# BOOK REVIEWS – REVUE DES LIVRES

*World Economic Outlook 1983 – A Survey by the Staff of the I.M.F. Occasional Paper No. 21, IMF, Washington D.C., 1983 – 242pp. $8.*

**Reviewed by Dr. Mbui WAGACHA***

The great inflationary bubble of 1979–1980 marked the beginning of an unusual era for policy-makers everywhere. In response to a general fear that the series of oil-price increases in 1978 and 1979 would culminate in a second oil shock of major proportions, the developed market-economy countries led the way by switching their policy choices from a pattern which had been successful from the 1960s to the 1970s.

The leading policy objectives of the previous two decades were the growth of output and employment under conditions of price stability. Measured by the levels of growth achieved under this policy stance which involved a primary role for fiscal policy with a supportive monetary policy, the choices were well justified by the results. Between 1963–1972, the real GNP of all industrial countries grew at the average compounded annual rate of 4.7 per cent. By comparison, the rates for oil-exporting developing countries and non-oil developing countries – excluding the Peoples Republic of China – were 9 per cent and 6 per cent respectively. These separate achievements by industrial and developing countries were linked by an evolving mosaic of interdependence between economic performance and trade relations. Between 1963–1972, world trade volume expanded at the compounded annual rate of 8.5 per cent. Although this interdependence was supportive of the development process in poor countries particularly by absorbing their primary commodity exports, it was also underpinned by a fundamental and increasing asymmetry in which developing countries had a marginal influence on international economic policy-making while industrial countries could apply endogenous policy actions with international repercussions. This asymmetry had never been better demonstrated than during the recession which began in 1978–79.

The deliberate policy choices of industrial countries in 1978–79 involved a new role for monetary policy in applying demand restraints. Fiscal policy was assigned a supportive role in the new policy combination whose objective was to bring down inflation as a precondition for a resumption of the growth and employment objectives of the two earlier decades. Many economists would argue that the policy-mix was bound to be a costly and painful way to fight inflation in industrial countries when less excruciating alternatives, such as an «incomes policy» approach involving negociated wage and price increases, could have been examined. In the event the

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anti-inflation process has continued in industrial countries since 1978–79 through most of 1982, and the pay-offs in terms of the resumption of economic growth by 1983 did not yet look impressive or lasting. *The World Economic Outlook, 1983* (WEO) is presented in the background of problems in the policy-mix, the relative economic costs of the recession to industrial, oil-exporting and non-oil developing countries, and the prospects for 1983.

The policy-mix problem in industrial countries arose from the difficulties, particularly of the United States, in withdrawing substantial fiscal stimuli which have acquired a para-legal status over time. This implied, from the beginning, that monetary policy had to bear the greater burden of restraint. The hidden costs of this problem were that interest rates rose to much higher levels than would have been the case if fiscal policy had been supportive, and the repercussions to debt-holding developing countries were devastating. The impacts of the policy-mix problem were further exacerbated by falling export earnings and deteriorating terms of trade related to recession. In the Industrial Countries themselves the excess burden on monetary policy and the resulting high interest rates have contributed to a serious retrenchment in fixed capital formation and therefore in future production capacity.

The WEO focuses on six aspects of economic activity: output and employment, inflation and interest rates, trade and protectionism, current account movements, the debt of non-oil developing countries and exchange market developments. There is also an «overview» of the global economic scene as well as detailed sections on each of the country sub-groups. The relative impacts of the recession on economic activity are shown by the changes in output performance during the anti-inflation period as compared to the averages for 1963–1972 cited above. Changes in output during 1981 and 1982 were 1.2 per cent and -0.3 per cent for industrial countries, -4.3 per cent and -4.8 per cent for oil-exporting countries and 2.5 per cent and 1.4 per cent for non-oil developing countries. The prospective growth rate for 1983 were 1.9 per cent, 2.3 per cent and 2.5 per cent respectively. *(1)*

The statistics on economic activity do not however unmask the draconian burden of adjustment which the anti-inflation process of the industrial countries imposed on their trading partners in the oil-exporting and non-oil developing countries. The gains of the former group from the 1978–79 oil price increases which contributed to a policy switch by the industrial countries, have been wiped out by the recession. The combined surpluses of the oil-exporters amounted to $114 billion in 1980, were halved by 1981 and disappeared altogether in 1982 as a result of lower demand and softer oil-markets. In most oil-exporting countries, particularly larger ones such as Nigeria, the erosion of export earnings has forced a massive and destabilizing retrenchment in investment programs including raw-material imports. The recession-induced fall in export demand and

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*(1) The growth rate for oil-exporting countries refers to the non-oil sector. The oil-sector was projected to decline by 5 per cent in 1983.*

deterioration in the terms of trade of non-oil exporting countries compounded by the decline in official and private capital flows have similarly imposed far greater expenditure adjustment requirements than the above GNP movements indicate. The WEO does not show a perception of the massive erosion in living standards in non-oil developing countries particularly after taking account of population growth. The marginal propensity to consume, known to be high at low income levels, implies that the substantial fall in per capita incomes in non-oil developing countries reduced private consumption far more than equivalent income reductions did in industrial countries. Furthermore while compensating flows from welfare programs in industrial countries supported private consumption, developing countries have to await effects of global recovery (and higher per capita incomes) for private consumption to rise again.

Although the WEO examines the six aspects of economic activity stated above, the most dramatic changes have occured in current account movements which are an important channel for external shocks. Since 1980, the combined current account of industrial countries has moved from a deficit of $40.1 billion to approximate balance in 1981 and 1982 and was projected to show a surplus of $16 billion in 1983. These improvements are explained principally by falling demand and price in the oil-market and have correspondingly taken place at the expense of oil-exporting countries whose own combined current account moved from surpluses of $114.3 billion and $65.0 billion in 1980 and 1981, respectively, to a deficit of $2.2 billion in 1982 and a further projected deficit of $27 billion in 1983. The improvements in the industrial countries have also been at the expense of the current accounts of non-oil developing countries. As their terms of trade and export demand worsened with recession in industrial countries, their current accounts deteriorated from-$89 billion to -$107.7 billion for 1980 and 1981, then improved to -$86.8 billion in 1982. A further projected improvement to -$68. billion was expected in 1983.

The above current account improvements, including the movements for oil-exporting countries do not reveal the massive costs which are implied for the future of developing countries. For non-oil developing countries in particular, the improvements have been achieved at the cost of a draconian compression of imports made inevitable by export earnings short-falls, costs of debt and the instigations of the IMF on its borrowers to restrain demand. These import compression requirements came after a decade of increasing import-content of production in developing countries as non-oil members pursued export processing and import substitution programs and oil exporters diversified their production from oil to investments in sectors such as agriculture and utilities. It was inevitable that imports compression would affect production and investment. One can thus state that the shocks from the recession in industrial countries and the particular policy-mix used to deflate their economies have been the cause of an unprecedented reversal in the development process. Having presented a refined analysis (WEO p. 19 and Appendix A7) which shows that the debt of non-oil developing countries is related to their support of the imports-investments-growth link rather than to consumption, the IMF does not seem to have learnt as much either in its lending and conditionality practices during the recession or in the prescriptions for the future.

First the WEO does not review the key issue of the appropriateness of the policies used by the industrial countries to deflate their economies in 1978/79. Other choices for deflating the economy are known to avoid the massive external-sector repercussions discussed above, particularly the massive transfers from the developing countries which higher interest rates implied for debt. Second the WEO shows the persistence of the IMF in its demand restraint policies during the recession in spite of the statistical evidence showing that correction of external imbalances in developing countries was not reducing so-called excessive demand as much as it was destroying investment plans and achievable growth via imports compression. Third the IMF seems to wear different pairs of glasses in surveying the policy choices for industrial countries relatively to the developing world. While the preferred «central» scenario for industrial countries envisages a perseverance with the anti-inflationary policy stance of the last four years, together with efforts to deal with fiscal and other structural rigidities, the developing countries are exhorted to position their economic policies such that economic recovery which begun in industrial countries in 1983 will stimulate economic activity again. As if nothing was learnt from the special circumstances of the recent recession for poor countries, the usual tool-kit of demand restraints is recommended again: (WEO, pp. 16–22) financial policy actions to cut fiscal expenditure including *crucial* investments, cuts in public sector employment, higher prices for goods and services via cuts in subsidies, cuts in public stimulation of economic activities whose international competitiveness is not assured. These demand restraints fall broadly on government investment and on private consumption even of home goods. The policy bias of the IMF is particularly alarming on the latter.

In theory, reductions in the disposable incomes of poor countries reduce private consumption by far greater amounts than similar reductions for higher-income industrial countries. Nevertheless the IMF does not hesitate to recommend these cuts while remaining completely silent on the common public policy stances of industrial countries on disposable incomes. In industrial countries, massive public programs exist to augment production and private consumption or support low incomes. What would the IMF say if African Countries formed a common agricultural policy (CAP) on the same lines as the EEC? Or if such a policy increased intra-African trade and achieved self-sufficiency in agricultural production such that public authorities could start food programs (food stamps) for lower income groups? And what is to be done to improve the international competitiveness of developing countries just after the terms of trade have worsened against them by two-digit figures for the past few years and industrial countries have added protectionism to the shocks which have reduced growth?