Averages <sup>2/</sup>									
Non-oil developing countries	-2.0	-5.0	-5.8	-3.8	-3.0	-3.2	-4.0	-4.7	-4.9
Net oil exporters	-2.9	-4.4	-7.3	-5.3	-4.4	-4.3	-3.7	-3.5	-3.8
Net oil importers	-1.8	-5.1	-5.5	-3.4	-2.7	-3.0	-4.0	-4.9	-5.1
Major exporters of manufactures	-1.5	-6.2	-6.0	-3.3	-1.9	-2.0	-3.5	-4.3	-4.5
Low income countries	-3.1	-4.9	-4.6	-2.6	-1.8	-3.0	-3.8	-4.4	-4.5
Other net oil importers	-0.9	-3.2	-5.4	-4.4	-4.9	-4.9	-5.1	-6.5	-6.8
Medians									
Non-oil developing countries	-4.1	-6.0	-8.9	-6.7	-6.4	-7.4	-7.6	-10.1	-10.4
Net oil exporters	-3.1	-1.9	-7.0	-6.7	-5.9	-6.9	-5.8	-3.1	-3.9
Net oil importers	-4.2	-6.2	-9.1	-6.7	-6.6	-7.4	-7.7	-10.6	-10.9
Major exporters of manufactures	-0.4	-6.2	-4.9	-4.0	-3.0	-3.0	-4.8	-4.2	-4.4
Low income countries	-7.9	-10.1	-11.8	-9.4	-8.6	-13.9	-11.2	-13.9	-15.2
Other net oil importers	-2.6	-3.6	-7.4	-6.4	-5.9	-6.7	-7.2	-10.1	-10.6
	----- As percentage of merchandise imports -----								
Weighted Averages <sup>2/</sup>									
Non-oil developing countries	-12.4	-25.1	-30.4	-20.4	-16.1	-17.1	-20.0	-22.1	-23.1
Net oil exporters	-22.6	-25.8	-43.3	-32.5	-25.8	-24.9	-19.3	-17.5	-18.9
Net oil importers	-10.9	-25.0	-28.1	-18.3	-14.4	-15.9	-20.1	-22.9	-24.0
Major exporters of manufactures	-8.1	-26.8	-27.3	-16.0	-9.3	-9.5	-15.8	-17.9	-19.2
Low income countries	-35.2	-44.5	-43.1	-24.7	-17.6	-27.2	-31.7	-37.3	-38.9
Other net oil importers	-4.8	-13.0	-23.1	-19.8	-22.0	-22.4	-23.4	-26.6	-27.3
Medians									
Non-oil developing countries	-20.2	-25.5	-33.9	-25.7	-25.3	-29.6	-28.9	-32.7	-34.6
Net oil exporters	-15.3	-5.1	-29.8	-26.5	-31.2	-27.8	-19.7	-10.2	-17.4
Net oil importers	-20.3	-26.1	-34.0	-25.7	-25.1	-29.6	-29.2	-37.0	-36.1
Major exporters of manufactures	-2.5	-18.2	-20.6	-8.4	-4.9	-7.5	-7.6	-15.9	-15.3
Low income countries	-30.3	-45.3	-53.6	-40.0	-35.2	-46.7	-48.7	-58.6	-62.8
Other net oil importers	-11.6	-16.1	-29.7	-22.2	-23.6	-23.8	-26.0	-27.6	-29.5
Memorandum: Weighted Averages based on data which include the People's Republic of China									
To GDP:									
Non-oil developing countries	...	...	...	...	-2.5	-2.7	-3.5	-4.1	-4.3
Low income countries	...	...	...	...	-0.7	-1.7	-2.2	-2.5	-3.4
To Imports:									
Non-oil developing countries	...	...	...	...	-14.9	-16.4	-19.3	-21.1	-21.9
Low income countries	...	...	...	...	-9.0	-19.6	-23.3	-25.8	-25.3

<sup>1/</sup> Excluding the People's Republic of China, except where noted.

<sup>2/</sup> Ratios of current account balances to GDP or imports for individual countries, averaged on the basis of current GDP or import weights. Such estimates correspond exactly to those obtained through calculation for any particular grouping of countries of the ratio of the sum of the current account balances to the corresponding sum of GDP or import values.



Table 11. Non-Oil Developing Countries: Current Account Financing, 1973-1981 <sup>1/</sup>

(In billions of U.S. dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981
Current account deficit <sup>2/</sup>	11.5	36.8	46.5	32.9	28.6	37.5	57.6	80.1	96.8
Financing through transactions that do not affect net debt positions	10.4	12.8 <sup>3/</sup>	12.0	11.9	14.6	15.3	21.6	20.6	23.9
Net unrequited transfers received by governments of non-oil developing countries	5.6	6.9 <sup>3/</sup>	7.3	7.4	8.2	7.8	10.4	10.6	11.9
SDR allocations, valuation adjustments and gold monetization	0.4	0.5	-0.7	-0.3	1.0	1.2	3.0	2.1	1.7
Direct investment flows, net	4.4	5.4	5.3	4.8	5.4	6.2	8.2	7.9	10.4
Net borrowing and use of reserves <sup>4/</sup>	1.1	24.0 <sup>3/</sup>	34.6	21.0	14.0	22.2	36.1	59.5	72.9
Reduction of reserve assets (accumulation -)	-9.7	-2.3	1.8	-13.2	-12.6	-15.2	-11.7	-1.9	-2.0
Net external borrowing <sup>5/</sup>	10.8	26.2 <sup>3/</sup>	32.8	34.3	26.6	37.4	47.8	61.5	74.9
Long-term borrowing	11.4	19.8 <sup>3/</sup>	26.7	28.2	27.7	35.1	44.7	47.1	56.6
From official sources	5.7	9.9 <sup>3/</sup>	11.7	10.8	12.5	14.3	14.5	21.0	24.2
From private sources	10.4	13.5 <sup>3/</sup>	14.9	19.0	21.3	27.0	33.1	26.2	31.0
From financial institutions	9.0	12.3	13.2	16.1	17.6	23.0	32.1	24.2	25.9
From other lenders	1.4	1.2	1.8	2.9	3.6	4.0	1.0	2.0	5.1
Residual flows, net <sup>6/</sup>	-4.7	-3.6	0.1	-1.6	-6.1	-6.1	-2.9	-0.1	1.5
Use of reserve-related credit facilities <sup>7/</sup>	--	1.5	2.3	3.7	-0.6	-0.5	0.2	2.3	7.5
Other short-term borrowing, net	--	5.1	7.8	4.9	-0.5	2.2	7.6	) 12.1	10.7
Residual errors and omissions <sup>7/</sup>	-0.6	-0.3	-4.0	-2.5	--	0.5	-4.7	)	

<sup>1/</sup> The data for 1977 and later years include estimates for the People's Republic of China and are therefore not entirely comparable to those for prior years, for which that country is not included.

<sup>2/</sup> Net total of balances on goods, services, and private transfers, as defined for Balance of Payments Yearbook purposes (with sign reversed).

<sup>3/</sup> Excludes the effect of a revision of the terms of the disposition of economic assistance made by the United States to India and repayable in rupees, and of rupees already acquired by the U.S. Government in repayment of such loans. The revision has the effect of increasing government transfers by about US\$2 billion, with an offset in net official loans.

<sup>4/</sup> I.e., financing through changes in net debt positions (net borrowing, less net accumulation--or plus net liquidation--of official reserve assets).

<sup>5/</sup> Includes any net use of nonreserve claims on nonresidents, errors and omissions in reported balance of payments statements for individual countries, and minor deficiencies in coverage.

<sup>6/</sup> These residual flows comprise two elements: (i) net changes in long-term external assets of non-oil developing countries; and (ii) residuals and discrepancies that arise from the mismatching of creditor-source data taken from debt records with capital flow data taken from national balance of payments records.

<sup>7/</sup> Comprises use of Fund credit and short-term borrowing by monetary authorities from other monetary authorities.

<sup>8/</sup> Errors and omissions in reported balance of payments statements for individual countries, and minor omissions in coverage.

Table 12. Non-Oil Developing Countries: Financing of Current Account Deficits and Reserve Accretions, 1973-81 1/

	1973	1974	1975	1976	1977	1978	1979	1980	1981
(In billions of U.S. dollars)									
Current account deficit	11.5	36.8	46.5	32.9	28.6	37.5	57.6	80.1	96.8
Increase in official reserves	9.7	2.3	-1.8	13.2	12.6	15.2	11.7	1.9	2.0
Total	21.2	39.1	44.7	46.1	41.2	52.7	69.3	82.1	98.8
Financed by:									
Nondebt creating flows, net	10.4	12.8	12.0	11.9	14.6	15.3	21.6	20.6	23.9
Long-term capital from official sources, net	5.7	9.9 <u>2/</u>	11.7	10.8	12.5	14.3	14.5	21.0	24.2
Long-term capital from private sources	5.7	9.9 <u>2/</u>	15.0	17.4	15.2	20.9	30.2	26.1	32.5
Other capital flows, net <u>3/</u>	-0.6	6.4	6.0	6.0	-1.1	2.2	3.0	14.4	18.2
(In per cent)									
Distribution of financing flows									
Nondebt creating flows, net	49.0	32.8 <u>2/</u>	26.8	25.8	35.4	29.0	31.2	25.1	24.2
Official long-term capital, net	26.9	25.3 <u>2/</u>	26.2	23.4	30.3	27.1	20.9	25.6	24.5
Private long-term capital, net	26.9	25.3	33.6	37.7	36.9	39.7	43.6	31.8	32.9
Other financing capital flows, net <u>3/</u>	-2.8	16.5	13.4	13.0	-2.7	4.2	4.3	17.5	18.4

1/ The data for 1977 and later years include estimates for the People's Republic of China and are therefore not entirely comparable to those for prior years, for which that country is not included.

2/ Excludes the effect of a revision of the terms of the disposition of economic assistance made by the United States to India and repayable in rupees, and of rupees already acquired by the U.S. Government in repayment of such loans. The revision has the effect of increasing government transfers by about US\$2 billion, with an offset in net official loans.

3/ Including, in addition to short-term capital flows, net use of Fund credit plus errors and omissions.

Table 13. Non-Oil Developing Countries: 1/ Long-Term External Debt  
Relative to Exports and to GDP, 1973-81

(In per cent)

	1973	1974	1975	1976	1977	1978	1979	1980	1981
Ratio of external debt to exports of goods and services <u>2/</u>									
All non-oil developing countries	89.3	81.0	97.8	99.0	102.6	109.9	102.3	93.4	92.7
Net oil exporters	104.4	87.9	131.9	139.1	156.3	158.2	126.8	105.8	97.2
Net oil importers	87.0	79.7	91.5	91.5	92.9	100.9	97.2	90.6	91.6
Major exporters of manufactures	74.4	69.7	80.8	79.7	79.1	87.4	82.4	73.0	72.5
Low income countries	190.1	183.0	193.4	194.6	189.8	198.3	192.1	191.8	192.2
Other net oil importers	70.0	61.7	72.7	74.7	82.2	92.1	94.9	95.3	100.7
Ratio of external debt to GDP <u>2/</u>									
All non-oil developing countries	16.7	16.4	18.4	20.1	21.9	23.7	23.0	21.6	20.9
Net oil exporters	17.7	17.9	22.5	26.5	32.6	34.9	32.3	27.8	25.1
Net oil importers	16.6	16.1	17.5	18.8	19.9	21.7	21.3	20.4	20.0
Major exporters of manufactures	16.3	15.4	17.4	18.1	19.5	22.2	21.2	19.5	18.8
Low income countries	16.5	16.9	17.7	20.9	21.0	20.6	20.2	18.2	17.5
Other net oil importers	17.1	16.8	17.5	18.3	19.7	21.7	22.3	24.0	24.5

Memorandum:

Ratios based on data which include the People's Republic of China

To exports:

All non-oil developing countries	...	...	...	...	99.0	105.7	97.9	89.8	89.2
Low income countries	...	...	...	...	136.5	137.5	124.1	121.6	120.5

To GDP:

All non-oil developing countries	...	...	...	...	22.0	23.8	23.1	21.8	21.2
Low income countries	...	...	...	...	21.5	21.0	20.9	19.5	19.0

Sources: World Bank Debtor Reporting System, IMF Data Fund, and Fund staff estimates and projections.

1/ For classification of countries in groups shown here, see Table 2.

2/ Ratio of year-end debt to exports or GDP for year indicated. Note that these estimates exclude data for the People's Republic of China.

Table 14. Medium-Term Projections of Payments Balances  
on Current Account 1/

	1972	1977	1980	1981	1985	
					A	B
(In billions of U.S. dollars)						
Industrial countries	16.2	-5.5	-46.5	-21½	70	50
Developing countries						
Oil exporting countries	3.0	31.1	112.0	100	50	95
Non-oil developing countries <u>2/</u>	-9.9	-31.3	-76.9	-93	-140	-165
Net oil exporters	-2.3	-6.8	-9.7	-13	-33	-31
Net oil importers <u>2/</u>	-7.6	-24.5	-67.2	-80	-107	-134
Major exporters of manufactures	-2.4	-8.1	-31.5	-39	-49	-68
Low income countries <u>2/</u>	-2.8	-5.2	-11.7	-13	-19	-20
Other net oil importers	-2.4	-11.3	-24.0	-28	-39	-46
Total <u>3/</u>	9.3	-5.7	-11.4	-15	-20	-20
(In per cent of exports of goods and services)						
Industrial countries	4.1	-0.6	-2.7	-1.2	2.6	1.8
Developing countries						
Oil exporting countries	11.5	18.9	34.3	27.6	9.1	15.0
Non-oil developing countries <u>2/</u>	-10.1	-11.5	-15.3	-16.2	-18.0	-21.6
Net oil exporters	-20.8	-21.1	-13.3	-14.7	-21.7	-19.1
Net oil importers <u>2/</u>	-12.1	-14.4	-21.8	-22.9	-17.1	-22.2
Major exporters of manufactures	-6.8	-7.9	-16.1	-17.3	-11.8	-17.1
Low income countries <u>2/</u>	-45.2	-40.2	-63.0	-64.6	-57.8	-61.7
Other net oil importers	-11.2	-20.5	-25.7	-26.6	-22.3	-26.6
Total <u>3/</u>	1.8	-0.4	-0.5	-0.5	-0.5	-0.5

1/ Excluding official transfers.

2/ Excluding India and the People's Republic of China.

3/ Reflects errors, omissions, and asymmetries in reported balance of payments statistics, plus balances of listed groups with other countries (mainly, the U.S.S.R., other nonmember countries of Eastern Europe, India, and the People's Republic of China).



Table 15. Non-Oil Developing Countries: Medium-Term Projections  
of Debt Burden

(In per cent)

	1972	1977	1980	1981	1985	
					A	B
Net oil exporters						
Ratio of gross external reserves to imports of goods and services <u>1/</u>	26.7	23.8	19.9	19.1	17.0	16.5
Ratio of external debt to exports of goods and services <u>2/</u>	130.8	156.3	105.8	97.2	102.9	94.2
Debt service ratio <u>3/</u>	25.3	25.8	23.6	26.2	25.9	24.3
Interest payments ratio	6.9	8.6	10.5	9.5	8.6	8.3
Amortization ratio	18.4	17.1	13.1	16.8	17.3	15.9
Major exporters of manufactures						
Ratio of gross external reserves to imports of goods and services <u>1/</u>	40.2	25.1	15.6	12.9	11.5	10.5
Ratio of external debt to exports of goods and services <u>2/</u>	96.0	79.0	73.0	72.5	77.3	89.8
Debt service ratio <u>3/</u>	17.7	13.2	18.5	20.0	20.3	23.5
Interest payments ratio	5.8	4.2	7.3	6.9	6.5	7.8
Amortization ratio	11.9	9.0	11.2	13.1	13.8	15.8
Low income countries <u>4/</u>						
Ratio of gross external reserves to imports of goods and services <u>1/</u>	23.7	20.8	12.8	10.4	7.0	7.0
Ratio of external debt to exports of goods and services <u>2/</u>	161.2	191.7	201.6	212.1	263.8	267.9
Debt service ratio <u>3/</u>	11.2	10.4	17.8	24.4	30.7	32.4
Interest payments ratio	3.0	3.7	5.3	6.5	8.5	9.9
Amortization ratio	8.1	6.6	12.4	18.0	22.2	22.5
Other net oil importers						
Ratio of external reserves to imports of goods and services <u>1/</u>	30.2	23.9	21.4	19.6	14.0	13.7
Ratio of external debt to exports of goods and services <u>2/</u>	89.6	82.2	95.3	100.7	123.9	133.1
Debt service ratio <u>3/</u>	12.3	11.6	17.1	19.4	24.3	26.3
Interest payments ratio	3.7	3.8	7.1	7.3	9.2	10.4
Amortization ratio	8.7	7.7	10.0	12.1	15.1	16.0

1/ Total reserves (with gold valued at SDR 35 per ounce).

2/ Includes medium-term and long-term, with and without public guarantee.

3/ Payments as percentages of exports of goods and services.

4/ Excluding India and the People's Republic of China.



25  
May 22, 1981

DRAFT PRESS COMMUNIQUE

1. The Development Committee held its sixteenth meeting in Libreville, Gabon, on May 22, 1981, under the chairmanship of H.E. David Ibarra Muñoz, Secretary of Finance and Public Credit of Mexico, and with the participation of Mr. R.S. McNamara, President of the World Bank, Mr. J. de Larosiere, Managing Director of the International Monetary Fund, and Mr. Hans E. Kastoft, Executive Secretary. Observers from a number of international and regional organizations and Switzerland also attended the meeting.

2. The Committee noted with concern that the developing countries continue to face serious problems and that their medium-term prospects remain poor. A number of factors are of importance in this respect. These include:

- slow down in the expansion of world trade and a depressing outlook for exports of developing countries;
- persistent international inflation;
- sharp increases in the current account deficits of non-oil developing countries from \$58 billion in 1979 to an estimated \$80 billion in 1980 and a projected \$97 billion in 1981;
- continuing slow growth of most industrial countries; the growth of real GDP in these countries had averaged 4 per cent in the 1976-79 period; it slowed down to only 1.5

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per cent in 1980 and is expected to fall to less than 1 per cent in 1981.

3. The financing of these large deficits has required a substantial rise in external borrowing at higher cost and, consequently, the debt service burden for developing countries has increased perceptibly in recent years. There is little or no expectation that the large imbalances will be corrected quickly and, therefore, problems relating to external financing and debt are likely to persist. The plight of the low-income countries is particularly acute because these countries have limited recourse to international capital markets and depend heavily on official donors and creditors; the volume of this type of concessional assistance <sup>cannot be</sup> is expected to increase <sup>as fast as</sup> ~~at a rate well~~ <sub>in recent years.</sub> ~~below the expansion in requirements.~~ [A concerted global effort is necessary to deal with this difficult situation.] ←

4. In view of these circumstances, the Committee concentrated its attention on a few selected topics addressing the expanded capital needs of developing countries, and the role of the international financial institutions in meeting them.

5. The Committee recognized that in view of the magnitude of the financing needs of the developing countries, including the addition of China, it was of particular importance and urgency to provide the multilateral development institutions such as the World Bank and the regional banks with <sup>adequate</sup> additional resources ~~required~~ to assist developing countries in their development efforts and to help them restore acceptable

Every effort should be made to maximise the contribution which can be made by private flows, and to give priority to the poorest countries in the allocation of concessional flows.

levels of growth. The Committee therefore urged the World Bank to <sup>continue</sup> reinforce its efforts with respect to the means of financing an <sup>activity</sup> expanded-lending program appropriate to the <sup>changed</sup> circumstances of the early 1980s, taking into account the budgetary pressures on ~~some~~ <sup>and to seek means of financing that activity which take</sup> governments.

[NB. The amendments revert to the undividedly of the line of agenda - item 1]

6. Of special concern to the Committee was the delay in bringing into effect the Sixth Replenishment of the International Development Association (IDA), with the result that IDA ran out of new commitment authority in April this year. Any extended disruption in IDA operations will have serious repercussions on the poorest developing countries. In view of the gravity of the circumstances, the Committee stressed the need for member governments to restore IDA's commitment authority as a matter of great urgency.

7. The Committee noted with satisfaction the reaffirmation of support for a general capital increase by all major donors. It also urged the Executive Directors to consider sympathetically at the time of the management's proposals for FY82 the maximum lending program that can appropriately be sustained.

[8.] The Committee acknowledged that the world energy situation poses a serious problem of adjustment for producers and consumers [and that there was need for a prompt and integrated approach involving all countries to deal with it.] In particular, the oil-importing developing countries face an acute and growing external financing problem

[NB. It would be better to revert to the undivided wording in the Antobates agenda - item 1(c). If this is not negotiable, the amendments shown are the desirable minimum.]



and need to reduce their dependence on imported oil. This will involve expanding exploration for and development of domestic oil and gas resources, increased development of coal, major expansion of renewable resources, maximum utilization of hydro-power capacity and conservation. In this regard, expanded World Bank lending for energy could, possibly through an energy affiliate, and in cooperation with other sources of capital, materially assist developing countries in designing and implementing comprehensive programs. The Committee therefore reiterated its support of the World Bank's initiative to expand its lending operations in the energy sector and urged that, in the light of the pressing need to reduce the strains on the balance of payments of the oil-importing developing countries, negotiations on <sup>consultation</sup> ~~specific~~ <sup>appropriate</sup> measures be undertaken promptly. The Committee stressed the importance that these measures should reflect the global nature of the problem and the international community's interest in a general approach to energy, which encompasses conservation and the development of conventional and non-conventional sources of energy.

9. The Committee considered the status reports on the future lending of both concessional and ordinary capital resources of the African Development Bank, the Asian Development Bank and the Inter-American Development Bank currently under review within these institutions. Given the pressing need to strengthen the lending operations of the regional development banks, the Committee urged member governments to seek means of financing their activities arising from the changed circumstances of the 1980s, taking into account the budgetary pressures which they currently face.

10. In the context of the review of the flow of non-concessional resources, the Committee considered the Report on Selected Issues by the Task Force on Non-concessional Flows both timely and useful. In its report the Task Force limited its comments to the following issues: (1) cooperation between multilateral development institutions and commercial lenders; (2) external indebtedness of developing countries; and (3) increases in lending capacity of the multilateral development institutions.

11. Based on the Task Force report, the Committee considered that a degree of additionality in non-concessional flows could be achieved by actions on the part of multilateral development institutions to help broaden the range of financial instruments and improve the attractiveness of lending to developing countries. In this regard, <sup>noted that</sup> the Committee endorsed the Task Force <sup>is examining proposals</sup> recommendations, which include: (1) the improvement of co-financing arrangements between multilateral development institutions and commercial lenders; (2) the sale of portfolio and loan participations by multilateral development institutions; (3) the use of guarantees by multilateral development institutions; and (4) the issue and placement of pass-through loan certificates by multilateral development institutions. The Committee invited the multilateral development institutions to discuss, as speedily as possible, these proposals with banks and other financial institutions in major financial centers.

12. The Committee also noted and endorsed the Task Force report on the external indebtedness of developing countries. It emphasizes that developments regarding external debt must be viewed in the broader context of the world economic situation. It notes that debt problems are due to many factors and believes that both short and long-term aspects of the debt question must be kept under constant review. The Committee stressed the importance of sound debt management in order to avoid debt servicing problems and thus help sustain large inflows of capital necessary for the economic development of developing countries. The Committee noted that debt indicators, taken on their own, are not a substitute for comprehensive reviews of the economic situation and prospects of the countries involved.

[13.] The Committee expressed concern over the impact of inflation on external debt and encouraged further study of this subject. The Committee recognized the importance of <sup>the role played by the</sup> a multilateral framework for the rescheduling of <sup>official</sup> debt ~~[which must be viewed as part of a comprehensive effort to assist the debtor country to implement necessary adjustment policies and to restore flows.]~~ The IMF, the World Bank and the regional development banks should provide good offices, <sup>consider the role they might play in facilitating</sup> in cooperation with <sup>private debt restructuring</sup> the UNCTAD, ~~in facilitating these matters.~~

14. Regarding ways of increasing the flow of funds from the multi-lateral development institutions, the Committee urged the Task Force to examine various proposals under consideration, ~~[and supported the request of the Task Force asking the World Bank for the elaboration of a paper examining these proposals.]~~

15. The Committee expressed its appreciation to those members of the private international financial community who have actively participated and supported the work of the Task Force on Non-concessional Flows.

[NBS 50  
would be  
much  
feasible to  
refer to the  
understand  
broader of  
the associated  
regards -  
item 3 of  
not negotiable  
the assessment  
shown are  
the minimum  
necessary, based  
on para 57  
and 58 of  
The Task Force  
Report  
DC/81-3]

16. The Committee discussed the critically important issue of concessional assistance and decided <sup>in principle</sup> to establish a Task Force to carry forward and widen the continuing study of the problems affecting the volume and quality of concessional flows, both in the shorter and longer term. The Committee urged that consultations with respect to composition and terms of reference be <sup>initiated</sup> completed quickly so as to enable the Task Force to undertake its work <sup>at the earliest opportunity</sup> without delay.

17. The deteriorating prospects for growth in sub-Saharan Africa have been a matter of serious concern to the international community. The Committee was pleased to learn from the President of the World Bank that the formulation of an action program was well under way and looked forward to discussing the program of action at its September 1981 meeting.

18. The Members reiterated their interest in a relationship between the Committee and United Nations global negotiations on the North/South issues. The Committee reaffirmed its desire to play a very active role in regard to matters pertaining to the <sup>its competence</sup> International Monetary Fund and the World Bank once the preparatory discussions on the subject had been completed.

19. The Committee decided that its future work program should evolve around matters now before it, and on work which is in progress in the Bank, the Fund and Task Forces. In particular, the work includes a regular review of the flow of resources to the developing countries, and the financial needs of these countries, keeping under review the specific recommendations of the G-24 Program of Immediate Action and the Brandt Commission with respect to measures to enhance the flow of resources to developing countries, in particular the link.

20. The Committee paid a special tribute to Mr. Robert S. McNamara in recognition of his long and distinguished tenure as President of the World Bank. It expressed its deep appreciation for his devoted and outstanding services to the cause of economic development and wished him the very best in his future endeavors.

21. The Committee expressed its special appreciation to the Government of Gabon for its warm hospitality and for the excellent arrangements provided for the meeting.

22. The next meeting of the Committee will be held in Washington, D.C. on September 28, 1981.



1. MR HAWCOCK *D.H. 9/6.*  
 2. CHANCELLOR

- cc Mr Dixon  
 Mrs Hedley-Miller  
 Mr Kemp  
 Mr Ashford  
 Mr Buckley  
 Mr Edwards  
 Mrs Gilmore  
 Mr P R Gordon  
 Mr Peretz  
 Mr Andren  
 Mr Gieved  
 Mr Matthews  
 Mr Scholes  
 Mr White

Copies attached for:

- PS/CST  
 PS/FST  
 PS/MST(C)  
 PS/MST(L)  
 Sir D Wass  
 Sir K Couzens

- ① for 2 annexes on C'que  
 ② Extra briefing includes latest C'que from below; + last doc. also  
 I wish to be done so after 2  
 colleagues.

- Mr Goodenough - Cabinet Office  
 Mr Jones Parry - FCO  
 Mr Butt - UKREP  
 Mr Smart - D/Employment

JUMBO COUNCIL : 11 JUNE

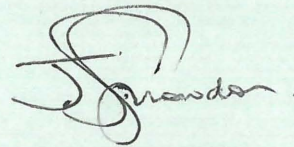
- ③ Also figures for inflation + unemployment trends since 1980

The attached briefing, which is also going to the Secretary of State for Employment, was agreed at an interdepartmental meeting chaired by the Cabinet Office on Monday 8 June.

2. It includes a copy of the draft communique prepared by the Dutch Presidency which is currently being considered at working level in Brussels, and again tomorrow in COREPER. Consequently the draft may change, and the final version may not be available before your arrival in Luxembourg. We shall however try to forward a note tomorrow summarising the result of the discussions.

3. Following the meeting it is possible that the Press will ask questions not only about the Council itself, but also about the position on the exchange rate and MLR. Mr Peretz will, I understand, submit a short note on this late tomorrow.

*And R.G. will follow the markets during day*



J S SNOWDON  
 9 June 1981

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Brussels, 9 June 1981

Draft Conclusions - Joint Council  
(ECO/FIN - Social Affairs) (1)

(Luxembourg, 11 June 1981)

1. In accordance with the instructions given by the European Council at its meeting on 23 and 24 March 1981 in Maastricht and taking account of the results of the Standing Committee on Employment on 29 May 1981 regarding unemployment problems in the Community, the Council met on 11 June 1981 in Luxembourg attended by the Ministers for Economic Affairs, Finance and Social Affairs.
2. The representatives of the European employers' and labour organizations were consulted during preparations for this meeting.
3. The Council reached agreement on the analysis of the socio-economic situation, the major problems, and the possibility of achieving some improvement by means of a joint approach.
4. Assessment of the current situation
  - a) The Council agreed that the reduction in growth rates resulting from the sharp increases in the price of oil, and from the difficulties experienced in redeploying resources quickly to satisfy potential demand, had combined with major expansion in labour supply to produce a disturbingly swift growth in unemployment. The Council noted that a lasting increase in job opportunities and effective action in combating unemployment would only be possible if economic growth were restored.

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(1) The Italian delegation has a reserve on the whole of the text drawn up by the Group and has suggested an alternative text which has been distributed to delegations in the Group.



The Council noted that sharp increases in import prices had given rise to a new surge in domestic costs. Anti-inflationary measures should accordingly be stepped up and diversified where necessary in order to get the economies moving again.

- b) The Council thought that to restore economic growth endeavours must be made to achieve financial stability, to restructure economies and to encourage investment at both national and Community level. It referred in this connection to the guidelines given by the European Council.
- c) The Council noted that in their endeavours to achieve lasting growth the Member States were confronted to a varying degree with policy restrictions imposed by differing financial and economic imbalances.

∩ ∩ The reduction of such imbalances, which were reflected in the balances of payment, the considerable budget deficits and high inflation, would contribute towards a return to lasting growth. The Council thought that the Community was now involved in this process of adjustment which would not only be long, but should also be characterized by adequate continuity. This means that policy-making must fit in with medium-term policy.

lr ∩ Certain delegations did not exclude the possibility of short-term measures at Community level for tackling unemployment. ∩ (1) It was to be recommended that the Member States follow developments closely and harmonize their policies with each other as far as possible to ensure a return to growth. The Council thought that discussions with management and labour, both assuming their own responsibilities, was essential.

lr ∩ The Council noted that the general worsening in the unemployment situation had more serious consequences in the less favoured regions of the Community. ∩ (2)

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(1) Text requested in particular by the Irish delegation.  
(2) Text requested by 3 delegations (GR, IRL, I).

The Council welcomed the fact that for some months now outside Europe there had been the first signs of economic recovery. A similar improvement might occur in Europe, as it had already in certain Member States. However, such a development was not certain, and high interest rates might prevent it. A strong anti-inflation policy remained imperative. / / (1)

Danish

[ The Council recognised the need, in the present economic situation, for a more expansionist economic policy to give the Community a positive impulse, whilst recognising that such a policy must be cautious and prudent. Concerted action is required to prevent the crisis of the Community economies from deteriorating further - with consequent political repercussions - and to avoid protectionist tendencies developing. The depth of the recession and the need for recovery make it essential to accept a temporary worsening of public deficits. /

- d) The Council was aware of the fact that the economic situation in the Community had a clear international dimension. On the one hand this meant that there had to be intensive consultation with other industrial countries and efforts must be continued to safeguard world trade against protectionist measures. On the other hand no less attention should be paid to the position of the developing countries which had suffered serious repercussions as a result of the economic recession, and efforts to help these countries should not be relaxed. The continued development of these countries was an essential stimulus for any revival of the economy in the industrialised countries.

{1} Text which corresponds with the wishes of most delegations.  
{2} Alternative text suggested by the Danish delegation.

5. Stimulation of investments

- a) The Council agreed that it was necessary to encourage investments which strengthened structures and increased productivity. This would only have a chance of success if at the same time the consequent risks and uncertainties were mitigated as far as possible. In this connection it was necessary to check sharp fluctuations in interest and exchange rates, to reduce costs and to improve the financial situation of companies, thus encouraging the supply of risk capital.

The Council also agreed that it was necessary to step up efforts directed towards achieving a shift in public spending towards investment and, where appropriate, vocational training.

- b) The Council thought that any strengthening of structures would depend to a considerable degree on renewing products, production processes and services. It recommended in this connection that the right conditions should be created for increasing production capacity and developing the activities of the future. The technological changes which were now occurring often affected numerous sectors. To develop such innovations, it was also necessary to speed up human capital formation and to [dismantle progressively]<sup>1)</sup> [control]<sup>2)</sup> aids for weak sectors of industry and undertakings.

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(1) Text wished by 2 delegations (D, DK).  
(2) Text accepted by the other delegations.



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- c) The Council thought that in encouraging investments to strengthen structures attention should not only be paid to large-scale projects but also to the introduction of new products by, and to the development of new technology in small and medium-sized undertakings and the services sector.
  
- d) The Council also thought that in strengthening economic structures energy policy had an important role to play. Both energy saving and the use of energy sources other than oil were of vital importance for job opportunities and the balance of payments. Efforts in this area would have to be intensified considerably. Efforts in this area would have to be intensified considerably. In this context, consideration should be given to the role which the Community's financial instruments could play and also to the possibility of a better co-ordination of these instruments in improving employment opportunities.

6. Improvement of competitive ability

- a) The Council noted that current economic difficulties were mainly caused by the inability of economies to adjust adequately to economic change. The Council therefore thought that a vigorous effort must be made to combat the lack of flexibility which stood in the way of adequate economic adjustment. This involved both adjustments to production capacity and adjustments to the labour markets. It also involved preserving social cohesion and promoting social solidarity - both important elements in remaining competitive.

- b) The Council thought that efforts should be made to break down the various sources of rigidity, in particular those acting on the labour market. Steps should accordingly be taken to increase mobility in the labour market and in this context to give priority to measures to improve vocational training. Also inflexibility in determining wages and incomes should be reviewed in the light of the negative effects which they could have on employment.

✓ Text of the Presidency

The Council also agreed that greater mobility on the labour market could be achieved by encouraging greater flexibility in the organisation of work and in working hours. This was in the first instance a matter for management and labour. ] (1)

X Alternative text of the Commission

The Council also agreed that an improvement in the employment situation and in flexibility could be encouraged by a series of measures concerning working hours. On the one hand the development of new forms of work (part-time work, temporary work) and of flexible retirement arrangements should be closely examined by the Community. On the other hand, methods of reducing working hours within a flexible framework (annual working time) should be examined at Community level with the social partners. ] (2)

Attention would also have to be paid here to cost aspects so as to safeguard the competitive position vis-a-vis other industrialised countries. Also the reversibility of any measures should be taken into account.

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(1) Text regarded favourably by 3 delegations (D, NL, UK).  
 (2) Text regarded favourably by the other delegations, the Danish delegation being able to accept either text.

7. Need for social solidarity

Text of the Presidency

a. The social security schemes and their financing should be examined more closely in order to see how socially justified adjustments could be made which would reduce labour costs. The same was true mutatis mutandis for social provisions other than social security.

D, NL, UK ✓

b. The Council recognised that in the matters referred to social solidarity played a particular role in the relationship between those who were and were not employed. ](1)

Text of the Commission

Social cohesion and willingness to share equitably in the effects of the recession must be strengthened in such a way as to support more effective policies of economic adaptation. Nevertheless, the way these policies are put into effect should take realistic account of the fact that world resources are growing more slowly.

The Council also noted that social solidarity could be sought by other ways than a simple recourse to public funds, particularly by the social partners through a greater degree of worker participation or by increases in low wages, and by means of local initiatives designed to meet certain collective needs and to create employment. ](2)

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(1) Text acceptable to 3 delegations (D, NL, UK).

(2) Text acceptable to the other delegations.

.../...

8. Youth unemployment

The Council expressed deep concern at the ever-increasing youth unemployment which had to be regarded as a serious social problem. Attention would have to be paid here to greater adaptation of education and vocational training to the requirements of the labour market, and in particular those resulting from the introduction of advanced technologies. The Council thought it of great importance that young people should be able during their training to gain experience in working life. In addition to national measures the Council saw possibilities for taking measures at Community level. There was urgent need for an investigation of possibilities for giving greater priority to those activities of the ESF concerned with young people.

9. Follow-up

- a) The Council invited the Commission to take these conclusions into account in the studies concerning the socio-economic and financial situation in the Communities and to make the necessary proposals in the light thereof.
  - b) The Council proposed, in its forthcoming meetings of Ministers of Economic and Financial Affairs, of Social Affairs, and of Education, to pay close and continuous attention to the various subjects referred to above, with a view to achieving an effective and coherent policy.
-



IMMEDIATE

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TO IMMEDIATE F C O

TELEGRAM NUMBER 2090 OF 10 JUNE 1981

INFO IMMEDIATE LUXEMBOURG

COREPER (AMBASSADORS) 10 JUNE

PREPARATIONS FOR JUMBO COUNCIL

Hd/ECDC(1)(2)  
 G. Hannay  
 Cab. Off. (3)  
 Tsy (5)  
 D/Employment (3)

[limited]  
 X13

SUMMARY

1. THE PRESIDENCY ACCEPTED THAT IT WOULD NOT BE POSSIBLE TO AGREE THE MAJOR OUTSTANDING POINTS IN THE DRAFT CONCLUSIONS BEFORE THE COMMITTEE (MY TELNO 2077 OF 10 JUNE) AND IT SHOULD THEREFORE BE TREATED AS A BACKGROUND PAPER FOR THE COUNCIL. THE PRESIDENCY WOULD ASSUME RESPONSIBILITY FOR SUMMING UP AND REPORTING THE COUNCIL'S DISCUSSION. THIS WOULD PROBABLY TAKE THE FORM OF A SHORT DOCUMENT SETTING OUT DIFFERENCES OF VIEW WHERE THEY PERSISTED AS WELL AS POINTS OF AGREEMENT.

2. THE PRESIDENCY WILL SUGGEST THAT THE DISCUSSION MIGHT FOCUS ON THE FOUR MAJOR OUTSTANDING ISSUES IN THE BACKGROUND PAPER.

THESE ARE:-

- (A) THE SCOPE FOR REFLATIONARY ECONOMIC ACTION IN THE SHORT-TERM;
- (B) WORK SHARING;
- (C) SOCIAL SOLIDARITY, AND IN PARTICULAR WHAT SHOULD BE SAID ABOUT SOCIAL SECURITY PAYMENTS, WORKER PARTICIPATION ETC;
- (D) WHETHER THERE SHOULD BE FURTHER JOINT COUNCILS.

THE PRESIDENCY WOULD AMEND THE BACKGROUND PAPER TO REFLECT THE DIFFERENCE OF VIEW IN COREPER ON FOLLOW-UP ACTION.

3. DETAIL TO FOLLOW.

4. LUXEMBOURG PLEASE PASS TO WILSON AND SMART.

FCO ADVANCE TO:-

- FCO - HANNAY, SPRECKLEY
- CAB - FRANKLIN, BROWN, WENTWORTH
- TSY - PS/CHANCELLOR, HANCOCK, SCHOLLES, ASHFORD, HEDLEY-MILLER
- D/EM - PS/S OF S, DEXX, SMART

BUTLER



10/6/81

1. MR HANCOCK
2. CHANCELLOR

cc attached list

JUMBO COUNCIL : 11 JUNE

COREPER today were unable to reach agreement on the Conclusions attached as Annex 3 to the brief we submitted yesterday.

Accordingly a modified version of the earlier document will now be presented to the Council as a background paper. The paper should be almost identical to the attached version which UKREP have sent us by telegram, except that a final paragraph may be added referring to the fact that some Member States would like to see further Jumbo Councils.

2. Instead of Conclusions the Presidency will issue a short communique to the Press on their own responsibility. Its content will be decided in the light of the meeting.

3. COREPER also decided that the meeting should concentrate on four points:

- (a) the scope for reflationary economic action in the short term;
- (b) work sharing;
- (c) Social solidarity, and in particular what should be said about Social Security payments, worker participation, etc;
- (d) whether there should be further Jumbo Councils.

4. Despite this agreement it seems likely that much of the meeting will be taken up with set piece speeches touching only in part on these points.

5. (b) and (c) are primarily for Mr Prior and are covered in the briefing we submitted yesterday. In addition, however, I understand that Mr Hancock has a few thoughts on (c) which he intends to give you on the plane tomorrow.

6. (a) is already covered in the speaking note included in yesterday's briefing.

7. I attach a speaking note which you may find helpful on (d). In some ways avoiding further Jumbo Councils (or worse, Tripartite Conferences) is our main objective. Such meetings would be particularly undesirable if during our Presidency, but they would also be unwelcome in 1982. Not only would they raise expectations which could not be fulfilled, but they would also be likely to involve us in tiresome and unproductive preparations during our Presidency.

J. Scholes  
 J SCHOLES  
 10 June 1981

So far as your comments on the earlier draft are concerned

(Mr. Wiggins' minute of 10 June) :-

- (i) Para. 4 (c) of the new version speaks of "discussions with management and labour" which is better but not as good as your suggestion "understanding"
- (ii) Para. 7 is a lot clearer on the division of costs and benefits between pensioners and employed people.
- (iii) Para. 5 (A) of the new version does speak of investment which increases productivity.

But this draft no longer matters for the reason explained in para's 1 & 2 of Mr. Scholes' minute.

PS/CST

PS/FST

PS/MST(C)

PS/MST(L)

Sir D Wass

Sir K Couzens

Mr Dixon

Mrs Hedley-Miller

Mr Kemp

Mr Ashford

Mr Buckley

Mr Edwards

Mrs Gilmore

Mr P R Gordon

Mr Peretz

Mr Andren

Mr Gieve

Mr Matthews

Mr Scholes

Mr White

Mr Goodenough - Cabinet Office

Mr Jones Parry - FCO

Mr Butt - UKREP

Mr Dykes - D/Employment



PRINCIPAL PRIVATE SECRETARY

cc Sir K Couzens  
Mr Lavelle  
Mrs Gilmore  
Mr Turnbull  
Mr Scholes  
Mr Owen  
Mr Snowdon

46  
EXCHANGE  
RATE  
BRIEFING  
10/6/81

JUMBO COUNCIL: 11 JUNE - EXCHANGE RATE BRIEFING

Mr Snowdon's minute of 9th June promises a further contribution against the possibility of Press questions after the Council about the exchange rate and MLR.

generally

2. On exchange rate matters/you have Mr Owen's contribution of yesterday to the briefing for today's meeting with the CBI. The rate is a little stronger this morning, with both the dollar and effective rates up since yesterday. On the specific question about interest rates and the exchange rate the new standard line to take is :-

"There is no Government target for the exchange rate, although the Bank does intervene to smoothe sharp fluctuations. The rate can of course have some temporary effect on prices, but in the long run the rate of domestic inflation is determined by the money supply. The monetary aggregates seem at present to be performing satisfactorily. As noted in the Budget speech, the exchange rate is one of the factors that affect the significance of the monetary figures, through its effect on the domestic economy, and is taken into account in the determination of short term interest rates. But at present there is no clear presumption about the need for a move in MLR in either direction".

DLP  
D L C PERETZ  
10 JUNE 1981



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10/6/81.

FIGURES ON INFLATION + UNEMPLOYMENT UNDER  
SUCCESSIVE GOVS - taken from MAIS LECTURE 12/5/81

3.

the only aspect of the economy on which Government should have a policy, or indeed because the conquest of inflation is our only goal. The ultimate goal must be to restore the British economy to growth and prosperity: defeating inflation is one crucial condition for that. The other is improving the performance of the economy, by making it more flexible and adaptable in its response to technological change and developments in market conditions. Both tasks are vital. But whilst the conquest of inflation may not be a sufficient condition for sustainable economic growth, it is, we believe, a necessary condition.

\* Some people no doubt would argue that our first priority now should be to reduce unemployment. I am equally concerned about unemployment, but I do not believe that the way to reduce it is to relax in the struggle against inflation. In the 50s and 60s - especially after the publication of Professor Phillips' famous article in 1958 - many people believed that there /was a policy

FIGURES  
ON  
INFLATION  
+  
UNEMPLOY-  
MENT



was a policy trade-off: that if you tolerated so many extra points on the inflation rate you could get so many extra points off the unemployment rate. But however strong a negative correlation Phillips found for the 100 years <sup>before</sup> up to 1957, more recent experience does not support the argument. In each cycle since then inflation has accelerated and unemployment has risen. The average rate of inflation under successive governments in the years to 1979 has marched remorselessly upwards: 3½ per cent, 4½ per cent, 9 per cent, 15 per cent. Meanwhile unemployment also rose: 300,000, half a million, three-quarters of a million, one and a quarter million.

\*

All this has strengthened the conviction that it is not possible to reverse that trend in unemployment by stimulating demand and permitting higher inflation. The notion of a trade-off in that form no longer commands wide acceptance. If we look instead at the simultaneous upward trends in inflation and unemployment a very

/different

Draft conclusions of the Joint Council  
(Eco/Fin - Social Affairs)

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Brussels, 11 June 1981

1. In accordance with the instructions given by the European Council, in particular, at its meeting in Maastricht on 23 and 24 March 1981 and in the light of the conclusions arrived at by the Standing Committee on Employment on 29 May 1981 regarding problems of unemployment in the Community, the Council met in Luxembourg on 11 June 1981 with Ministers for Economic, Financial and Social Affairs attending.
2. Representatives of European employers' and employees' organizations were consulted during discussions preparatory to the meeting.
3. This convening of the European Council made possible an initial meeting for the purpose of determining consistently with the Maastricht Council's decisions, joint action against unemployment by the Member States and the Community.

The key factors in such action were identified by the Heads of State and of Government at the Luxembourg meeting as follows: (a) bringing down inflation rates; (b) improving business competitiveness; (c) increased, appropriate investment so as to generate more growth and promote employment.

Particular emphasis was placed on the Community's role in action via the various Community instruments, as a matter of priority, to reduce structural unemployment and to improve the infrastructure and economic situation of the least favoured rural areas.

4. The Council therefore concentrated particularly on the part which the Community can play and noted that the Commission,

as instructed on 30 May 1980, would be submitting proposals for substantial changes in structural policy.

5. The Council requested the Commission to take particular account, in carrying out its instructions, of the following points:
- (a) development of the procedures for co-ordinating national economic policies, in particular measures to combat inflation;
  - (b) co-ordination of Community and national instruments to stimulate investments designed to promote employment (identification of growth sectors, new forms of technology, energy-saving and the development of alternative resources particularly in the small and medium-sized undertakings sector).

In particular, the Council stressed the fundamental importance of a positive decision at the next ECOFIN Council on 15 June on renewing the NCI, by providing it with sufficient financial means to make a substantial contribution to national efforts to achieve the abovementioned objectives;

- (c) improvement of the competitiveness of undertakings.

This aim must derive from the need to transform a trading Community into a producing Community so as to exploit all the possibilities offered by such a large economic area.

In this connection, it is important to make real progress in removing non-tariff barriers to the full functioning of the internal market, to co-ordinate the national financial and legal instruments of industrial policies either for the crisis sectors or for the new growth sectors, to define a common research policy, particularly in the applied research sector, and to give political impetus to defining the status of the European Company.

The Council also thought that mobility on the employment

6. The Council recognized that in combatting unemployment, employment policy must form a permanent part of Community action; however, the Joint ECOFIN/Social Affairs Council would have to meet at least once a year to act on the Commission proposals concerning action to be taken at both Community and national level and to determine the guidelines and priorities for such policies, taking account of the medium-term economic policy programme.

In this connection, the Joint Council proposed the following objectives:

- (a) encouraging the conciliation of national employment policies;
  - (b) making a more systematic assessment of the impact on employment of other Community policies;
  - (c) encouraging the co-ordinated use of the various Community financial instruments intended to promote the development of employment, in particular in developing regions and to facilitate adaptation and industrial redevelopment.
-



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11/6/81.



SOCIAL SOLIDARITY

PASSAGE FOR INSERTION IN MINISTERIAL STATEMENT

No doubt we would all agree that the burdens of unemployment should be equitably shared in our societies. This certainly means ensuring that those who suffer the hardship and distress of involuntary unemployment are looked after as well as society can afford. It also means ensuring that fraud and abuse of the social security system are checked and that the system does not overburden the productive sector from which must come the real solution to unemployment - more jobs. I suppose that 'fairness' is the essential meaning of 'social solidarity', and the best way that I know of achieving that is to pursue policies that will return us to low unemployment on a sustainable basis as soon as possible. This must mean dealing with inflation as a precondition. High inflation is the most socially divisive condition known and no policies which lead to it can produce "social solidarity".

THE COST OF SOCIAL SECURITY IN PRESENT CONDITIONS

Reducing social security contributions does not solve the problem. Pensions and other benefits have to be financed somehow. It is not necessarily an advantage to transfer the costs from social security to general taxation. To increase Government borrowing in order to pay for benefits will either push up interest rates or be inflationary.

2. This shows that we <sup>MAY NEED</sup> ~~must~~ take a more fundamental look at the problem. Many of our social security schemes were designed in a period of higher growth which was assumed to continue. In conditions of low growth our economies may not be able to generate the incomes necessary to finance the benefits for which we have legislated.

3. This is a problem on which I recently invited public discussion in my own country. I posed the question whether we are in danger of asking the working population, through their contributions or taxes, to provide more for the retired population than those in <sup>employment</sup> ~~employed~~ are prepared to tolerate. The recent proposals by the Reagan administration to cut social security benefits in the United States shows that the problem is not confined to the United Kingdom. [If possible, refer to earlier comments in the debate.]

4. I think that it would be very helpful if you, Mr. President, could refer to this discussion when you report our proceedings to the press. You might say that, although we were all very reluctant to contemplate a cut in social security benefits, the Council felt that it was right to pose the question whether the costs of our existing schemes could continue to be afforded in a period of low growth.

JUMBO COUNCIL: 11 JUNE 1981

1. Following is the list of Ministers likely to attend:

Chairman: Mr van der Stee, Minister of Finance.

Belgium: Mr Claes, Economics Minister.

Mr de Wulf, Minister of Labour.

Denmark: Mr Auken, Minister of Labour. *MR Nørgaard*

Germany: Mr Ehrenberg, Minister of Labour.

Mrs Fuchs, State Secretary, Ministry of Labour.

*Mr. SCHLECHT*

France: Mr Delors, Economics Minister.

Mr Auroux, Minister of Labour.

Ireland: - No Minister. *DILLON*

Italy: Mr Fracanzani, State Secretary, Treasury.

Mr Zito, State Secretary, Ministry of Labour.

Luxembourg: Mr Santer, Minister of Finance and Minister of Labour.

Netherlands: Mr Albeda, Minister of Social Affairs.

(Mr van der Mei), State Secretary, Ministry of Foreign Affairs.

United Kingdom: Sir Geoffrey Howe, Chancellor of the Exchequer.

Mr James Prior, Secretary of State for Employment.

Greece: Mr Laskaris, Minister of Labour.

*Mr EVERT (F.W.)*

Commission: Mr Richard.

Mr Davignon.

Mr Ortoli.

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Luxembourg, 11th June 1981

DRAFT CONCLUSIONS - JOINT COUNCIL

(ECO/FIN - SOCIAL AFFAIRS)

SUGGESTIONS BY THE BELGIAN DELEGATION

- Page 2, point c):

Given the problem of the restructuring of our economies referred to in the preceding paragraphs, it is suggested that the end of the first sentence should read:

"... differing financial, economic and structural imbalances".

- Page 3, point a), 2nd para.:

It would seem preferable to draft this paragraph in more general terms and to bring it more into line with the conclusions of the European Council at Maastricht. The need to put more emphasis on vocational training is already mentioned in other parts of the conclusions. The Belgian delegation accordingly suggests that this paragraph should be drafted as follows:

"The Council also agreed that it was necessary to step up efforts directed towards achieving a shift in public spending towards investment."

- Page 5, point b):

The Belgian delegation asks that this paragraph should be slightly amended (reversal of the order of the second and third sentences, with some alteration to the beginning of the original third sentence) to read as follows:

.../...

"The Council thought that efforts should be made to break down the various sources of rigidity, in particular those acting on the labour market. The many economic constraints, particularly those concerning the fixing of wages and salaries, should be reviewed in the light of the negative effects which they could have on employment. Steps should also be taken to increase mobility in the labour market and in this context to give priority to measures to improve vocational training."

- Page 6, section 7 "Need for social solidarity":

The Belgian delegation cannot accept either of the texts in its entirety. It accordingly suggests that certain of the ideas included in these texts should be combined in a single text as follows:

"The social security schemes and the methods of financing them should be examined more closely in order to see how socially justified adjustments could be made which would reduce average labour costs. The same was true mutatis mutandis for social provisions other than social security.

In this context, the Council recognised that social solidarity, reflected in a willingness to share equitably in the effects of the recession, had a role to play. This social solidarity could be sought by other ways than a simple recourse to public funds, particularly by the social partners through a greater degree of worker participation or by increases in low wages, and by means of local initiatives designed to meet certain collective needs and to create employment."

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DRAFT CONCLUSIONS - JOINT COUNCIL  
(ECC/FIN - SOCIAL AFFAIRS) (1)

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(LUXEMBOURG, 11 JUNE 1981)

(1) The Italian delegation has a reserve on the whole text and has suggested an alternative version

1. IN ACCORDANCE WITH THE INSTRUCTIONS GIVEN BY THE EUROPEAN COUNCIL AT ITS MEETING ON 23 AND 24 MARCH 1981 IN MAASTRICHT AND TAKING ACCOUNT OF THE RESULTS OF THE STANDING COMMITTEE ON EMPLOYMENT ON 29 MAY 1981 REGARDING UNEMPLOYMENT PROBLEMS IN THE COMMUNITY THE COUNCIL MET ON 11 JUNE 1981 IN LUXEMBOURG ATTENDED BY THE MINISTERS FOR ECONOMIC AFFAIRS, FINANCE AND SOCIAL AFFAIRS.

2. THE REPRESENTATIVES OF THE EUROPEAN EMPLOYERS' AND LABOUR ORGANIZATIONS WERE CONSULTED DURING PREPARATIONS FOR THIS MEETING.

3. THE COUNCIL REACHED AGREEMENT ON THE ANALYSIS OF THE SOCIO-ECONOMIC SITUATION, THE MAJOR PROBLEMS, AND THE POSSIBILITY OF ACHIEVING SOME IMPROVEMENT BY MEANS OF A JOINT APPROACH.

4. ASSESSMENT OF THE CURRENT SITUATION

A) THE COUNCIL AGREED THAT THE REDUCTION IN GROWTH RATES RESULTING FROM THE SHARP INCREASES IN THE PRICE OF OIL, AND FROM THE DIFFICULTIES EXPERIENCED IN REDEPLOYING RESSOURCES QUICKLY TO SATISFY POTENTIAL DEMAND, HAD COMBINED WITH MAJOR EXPANSION IN LABOUR SUPPLY TO PRODUCE A DISTURBINGLY SWIFT GROWTH IN UNEMPLOYMENT. THE COUNCIL NOTED THAT A LASTING INCREASE IN JOB OPPORTUNITIES AND EFFECTIVE ACTION IN COMBATING UNEMPLOYMENT WOULD ONLY BE POSSIBLE IF ECONOMIC GROWTH WERE RESTORED.

THE COUNCIL NOTED THAT SHARP INCREASES IN IMPORT PRICES HAD GIVEN RISE TO A NEW SURGE IN DOMESTIC COSTS. ANTI-INFLATIONARY MEASURES SHOULD ACCORDINGLY BE STEPPED UP AND DIVERSIFIED WHERE NECESSARY IN ORDER TO GET THE ECONOMIES MOVING AGAIN.

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(1) THE ITALIAN DELEGATION HAS A RESERVE ON THE WHOLE OF THE TEXT DRAWN UP BY THE GROUP AND HAS SUGGESTED AN ALTERNATIVE TEXT WHICH HAS BEEN DISTRIBUTED TO DELEGATIONS IN THE GROUP.

B) THE COUNCIL THOUGHT THAT TO RESTORE ECONOMIC GROWTH ENDEAVOURS MUST BE MADE TO ACHIEVE FINANCIAL STABILITY, TO RESTRUCTURE ECONOMIES AND TO ENCOURAGE INVESTMENT AT BOTH NATIONAL AND COMMUNITY LEVEL. IT REFERRED IN THIS CONNECTION TO THE GUIDELINES GIVEN BY THE EUROPEAN COUNCIL.

C) THE COUNCIL NOTED THAT IN THEIR ENDEAVOURS TO ACHIEVE LASTING GROWTH THE MEMBER STATES WERE CONFRONTED TO A VARYING DEGREE WITH POLICY RESTRICTIONS IMPOSED BY DIFFERING FINANCIAL AND ECONOMIC IMBALANCES.

*(3) Text which corresponds with wishes of most delegations*  
// //THE REDUCTION OF SUCH IMBALANCES, WHICH WERE REFLECTED IN THE BALANCES OF PAYMENT, THE CONSIDERABLE BUDGET DEFICITS AND HIGH INFLATION, WOULD CONTRIBUTE TOWARDS A RETURN TO LASTING GROWTH.

THE COUNCIL THOUGHT THAT THE COMMUNITY WAS NOW INVOLVED IN THIS PROCESS OF ADJUSTMENT WHICH WOULD NOT ONLY BE LONG, BUT SHOULD ALSO BE CHARACTERIZED BY ADEQUATE CONTINUITY, THIS MEANS THAT POLICY-MAKING MUST FIT IN WITH MEDIUM-TERM POLICY

*(1) Text requested by Inst.*  
//CERTAIN DELEGATIONS DID NOT EXCLUDE THE POSSIBILITY OF SHORT TERM MEASURES AT COMMUNITY LEVEL FOR TACKLING UNEMPLOYMENT.// (1)

IT WAS TO BE RECOMMENDED THAT THE MEMBER STATES FOLLOW DEVELOPMENTS CLOSELY AND HARMONIZE THEIR POLICIES WITH EACH OTHER AS FAR AS POSSIBLE TO ENSURE A RETURN TO GROWTH. THE COUNCIL THOUGHT THAT DISCUSSIONS WITH MANAGEMENT AND LABOUR, BOTH ASSUMING THEIR OWN RESPONSIBILITIES, WAS ESSENTIAL.

*(2) Text requested by GR, IRL & I.*  
//THE COUNCIL NOTED THAT THE GENERAL WORSENING IN THE UNEMPLOYMENT SITUATION HAD MORE SERIOUS CONSEQUENCES IN THE LESS FAVOURED REGIONS OF THE COMMUNITY.// (2)

THE COUNCIL WELCOMED THE FACT THAT FOR SOME MONTHS NOW OUTSIDE EUROPE THERE HAD BEEN THE FIRST SIGNS OF ECONOMIC RECOVERY. A SIMILAR IMPROVEMENT MIGHT OCCUR IN EUROPE, AS IT HAD ALREADY IN CERTAIN MEMBER STATES. HOWEVER, SUCH A DEVELOPMENT WAS NOT CERTAIN, AND HIGH INTEREST RATES MIGHT PREVENT IT. A STRONG ANTI-INFLATION POLICY REMAINED IMPERATIVE. // // (3)



*D. Br. m. m. m.*

*(1)  
Alternative  
text requested  
by Danish  
Delegation*

//THE COUNCIL RECOGNISED THE NEED, IN THE PRESENT ECONOMIC SITUATION, FOR A MORE EXPANSIONIST ECONOMIC POLICY TO GIVE THE COMMUNITY A POSITIVE IMPULSE, WHILST RECOGNISING THAT SUCH A POLICY MUST BE CAUTIOUS AND PRUDENT. CONCERTED ACTION IS REQUIRED TO PREVENT THE CRISIS OF THE COMMUNITY ECONOMIES FROM DETERIORATING FURTHER - WITH CONSEQUENT POLITICAL REPERCUSSIONS - AND TO AVOID PROTECTIONIST TENDENCIES DEVELOPING. THE DEPTH OF THE RECESSION AND THE NEED FOR RECOVERY MAKE IT ESSENTIAL TO ACCEPT A TEMPORARY WORSENING OF PUBLIC DEFICITS.//(1

D) THE COUNCIL WAS AWARE OF THE FACT THAT THE ECONOMIC SITUATION IN THE COMMUNITY HAD A CLEAR INTERNATIONAL DIMENSION. ON THE ONE HAND THIS MEANT THAT THERE HAD TO BE INTENSIVE CONSULTATION WITH OTHER INDUSTRIAL COUNTRIES AND EFFORTS MUST BE CONTINUED TO SAFEGUARD WORLD TRADE AGAINST PROTECTIONIST MEASURES. ON THE OTHER HAND NO LESS ATTENTION SHOULD BE PAID TO THE POSITION OF THE DEVELOPING COUNTRIES WHICH HAD SUFFERED SERIOUS REPERCUSSIONS AS A RESULT OF THE ECONOMIC RECESSION, AND EFFORTS TO HELP THESE COUNTRIES SHOULD NOT BE RELAXED. THE CONTINUED DEVELOPMENT OF THESE COUNTRIES WAS AN ESSENTIAL STIMULUS FOR ANY REVIVAL OF THE ECONOMY IN THE INDUSTRIALISED COUNTRIES.

5. STIMULATION OF INVESTMENTS

A) THE COUNCIL AGREED THAT IT WAS NECESSARY TO ENCOURAGE INVESTMENTS WHICH STRENGTHENED STRUCTURES AND INCREASED PRODUCTIVITY. THIS WOULD ONLY HAVE A CHANCE OF SUCCESS IF AT THE SAME TIME THE CONSEQUENT RISKS AND UNCERTAINTIES WERE MITIGATED AS FAR AS POSSIBLE. IN THIS CONNECTION IT WAS NECESSARY TO CHECK SHARP FLUCTUATIONS IN INTEREST AND EXCHANGE RATES, TO REDUCE COSTS AND TO IMPROVE THE FINANCIAL SITUATION OF COMPANIES, THUS ENCOURAGING THE SUPPLY OF RISK CAPITAL.

THE COUNCIL ALSO AGREED THAT IT WAS NECESSARY TO STEP UP EFFORTS DIRECTED TOWARDS ACHIEVING A SHIFT IN PUBLIC SPENDING TOWARDS INVESTMENT AND, WHERE APPROPRIATE, VOCATIONAL TRAINING.

(1) Text wished by D + DK.  
(2) Text accepted by other delegations

B) THE COUNCIL THOUGHT THAT ANY STRENGTHENING OF STRUCTURES WOULD DEPEND TO A CONSIDERABLE DEGREE ON RENEWING PRODUCTS, PRODUCTION PROCESSES AND SERVICES. IT RECOMMENDED IN THIS CONNECTION THAT THE RIGHT CONDITIONS SHOULD BE CREATED FOR INCREASING PRODUCTION CAPACITY AND DEVELOPING THE ACTIVITIES OF THE FUTURE. THE TECHNOLOGICAL CHANGES WHICH WERE NOW OCCURRING OFTEN AFFECTED NUMEROUS SECTORS. TO DEVELOP SUCH INNOVATIONS, IT WAS ALSO NECESSARY TO SPEED UP HUMAN CAPITAL FORMATION AND TO //DISMANTLE PROGRESSIVELY))(1)//CONTROL//(2) AIDS FOR WEAK SECTORS OF INDUSTRY AND UNDERTAKINGS.

C) THE COUNCIL THOUGHT THAT IN ENCOURAGING INVESTMENTS TO STRENGTHEN STRUCTURES ATTENTION SHOULD NOT ONLY BE PAID TO LARGE-SCALE PROJECTS BUT ALSO TO THE INTRODUCTION OF NEW PRODUCTS BY, AND TO THE DEVELOPMENT OF NEW TECHNOLOGY IN SMALL AND MEDIUM-SIZED UNDERTAKINGS AND THE SERVICES SECTOR.

D) THE COUNCIL ALSO THOUGHT THAT IN STRENGTHENING ECONOMIC STRUCTURES ENERGY POLICY HAD AN IMPORTANT ROLE TO PLAY. BOTH ENERGY SAVING AND THE USE OF ENERGY SOURCES OTHER THAN OIL WERE OF VITAL IMPORTANCE FOR JOB OPPORTUNITIES AND THE BALANCE OF PAYMENTS. EFFORTS IN THIS AREA WOULD HAVE TO BE INTENSIFIED CONSIDERABLY. EFFORTS IN THIS AREA WOULD HAVE TO BE INTENSIFIED CONSIDERABLY. IN THIS CONTEXT, CONSIDERATION SHOULD BE GIVEN TO THE ROLE WHICH THE COMMUNITY'S FINANCIAL INSTRUMENTS COULD PLAY AND ALSO TO THE POSSIBILITY OF A BETTER CO-ORDINATION OF THESE INSTRUMENTS IN IMPROVING EMPLOYMENT OPPORTUNITIES.

6. IMPROVEMENT OF COMPETITIVE ABILITY

A) THE COUNCIL NOTED THAT CURRENT ECONOMIC DIFFICULTIES WERE MAINLY CAUSED BY THE INABILITY OF ECONOMIES TO ADJUST ADEQUATELY TO ECONOMIC CHANGE. THE COUNCIL THEREFORE THOUGHT THAT A VIGOROUS EFFORT MUST BE MADE TO COMBAT THE LACK OF FLEXIBILITY WHICH STOOD IN THE WAY OF ADEQUATE ECONOMIC ADJUSTMENT. THIS INVOLVED

BOTH ADJUSTMENTS TO PRODUCTION CAPACITY AND ADJUSTMENTS TO THE LABOUR MARKETS. IT ALSO INVOLVED PRESERVING SOCIAL COHESION AND PROMOTING SOCIAL SOLIDARITY - BOTH IMPORTANT ELEMENTS IN REMAINING COMPETITIVE.

B) THE COUNCIL THOUGHT THAT EFFORTS SHOULD BE MADE TO BREAK DOWN THE VARIOUS SOURCES OF RIDIGITY, IN PARTICULAR THOSE ACTING ON THE LABOUR MARKET. STEPS SHOULD ACCORDINGLY BE TAKEN TO INCREASE MOBILITY IN THE LABOUR MARKET AND IN THIS CONTEXT TO GIVE PRIORITY TO MEASURES TO IMPROVE VOCATIONAL TRAINING. ALSO INFLEXIBILITY IN DETERMINING WAGES AND INCOMES SHOULD BE REVIEWED IN THE LIGHT OF THE NEGATIVE EFFECTS WHICH THEY COULD HAVE ON EMPLOYMENT.

//TEXT OF THE PRESIDENCY

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*1) Text regarded favourably by D, NL + UK.*

THE COUNCIL ALSO AGREED THAT GREATER MOBILITY ON THE LABOUR MARKET COULD BE ACHIEVED BY ENCOURAGING GREATER FLEXIBILITY IN THE ORGANISATION OF WORK AND IN WORKING HOURS. THIS WAS IN THE FIRST INSTANCE A MATTER FOR MANAGEMENT AND LABOUR //(1)

//ALTERNATIVE TEXT OF THE COMMISSION

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*(2) Text regarded favourably by the other delegations. Danish accept either text*

THE COUNCIL ALSO AGREED THAT AN IMPROVEMENT IN THE EMPLOYMENT SITUATION AND IN FLEXIBILITY COULD BE ENCOURAGED BY A SERIES OF MEASURES CONCERNING WORKING HOURS. ON THE ONEHAND THE DEVELOPMENT OF NEW FORMS OF WORK (PART-TIME WORK, TEMPORARY WORK) AND OF FLEXIBLE RETIREMENT ARRANGEMENTS SHOULD BE CLOSELY EXAMINED BY THE COMMUNITY. ON THE OTHER HAND, METHODS OF REDUCING WORKING HOURS WITHIN A FLEXIBLE FRAMEWORK (ANNUAL WORKING TIME) SHOULD BE EXAMINED AT COMMUNITY LEVEL WITH THE SOCIAL PARTNERS. : (2)

ATTENTION WOULD ALSO HAVE TO BE PAID HERE TO COST ASPECTS SO AS TO SAFEGUARD THE COMPETITIVE POSITION VIS-A-VIS OTHER INDUSTRIALISED COUNTRIES. ALSO THE REVERSIBILITY OF ANY MEASURES SHOULD BE TAKEN INTO ACCOUNT.



## 7. NEED FOR SOCIAL SOLIDARITY

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### //TEXT OF THE PRESIDENCY

- (1) Text acceptable to D, NL + UK
- A. THE SOCIAL SECURITY SCHEMES AND THEIR FINANCING SHOULD BE EXAMINED MORE CLOSELY IN ORDER TO SEE HOW SOCIALLY JUSTIFIED ADJUSTMENTS COULD BE MADE WHICH WOULD REDUCE LABOUR COSTS. THE SAME WAS TRUE MUTATIS MUTANDIS FOR SOCIAL PROVISIONS OTHER THAN SOCIAL SECURITY.
- B. THE COUNCIL RECOGNISED THAT IN THE MATTERS REFERRED TO SOCIAL SOLIDARITY PLAYED A PARTICULAR ROLE IN THE RELATIONSHIP BETWEEN THOSE WHO WERE AND WERE NOT EMPLOYED //(1)

### //TEXT OF THE COMMISSION

(2) Text acceptable to other delegations

SOCIAL COHENSION AND WILLINGNESS TO SHARE EQUITABLY IN THE EFFECTS OF THE RECESSION MUST BE STRENGTHENED IN SUCH A WAY AS TO SUPPORT MORE EFFECTIVE POLICIES OF ECONOMIC ADAPTATION. NEVERTHELESS, THE WAY THESE POLICIES ARE PUT INTO EFFECT SHOULD TAKE REALISTIC ACCOUNT OF THE FACT THAT WORLD RESOURCES ARE GROWING MORE SLOWLY.

THE COUNCIL ALSO NOTED THAT SOCIAL SOLIDARITY COULD BE SOUGHT BY OTHER WAYS THAN A SIMPLE RECOURSE TO PUBLIC FUNDS, PARTICULARLY BY THE SOCIAL PARTNERS THROUGH A GREATER DEGREE OF WORKER PARTICIPATION OR BY INCREASES IN LOW WAGES, AND BY MEANS OF LOCAL INITIATIVES DESIGNED TO MEET CERTAIN COLLECTIVE NEEDS AND TO CREATE EMPLOYMENT. //(2)

### 8. YOUTH UNEMPLOYMENT

THE COUNCIL EXPRESSED DEEP CONCERN AT THE EVER-INCREASING YOUTH UNEMPLOYMENT WHICH HAD TO BE REGARDED AS A SERIOUS SOCIAL PROBLEM. ATTENTION WOULD HAVE TO BE PAID HERE TO GREATER ADAPTATION OF EDUCATION AND VOCATIONAL TRAINING TO THE REQUIREMENTS OF THE

LABOUR MARKET, AND IN PARTICULAR THOSE RESULTING FROM THE INTRODUCTION OF ADVANCED TECHNOLOGIES. THE COUNCIL THOUGHT IT OF GREAT IMPORTANCE THAT YOUNG PEOPLE SHOULD BE ABLE DURING THEIR TRAINING TO GAIN EXPERIENCE IN WORKING LIFE. IN ADDITION TO NATIONAL MEASURES THE COUNCIL SAW POSSIBILITIES FOR TAKING MEASURES AT COMMUNITY LEVEL. THERE WAS URGENT NEED FOR AN INVESTIGATION OF POSSIBILITIES FOR GIVING GREATER PRIORITY TO THOSE ACTIVITIES OF THE ESF CONCERNED WITH YOUNG PEOPLE.

9. FOLLOW-UP

- A) THE COUNCIL INVITED THE COMMISSION TO TAKE THESE CONCLUSIONS INTO ACCOUNT IN THE STUDIES CONCERNING THE SOCIO-ECONOMIC AND FINANCIAL SITUATION IN THE COMMUNITIES AND TO MAKE THE NECESSARY PROPOSALS IN THE LIGHT THEREOF.
- B) THE COUNCIL PROPOSED, IN ITS FORTHCOMING MEETINGS OF MINISTERS OF ECONOMIC AND FINANCIAL AFFAIRS, OF SOCIAL AFFAIRS, AND OF EDUCATION, TO PAY CLOSE AND CONTINUOUS ATTENTION TO THE VARIOUS SUBJECTS REFERRED TO ABOVE, WITH A VIEW TO ACHIEVING AN EFFECTIVE AND COHERENT POLICY.

ENDS

2. WE HAVE NOTED A DISCREPANCY BETWEEN THE ENGLISH AND FRENCH TEXTS OF THE FIRST SENTENCE OF PARAGRAPH 5(A). IN FRENCH IT READS AS FOLLOWS:-

BEGINS

LE CONSEIL A ESTIME NECESSAIRE DE STIMULER DES INVESTISSEMENTS CREATEURS D'EMPLOIS ET ECONOMIQUEMENT VIABLES DESTINES A RENFORCER LES STRUCTURE EN AUGMENTANT LA PRODUCTIVITE.

ENDS

COMMS NOTE :

- // // SIGNIFIES DOUBLE SQUARE BRACKETS
- // SIGNIFIES SQUARE BRACKETS

THE COST OF SOCIAL SECURITY IN PRESENT CONDITIONS

Reducing social security contributions does not solve the problem. Pensions and other benefits have to be financed somehow. It is not necessarily an advantage to transfer the costs from social security to general taxation. To increase Government borrowing in order to pay for benefits will either push up interest rates or be inflationary.

2. This shows that we must take a more fundamental look at the problem. Many of our social security schemes were designed in a period of higher growth which was assumed to continue. In conditions of low growth our economies may not be able to generate the incomes necessary to finance the benefits for which we have legislated.

3. This is a problem on which I recently invited public discussion in my own country. I posed the question whether we are in danger of asking the working population, through their contributions or taxes, to provide more for the retired population than those in employed are prepared to tolerate. The recent proposals by the Reagan administration to cut social security benefits in the United States shows that the problem is not confined to the United Kingdom. [If possible, refer to earlier comments in the debate.]

4. I think that it would be very helpful if you, Mr. President, could refer to this discussion when you report our proceedings to the press. You might say that, although we were all very reluctant to contemplate a cut in social security benefits, the Council felt that it was right to pose the question whether the costs of our existing schemes could continue to be afforded in a period of low growth.

FURTHER  
SPEAKING  
NOTE  
ON  
COST OF  
SOCIAL  
SECURITY



JUMBO COUNCIL : 11 JUNE 1981

STEERING BRIEF

Introduction

This brief gives the UK objectives, the likely course of the meeting and the possible attitude of other member states. It also suggests how the outcome might be presented to the press.

2. Annex 1 summarises the administrative arrangements; Annex 2 gives two speaking notes which could be used if UK Ministers are called on to make a general statement of the UK approach; Annex 3 contains the draft Conclusions of the Council which should have been substantially agreed by COREPER on 10 June; Annex 4 lists the supporting briefs which give background information and points to make on particular topics.

Objectives

3. To use the opportunity to demonstrate that the United Kingdom's problems of high inflation and high unemployment are not unique, but shared throughout the Community.
4. To demonstrate the Community's concern about unemployment.
5. To persuade Ministers from other member states that it is essential to persevere with the agreed strategy of giving priority to bringing down inflation.
6. To explain the many things that the United Kingdom is doing to cope with the special problems of high unemployment consistently with that strategy.
7. To emphasise that there are certain things that the Community can do to help, notably:
  - (i) giving each other support in facing the difficult problems involved in controlling monetary aggregates and maintaining tight fiscal policies:





Brussels. These discussions will continue in COREPER on 10 June.

15. As it stands the draft, though wordy and not ideal, is unobjectionable and does not propose any undesirable initiatives. It is not inconsistent with UK Government policies and endorses the view that cutting inflation is the key to reducing unemployment. Indeed the main difficulty will be to prevent others from inserting objectionable amendments. A copy of the agreed text will be forwarded as soon as it is available (which may not be until Ministers' arrival in Luxembourg).

16. Part of the meeting may be devoted to going through a list of topics given in paragraph 3 of the draft Conclusions. If so, you can draw on the supporting briefs listed in Annex 4.

17. It is virtually certain, however, that most of those present will want to make set-piece speeches on their general approach. This could take most of the day, given that some member states will be fielding up to 3 Ministers each. The speaking notes at Annex 2 provide the basis for 2 speeches, one for the Chancellor on macro-economic policy, and the other, for the Secretary of State, on labour market policies.

#### Attitude of other member states

18. The idea of holding a Jumbo Council has been endorsed by the last two European Councils. But in the case of some member states this is more because the idea is rather difficult to oppose than because there is any enthusiasm for it.

19. Like us Germany probably sees the Council as a potential source of embarrassment and is likely to have broadly similar objectives to our own (no follow up, anodyne conclusions etc).

20. The Netherlands no doubt shares this view, but it is in a special position because not only does it hold the Presidency, but it also made the original proposal to hold the Council. It is likely to be uncomfortably aware that it will be held partly responsible when the Council fails to come up with any contribution to easing the unemployment situation.

21. France, Belgium, Denmark and Luxembourg are likely to favour a more expansionist approach and may hope to use the Council to put pressure on their neighbours to relax somewhat their stand against inflation. Their pleas probably stand most chance of success if they concentrate on high interest rates, on which Germany has been somewhat ambivalent.

22. Italy, Ireland and Greece are likely to seize any opportunity they can to seek more Community help, such as an expansion of the Social and Regional Funds.

23. The Commission can be expected to favour anything which would expand their own role. They might, for example, wish to organise a series of further discussions on unemployment, perhaps involving the social partners.

#### Report to the European Council

24. Others may suggest reporting the outcome of the Jumbo Council to the European Council on 29-30 June. If such a report proved necessary it should, in our interests, be kept as low-key as possible to avoid the risk of the European Council calling for a Tripartite Conference or further Jumbo Councils. It would therefore be preferable for any report to be made orally by the Dutch Presidency.

#### Press

25. Ministers from other countries are likely to brief their press on emerging from the Council. It is therefore essential that we should do the same to get our point of view on record. The Chancellor and the Secretary of State should therefore hold a joint Press Conference.

*Does broad aim of general*

26. The main points to get across are:-

(i) The problems of high inflation and high unemployment are shared by the whole Community and not unique to the UK.

(ii) The Government's strategy is right and nothing said at the Council in any way invalidates the need to give priority to getting down inflation. ~~If it survives, the sentence at the end of paragraph 5(c) of the draft communique should be quoted: "a strong and coordinated anti-inflation policy remained imperative".~~

*W. M. J. do  
the only  
planned:*

- (iii) HMG is doing a great deal to meet the special problems of high unemployment consistently with that strategy. At the present time nearly 1 million people are benefiting from various employment and training measures supported by the Government. The total cost of these measures this year is nearly £1 billion.
- (iv) There is a great deal that the Community can do to help, particularly by mutual support in sustaining essential but unpopular policies; exchanging experience in dealing with the particular effects of unemployment; and appropriate reform of the Regional and Social Funds.

27. It will be important to ensure that the agreements on follow-up action are correctly reported. In our view each particular aspect should be dealt with by the appropriate Council: for example, the review of the economic situation by the Finance Council; exchanging experience on unemployment measures and appropriate reform of the Social Fund by the Social Affairs Council; and appropriate reform of the Regional Fund by the Foreign Affairs Council. Ministers should make it clear that when we take over the Presidency on 1 July we shall be very positive in directing such appropriate follow-up action.

*Comm no study, under heading*



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ANNEX 1

ADMIN.  
ARRANGEMENTS

ADMINISTRATIVE ARRANGEMENTS

The Council will be held in Luxembourg, starting at 10.00 am.

The Chancellor and Secretary of State for Employment will fly to and from Luxembourg by RAF plane. The plane will leave the UK from Heathrow at 06.55, arriving in Luxembourg at about 09.15. Ministers will be accompanied by Mr Hancock, Mrs Gilmore/Mr Wiggins\* and Mr Dykes. Mr Derx and Mr Smart will already be in Luxembourg after attending the Social Affairs Council the previous day.

With luck the Council should finish between 17.00, and 18.00, allowing Ministers to see the Press before their return. The plane should take off by 19.00 in order that the Chancellor can get to his 20.00 dinner engagement at Claridges. (Take off at 19.00 would get you to the UK at about 19.20).

\* to be decided

Modest manner

11/6/84 70

SPEAKING NOTE FOR CHANCELLOR

← ECHO - NO OTHER DIRECTION

MACRO-ECONOMIC POLICY

↑ CANNOT BE TRENDED AWAY

Unemployment a serious problem. But not the only one. Indeed, problems of unemployment and inflation are closely linked. Need a proper analysis of these linkages. Otherwise a danger that policy will attempt to treat symptoms rather than tackling the underlying problems.

CANNOT CAST AWAY SCARENS GAINS ALREADY MADE

Some argue that reducing unemployment should now be first priority. But our experience of the last 20 years, in which inflation and unemployment have been worse in each successive business cycle surely shows it is not possible to reverse the trend in unemployment simply by stimulating demand. The inflationary risks of such policies are too great. And our experience has also shown us how economically harmful and socially divisive inflation can be. It reduces confidence, discourages new fixed investment and distorts choices. It is thus inimical to the growth of output and employment. We cannot therefore go on compromising with inflation. To do so may alleviate the unemployment problem somewhat in the short run, but would not solve our long term problems.

↑ GIVEN OVERRIDING

INFLATION ITSELF WHICH PRICES PEOPLE OUT OF WORK

A LITTLE

IN LONG RUN TO COMPROMISE

We all agree that ultimate goal must be to restore our economies to growth and prosperity. Defeating inflation is one crucial condition for this. Another is the need to make our economies more flexible and adaptable in their responses to technical change and developments in market conditions. This will enable an economic recovery that is sustainable and lead to the creation of soundly based new jobs. Employment cannot be preserved by over-manning or attempting to hold back the tide of technical progress. To attempt to do so will only worsen further our international competitiveness. Nor can employment be created by continually increasing the size of the public sector: this would increase the tax burden on the rest of the economy and reduce its dynamism.

WITH INFLATION IS TO COMPROMISE WITH UNEMP. ALWAYS SO

BUT NOT THE ONLY ONE

← for linked  
→ for Rem Growth  
→ for more

MORE IMP - AS RICHARDSON - PROMOTE SMALL BUSINESSES = BRIDGE 'G'

RICHARDSON  
ILLUSTRATION:  
NOT LINKED  
TO OTHER  
INDUSTRIES  
TARIFTS  
WITHOUT  
A FALL IN  
INFLATION

TO FACILITATE  
- DEVEL -  
GROWTH OF WORKS  
RICHARDSON:  
CHANGING  
INTERNATIONAL  
DIVISION OF  
LABOUR

INDUSTRIAL  
INNOVATION  
NOT PRODUCE  
MORE JOBS?  
ROBOTS



inflation has become all too well entrenched in our economies. It has had powerful direct and indirect effects on the profitability of our industry and on its international competitiveness. It is thus the enemy of economic prosperity and both fiscal and monetary policy will have to continue to reflect the need to bring down and then keep down the rate of inflation.

As Deans said:

We are all agreed that the aim should be to secure lower interest rates and so improve the prospects for industry and employment. But we must pursue that aim consistently with the need to control monetary aggregates in order to get inflation down. The essential requirement for reconciling these two aims is to maintain tight control over our fiscal policies, to restrain the growth of public expenditure and to avoid reductions in taxation inconsistent with the fundamental requirements of policy. Only by these means can we implement what the draft <sup>pieces of work</sup> ~~draft~~ <sup>document</sup> ~~communiqué~~ <sup>refers to</sup> describes as "a strong and co-ordinated anti-inflation policy" [Last sentence of EMRENBURG: paragraph 5(c)].

UNIL WE CAN AFFORD TO DO

IN 2 BRANCHES AND AS DEANS AT THE SAME QUESTION

RADIATING DOLLAR INFLUENCE ACROSS THE OCEAN

In our dealings with our ~~American friends~~, we need to make this same point, namely that it is essential to maintain tight fiscal policy in order to avoid placing too much strain on monetary policy and thus causing unnecessarily high interest rates. But I am very doubtful of the wisdom of indulging in public criticism of United States policy. Such criticism could easily be misconstrued as a lack of interest in a strong dollar. The stability of the international monetary system depends on confidence in the main reserve currencies. In the past we have criticised the United States for allowing the dollar to weaken - this is what we used to mean by "benign neglect". We cannot now, when the dollar is strong, criticise them for policies which are keeping it strong. Our approaches to the <sup>question in international context</sup> ~~American authorities~~ should therefore be conducted in private and should emphasise three points:-

SCHEM

IMPREG N

- i. Support for their ~~underlying~~ anti-inflation policy.
- ii. Emphasis on the essential need to maintain tight fiscal policy to avoid unnecessarily high interest rates.

ATTN 10

iii. ~~Emphasis on the problems caused for their Allies by if their techniques of monetary control result in highly volatile interest rates.~~

CD ELORS

That is why an aspect of way in which work together

Our approach to the solution of these joint problems of high inflation and high unemployment has an essential Community dimension. In the Community we can share experience and help each other to convince public opinion of the need for policies to lay the foundations for sustainable economic growth. We also need to adapt <sup>specify</sup> Community policies to respond to new problems as they emerge. The forthcoming reviews of the Regional and Social Funds provide an opportunity to do this. We must take that opportunity to ensure that these Funds contribute to the solution of the special problems of <sup>Economic Growth</sup> ~~urban and industrial decline~~ created or made worse by the oil price increases and growing competition from the newly industrialised countries. Many traditional industries have been severely affected by these developments and this has caused considerable problems for urban areas which depend on them for a substantial proportion of their employment opportunities.

IMPACT - DELORS - A  
CO. OP ~~WAS~~ WERE  
APPROPR. ARE, + A  
COMPET. WERE THAT  
IS APPROPR. ARE

- Close by ELORS, 26  
DELORS

① Not a Cique; grand; dirigisme  
But

② Confidence in President's ability to draw together



Press

Must deal with

What is going round outside  
about "French call for lower  
US interest rates"

repeat you  
3 points

There is also a view  
detectable among them that  
a "reflation bandwagon"  
may be rolling.

quote  
sentence  
about  
inflation



? EMS

Paris speed  
until now.

even so positive steps can  
be taken.

small & medium sized coys.

# Good days work: degree of agreement

- Possible to draw a no. of conclusions:
  - my personal impression
- Unanimous: diff. concern about dev. of unemp.
- Broad degree of agreement: on analysis
- When difficulties lay.
- No magic formula.
- Need for joint action to back up past efforts
- Economy & coalition
- Policy to fight with & meet, decreasing highest priority: stimulus closely inter-connected
- Re. cat. of Macroeconomic.
- Role of ability to grant influence: under use of various policy instruments
  - reducing structural unemp.
  - improving infra. standards, other. local development
- Problems common to all. Different states can accept different imbalances, with different categories.
- Nevertheless, most states show co. objective action to join
- Some signs that some. necessary a way. but still might be extra degree of unambiguity
- Partic. level of interest rather than a wide area.
- Must not forget to provide financial means as it is.
- Has a intended dimension

}

An inv. invited Com.,  
 in light of the fact,  
 to make the records  
also, in light of the facts of Com.,  
 the fact. to a certain extent it is not  
do the fact to derive by fact, in  
 the form.  
 If this Com. is to collect, then  
 it is to follow the procedure.

- Need more productivity
- .. shorter hours
- .. smaller product
- improve product processes.

This means gradual reduction of subsidies to  
 welfare, education, training in small  
 social changes.

For market: not only need large projects,  
 but also build + maintain high standards,  
 + in many parts.

Also need to remedy lack of flexibility,  
 especially those concerning labour market:  
 need for mobility,  
 vocational training -

Rigid systems of fixing wages + incomes needed with  
 minimum, loss of other jobs

diff. Council @ unemp. of women, youth + old.

Looked for

- 1) Coordination of work units
- 2) N.C.I
- 3) Reform of soc. + regional funds

- 1 - this latter, greater priority to problems of young people
- 4) Capital of E.C.B
  - 5) Better co-ordination of structural funds





- U.S.

77

- Williams

-

I do hope ( in the interests of  
establishing good relations with Delors) that  
you will say to Press that you were v.  
pleased to welcome him, v. unpleased by  
his considered intervention, his commitment to  
responsible monetary policies and, above all,  
by his commitment to the Community.

JUMBO COUNCIL

11/6/81

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SPEAKING NOTE FOR SECRETARY OF STATE FOR EMPLOYMENT

I am sure that everyone at this Council is deeply concerned about the high levels of unemployment throughout the Community. Unemployment represents a tragic waste of human and economic potential, and we should certainly not wish to neglect any opportunity of practical action which the Community might be able to take, consistent with our varying national objectives, which would help to reduce it to more tolerable levels.

It would be wrong to suggest that unemployment is necessarily either wholly or mainly the fault of governments. In the UK, successive governments over the past twenty years have tried various means of supporting industry, stimulating investment and creating jobs. Yet the underlying trend of unemployment has continued to rise with seeming inexorability. The fact is that we are confronted with far reaching changes in the economy and the nature of the labour market, and in some cases with failure to adapt to them quickly enough. The remedy must lie in changes in structures and in attitudes in which all parties - employers, workers and governments - must be ready to play their part, both at the national and the Community level.

As the Chancellor has said, measures to reduce unemployment will not succeed unless they are linked with a general economic strategy aimed at reducing inflation and ensuring that industry is competitive and profitable. These are the priorities which we have set ourselves in economic policy in the UK, and our success in achieving them - among many difficult problems - is a pre-condition for the success of the considerable efforts which we are making to meet the effects of unemployment. I should like to mention these briefly as an example of action by

.../one member

UNEM-  
PLOYMENT  
(SPEAKING  
NOTE)

one member state for which the Community can provide valuable support. 79

In the UK we are currently maintaining and developing a wide range of programmes aimed particularly to meet the needs of young people and other groups hard-hit by unemployment. At the present time, nearly 1 million people are benefiting from various employment and training measures supported by the government at an estimated annual cost of £1 billion. We are also spending a large amount of money to help industry adjust to the severity of the present recession.

We are paying particular attention to unemployment among young people, and our programmes for training or preparing them for employment are running at the highest level ever. This year our Youth Opportunities Programme will help no fewer than 440,000 young people and we want to move towards the position where all young people will have the opportunity of either continuing in full-time education or going into similar kinds of schemes.

Apart from these measures to help young people, we have schemes for the provision of temporary work for some of those suffering long-term unemployment, the encouragement of new, small enterprises, earlier retirement where a job is made available to an unemployed person and temporary support of people on short-time working to avoid redundancies. We are concurrently giving increasing attention to the quality and cost-effectiveness of these various programmes and to tailoring them to suit the particular circumstances of the population, industries and areas which they serve.

Looking towards the longer term, we have recently launched for consultation proposals for a major New Training Initiative, involving three objectives.

.../Training

Training to recognised standards should be available for the broadest possible range of skills and the greatest possible number of people. Young people entering jobs for the first time should receive a proper foundation of skills, knowledge and experience which they can apply to the many and varied demands they will meet in their working lives. And working people should be able to up-date and build upon their existing stock of skills, knowledge and experience during their careers. Our consultations in the UK will help us to find how best to achieve these objectives in our particular circumstances. But we do not forget that we are also training part of the future European labour market, and would hope to contribute to a joint development of training policies adapted to current and likely future needs through the medium of the Community.

I mention these schemes as examples of responses which one member state is currently taking to counter the problem of unemployment in our particular national circumstances. I am sure that my colleagues can refer to contrasting initiatives being taken in their countries and we are very willing to study and learn from their experience, wherever it may have a bearing on our own problems. Indeed, in a situation where none of us would claim to have found definitive answers to unemployment, I would see it as a major task for the Community and the Commission to encourage exchanges of experience, particularly on new experimental developments which need to be more widely known.

In saying this, I am arguing for an open-minded empirical approach and would hope for this reason that the Community should avoid binding instruments except where there is a clear consensus among member states that these offer the most effective answer to a particular problem. This applies particularly to the important subject of work-sharing, on which

.../the Commission



81

the Commission has produced a number of ideas, in their recent paper on "Problems of Unemployment", which deserve serious attention. Without wishing to prejudge the issues, we would see the main way forward in this field through the encouragement of collective bargaining, adapting work-sharing measures to the circumstances of each industry, sector or firm.

One of the major instruments of the Community for improving employment opportunities is the European Social Fund and I would like to say a word in conclusion about the forthcoming review of the Fund. While recognising all that has been achieved through the Fund in its present form, I hope that we will be able to adapt it more closely to the changing circumstances and needs of the Community. In particular, I hope that the Community will place more emphasis on measures to support training for young people and to deal with the effects of declining employment in traditional manufacturing industries, which is causing serious problems in the UK and several other member states. I also believe that there may be an important and expanded role for the Fund in supporting training to meet the needs of new technology, both for young people and adults. I hope that we shall be able during our forthcoming Presidency to help the Commission and other member states to develop our thinking on this key element in the Community's strategy for dealing with unemployment.

COMMISSION

RICHARD THORN ORTOLI DAVIGNON

(appui médi)

ΕΛΛΑΣ

EVERT (FIN)  
LASKARIS (EMPLOI)

FRANCE

DELORS (ECO-FIN)  
AURoux (TRAVAIL)

~~QUESTIAUX (Solid. nat.)~~

IRELAND

DILLON

Amb Reps Presm

ITALIA

ZITO

Sec. d'Etat TRAVAIL

LUXEMBOURG

SANTER (TRAVAIL)

HELMANGER  
(Sec. d'Etat Econ.)

VAN DER STEE

PRESIDENT

DEUTSCHLAND

EHRENBERG (TRAVAIL)  
FUCHS (Sec. d'Etat TS)  
~~SEHLECHT~~  
(Sec. d'Etat Econ)

DANMARK

NØRGAARD (Econ)

ANKEN (Travail)

BELGIË  
BELGIQUE

CLAES (ECON)

DEWULF (EMPLOI)

UNITED  
KINGDOM

HOWE (FIN)

PRIOR (EMPLOI)

NEDERLAND

ALBEDA  
(SOC)

11/6/81 -

FINAL VERSION

Provisional text

Draft conclusions - Joint Council (ECO/FIN - Social Affairs)

1. In accordance with the instructions given by the European Council at its meeting on 23 and 24 March 1981 in Maastricht and taking account of the results of the Standing Committee on Employment on 29 May 1981 regarding unemployment problems in the Community, the Council met on 11 June 1981 in Luxembourg attended by the Ministers for Economic Affairs, Finance and Social Affairs.
2. The representatives of the European employers' and labour organizations were consulted during preparations for this meeting.
3. The joint Council meeting dealt with the following subjects:
  - (a) Assessment of current economic and financial policy with reference to the crisis and in particular the job opportunity situation (i.e. anti-inflation measures together with interest policy)
  - (b) Stimulation of investments to encourage job opportunities
    - identification of new growth sectors (new technology, energy and services)
    - private and public investments
    - the role of small and medium-sized undertakings
  - (c) Improvement of competitive ability
    - need for industrial adjustment (productivity)
    - flexibility of the labour market (mobility, training and wage policy)
  - (d) Need for social solidarity
    - fair distribution of the burdens which result from combating the crisis (costs of social security)
  - (e) Specific measures to combat youth unemployment

DRAFT  
CONCLUSIONS  
OF  
THE  
COUNCIL



4. The Council reached agreement on the analysis of the socio-economic situation, the major problems and the possibility of achieving some improvement by means of a joint approach.

5. Assessment of the current situation

- (a) The Council agreed that the world recession, which was largely the result of the sharp increases in the price of oil, and the great expansion in labour supply had led to the disturbingly swift growth of unemployment. The Joint Council of Ministers for Economic Affairs, Finance and Social Affairs noted that a lasting increase in job opportunities and combating unemployment would only be possible if economic growth were restored.
- (b) The Council thought that to restore economic growth endeavours must be made to achieve financial stability and restructure economies at both national and Community level. It referred in this connection to the guidelines given by the European Council.
- (c) The Council noted that in their endeavours to achieve lasting growth the Member States were confronted to a varying degree with policy restrictions, imposed by differing financial and economic imbalances. The removal of such imbalances, which were reflected in the balances of payment, the considerable budget deficits and high inflation, was a sine qua non for achieving a lasting increase in growth.

The Council thought that the Community was now involved in this process of adjustment which would not only be long, but should also be characterized by adequate continuity. This meant that policy-making must fit in with medium-term policy. It was to be recommended that the Member States follow developments closely and harmonize their policies with each other as far as possible to ensure that they did not fall into a deflationary spiral. The Council thought that an agreement with management and labour, both assuming their own responsibilities, was essential.



The Council welcomed the fact that for some months now outside Europe there had been the first signs of economic recovery and consequently it could be expected that economic recovery within Europe might begin before the end of the present year. However a high international interest level remained a hindrance to achieving such recovery. A strong and co-ordinated anti-inflation policy remained imperative.

- (d) The Council was aware of the fact that the economic situation in the Community had a clear international dimension. On the one hand this meant that there had to be intensive consultation with other industrial countries and efforts must be continued to safeguard world trade against any restriction through protectionist measures. On the other hand no less attention should be paid to the position of the developing countries which had suffered serious repercussions as a result of the economic recession. The continued development of these countries was an essential stimulus for any revival of the economy in the industrialized countries.

#### 6. Stimulation of investments

- (a) The Council agreed that to create permanent, economically viable job opportunities, it was necessary to encourage investments which strengthened structures by means of cost restrictions and increased productivity. This would only have a chance of success if at the same time the consequent risks and uncertainties were mitigated as far as possible. In this connection it was necessary to check sharp fluctuations in interest and exchange rates, to limit cost levels and to encourage the supply of risk capital.

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*Why is not 2nd also a precondition?*

The Council further pointed out that both private and official investments should be increased. As far as private investments were concerned a shift from income distribution to earnings was a precondition. This would have to be accompanied by measures designed to protect the situation of the lowest income groups as far as possible. As for official investments, the Council thought that efforts directed towards achieving a shift from current to investment expenditure would have to be stepped up.

(c) The Council thought that any strengthening of structures would depend to a considerable degree on renewing products, production processes and services. It said in this connection that the Community and the Member States must, by means of a co-ordinated policy, aim at increasing production capacity in growth sectors, and finding new growth possibilities in traditional sectors. The technological changes which were now occurring often affected numerous sectors. To develop such innovations, it was also necessary to speed up human capital formation and desirable to dismantle support for weak branches of industry and undertakings.

The Council thought that in encouraging investments to strengthen structures attention should not only be paid to large-scale projects but also to the introduction of new products by, and the development of new technology in small and medium-sized undertakings and the services sector.

(d) The Council also thought that in strengthening economic structures energy policy had an important role to play. Both energy saving and the use of energy sources other than oil were of vital importance for job opportunities and the balance of payments. Efforts in this area would have to be intensified considerably.



7. Improvement of competitive ability

- (a) The Council noted that current economic difficulties were also caused by the inability of economies to adjust adequately to economic change. The Council therefore thought that a vigorous effort must be made to combat the lack of flexibility which stood in the way of adequate economic adjustment. This involved both adjustments to production capacity and adjustments to the labour markets.
- (b) The Council thought that there should be greater mobility on the labour markets. This should in the first place involve measures to encourage retraining, rehabilitation and supplementary training. Also inflexibility in determining wages and incomes should be removed. This would involve taking a critical look at the system of indexed incomes and minimum wages.

The Council also agreed that greater mobility on the labour market could be achieved by encouraging greater flexibility in working hours (part-time working, overtime, temporary work and flexible pension arrangements). This was in the first instance a matter for management and labour. Attention would also have to be paid here to cost aspects with an eye to the competitive position regarding other industrial powers. Also the reversibility of any measures should be taken into account.

8. Need for social solidarity

- (a) The social security schemes and their financing should be examined more closely in order to see how socially justified adjustments could be made which at the same time had a less hampering effect on economic development and a limiting effect on labour costs. The same was true mutatis mutandis for social provisions other than social security.

- (b) The Council recognized that in the matters referred to social solidarity played a role in the relationship between those who were and were not employed.

9. Youth unemployment

The Council expressed deep concern at the ever-increasing youth unemployment which had to be regarded as a serious social problem. In addition to national measures the Council saw possibilities for taking measures at Community level. Attention would have to be paid here to greater co-ordination of schooling and training with the requirements of the labour market. The Council thought it of great importance that young people should after their training be able to gain experience in working life. To this end the Council said account should be taken of possibilities for part-time work for young people. Also there was urgent need for an investigation of possibilities for giving greater priority to those activities of the ESF concerned with young people.

10. Follow-up

- (a) The Council invited the Commission to take these conclusions into account in the studies concerning the socio-economic and financial situation in the Communities and to make the necessary proposals in the light thereof.

- (b) The Council proposed, in its forthcoming meetings of Ministers <sup>of Social Affairs,</sup> of Economic and Financial Affairs, and of Education, to pay close and continuous attention to the various subjects referred to above, with a view to achieving an effective and coherent policy.

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IRENE RIPLEY

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