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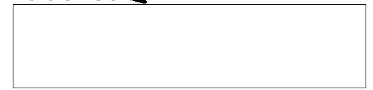

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International Economic & Energy Weekly

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18 March 1983

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International Economic & Energy Weekly

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International Economic & Energy Weekly

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Synopsis

Perspective—*OPEC: Awaiting the Market's Verdict*

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The longest ministerial meeting in OPEC's history ended in London this week with the unprecedented decision to lower official oil prices by $5 per barrel. Should the agreement survive the coming weeks of non-OPEC price cuts and destocking, the key to further success will rest with a rebound in consumption.

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World Economy: Fallout From Recession

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The worldwide economic slump of the last three years had created unprecedented problems in the postwar period. In the OECD, unemployment rose by record numbers; industrial capacity use fell to extremely low levels; and business failures surpassed all previous postwar peaks in most major OECD countries. In the LDCs, the recession slashed export earnings, contributing significantly to their debt problems, and forced a record 30 of them into IMF-mandated austerity programs. More favorably, the recession led to a surprisingly marked slowdown in world inflation rates.

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World Economy: Moving Into Recovery

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After three years of slump, the world economy appears on the verge of recovery. We believe that world economic growth in 1983 could be stronger than foreseen in many recent forecasts.

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United Kingdom: Protectionist Trends

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Trade protectionism is increasing in the United Kingdom despite Prime Minister Thatcher's vocal public support for and philosophical commitment to free market economic policies.

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United Kingdom: The Election Budget

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The new British budget announced on 15 March may have been the last chance for Prime Minister Thatcher's Conservative government to convince voters that it has delivered on its promises. It will have little impact on unemployment or on domestic growth but may be enough to keep Thatcher in office for another term.

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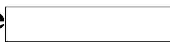
Financially Troubled Oil Exporters Adjusting to Price Decline 

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A further slide in oil prices will exacerbate the financial difficulties of a number of LDC oil producers, particularly Egypt, Indonesia, Mexico, Nigeria, and Venezuela. With foreign reserves down to a month or two of imports in some cases and with limited capability to borrow from Western banks, the falloff in oil revenues will necessitate tough and politically unpopular austerity measures.

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18 March 1983

Perspective

OPEC: Awaiting the Market's Verdict

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The longest ministerial meeting in OPEC's history ended in London this week with the unprecedented decision to lower official oil prices by $5 per barrel. The most important points of the new agreement are:

- The official price of Arab Light, OPEC's benchmark crude oil, was lowered to $29 per barrel.
- An overall production ceiling of 17.5 million b/d was set as an average for the rest of the year.
- Individual production quotas were allocated to all members except Saudi Arabia, which will act as a "swing" producer to balance supply and demand.
- Price differentials established a year ago will be retained, except for Nigeria, which will be allowed to maintain an advantageous $1 price differential over the marker crude.

The oil ministers agreed that the new prices were to be considered as floors, and the individual country allocations as ceilings. Price discounting and the dumping of oil onto the spot market were also forbidden.

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The intense pressures on OPEC to adjust prices were the result of falling oil consumption and company efforts to reduce inventories. Free World oil consumption this winter fell about 6 percent below year-earlier levels as relatively warm weather—about 15 percent warmer than normal—pushed heating oil use about 1 million b/d below expected levels. As a result, oil companies were left with stocks well in excess of their needs and, combined with expectations of lower prices, caused a sizable inventory liquidation of about 4 million b/d in early 1983. Inventory liquidation and reduced consumption pushed demand for OPEC oil down to the 15 million b/d level in recent weeks. Market weakness was further intensified by reports of increased Soviet exports to Western Europe in recent months.

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Given current market conditions, OPEC's new overall ceiling is about 2.5 million b/d in excess of demand. Most of this is being absorbed by Saudi Arabia, whose current production is under 3 million b/d. Much uncertainty surrounds the willingness of certain members to observe the new ceilings and the apparent room for cheating in the agreement. Because the quotas are for production only, some members can still raise sales by exporting from stocks.

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Two members that ignored last year's quotas—Iran and Libya—are currently producing a combined 300,000 b/d above their assigned ceilings and their adherence to the new accord is in doubt. Venezuela, however, apparently has enough oil in storage to meet its export goals for the year while producing within the new ceiling. At the same time, members facing serious revenue problems, such as Nigeria and Indonesia, are producing a combined 500,000 b/d below their quotas and would like to produce more.

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Nigeria will come under severe pressure to cut prices again if sales fail to increase or if North Sea producers adjust prices downward as several market observers expect. Lagos has already threatened to match any North Sea price cut. Price cuts by other non-OPEC producers would also add downward pressure and fuel market expectations of a downward price spiral. Mexico lowered its prices $2 to $3.50 per barrel following the OPEC meeting, and the Soviet Union can be expected to remain competitive to ensure hard currency sales.

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The main near-term factors heavily influencing the fate of the agreement are market psychology and Saudi willingness to bear the brunt of the likely downard pressure on demand. Both these factors pose considerable uncertainties:

- Most observers believe the agreement lacks credibility under present market conditions. If this attitude continues, as seems likely for at least a few weeks, companies will continue to unload stocks and keep OPEC production well below 17.5 million b/d.
- The Saudis achieved the price cut they apparently have desired for several months, and Riyadh's willingness to play the role of swing producer may underpin the agreement. Saudi output, however, is already below 3 million b/d and they may have little room or desire to go much lower.

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Should the agreement survive the coming weeks of non-OPEC price cuts and destocking, the key to further success will rest with a rebound in consumption. There are no signs yet that the decline in oil use has bottomed out, and there is little hope that it will until a sustained economic recovery gets under way in OECD countries.

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Briefs

Energy

Mexican Oil Price Cut

We believe Mexico City's recent oil price cut was not large enough and came too late to allow Mexico to restore its export volume. On 14 March, Pemex cut light oil prices $3.50 per barrel to match the new $29 OPEC benchmark, while it cut its heavy oil $2 per barrel to $23 per barrel; Mexico's new average oil price stands at $26 per barrel compared with an earlier level of $28.75. Because Mexico deferred lowering oil prices so long, exports fell one-third in February and another one-third during the first nine days in March. To regain its earlier export level, we believe Mexico would have to cut average oil export prices another $1 to $2 per barrel.

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Ottawa Considers Reducing Gas Export Price

Faced with a shrinking share of the US market and the prospect that falling oil prices may cut that share even more, Ottawa is considering an adjustment in the price of Canada's natural gas exports. The current price of $4.94 per thousand cubic feet could be cut by 40-60 cents. Although a decision has not yet been made, Ottawa is under considerable pressure from the gas-producing provinces to take some action to prevent a further decline in Canada's gas exports, currently less than half of the authorized volumes. A reduction in the Canadian export price could force a similar cut by Mexico in the price of its gas exports.

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Iranian Oilfield Damage

two production platforms in the Nowruz oilfield suffered extensive damage as a result of an Iraqi attack on 1 March. Both platforms are blowing oil and on fire. A third platform received some minor damage as a result of the attack, which also sank an Iranian workboat, killing 11 people. Another well on a fourth platform in the Nowruz oilfield has been leaking crude at a rate of about 1,500 b/d for more than a month. The large oil slick that has formed is creating a potential threat to water supplies in Kuwait, Saudi Arabia, Bahrain, and Qatar. Some of the approximately 85 desalination plants serving these countries may have to be shut down if the slick reaches the plants' water inlets. Water shortages lasting up to several weeks could result. Because of the risk of further Iraqi attacks, no attempt will be made to extinguish the fires and stop the flow of oil until Baghdad provides some guarantee that it will not interfere with the work.

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Polish and South African Coal Export Plans

According to the state coal trading company, Weglokoks, Poland intends to export 33 million tons of coal in 1983, with 20 million tons earmarked for Western markets to earn hard currency. Last year, exports totaled 28.5 million tons—15.5 million tons to the West and 13 million tons to socialist countries. South Africa plans a 17-percent rise in exports this year to 32 million tons. In 1982 South African shipments declined for the first time in over a decade, largely because of increased competition from Polish exports. Although we believe projections for both countries will prove optimistic because of sluggish worldwide demand and coal transportation problems in Poland, US suppliers nevertheless will face fierce competition in the world coal market. 25X1

Indonesian Loan Agreement for Refinery Expansion

25X1 Jakarta has signed a loan agreement with the US Export-Import Bank to help finance expansion of Indonesia's Cilacap oil refinery on the southern coast of Java. The loan—$292.5 million with 11-percent annual interest—will be repaid over 10 years. The Japanese reportedly will put up an additional $300 million for the project. The planned expansion of Cilacap's refining capacity from about 90,000 b/d to some 300,000 b/d by the end of the year will bring total refining capacity to about 550,000 b/d, enough to meet current domestic requirements of 485,000 b/d. With this expansion and completion of planned expansion of the Balikpapan refinery and Dumai hydrocracking facility, Jakarta will be able to meet all of the country's growing domestic requirements, making processing deals it currently has with Singapore refiners unnecessary. 25X1

Cameroonian Petroleum Plans for 1983

We estimate Cameroon's oil production will average over 120,000 b/d this year, up almost 20 percent from 1982 levels. Lokele field, operated by the US company Pecten, was brought on stream at 5,000 b/d in early February and was the first of several small fields that will be placed in production this year. Oil exports should average some 90,000 b/d, netting revenues close to $1 billion if Cameroon's 1983 average export price maintains its historical parity with the OPEC benchmark. 25X1 about 70 development and exploration wells will be drilled this year, compared with 86 in 1982. The French company Elf is the only operator with a firm exploration drilling program for 1983. Gulf Oil has not had a drilling program since 1981 because of the soft oil market and negotiating difficulties with the Cameroonian Government over contract renewals. Last week the company formally notified the Ministry of Mines and Energy that it would seek international arbitration to settle the yearlong dispute. 25X1

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International Trade, Technology, and Finance

EC Exchange Rate Realignment Expected

A realignment of the exchange rates of the eight currencies in the European Monetary System may come as early as this weekend. For most of the past three weeks, the Belgian and French francs have been at the bottom of the range allowed against the West Germany mark under the EMS. According to the financial press, the French, West German, and Belgian central banks spent more than $1 billion in that period to support the exchange rate. Despite denials that a realignment is imminent, the French Finance Ministry reportedly prepared a study of the economic impact of an 8-percent devaluation of the franc against the mark. West German Chancellor Kohl's election victory and the trouncing of the left in the French municipal elections last week have further strengthened the mark and weakened the franc. Moreover, speculation about a realignment has increased pressure on the exchange rates. 25X1

Brussels, Paris, and Bonn have been resisting a realignment. The Belgian Government imposed capital controls last Monday, which strengthened the Belgian franc against the mark. The Belgians and the French fear the inflationary impact of a devaluation. The West Germans believe that a more expensive mark would harm exports at a time of double-digit unemployment rates. At a minimum, the three governments all want to put off a realignment until after cabinet changes in France and West Germany. Pressure on the foreign exchange markets, however, probably will force their hands. When the realignment comes, the French may effectively devalue the franc by as much as 10 percent against the mark. The West Germans may revalue the mark, a move that would be equivalent to devaluing the other currencies. The Belgians—and possibly the Italians, Irish, Dutch, and Danes—also may devalue their currencies, but by a smaller amount. 25X1

MITI Efforts To Restrain Machine Tool Exports to the United States

In a belated effort to slow Japanese penetration of US machine tool markets, MITI now intends to enforce its export cartel's floor price on machine tools, the action to result in substantial price increases for Japanese machine tools sold in the US market. 25X1 Established in 1978 to head off US dumping charges, the cartel sets a base price for Japanese machine tool exports, but it has been ignored by Japanese firms 25X1

MITI efforts to restrain machine tool exports probably will have little immediate effect on Japanese sales if US demand recovers, because Japanese firms are sitting on huge US inventories of machine tools. The buildup occurred when demand plummeted in the US market in 1981-82. In one recent example, the president of the Japanese Machine Tool Builders Association said that Japanese manufacturers had 3,000 unsold numerically controlled (NC) lathes in the United States in November 1982. 25X1

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Japanese firms had a nine-month supply of NC machine tools in US warehouses in January. the Japanese plan to lower prices to unload these machines if demand recovers sufficiently in 1983.

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LDCs Deemphasize Global Negotiations

The Nonaligned Summit, held in New Delhi earlier this month, downplayed Global Negotiations—the long-stalled Third World proposal for comprehensive reform of international economic institutions such as the IMF, the World Bank, and GATT—and emphasized instead the idea of piecemeal international economic change. The LDCs probably will directly pursue such reforms as the relaxation of IMF conditionality and an increase in the World Bank's lending capacity. They are likely to employ their new strategy at UNCTAD VI, the North-South conference scheduled for June in Yugoslavia.

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West German Turbine Parts for Soviet Pipeline

The West German firm AEG-Kanis is to supply rotor parts for Soviet-manufactured, 25-megawatt turbines, some of which may be intended for the gas export pipeline to Western Europe.

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By late February AEG reportedly had begun ordering forgings and was buying machine tools, using development funds provided the company by the state government of North Rhine–Westphalia during the US embargo on oil and gas equipment to the USSR. By seeking West German help, the Soviets appear to acknowledge they are having problems producing the turbines. Although the press in the USSR has announced the successful testing and the start of serial production of the turbines in Leningrad, the plant there could either be having trouble with the first batch or be unable to produce enough units. Production of 12 to 17 turbines was scheduled for 1983, and the media have claimed some units were to be used on the export pipeline.

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Japan Reschedules North Korean Debt

Japanese creditors have agreed in principle to reschedule North Korean debt payments due through 1985, according to Japanese press reports. Under the new agreement, payments of approximately $102 million in principal will be deferred until 1986-89; P'yongyang, however, will continue to make semiannual interest payments on its $255 million debt. North Korea remains in default on debts amounting to $1.3 billion owed other Western creditors, mainly European banks. While North Korea is not actively seeking a resolution of default because of its severe hard currency shortage, it is attempting to preserve trade relations with Tokyo. Japan is North Korea's largest Western trading partner and is the most likely source of advanced technology and equipment the North needs to modernize its industry.

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Saudi Restrictions on Imports From Lebanon

Saudi Arabia is restricting imports from Lebanon, apparently because of unhappiness with Lebanon's handling of Palestinian issues as well as concern that Israeli goods have entered Arab markets via Lebanon. The US Embassy in Beirut has obtained a circular allegedly issued by Riyadh prohibiting temporarily the importation of certain foods and manufactured items from Lebanon and requiring strict inspection and an acceptable certificate of origin on all other goods from there. The letter cited concern that Israeli goods have circumvented the Arab boycott by being transshipped through Lebanon. Contradictory claims by the Lebanese and the Saudis make it difficult to assess the impact of Saudi restrictions. The US Liaison Office in Riyadh reports that customs officials and Lebanese merchants in Saudi Arabia are playing down the effect. The Lebanese claim, however, that the restrictions are having a devastating impact on their exports. 25X1

National Developments

Developed Countries

British Bank in Trouble

25X1 Many international banks reportedly have cut their interbank deposits with Hambros because of its poor financial outlook—a number of British and Norwegian banks are major depositors. Hambros is a small but well-known international bank with 1982 assets of about $2.5 billion; it has been one of the major banks involved in oil tanker financing. Both the drop in demand for oil and poor real estate investments were cited as causes for Hambros's problems. In considering any rescue effort, the Bank of England will have to determine the extent of difficulties that Hambros faces. 25X1 In the event Hambros does fail, the interbank market may react further and cut deposits with those banks exposed to Hambros. 25X1 25X1

Continued Italian Budget Austerity

New Italian budget estimates indicate that Rome's goal of holding this year's deficit to last year's level of $52 billion—about 15 percent of estimated GNP—may not be reached. According to press reports, some officials estimate that the deficit could rise to about $57 billion unless Rome comes up with additonal spending cuts or revenue. Although the government already has approved several measures to keep the deficit in line, including higher transportation fees and tax increases, these measures have been offset to a large extent by a reduction in income tax rates to correct for "bracket creep," part of the government's concessions in a January labor accord. Rome is considering additonal measures including cuts in politically sensitive social programs and further tax increases. In addition, the government is considering limiting the drop in administered oil product prices and applying the additional revenues, as it did last year, to Italy's financially troubled electric utility. 25X1

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Social spending cuts will be the most difficult austerity measure to take. Rome already has modified earlier proposals for lower social security and health benefits in the face of strong labor union opposition. If the ruling coalition becomes deadlocked over the issue, Socialist party leader Craxi may use the crisis to force early elections. The government could avoid a protracted debate by resorting to revenue measures to keep the budget in line. We believe, however, that even if Rome adopts new austerity measures, sluggish GNP growth this year, government concessions on the labor accord, and high interest payments on the national debt will result in an expansion of the deficit, a worsening balance-of-payments situation, and higher inflation.

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Closer Scrutiny by Tokyo of Overseas Commercial Loans

With many Western banks under increasing strain because of their large lending to LDCs, the Japanese Government is imposing new guidelines on domestic banks and has indicated that it will be monitoring their overseas lending more closely. According to the US Embassy, a Ministry of Finance official has acknowledged that Japan has decided to improve collection of country exposure data and require a higher proportion of long-term deposits as funding for long-term loans. Other changes under study include a limit on banks' holdings of foreign currency assets and the creation of a reserve for bad debts on overseas lending. Under certain circumstances, banks will be allowed to exceed the current ceiling of 20 percent of equity on a bank's medium- and long-term loans to any one foreign country. This would permit Japanese banks to participate in refinancing packages for LDCs where heavy exposure already exists; such an exception already has been made in the case of Mexico.

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Estimated Japanese Private Overseas Loans Outstanding [a]

Billion US $

Total loans	**58.44**	LDCs (Continued)	
LDCs	29.30	OPEC	4.60
Latin America	17.42	Venezuela	1.75
Mexico	5.98	Indonesia	0.99
Brazil	5.83	Algeria	0.78
Argentina	2.09	Ecuador	0.39
Panama	1.53	Nigeria	0.34
Asia	5.15	Communist countries	3.81
South Korea	1.86	East Germany	0.96
Hong Kong	0.88	Hungary	0.81
Philippines	0.87	Poland	0.55
Africa	2.06	USSR	0.19
Liberia	1.46		

[a] Medium- and long-term loans by Japanese banks and insurance companies as of the end of September 1982.

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The level of Japanese overseas lending has grown rapidly since 1980 when the government began liberalizing foreign exchange laws. According to a Japanese business newspaper, medium- and long-term offshore loans totaled about $58.4 billion by the end of September 1982, up $11.6 billion from the year before, but we cannot judge the accuracy of the data. In addition, short-term loans have increased substantially, particularly in 1982, as banks tried to avoid the 20 percent of equity guideline and short-term credits seemed less risky. We do not believe the new MOF guidelines will bring about any significant reduction in Japanese medium- and long-term lending, although some private banks reportedly are reluctant to increase their short-term exposure in Latin American countries. 25X1 25X1

Australia's Economic Situation Worsens

The economy continues to deteriorate with unemployment in February reaching 9.6 percent compared with 9.2 percent in January. In addition, the projected budget deficit for the fiscal year beginning July 1983 has been revised upward from $5 billion to $8 billion. As a result, Prime Minister Hawke suggests the Labor government will reassess its economic program and may not be able to follow through on campaign promises to stimulate the economy, including a proposal to cut taxes. Hawke may also extend the current wage freeze, scheduled to end in June, to the end of this year and has called for a week-long summit of government, business, and union officials to try to deal with the economic situation. 25X1

Less Developed Countries

Mexican Debt Developments

Mexican financial authorities are drafting schemes to encourage Mexican companies to reschedule debts held by foreign creditors, according to US Embassy reporting. To handle financing for private debt, FICORCA, a new government trust funds was formed on 11 March. Although financial details have not yet been made public, the US Embassy reports that FICORCA will finance foreign exchange obligations at about one-third below the current controlled exchange rate if a foreign creditor is willing to reschedule the private debt over six to eight years. In addition, to take some pressure off businesses, the government has announced a new subsidy in the form of three-year credits for one-fourth the interest obligations incurred by the firm from 5 August 1982 to 31 January 1983. 25X1

Because little progress on private debt rescheduling has been made, private-sector debt arrearages are increasing. Since August, because of the lack of exchange at the subsidized rates offered by the government, interest payments of only about $60 million have been paid on more than $1 billion past due by the private sector. Another $1 billion in debt principal is currently past due.

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Under these circumstances, many commercial banks have begun classifying the writing off private-sector Mexican loans. Alfa Industries of Monterrey—the largest private sector firm in Mexico—is an example of a Mexican firm under great pressure. Some creditors are challenging Alfa's debt rescheduling discussions because they want to declare the company in default and attach its assets. Other Alfa creditors may have to spend as much as $75 million to buy out the hardliners, avoid default, and prevent the implementation of more complicated cross-default clauses. 25X1

Argentina Backing Away From Austerity

According to US Embassy reports, Argentina apparently intends to breach agreements with foreign public and private lenders by imposing price controls on essential goods, postponing public-service rate hikes, and reducing interest rates. They also reportedly plan to approach the IMF to renegotiate their three-month-old agreement, made public only recently. One cabinet member has already resigned in anticipation of the policy shift, and other officials probably will follow. Foreign lenders will probably not make new loans, which could prompt the Argentines to unilaterally suspend debt payments. Lack of fresh funds will prevent economic recovery and fuel inflation, which so far this year is running well over 200 percent. 25X1

Jamaica Considers Lowering Bauxite Taxes

The weak world aluminum market and producer threats to scale down their Jamaican operations have prompted Kingston to consider bauxite tax modifications before the 1974 levy expires in December. Possible adjustments include more favorable tax rates for alumina producers and other production and investment incentives. Kingston is anxious to rekindle investor interest in modernization and expansion. US suppliers have steadily shifted to non-Caribbean sources, but Jamaica still contributes about 30 percent of the bauxite and alumina required for US aluminum consumption. Nonetheless, Kingston will resist any immediate slash in bauxite tax receipts that could cause Jamaica to overshoot its budget deficit target under the IMF program. Any reduction in the cost of Jamaican bauxite would make it difficult for Suriname to sustain its recent demand for higher bauxite taxes. 25X1

Grenadian Claims Belie Economic Troubles

According to Embassy reporting, the Grenadian economy appears to have stagnated in 1982, despite Deputy Prime Minister Coard's claim of 5.5 percent real growth. Continued low world prices will keep key export earners—nutmeg, mace, and bananas—from providing much relief. In addition, the probable move from Grenada of the US-run medical school, which contributes about 20 percent of the country's foreign exchange receipts, will be an economic blow. Many local businessmen predict an economic decline as Cuban-assisted construction on the Port Salines airport nears completion and

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associated loan repayments begin to come due over the next few years. Grenadian officials have publicly voiced optimism that better flight connections will reverse the 10-year decline in tourism, but hotels are not expected to expand sufficiently to support a large tourist influx. Without larger Soviet Bloc support, public spending to offset poor private-sector performance will become much harder to sustain. 25X1

Problems in Restructuring Sudan's Foreign Currency Market

Recently implemented government regulations designed to reorganize Sudan's foreign exchange market have halted private foreign exchange transactions and could curtail the few imports that are privately financed unless the government corrects the situation soon. Khartoum on 7 March ordered commercial banks to replace licensed private traders in the free foreign exchange market. The free market is necessary to generate badly needed foreign exchange for private transactions, and the government prefers a regulated to a black market. The central bank, however, has issued contradictory regulations and has so far failed to authorize foreign banks to operate in the new market. Unless swiftly resolved, the present confusion will further tarnish Sudan's business reputation, already poor because of foreign debt problems. 25X1

Kinshasa Trims Budget Deficit To Secure IMF Loan

In an attempt to strengthen its case for a one-year standby loan from the IMF, Zaire recently announced a budget for 1983 that projects a deficit exactly equal to the amount—$420 million—that the Fund has indicated would be tolerable, according to the US Embassy in Kinshasa. By deferring all public spending except for salaries, Zaire reportedly has achieved surpluses during the first two months of 1983 and has remained well within suggested IMF budget targets. We believe that Kinshasa will find it increasingly difficult to stay within the budget as spending pressures mount later this year. Even if Zaire secures an IMF agreement and Paris Club debt rescheduling, the government's ability to live within the budget will depend largely on export revenues and foreign aid. 25X1

Kenyan Financial Problems

Kenya continues to experience severe financial difficulties that could jeopardize access to vital Western aid. Nairobi's most immediate problem is to reduce its budget deficit by nearly $80 million to meet IMF targets by the end of this month. In addition, Embassy reporting indicates that Nairobi's efforts to conserve scarce foreign exchange—currently enough for about a month's imports—have substantially reduced business and international trade activity, major sources of revenue. Kenya's deteriorating financial situation raises questions about Nairobi's ability to secure enough assistance to cover this year's projected current account deficit of $375 million. Failure to meet IMF conditions probably would prompt Western donors to hold off until Nairobi

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indicates a greater determination to restore financial order. Western countries may decide to withhold funds in any case if Kenya goes ahead with plans to use aid money currently on hand for unauthorized purposes. President Moi already is under growing public pressure for his handling of the economy and cannot afford additional cuts in imports associated with the loss of aid.

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Thailand Seeks Second Structural Adjustment Loan

Thai Government and World Bank officials are negotiating the details of the $175 million loan, which is intended to enable the Thai economy to be more competitive internationally. Bangkok largely met conditions attached to its first structural adjustment loan, $150 million, granted last year. The government eased export and import restrictions slightly, implemented new tax measures, and raised energy prices to near-market levels. Conditions for the new loan, especially further tariff reductions and tax increases, will be harder to meet. Proposed increases in bus and rail fares, which Bangkok earlier promised the World Bank, are being reconsidered because of public opposition. These price hikes probably will be a point of contention in the current negotiations.

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1983 Singapore Budget

The 1983 budget introduced in Parliament early this month continues efforts to move the city-state into knowledge-intensive manufacturing and service industries and to compensate for slower export growth. Spending in the fiscal year that begins 1 April will be 18 percent higher than last year and emphasizes housing construction and infrastructure projects—such as industrial parks and the first phase of a $2.5 billion rapid-transit system. The government policy to encourage wider use of computers in manufacturing will be spurred by permitting full depreciation of computer purchases in one year. In an effort to improve Singapore's competitiveness against other international financial centers, especially Hong Kong, banks will receive a five-year tax holiday on all income from loans syndicated abroad.

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Communist

Possible Chinese Retaliation in Textile Trade With the United States

Several US firms report that business with China has declined since mid-January. At that time, Beijing announced it would stop new purchases of US synthetic fibers, cotton, and soybeans because of the failure of bilateral textile trade talks. Although trade officials in Beijing say that only those three products are officially affected, some businessmen believe there has been a shift away from imports of other US products such as machinery and equipment and chemicals. Chinese buyers have implied to textile machinery sales representatives that they will no longer exclusively buy US-origin equipment and that foreign-made equipment must be included in any purchase.

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We believe there may be a modest effort under way to nudge the United States into offering China more favorable textile trade terms. In many of the product categories experiencing sales declines, however, China already has surplus inventories or can obtain better quality products or lower prices elsewhere. Beijing may reduce purchases of some manufactures, but we expect continued grain trade and an overall increase in US exports of machinery and equipment to China. US businesses with countertrade contracts with China—the US firms supply equipment and assistance to Chinese textile mills in return for products—may be the hardest hit by the textile impasse. With relatively strict quotas on US imports of Chinese-origin textile goods, these firms now must sell their products in the less-lucrative international market. One US trading firm estimates that its combined losses from reduced fiber sales, decreased business opportunities in China, and losses on sales of Chinese fabrics and apparel will result in a decline of $100 million—20 percent of 1982 sales—in projected 1983 earnings.

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World Economy: Fallout From Recession

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The worldwide economic slump of the last three years has created unprecedented problems in the postwar period. In the OECD, unemployment rose by record numbers; industrial capacity use fell to extremely low levels; and business failures surpassed all previous postwar peaks in most major OECD countries. In the LDCs, the recession slashed export earnings, contributed significantly to their debt problems, and forced a record 30 of them into IMF-mandated austerity programs. More favorably, the recession led to a surprisingly marked slowdown in world inflation rates.

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Demand management policies generally fostered the declines in world economic activity over the past three years. As they focused on the goal of lowering inflation, most OECD governments put in place exceptionally tight fiscal policies in 1980-82. Central banks generally pursued tighter monetary policies as well.

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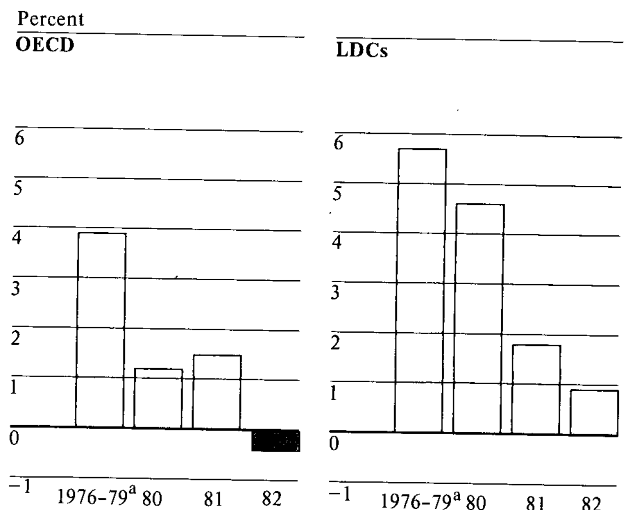
World Real GNP Growth



[a] Average annual.

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The Worldwide Slump in GNP

Over the last three years, the world economy experienced its worst slump since the end of World War II. In 1980-82, OECD real GNP rose a scant 2 percent; LDC real output increased at about a 2-percent annual rate, compared with a 6-percent pace in the last half of the 1970s.[1]

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The slump was unprecedentedly broad:

- Among the Big Seven OECD countries, only Japan recorded cumulative growth greater than 1.5 percent a year in 1980-82; despite a slight rebound, the UK's real GNP last year remained lower than in 1978.
- Unlike the 1974-75 recession, the downturn severely affected the smaller OECD countries. In 1981-82 seven of these countries—Belgium, Greece, Iceland, Luxembourg, the Netherlands, Sweden, and Switzerland—recorded cumulative GNP declines; only Turkey managed greater than 2-percent growth for the two years.
- The LDCs—both OPEC and non-OPEC—experienced the worst growth performances in over 30 years. OPEC real GNP grew only 2 percent

[1] Historical data presented in this article were obtained primarily from OECD and IMF statistical publications; estimates for 1982 were made by CIA.

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The Recession's Impact on LDCs

The world recession has had far-reaching impacts on the Third World. It has depressed growth to the lowest levels in the postwar period, slashed export earnings, caused unemployment to soar, and created major international financial problems. Moreover, it has not provided a reduction in inflation. The strength of the adverse effects on LDCs is in marked contrast to their success in insulating themselves from the 1974-75 recession.

The chief differences between now and 1974-75 lie in the international economic arena. In 1974-75 the Third World countries were able to finance economic expansion at rates more rapid than that possible with domestic resources because they had easy access to foreign funds. OPEC used its oil surplus to finance its expansion; the non-OPEC LDCs used increased borrowings from commercial banks to cover their needs.

The reverse of this situation has been true in this recession. The OPEC surplus is gone, constraining OPEC members' ability to expand their own economies. In addition, the indebtedness of the non-OPEC LDCs has become so large that concerns about their creditworthiness have forced many to reduce their rates of economic expansion. Many have had to implement formal austerity programs in response to IMF mandates.

Key LDCs Operating Under IMF-Mandated Austerity Programs

1980	1981	1982
Bangladesh	Bangladesh	Argentina
Guyana	Costa Rica	Bangladesh
Honduras	Guyana	Brazil
Jamaica	Honduras	Chile
Kenya	India	Costa Rica
Liberia	Ivory Coast	Guyana
Madagascar	Jamaica	Honduras
Malawi	Kenya	India
Morocco	Liberia	Ivory Coast
Pakistan	Madagascar	Jamaica
Panama	Malawi	Kenya
Sudan	Morocco	Liberia
Uruguay	Pakistan	Madagascar
	Panama	Malawi
	Senegal	Mexico
	Sierra Leone	Morocco
	Sudan	Pakistan
	Thailand	Panama
	Togo	Peru
	Uganda	Philippines
	Uruguay	Senegal
	Zaire	Sierra Leone
	Zambia	Sudan
	Zimbabwe	Thailand
		Togo
		Uganda
		Uruguay
		Zambia
		Zimbabwe

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during 1981-82 with a number of OPEC members experiencing declines in real output. In the non-OPEC Third World, the 0.7-percent growth estimated for 1982, was dramatically lower than any annual growth performance since 1950.

Impacts of the Recession

The impacts of the recession on the OECD economies were strong and mostly negative. Unemployment and business failures skyrocketed; only on the inflation front was there a significant positive effect.

Increased Unemployment. OECD out-of-work totals rose by 11 million persons in 1980-82, nearly double the jump that occurred in 1974-75. More than 30 million persons are now jobless in the OECD, nearly 9 percent of the labor force.

Western Europe was particularly hard hit. A cut in West European labor usage—in part a response to increases in real wages in the late 1970s—combined with rapid labor force growth to push joblessness up by 2.5 million even during the expansion

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World Economy: Changes in Real GNP *Percent*

	1976-79 [a]	1980	1981	1982 [b]
OECD	3.9	1.2	1.5	−0.4
United States	4.5	−0.4	1.9	−1.8
Japan	5.2	4.4	3.2	2.5
Canada	3.8	0.5	3.8	−4.8
Western Europe	3.3	1.4	−0.2	0.2
West Germany	3.9	1.9	0.2	−1.1
France	3.8	1.1	0.2	1.6
United Kingdom	2.5	−2.0	−2.0	0.5
Italy	3.8	3.9	−0.2	0.7
LDCs	5.7	4.6	1.8	0.9
Non-OPEC	5.6	5.7	3.1	0.7
Argentina	2.0	−1.6	−6.0	−7.0
Brazil	6.5	8.0	−2.0	0.0
India	0.4	7.5	4.6	−0.5
Mexico	6.2	8.3	8.1	1.0
Singapore	12.6	10.2	12.5	13.4
South Korea	10.4	−6.2	6.4	6.0
OPEC	5.8	2.0	−1.4	1.2
Indonesia	6.9	7.0	7.6	6.5
Nigeria	5.9	3.7	−2.4	−11.0
Saudi Arabia	9.5	10.9	8.1	5.2
Venezuela	4.8	−1.2	1.0	0.4

[a] Average annual percent change.
[b] Estimated.

OECD: Unemployment *Million persons*

	1979	1980	1981	1982 [a]
OECD	**19.1**	**21.3**	**24.7**	**30.2**
United States	6.1	7.6	8.3	10.6
Japan	1.2	1.1	1.3	1.4
Canada	0.8	0.9	0.9	1.3
Western Europe	10.4	11.5	13.8	16.2
West Germany	0.8	0.9	1.3	1.8
France	1.4	1.5	1.7	2.0
United Kingdom	1.3	1.7	2.6	2.9
Italy	1.7	1.7	1.9	2.1

[a] Estimated.

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years of 1976-79. Since 1979 an additional 6 million West Europeans have joined the unemployed ranks, pushing the overall unemployment rate past the 9-percent mark.

Depressed Manufacturing. Capacity utilization in the Big Seven manufacturing sectors fell to record low levels. Revenue losses, combined with high finance charges, to push many firms to the point of bankruptcy.

- In the United States, where manufacturing capacity utilization has fallen to the lowest point since the series has been recorded, business liquidations in 1982 were at the highest levels since the 1930s.

- In West Germany, 1982 capacity usage was 5 percentage points below the 1975 low point; at the same time, business failures, including some large prominent firms, hit postwar record levels.

- Even in Japan, where the recession has been mildest and capacity utilization remains the highest, bankruptcies have risen sharply.

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Drop in Inflation. The prolonged slump in real economic activity did lead to a rapid slowdown in world inflation. At about 8 percent, OECD consumer price increases in 1982 showed a remarkable turnaround from 1980 when OECD consumer prices rose by 13 percent, the worst record of the postwar period except for 1974.

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The shift in inflationary trends was even more pronounced in commodity markets. World oil prices stagnated, agricultural and metallic raw material prices dropped over one-fifth, and prices

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World Economy: Changes in Prices *Percent*

	1976-79 [a]	1980	1981	1982 [b]
Consumer prices				
OECD	8.8	12.9	10.6	8.4
United States	7.8	13.5	10.3	6.2
Japan	6.2	8.0	4.9	2.6
Canada	8.4	10.1	12.5	10.8
Western Europe	10.8	15.1	13.3	10.9
West Germany	3.7	5.5	5.9	5.3
France	9.7	13.6	13.4	12.0
United Kingdom	13.4	18.0	11.9	8.6
Italy	15.5	21.2	19.5	16.4
LDCs	31.5	35.9	30.0	53.8
Non-OPEC	38.3	42.7	35.6	59.7
OPEC	15.4	17.6	16.7	19.0
Factor prices				
Oil	14.1	65.3	11.8	−2.7
Food	0.5	34.0	−13.9	−20.9
Agricultural raw materials	13.9	4.1	−9.8	−13.8
Metals	11.7	10.6	−13.8	−9.7

[a] Average annual percent change.
[b] Estimated.

OECD: Changes in Hourly Earnings in Manufacturing *Percent*

	1972-80 [a]	1981	1982 [b]
OECD	**11.5**	**10.3**	**8.6**
United States	8.4	9.9	6.6
Japan	12.6	5.6	5.4
Canada	11.0	12.1	9.2
Western Europe	14.1	12.2	10.8
West Germany	7.5	5.2	4.4
France	14.8	14.5	13.6
United Kingdom	16.3	13.2	11.0
Italy	22.4	23.7	17.8

[a] Average annual percent change.
[b] Estimated.

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of world-traded food items were off one-third. Except for food, where downward price pressures have emanated chiefly from high levels of production, the recession has played a key role in commodity price declines.

OECD wage increases also moderated substantially. In Western Europe, rises in hourly earnings fell to only 11 percent last year, well below the 14-percent-a-year pace of the 1970s and fairly close to the 9-percent increases of the 1960s. Japan also has achieved a marked slowing of wage gains.

Recession-induced slowdowns in productivity growth, however, have limited the impact of favorable wage settlements on business costs. Unit labor cost increases in the Big Seven OECD countries have remained above 7 percent, down only about a percentage point from the average pace of the 1970s and a full 5 percentage points above the rate of unit labor cost increases in the 1960s.

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Government Economic Policies

Government demand management policies generally fostered rather than counteracted the decline in world economic activity, over the past three years as the political response to a decade of rampant inflation led to strong commitments to end the price spiral. In the Big Seven OECD countries, for example:

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- The Thatcher government implemented extremely contractionary fiscal policies, actually moving the budget toward surplus even in the face of a three-year decline in real output. According to OECD estimates, London's discretionary shifts in fiscal policy were more contractionary than in any other Big Seven country. London's monetary

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OECD: Changes in Money Supply

Percent [a]

	1976-79			1980-82 [b]		
	Monetary Base	M1	M2	Monetary Base	M1	M2
OECD	**10.2**	**9.8**	**11.7**	**5.5**	**6.8**	**12.1**
United States	8.1	7.6	8.6	3.8	4.7	7.1
Japan	9.9	9.3	12.4	4.6	4.9	8.8
Canada	10.4	4.8	16.7	4.6	7.6	13.6
Western Europe	12.5	12.4	13.9	6.4	8.8	12.8
West Germany	8.9	8.0	9.2	2.7	2.5	5.2
France	9.2	10.3	13.8	13.2	11.5	10.8
United Kingdom	11.2	14.5	11.9 [c]	2.0	10.1	14.6 [c]
Italy	19.8	22.3	21.4	13.7	10.1	10.3

[a] Average annual percent change.
[b] Estimated.
[c] Sterling M3 definition of the money supply.

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policy in 1980-82 was mixed. Growth rates of narrowly defined monetary aggregates, such as the monetary base and M1, were reined in sharply. On the other hand, broader definitions of the money supply, such as sterling M3, grew more rapidly, largely because of technical factors and institutional shifts similar to the recent changes in the US financial sector.

- Japan's demand management policies were generally contractionary on both the monetary and fiscal fronts. Despite a steady slowing of real domestic economic activity, the budget deficit as a share of GNP declined in 1980-81 only to rebound last year. The chief cause of the increase in the 1982 deficit was an unexpectedly large shortfall in tax revenues. Concurrently, expansion of Japan's monetary aggregates was reined in sharply.

- The OECD estimates that the discretionary tightening of Canadian fiscal policy was exceeded only by the United Kingdom and Japan's. Ottawa's monetary policy also generally was tighter in 1980-82 than in the 1970s.

- Ever fearful of inflation, Bonn also engaged in essentially contractionary demand management policies over the past three years. Despite a drop in GNP of 1.1 percent last year, West Germany's government budget deficit remained at a constant 4 percent of GNP. In addition, the Bundesbank slowed growth of credit. In 1980-82, M2 increased 4 percentage points less per year than in 1976-79; growth of M1 and the monetary base dropped even more.

- France shifted to expansionary policies with the coming to power of President Mitterrand in May 1981; the subsequent acceleration of French inflation, deterioration of competitiveness, and depreciation of the franc, however, forced a shift to contraction.

- In Italy, the budget deficit increased more in 1980-82 than in any Big Seven country except Canada and the United States. With shaky coalition governments unable to chart a clear fiscal

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Big Seven: Changes in Government Budget Balances, 1979-82 [a]

Percent of GNP

	Actual Change	Effect of Changes in Economic Activity	Effect of Increased Interest Payments	Estimated Discretionary Change
Big Seven	**−2.3**	**−3.0**	**−0.8**	**1.5**
United States	−4.3	−3.5	−0.6	−0.2
Japan	1.5	−0.7	−1.2	3.4
West Germany	−1.4	−2.8	−0.7	2.1
France	−2.2	−2.5	−0.9	1.2
United Kingdom	1.1	−4.4	−0.5	6.0
Italy	−2.9	−2.3	−1.8	1.2
Canada	−4.4	−5.7	−1.3	2.6

[a] OECD estimates.

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Big Seven: Change in Government Budget [a]

Percent of GNP

	1976-79	1980-82
Big Seven	**2.5**	**−2.3**
United States	4.7	−4.3
Japan	−2.1	1.5
Canada	0.5	−4.4
Western Europe [b]	2.1	−1.3
West Germany	2.8	−1.4
France	1.5	−2.2
United Kingdom	1.5	1.1
Italy	2.4	−2.9

[a] OECD estimates.
[b] Big Four only.

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course, the Bank of Italy battled inflation by substantially slowing the growth of all three monetary aggregates.

- The United States followed the least contractionary fiscal policies in 1980-82. According to estimates by the OECD, it was the only major OECD country to engage in discretionary shifts in fiscal policy that have been expansionary. On the other hand, monetary policy was quite tight, with all major monetary aggregates expanding considerably more slowly in 1980-82 than in the previous four years. 25X1

Fiscal and monetary policy in the smaller OECD countries also was generally tight. The weighted average budget deficit for Australia, Austria, Belgium, Denmark, the Netherlands, Norway, and Sweden increased by only 1.3 percent of GNP during 1981-82, despite real GNP growth that averaged only 0.4 percent a year. During 1974-75 these countries swung into deficit by a degree equal to nearly 3 percent of their GNP. Monetary policy also was tightened, with more than half of the Small Seventeen—including larger countries such as Spain, Sweden, the Netherlands, and Belgium—recording reductions in the growth of their broadly defined money stocks between 1976-79 and 1980-82. 25X1

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World Economy: Moving Into Recovery [1]

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After three years of slump, the world economy appears on the verge of recovery. There are a number of obstacles to a strong rebound, but we believe world economic growth in 1983 could be stronger than foreseen in many recent forecasts. To some extent, the recovery path will depend on the demand management policy stances of OECD governments. At present, both fiscal and monetary policies are tight in most countries; some relaxation—particularly of monetary policy—may be needed to support a more rapid recovery.

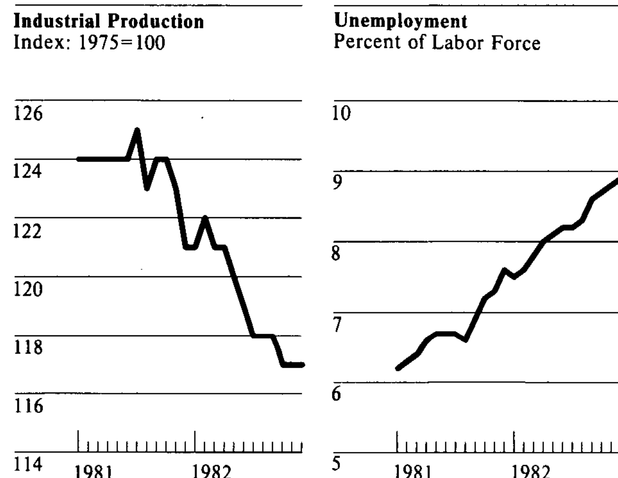
Signs the Slump Is Over

A number of signs have emerged that indicate the 1980-82 world recession has bottomed out. In the OECD:

- According to the IMF data, OECD-wide industrial production stopped declining in late 1982; even where decline continued, notably in some West European countries, the pace slowed from that of earlier months.[2]
- According to both the OECD Secretariat and the US Conference Board, leading indicators of industrial production are up for recent months in most OECD countries.

In the LDCs, sketchy, end-of-1982 data indicate that their domestic situations are not as close to recovery as are those in the OECD. On the other hand, the "free-falls" their economies were in during much of 1982 may be nearing an end.

OECD Countries: Economic Indicators[a]



[a] Seasonally adjusted.

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Underlying Factors

The bottoming out of the slump is attributable to a number of influences. One key factor has been the greater-than-expected slowdown in world inflation that the recession triggered. While wage gains have also been pulled down, the decline in price inflation has been greater in a number of key OECD countries. As a result, real wages rose in 1982 for the first time in three years; it appears that much of the increase occurred later in the year. This improvement in real wages is enabling consumers to

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[1] This article provides an overview of the factors that will play important roles in 1983 world economic trends; a forthcoming intelligence assessment will provide greater detail on our expectations on the course of recovery, particularly in the OECD countries.
[2] Data presented in this article were obtained primarily from OECD and IMF statistical publications.

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increase their real expenditures. At the same time, the leveling off of unemployment in some countries probably is increasing their willingness to do so.

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A second factor in the turnaround has been the fall in oil payments from the OECD and non-OPEC LDCs to OPEC—a decline that conservation and substitution have caused to far outpace the drop that would has been dictated by the world recession alone. In 1982 these payments to OPEC by the rest of the world declined by $60 billion; the so-called Low-Absorbers of OPEC—chiefly the Persian Gulf states—shouldered more than $40 billion of the decline. This shift in world spending flows is, in effect, leaving additional spending power equal to between 0.5 and 1 percent of world GNP in the hands of Western and non-OPEC LDC businesses and consumers—groups with a much higher propensity to spend than the OPEC countries.

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A third factor that seems to have played some role in the bottoming out has been a relaxation of monetary policy in three of the Big Seven OECD countries:

- In the United States the Federal Reserve's discount rate has been cut from 14 percent in late 1981 to 8.5 percent; growth of the primary monetary aggregates has accelerated to or above the high end of the Fed's target range for monetary expansion.

- In West Germany the central bank money stock has recently has been allowed to grow at the upper end of the Bundesbank 4-7 percent target range; in 1981 its growth was held to the low end of that range. Concurrently, the Lombard rate has been cut from 7.5 to 5 percent.

- In the United Kingdom, sterling M3—the money stock definition traditionally used in the Bank of England's policy formulations—has increased more rapidly in recent months, but the government claims that this is due to technical factors rather than a change in policy.

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Speed of Recovery

The speed of the recovery will depend on a variety of influences. A number of factors are likely to hold it back:

- ***Stock Adjustment.*** Stock overhangs in Japan and Western Europe likely will retard first-half 1983 production gains as business relies on inventories to meet increases in demand. In Japan, stockbuilding accelerated last year despite slower growth of final demand. Of the four largest West European countries, only in the United Kingdom were stocks actually drawn down; in West Germany and France, stockbuilding accelerated sharply.

- ***Structural Problems in Industry.*** The depressing effect of slack capacity on business investment is compounded by structural problems. The production declines in many old-line industries, most notably iron and steel, have been so severe that disinvestment in these sectors may offset investment rebounds in stronger industries.

- ***No LDC Import Growth.*** Imports by LDCs cannot be counted on to provide impetus to OECD growth as in the 1975-76 recovery. The widespread financial problems in these countries resulted in a 1-percent drop in import volume last year after 9-percent growth in 1981. Continuation of the debt problems and the impact of IMF-mandated austerity programs are expected to lead to, at best, no import volume growth again this year. We estimate that the zero import volume increases in the LDCs, instead of a more typical 5-percent expansion of imports, will cost the OECD between 0.5 and 1.0 percentage point in growth.

- ***High Long-Term Interest Rates.*** Long-term interest rates remain high, depressing both business fixed investment and household investment expenditures. While short-term rates have fallen, the trend in longer term rates is more important

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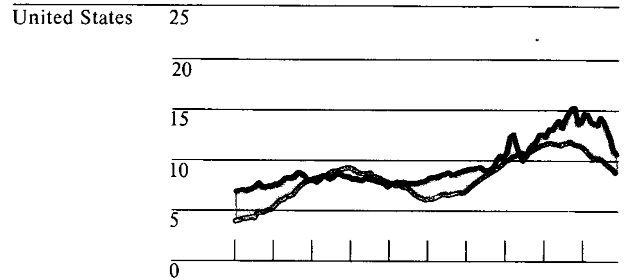
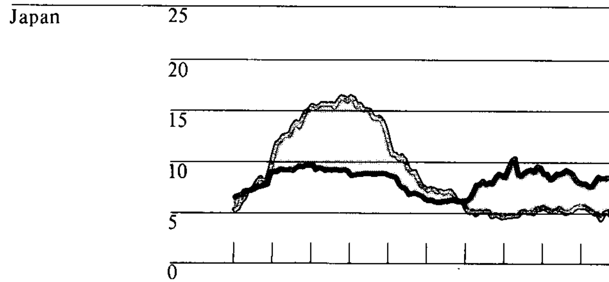
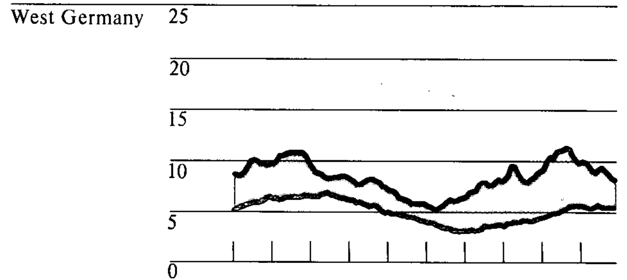
Big Seven Countries: Long-Term Interest Rates

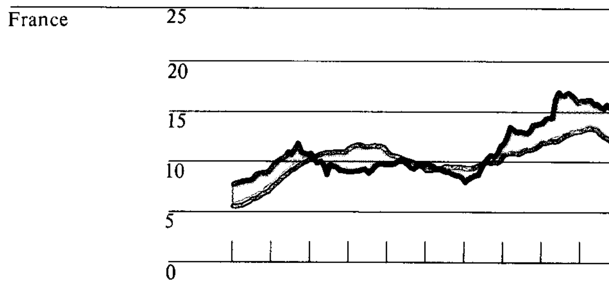
Percent

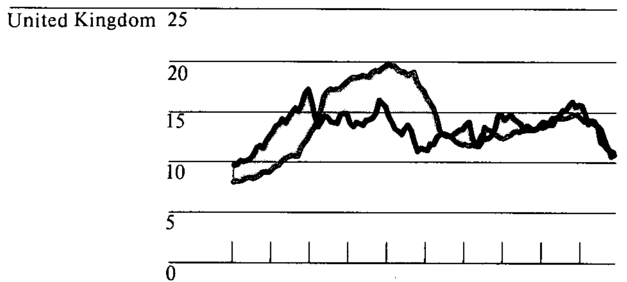
Nominal Rate
Three-year Inflation Rate
Positive Real Interest Rates
Negative Real Interest Rates

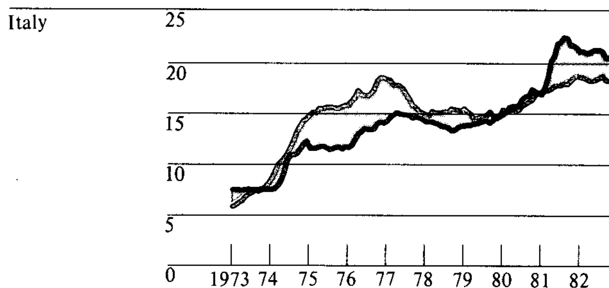


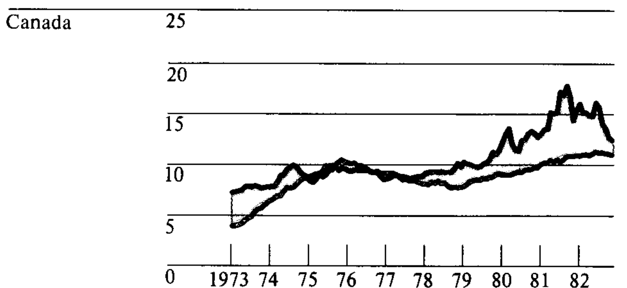












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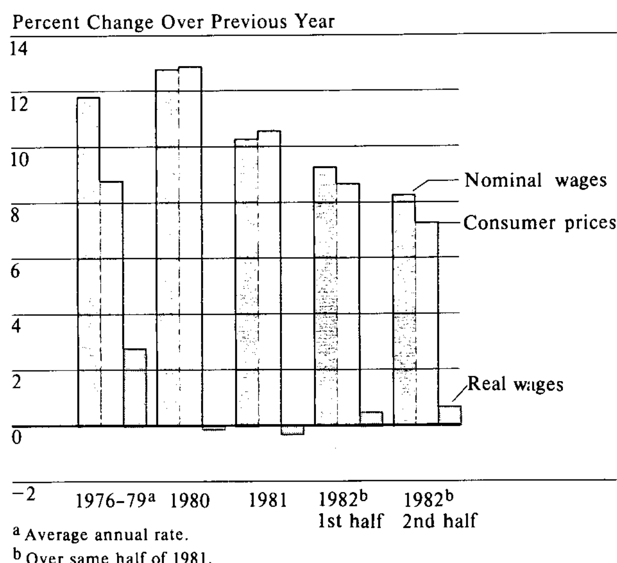
OECD Countries: Real Wages



a Average annual rate.
b Over same half of 1981.

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for major fixed investment decisions such as installation of plant and equipment or housing construction. In several of the major OECD countries, real long-term rates are down only slightly from the 1982 peak.

An additional constraint on recovery in 1983 may be the recent spread of protectionist measures. The impact of this factor on the world economy is difficult to quantify, but, because world economic expansion has depended heavily on increasing trade, protectionism probably is providing an additional small hurdle to recovery.

Finally, OECD fiscal policies have remained tight. Except for France, Italy, and Canada, the fiscal policies of the Big Seven are designed to trim government deficits.

Some Positive Signs

The presence of these negative influences probably will prevent a robust world economic recovery of the 1975-76 variety, when OECD real GNP increased at more than a 5-percent annual rate in the first 18 months of recovery. There are, however, some positive signs:

- First, the US economy seems to be coming off the mark faster than expected late last year. In its December 1982 Economic Outlook, for instance, the OECD called for 2-percent first-half 1983 growth in the United States. The Department of Commerce now estimates a 4-percent growth rate in the first quarter, and Data Resources Incorporated calls for essentially as strong growth in the second quarter.

- A second encouraging factor is the slide in oil prices. Energy-producing sectors—and their investment spending—will be depressed by continuing oil price declines, but most other sectors will benefit. We estimate that each $1 drop in OPEC's oil price leaves $6 billion in the hands of non-OPEC consumers and businesses.

Government Policy Options

A third factor that could help boost growth would be a further shift in demand management policies in key OECD countries, as occurred in the mid-1970s. Looser fiscal policy is not considered by most OECD governments to be economically or politically practical Japan, the United Kingdom, and a few small West European countries, nevertheless, may have room to adopt more expansionary fiscal measures.[3] Moreover, some relaxation of monetary policy is likely, particularly if US interest rates decline further.

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World Economy: Government Policies in the Mid-1970s

By early 1975 the OECD economies had sunk to depths akin to, although not as severe as, those currently being experienced. Demand management policies during 1974-75 were tight on both the fiscal and monetary fronts:

- *In 1974 the combined government budget deficits of the Big Seven countries widened by only 0.7 percent of GNP, despite just 0.7 percent real growth. In the two largest economies—the United States and Japan—the tightness of fiscal policy was more pronounced than for the OECD as a whole.*

- *OECD monetary policy also turned tighter in 1974 as money stock expansion rates were cut sharply from the rapid pace of 1971-73.*

Expansionary Policies in 1975-76
These contractionary policies were significantly modified during 1975 and 1976. Budget deficits were allowed to increase sharply in 1975 and remain high in 1976 even though economic recovery proceeded rapidly. More rapid expansion of demand also was supported by a looser monetary policy in most OECD countries.

The strongest shifts to expansionary policies were in the United States—where money supplies grew at about double the 1974 rate and the 1975-76 budget deficits ran about 3 percent of GNP higher than in 1974. West Germany also allowed a substantial rise in money stock growth and budget deficits.

Response to Stimulus: Growth and Inflation
The policy modifications of 1975-76 coincided with a reversal of real output trends. OECD real output rose at more than a 5-percent pace in late 1975 and 1976. Nearly all OECD countries shared in this rebound. Moreover, the growth slump in the non-OPEC LDCs bottomed out and was reversed in the OPEC countries.

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The initial inflation costs of the robust economic recovery were low. OECD inflation continued to decelerate through the end of 1976; 20 of the 24 OECD countries had lower inflation in late 1976 than they did at the trough of the 1974-75 recession.

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Several factors combined to provide the deceleration of inflation:

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- *Continued slack in world oil markets kept oil prices steady.*

- *Nonoil commodity prices also increased only moderately.*

- *Most important, inflationary pressures from the wage side diminished considerably. Despite the onset of recovery, wage increases remained moderate as a result of still-high unemployment; the sharp gains in productivity that occurred as the economies rebounded also held down price pressures.*

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Despite the continued steady expansion of world economic activity in the intervening years, it was not until 1979 that there was a major reacceleration of global inflation pressures brought on by:

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- *Continuation of expansionary policies as capacity output levels were approached.*
- *Spillover impacts from US inflation.*
- *The initial impacts of Oil Shock II.*

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World Economy:
Changes in Real GNP and Prices

Percent

	1973	1974	1975	1976	1977	1978	1979
OECD							
Real GNP	6.1	0.7	−0.2	4.8	3.8	4.0	3.1
Consumer prices	7.8	13.4	11.3	8.7	8.9	8.0	9.8
United States							
Real GNP	5.5	−0.7	−0.7	4.9	5.5	5.0	2.8
Consumer prices	6.2	11.0	9.1	5.8	6.5	7.7	11.3
Japan							
Real GNP	8.8	−1.0	2.3	5.3	5.3	5.0	5.1
Consumer prices	11.7	24.5	11.8	9.3	8.1	3.8	3.6
Canada							
Real GNP	7.5	3.5	1.1	5.8	2.4	3.9	3.2
Consumer prices	7.6	10.8	10.8	7.5	8.0	9.0	9.1
Western Europe							
Real GNP	5.8	2.1	−0.8	4.6	2.4	3.0	3.2
Consumer prices	7.9	12.0	13.3	11.4	11.6	9.7	10.7
West Germany							
Real GNP	4.5	0.7	−1.6	5.4	3.1	3.1	4.1
Consumer prices	6.9	7.0	6.0	4.5	3.7	2.4	4.1
France							
Real GNP	5.4	3.2	0.2	5.2	3.1	3.8	3.3
Consumer prices	7.3	13.7	11.8	9.6	9.4	9.1	10.8
United Kingdom							
Real GNP	7.5	−1.0	−0.7	3.6	1.3	3.7	1.6
Consumer prices	9.2	16.0	24.2	16.5	15.8	8.3	13.4
Italy							
Real GNP	7.0	4.1	−3.6	5.9	1.9	2.7	4.9
Consumer prices	10.8	19.1	17.0	16.8	18.4	12.1	14.8
LDCs							
Real GNP	8.9	7.1	4.5	6.5	6.3	4.7	5.1
Consumer prices	20.9	30.1	31.6	42.3	29.1	24.1	31.1
OPEC							
Real GNP	12.1	9.1	3.9	10.1	8.2	1.1	4.0
Consumer prices	13.2	19.0	21.3	18.9	12.2	18.7	11.9
Non-OPEC							
Real GNP	7.7	6.4	4.7	5.1	5.5	6.2	5.5
Consumer prices	23.7	31.1	35.4	51.0	35.4	29.9	38.3
Factor Prices							
Oil	15.0	233.0	−2.4	6.8	9.4	0.4	44.4
Food	54.0	60.2	−21.2	−18.4	−3.7	14.0	14.1
Agricultural raw materials	79.2	−3.6	−19.7	24.2	3.2	7.6	22.0
Metals	46.9	24.9	−19.4	6.0	7.4	5.5	29.8

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OECD: Money Supply and Budget Deficits

	1973	1974	1975	1976	1977	1978	1979
OECD [a]							
Budget deficit (*percent of GNP*)	0	−0.7	−5.4	−3.0	−2.3	−2.4	−1.9
M2 (*percent change*)	14.0	10.8	11.9	13.6	11.9	10.5	10.7
United States							
Budget deficit (*percent of GNP*)	0.5	−0.2	−4.2	−2.1	−1.0	0	0.5
M2 (*percent change*)	6.6	4.7	9.0	11.4	11.0	5.6	6.5
Japan							
Budget deficit (*percent of GNP*)	0.5	0.4	−2.7	−3.7	−3.8	−5.5	−4.8
M2 (*percent change*)	22.2	12.6	12.6	15.1	11.5	12.1	11.0
Western Europe [b]							
Budget deficit (*percent of GNP*)	−0.9	−2.1	−5.5	−3.9	−3.0	−3.9	−3.4
M2 (*percent change*)	17.1	14.7	13.8	14.6	12.8	14.4	13.7
West Germany							
Budget deficit (*percent of GNP*)	1.2	−1.4	−5.7	−3.6	−2.4	−2.6	−2.9
M2 (*percent change*)	10.5	7.1	9.4	10.1	8.6	10.0	8.2
France							
Budget deficit (*percent of GNP*)	0.9	0.6	−2.2	−0.5	−0.8	−1.8	−0.7
M2 (*percent change*)	14.2	17.2	15.0	16.0	12.4	13.5	13.4
United Kingdom							
Budget deficit (*percent of GNP*)	−2.7	−3.7	−4.6	−4.9	−3.1	−4.3	−3.1
M2 (*percent change*) [c]	27.2	10.2	10.8	9.4	10.3	15.2	12.7
Italy							
Budget deficit (*percent of GNP*)	−5.8	−5.4	−11.7	−9.0	−8.0	−9.7	−9.3
M2 (*percent change*)	20.9	20.0	20.9	22.0	21.4	23.0	19.1
Canada							
Budget deficit (*percent of GNP*)	1.0	1.9	−2.4	−1.7	−2.6	−3.1	−1.9
M2 (*percent change*)	15.6	24.2	14.4	19.0	15.3	14.0	18.7

[a] Big Seven only for budget deficit.
[b] Big Four only for budget deficit.
[c] Sterling M3 balances.

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Implications

The benefits of something more than flat or minimal real GNP growth this year would be widespread. The most important benefit likely to come from more rapid growth will occur in the debt-troubled LDCs. Each 1-percentage-point increase in OECD real GNP will add $5 billion to LDC export earnings and, in turn, reduce financing needs. While credit relief for many LDCs is necessary in the short run, their debt problems can be solved over the longer run only through increased world demand for their products.

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United Kingdom: Protectionist Trends

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Trade protectionism is increasing in the United Kingdom despite Prime Minister Thatcher's vocal public support for and philosophical commitment to free market economic policies. Rising unemployment, increased import penetration, a considerable contraction of the UK's industrial base, and a deteriorating trade surplus has boosted public pressure for the government to take a more interventionist stand on trade. In the 1970s—before Thatcher took office—nontariff barriers became the main impediment to trade. While Thatcher has been less willing to impose restrictions on foreign goods and services, she has recently been forced by a still sluggish economy and a fast-approaching national election to take measures aimed at "preserving British jobs." Additional measures are likely even should Thatcher win—as expected—because growth will remain below past levels and high unemployment will continue.

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London's Attitude Toward Protectionism

Thatcher's government has been an outspoken advocate of free trade since it took office in May 1979. It has pledged to reduce subsidies to industry and return publicly owned firms to private control as part of its effort to promote competition and efficiency. Chancellor of the Exchequer Howe and Trade Minister Peter Rees have, for the most part, resisted labor union, business, and opposition party calls for significant increases in trade restrictions. In elaborating the UK's position on GATT, Trade Minister Rees has stated that London supports:

- A consensus on reducing protectionism that—although stopping short of the US proposal for an immediate standstill—would significantly liberalize trade in manufactures.
- A study on reducing trade barriers in the newly industrializing countries (NICs).
- Limited and selective safeguard measures and increased transparency of voluntary restraint and industry-to-industry arrangements.
- Negotiations on agriculture including proposals to bring the Common Agricultural Policy of the European Community under GATT.
- New efforts at liberalizing trade in services.

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Despite the Thatcher government's public stance, there are a large number of trade-distorting policies used by the United Kingdom. According to a recent report by the quasi-official National Institute of Economic and Social Research, 48 percent of total trade was subject to some form of government management in 1980 versus 36 percent in 1974. The 1980 average for the EC was 45 percent, and only Italy, with 52 percent of its trade subject to some form of management, was higher than the United Kingdom. Perhaps most significant, the study found that over 17 percent of British manufactured goods were subject to restrictions in 1980 versus 0.2 percent in 1974.

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In part, nontariff controls on trade were an inevitable result of the increased role of the government in economic and industrial management which took place in the years before Thatcher came to power. They were also a response to the decline in domestic and foreign sales of traditional industries as tariff walls were reduced under successive rounds of the GATT. The recession and rising unemployment have slowed Thatcher's effort to reduce subsidies, especially for many nationalized firms in traditional industries, keeping the level of managed trade high despite her philosophical commitment to free trade. However, she has thus far resisted the more extreme protectionist measures demanded by the opposition.

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United Kingdom: Key Sectors Subject to Protectionism

Sector	Target	Employment (Percent Change May 79–Sep 82)	Output (Percent Change May 79–Dec 82)	Percent Change in Imports as a Share of the Domestic Market May 79–Sep 82	Examples of Protectionist Measures
Steel	Japan Eastern Europe European Community	−53	−38	25	Government ownership, $720 million subsidy in FY 1982, licensing-marketing agreements.
Coal	Eastern Europe United States	−10	0	−6	Government ownership, government purchasing policies, $1.5 billion subsidy in FY 1982.
Shipbuilding	Japan NICs	−33	−8	−54 [a]	Government ownership, government purchasing policies, $140 million subsidy in FY 1982.
Aircraft, aerospace	United States	−7	−7	19	Government ownership, government procurement policy, $900 million subsidy.
Autos	Japan Spain	−52	−36	15	Government ownership, $540 million subsidy in FY 1982, Japan limited to 11 percent of the market, voluntary export restraints (quota).
Textiles, clothing, footwear	Japan NICs United States	−13	−32	28	Multifiber arrangement, quotas.
Chemicals	United States	− 9	−11	10	High government participation, licensing and labeling restrictions.
Agriculture	United States European Community	−7	0	−6	Health and safety standards, labeling requirements, marketing board, buy national campaign, CAP (EC) tariffs and quotas.
Electronics, computers	Japan NICs	−12	−14	27	Heavy government participation, Large subsidies, buy national, VERs on TVs and VTRs.
Machine tools	Japan NICs United States	−28	−16	15	Growing subsidies, VER, buy national campaign.
Legal, financial services	European Community United States	−8	NA	NA	Licensing restrictions on banking, insurance, and legal services.
Engineering consulting services	Japan	−2	NA	NA	Subsidy to domestic design and engineering firms.

[a] Change is the result of replacement of ships lost during the Falklands crisis.

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General Tools of Protectionism

The United Kingdom draws a substantial degree of protection from its membership in the European Community. Community tariffs on some sensitive products, such as autos (10 percent) and semiconductors (17 percent), are relatively high. Variable import levies on agricultural products under the Common Agricultural Policy, however, are less beneficial to the the United Kingdom as a small food producer than they are to other member states. The UK also looks to the Community for protection against imports of foreign steel, textiles, coal, and electronic goods (TVs, VTRs, stereos)—commodities coming principally from Japan and the NICs. British automakers have led the fight for more stringent EC controls on Japanese cars and trucks and on autos from Spain. London is also pushing for a producer agreement on aircraft with the European Community.

The United Kingdom's most important trade protection measures are not formal barriers to foreign imports, however; rather, they are business subsidies, to both private and state firms. Tax subsidy rates on British manufactures, as a percent of asset prices, rose from an average 7.3 percent in 1973 to 10.9 percent in 1980 and 13.1 percent in 1981. Industrial subsidies and grants, including those to nationalized industries, accounted for 41.6 percent of government spending and 17.8 percent of GNP in FY 1982/83. Direct subsidies to private industry alone accounted for 4 percent of GNP last year.

London also provides subsidized export financing through the Export Credits Guarantee Department (ECGD). Under this plan, British banks provide export credits in exchange for unconditional repayment guarantees, interest rate subsidies, and limited portfolio refinancing by the government. Between 80 percent and 100 percent of long-term contract values are supported under the program. A recent British Treasury report questions the cost-effectiveness of official subsidies to capital goods exports (10 percent of total exports) and suggests they be discontinued. Trade Secretary, Lord Cockfield, however, opposes the Treasury position as well as US proposals for a flexible system on export credit interest rates.

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Nationalized firms enjoy virtual domestic monopolies in the steel, coal, shipbuilding, aerospace, and auto industries. The government also has a large stake in the chemical, computer, telecommunications, and petrochemical sectors. State firms generally are not subject to constraints on expenditure, research, development, or expansion and are often guaranteed sales to other government-owned firms regardless of price. Government-owned electrical plants, for example, are forced to buy coal from government-owned National Coal Board mines even though subsidized domestic prices are higher than import prices; the costs are passed on to consumers.

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Government policies on purchasing, licensing, labeling, and standards also act to restrict entry of foreign goods. British state companies do most of their purchasing in the United Kingdom; three domestic companies, for example, supply 60 percent of British telecommunications purchases. Local governments were encouraged to "buy national" on computer purchases in 1982 from the 25-percent government-owned computer manufacturer ICL. The United Kingdom has also expanded the domestic and export powers of its agricultural marketing organization. Health, safety, and labeling standards have been used to keep out milk, poultry, and some alcoholic beverages from the EC. Licensing practices have been used to restrict or ban imports of foreign services such as banking and insurance. The French claim that the United Kingdom uses customs regulations and reduced customs entry points to slow imports.

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Quantitative restrictions are increasingly being used to reduce import penetration by Japan and the NICs. Japanese auto imports are held to 11 percent of the British market under a voluntary agreement. Color television sets, picture tubes, video tape

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recorders, machine tools, motorcycles, and forklift trucks are also covered by voluntary export agreements (VERs) between the British and the Japanese.

Rising Protectionist Pressures

The key factor behind the rise in protectionist pressures is the decline in manufacturing employment. A protracted recession, tight monetary policies, loss of export market shares, and import penetration contributed to a loss of 2.7 million jobs in industry between 1974 and 1982; of these, nearly 2 million were lost after Thatcher took office. Unemployment now stands at 3 million adult workers or 13 percent of the labor force.

Some industries have been hit even harder. Employment in the steel and auto sectors is half the 1979 level, and one-third of the workers in the shipbuilding industries have been laid off over the period. Sales of British machine tools are now 55 percent below their 1975 level, and imports now account for 40 percent of domestic sales compared with 28 percent in 1975. Japan has increased its share of the UK market more than 8 percentage points. Meanwhile, jobs in the industry are down nearly 30 percent.

Unions and trade associations like the Confederation of British Industry, which represents 300,000 British employers, want the government to increase aid to industries and take action to keep out foreign goods. Automakers and the unions want a quota on auto imports from Spain, and shipbuilding unions are pushing for more government aid, a scrap-and-build program, and financial incentives for purchasers of British-built ships. Steel and coal workers are demanding new subsidies to keep open plants and mines that are no longer competitive.

Thatcher's political opponents—with an eye to an election some time between June 1983 and May 1984—have made protectionism a key part of their programs. Most radical has been the proposal by Labor's shadow Chancellor of the Exchequer Peter Shore which calls for a mixture of devaluation and protectionism to reinforce a major reflationary program. The plan includes a 30-percent devaluation over two years, renationalization of British industry, and strict planning of production and trade. The Social Democratic–Liberal Alliance has stated a preference for a less radical plan calling for increased subsidies and trade constraints only in especially hard-hit sectors.

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Recent Trends

Thatcher has been forced to take a more pragmatic approach toward protectionism with an early election possible and unemployment still at record levels. Some of the government's most recent actions on trade clearly have been taken to show its concern about unemployment and thus attract votes. The most notable instance is the subsidy that accompanied London's December 1982 order to British Steel Corporation to continue production at all five of its plants, even though there is sufficient demand to support only four integrated steel plants.

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Major financial commitments have also been announced to support British production of high-technology goods. A $25 million grant went to British microchip manufacturer Inmos International, and London has reiterated its support for computer maker ICL by pressing local governments to boost spending on British computer and office equipment. The government has also told British Leyland—the nationalized auto company—to hold off its plans to shift to foreign suppliers. Another plan under study would subsidize British suppliers in order to match prices offered by foreign companies. In an effort to slow layoffs in the mines, London also is applying new pressures on electricity producers to buy more expensive domestic coal. This new pragmatism represents a substantial shift from Thatcher's earlier policies.

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One result of the increased pressure against Japanese goods has been a substantial increase in Japanese investment in the United Kingdom. Britain has allowed Japan to increase its direct investment in order to promote new employment even though it will eventually mean additional cash flow to Japan. Ten Japanese plants designed to produce color TVs, VTRs, or stereos (creating several thousand new jobs) have opened in the United Kingdom at an increasing rate since the mid-1970s. Joint ventures between British and Japanese auto and machine toolmakers are also being explored.

Outlook and Impact on the United States

Pressures for protection are likely to rise because current levels of unemployment are expected to continue through the mid-1980s. A Thatcher victory at the polls, however, would probably result in substantially lower levels of British protectionism than under any other government. Under the Tories, subsidies and government ownership of industry would probably continue to be gradually reduced and some progress toward trade liberalization would be likely. A Labor government, on the other hand, would sharply increase both protectionism and government control of industry. The Social Democratic–Liberal Alliance would be in the middle applying new nontariff barriers only in specific areas where import penetration is highest. Most of the protectionism contemplated would be directed against imports from Japan and the NICs.

Only minor pressure on US exports will come directly from the United Kingdom. Most actions against US goods will be carried out in the context of the EC. Agricultural exports will be a prime area of contention, although London believes the EC has room to compromise in upcoming negotiations with the United States.

Chemicals and high-technology goods are areas of potential bilateral US-UK trade conflict. The United Kingdom is intent on developing its domestic industry and has already demonstrated its willingness to increase financial support and employ purchasing policies to aid in further expanding its computer industry. Thatcher views high-technology industries as important for developing the UK service sector and providing long-term employment growth as well as export earnings. To that end she can be expected to argue for the protection of an "infant industry." She will, however, join the United States in pushing for liberalization of trade in services because she believes Britain has a competitive advantage in that area and will benefit from increased trade flows

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United Kingdom: The Election Budget

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The new British budget announced on 15 March may have been the last chance for Prime Minister Thatcher's Conservative government to convince voters that it has delivered on its promises. Mixed signals on an economic recovery, record levels of unemployment, falling oil revenues, and a plummeting British pound have left the Tories vulnerable to criticism on economic policy—with an election widely expected this year, perhaps as early as June. The budget takes a middle road between the massive reflationary program called for by the Labor Party and the relatively tight monetary and fiscal policy mix the Tories have pursued since taking office in May 1979. What little stimulus there is will come from cutting personal taxes and cosmetic trimming of business taxes. The budget will have little impact on unemployment or on domestic growth because of the expected increase in imports. It may, nevertheless, provide enough of a boost to keep Thatcher in office for another term.

The Economic Setting

The Tories came into office in May 1979 promising to turn the economy around. To this end, they introduced a Medium-Term Financial Strategy focused on cutting inflation, reducing the role of government in the economy, and improving productivity and competitiveness. Their program called for:

- Sustained reduction in money stock growth from 9 percent in 1980/81 to 6 percent in 1982/83.
- One-percent annual reduction in real budget spending through 1984.
- A reduction in taxation, featuring a shift from direct (income) to indirect (VAT) taxes to foster competitiveness and investment.
- "Privatization" and reduced subsidies for government-owned firms.
- A return to realistic wage bargaining.

The economic record that Thatcher would bring into the election is mixed. Inflation, which peaked at 22 percent in May 1980, now stands at 5.6 percent over a year earlier largely as a result of lower wage demands. Unemployment, however, has grown from 5.6 percent of the work force when Thatcher took office to 12.9 percent. After three years of stagnation, real GNP is turning upward and is projected to rise 1.4 percent in 1983; on the other hand, the trade and current accounts are moving toward deficit.

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The budget deficit has shown marked improvement; last year the $14 billion deficit was nearly $3 billion below its target despite added expenses stemming from the Falklands conflict, higher social welfare payments to the unemployed, new subsidies for failing industries, and less-than-expected oil earnings. Taxes as a share of GDP have increased, however, from 34.4 percent in 1979 to 40.1 percent last year. Although productivity and competitiveness have improved markedly because of layoffs and a 13-percent trade-weighted depreciation of the pound since November 1982, key industries such as steel, autos, shipbuilding, and textiles continue to lose ground. Moreover, Thatcher has been forced to go slow on her privatization program because she cannot find buyers for several of the failing firms.

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Falling oil prices are a mixed blessing for the United Kingdom. Lower oil prices will slow returns for the oil companies—which provided most of the growth Britain experienced over the last three years—and will cut government tax revenues. They will also put downward pressure on the pound, boost import prices and, in the short term, reduce the trade surplus. On the export side, reduced

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18 March 1983

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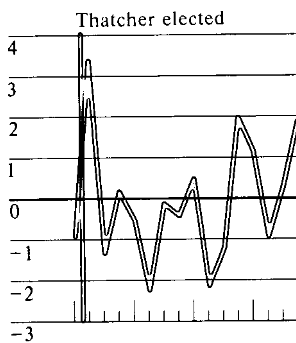
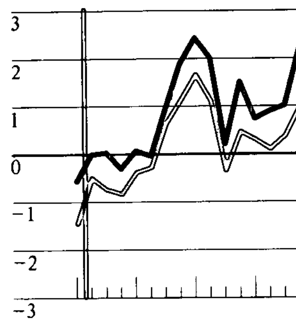
United Kingdom: Economic Indicators

Note change in scales

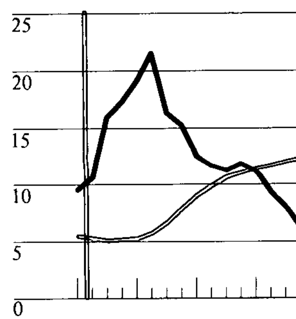
Real GNP[a]
Percent



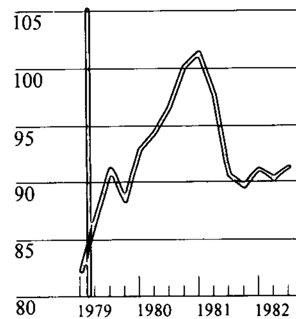
Current Account-Trade Balance
Billion £



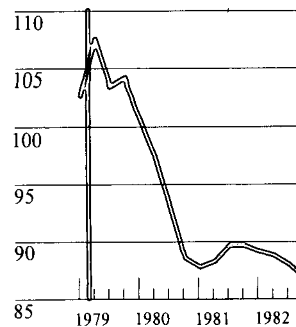
Consumer Prices-Unemployment Rate
Percent



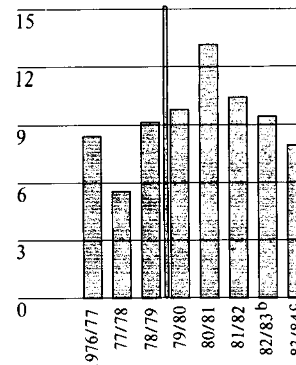
Trade-Weighted Exchange Rate
Index: 1975=100



Industrial Production, Manufacturing
Index: 1975=100



Public Sector Borrowing Requirement
Billion £



[a] Seasonally adjusted annual rates.
[b] Estimated.
[c] Target.

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foreign sales of oil will be offset only after an adjustment in exchange rates leads to improvements in the price competitiveness of British manufactured goods. Rising import prices will cause new domestic inflationary pressures, tending to offset the deflationary benefits of reduced oil prices. The domestic growth stimulus from a $5 per barrel drop in oil prices will add no more than 0.4 percent to real GNP growth from increased consumption. London may be forced to reduce its taxes on oil companies, however, in order to maintain an adequate level of exploration and development and to assure oil supplies for the 1990s.

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Loosening the Reins

Aware that this will be the last full fiscal year budget for the present Parliament regardless of when the election takes place, Thatcher has used the event to solidify her current lead in the polls. To this end, she provided the maximum amount of stimulus she could and still remain within her $12 billion target for the deficit. The cautiously expansionary $182 billion budget seems to take into account another cut in the price of North Sea oil that is widely expected to come before April. Most of the stimulus comes on the revenue side; about $3.8 billion goes to cuts in personal income taxes and an additional $585 million goes to reduce the burden of National Insurance payroll taxes on corporations. Child benefit payments are raised by 11 percent on the expenditure side. As expected, the government raised excise duties on beer, wine, liquor, cigarettes, gasoline, and vehicle sales slightly less than the change in inflation over the past year.

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Tight monetary targets—the keystone of Thatcher's economic program until now—will be eased. This year's growth target for monetary aggregates is to be 7 to 11 percent—the same as in the FY 1982 budget announcement but well above the 4 to 8 percent target called for in the original Medium-Term Financial Strategy. The government has not

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confirmed that it will set the 13-percent target for M1 that had been suggested in a recent British Treasury Department staff report.

The budget also contains significant tax relief for companies engaged in exploration and development in the North Sea. The recent decline in drilling activity and the expected impact of falling oil prices on company spending plans has apparently convinced the government that tax relief is necessary if the United Kingdom is to be assured of adequate oil supplies in the 1990s. The advance petroleum revenue tax has been cut from 20 to 15 percent starting in July and there are plans to phase it out altogether by the end of 1986. New fields developed after April 1982 will no longer be subject to royalties, and the quantity of oil exempted from petroleum revenue tax will be doubled.

Opposition Proposals

Although largely a paper exercise, the opposition parties have announced their own proposals for the economy in hopes of gaining some political ground. Labor Party leader Michael Foot and shadow Chancellor Peter Shore are calling for massive reflation, a 30-percent devaluation of sterling, and increased protection against foreign imports. Labor wants to increase public spending by over $7.8 billion in order to reduce unemployment. Much of the Labor program has been derived from the Cambridge Policy Group, which holds that free trade is not effective and claims that the United States and the United Kingdom would be better off with high tariffs used to subsidize wages. Labor has taken the program further by proposing a devaluation to make British exports more competitive and to reduce imports. The Party also wants to increase government control of the economy by reversing Thatcher's privatization policies and instituting a centralized planning framework for both production and trade.

The Social Democratic–Liberal Alliance has proposed a budget directed at creating new production and jobs and steering a middle course between the Tories and Labor. The Alliance proposes a $4.2 billion increase in borrowing—to $16.2 billion—to support a 2.5-percent cut in indirect taxes (VAT), a $1.3 billion increase in capital spending, $1.5 billion in tax relief to small business, and $2.1 billion in special unemployment programs. It claims the plan would create 465,000 additional jobs in FY 1983 and boost real GDP by over 1 percent. While the Alliance admits the measures would be slightly inflationary, it claims that the benefits from added employment would far outweigh the costs of increased inflation.

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Outlook

The budget may have some psychological impact on voters, but it is unlikely to result in any substantial improvement in unemployment by election time. Thatcher currently leads in the polls and there are already signs that a recovery is under way. The government estimates that it costs $35,000 to create one job and that the lag between expenditure and employment may be as long as six to nine months—barely enough time for an October 1983 election even if all goes well. Moreover, the OECD estimates that unemployment will remain at current levels through 1985.

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Political observers view the budget as Thatcher's initial move to influence both the general election and the important Darlington byelection, which will take place on 24 March. The budget's political purpose is to ensure Tory unity, to offer sufficient tax concessions to consolidate the Conservatives' lead in the polls, and to reassure business groups allied to the party that the government is working to ensure economic growth. At the same time, Thatcher will be careful to maintain her reputation as a strong leader who will not curry favor with the voters at the expense of sound long-term recovery. Opposition parties may face a quandary in attacking the budget for making too many concessions to Conservative interest groups while also accusing

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the government of not doing enough to stimulate the economy and reduce unemployment. Most polls show voter dissatisfaction with the government's economic policy, but they also show that the voters have little faith in the programs advocated by Labor or the Social Democratic–Liberal Alliance.

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Financially Troubled Oil Exporters: Adjusting to Price Decline

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A further slide in oil prices will exacerbate the financial difficulties of a number of LDC oil producers, particularly Egypt, Indonesia, Mexico, Nigeria, and Venezuela. With foreign reserves down to a month or two of imports in some cases and with limited capability to borrow from Western banks, the falloff in oil revenues will necessitate tough and politically unpopular austerity measures. Resort to IMF assistance may also be in the cards for some. Cuts in imports will fall heavily on the OECD, which supplies nearly 85 percent of foreign goods purchased by these countries.

Payments Impact of Oil Price Cuts

Current account prospects for the financially troubled LDC oil exporters have markedly deteriorated as a result of the decline in world oil prices.

- If the annual OPEC selling price were to fall to $25 a barrel from last year's $33.50, the oil export revenues of these five oil producers could drop by $6-16 billion from last year's $60 billion depending on the strength of the recovery in oil demand. We estimate that under the most optimistic production assumptions Mexico would be most seriously affected, with oil export revenues plummeting by 22 percent.

- If the OPEC price were to drop to $20 a barrel for the year, oil revenues of the financially troubled LDC oil exporters would dip to $35-44 billion.

Adjustments to Price Decline

The financially troubled oil producers have few options available for dealing with an oil price decline. The creditworthiness of most has fallen, and commercial bankers are reluctant to extend new credits. Foreign exchange reserves have fallen sharply in many cases, ruling out the possibility of financing a large current account deficit through reserve drawdowns. In our judgment, massive cuts in imports will be the principal avenue for adjustment, although four of the oil exporters could finance part of the deficit through IMF loans.

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The import cuts needed to offset decines in oil prices would be substantial if prices continue to drop throughout 1983. For instance, if the annual OPEC selling price averaged $25 per barrel this year, we estimate that the volume of imports for the five countries would have to be reduced by a minimum 15 percent to achieve the 1983 current account balances expected at the end of last year.

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- Mexico and Venezuela would have to cut imports the most—24 percent in each case.

- The other three countries could hold the reductions to around 9 percent. At a price of $20 a barrel, the volume of imports would have to be slashed by an average 30 percent. Reductions of this magnitude would lead to substantial declines in other sectors of the economy, intensify social problems in these countries, and probably lessen this year's election chances of the ruling parties in Venezuela and make orderly elections more difficult in Nigeria.

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The OECD countries, particularly the United States, would feel the effects of austerity measures. In 1981 these five countries purchased around $70 billion in goods from the OECD—nearly 85 percent of their total import bill. The United States accounted for the bulk of Mexican purchases and

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Financially Troubled Oil Producers: Geographical Distribution of Imports, 1981

Million US $

	Egypt	Indonesia	Mexico	Nigeria	Venezuela
Total	8,782	13,520	29,132	18,776	11,493
OECD	6,335	9,463	27,396	15,536	9,869
United States	1,737	1,432	19,568	1,675	5,445
Japan	38	4,527	1,869	2,368	922
West Germany	897	1,253	1,625	2,382	552
France	833	322	711	1,865	399
United Kingdom	433	315	459	3,368	252
Italy	652	160	632	958	582
Canada	79	85	670	92	700
Small 17	1,666	1,369	1,862	2,828	1,017
OPEC	64	1,127	39	16	10
Africa	69	143	43	134	54
Asia	301	2,062	282	1,726	292
Hong Kong	23	916	57	463	68
India	79	43	10	56	
Singapore	65		42	242	19
South Korea	36	401	34	123	36
Middle East	59	10	25	76	13
Western Hemisphere	201	65	672	420	973
Brazil	103	42	440	299	186
USSR, East Europe	953	184	204	381	24

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nearly 50 percent of Venezuelean imports. Japan supplied one-third of Indonesian purchases; the Big Four European countries provided 45 percent of Nigeria's imports.

The Countries

If oil prices fall sharply in 1983 *Egypt* would be forced to try to borrow additional amounts in the Eurodollar market and to impose much tougher and politically risky austerity measures. We estimate that for each $1 per barrel decline in the price of oil Egypt stands to lose $150-200 million in foreign exchange earnings from oil exports, Suez Canal tolls, and worker remittances. Oil exports now account for one-fourth of Egypt's total foreign exchange earnings; the direct revenue losses from a decline in oil prices to $25 could approach $750 million. Cairo probably would attempt to blunt the impact of reduced earnings by seeking more US aid for balance-of-payments support and by reducing ambitious economic growth targets. The Egyptians might be tempted to seek official aid from other Arab states.

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Since the end of last year, *Indonesia's* financial outlook has deteriorated markedly because of the decline in oil prices, the continuing soft market for nonenergy raw materials, and the below-average rice crop expected this year. While most analysts earlier believed that Indonesia would be able to cover its deficit for 1983 without having to resort to

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stiff domestic austerity measures, Djakarta could be forced to take difficult steps if oil prices continue to tumble. At $25 per barrel, imports would have to be cut about 9 percent to hold the deficit to $8 billion even if oil demand picked up this year. Djakarta to date has had no difficulty in lining up foreign credits to finance its payments deficit. However, the Indonesians are having to pay higher interest rates and are displaying growing nervousness over the availability of funds. International bankers are becoming increasingly concerned over their exposure; any further weakening in Indonesia's external accounts would intensify bankers' fears.

Each $1 drop in oil prices costs *Mexico* $550 million; a continued slide in oil prices would necessitate additional financial support or further austerity measures. Without offsetting financing, a 25-percent drop in oil prices, for instance, would entail a minimum 25 percent reduction in real imports to hold the current account deficit to $4.2 billion, the amount projected under the IMF adjustment program last fall. If Mexico misses its IMF targets by wide margins and international bankers perceive that de la Madrid's policies are off base, we believe that the risk of losing international financing could be significant.

Nigeria will have to substantially tighten current restrictions on government spending and imports since it is already in serious trouble with creditors; foreign exchange reserves are low, borrowing capacity is limited, and arrearages are growing. At $25 a barrel, imports would have to cut by almost 10 percent even if oil demand recovered in order to hold the deficit at $5-6 billion. We believe that the Shagari government would choose to cut spending on capital equipment in order to keep consumer items flowing in the country. This will hurt the country's import-dependent manufacturing sector, intensify the urban unemployment and force unpopular economic reforms.

In our judgment, Lagos will not turn to the IMF for assistance before this summer's elections since such a move would be cited by the opposition as tangible evidence the present government is unable to handle the economy. We believe Shagari will increasingly look to the United States for financial assistance, citing Nigeria's longstanding role as a reliable source of US energy needs.

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Venezuela will have to sharply curtail both public spending and imports if oil prices continue to fall. Caracas would have to reduce sensitive social programs and further curtail its domestic economic development program. Public expenditures were already slated to fall some 10 percent in nominal terms this fiscal year even with no decline in the price of oil. Venezuela's options are limited because its creditworthiness has sharply deteriorated. The government is attempting to restructure half of the $19 billion public debt to a longer maturity, and last month it imposed currency controls and a three-tier exchange rate in an effort to stem capital flight.

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