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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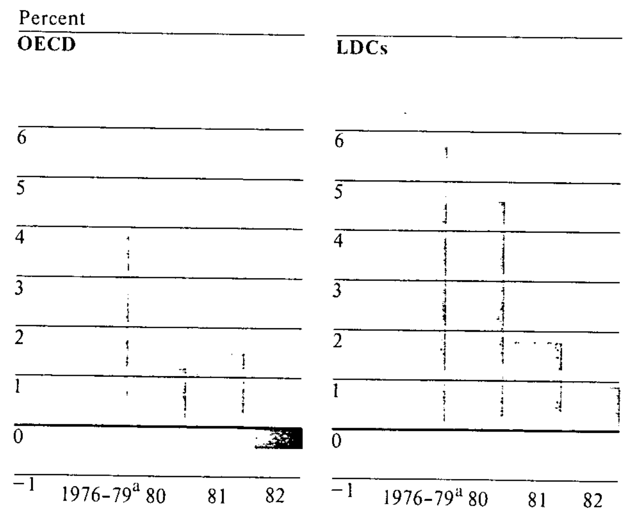
World Real GNP Growth



[a] Average annual.

Unclassified

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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. 25X1

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. 25X1

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. 25X1

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

This table is Unclassified.

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. 25X1

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. 25X1

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 25X1

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.

This table is Unclassfied.

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.

This table is Unclassified.

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. [redacted]

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. [redacted] 25X1

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. [redacted] 25X1 25X1

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

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.

This table is Unclassified.

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.

This table is Unclassified.

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. 25X1

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: 25X1

- 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 25X1

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.

This table is Unclassified.

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

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.

This table is Unclassified.

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.

This table is Unclassified.

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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