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INTERNATIONAL TRADE IN 1984 AND CURRENT PROSPECTS

First Assessment by the GATT Secretariat[1]

This is the GATT Secretariat's first summary and assessment of world trade and major economic developments in 1984. Part I summarizes the main facts. Part II provides a more detailed analysis of the rebound of world trade in 1984, including a comparison with the expansion of trade during recoveries from previous recessions, and an examination of the extent to which various groups of countries participated in the increase in trade in 1984. Part III notes that tensions over trade policies have persisted in the course of the expansion in world production and trade, and goes on to explain this unexpected development in terms of the unusual nature of that cyclical upswing.

PART I - DEVELOPMENTS IN 1984

The volume of world trade increased 9 per cent in 1984, continuing the recovery that began in 1983 (Table 1).[2] This increase, which was nearly double the growth of world production in 1984, was the largest gain in eight years and brought the volume of world trade to an all-time high.

Although each of the main product groups participated in the trade expansion, manufactures trade grew more than twice as fast as trade in agricultural and mineral products (Table 1 and Chart I).

[1] Many of the figures for 1984 in this report are preliminary estimates based on data available as of the end of February. Later in 1985, when more complete information is available, major economic developments will be analyzed in greater detail in the GATT annual report International Trade 1984/85.

[2] Basic trade statistics covering all of 1984 are available for most industrial countries. For other countries, data referring to the year 1984 are rough estimates based on the months available and on the returns of those of their trading partners for which more complete data are available.

TABLE 1. - GROWTH OF WORLD PRODUCTION AND TRADE, 1980-1984
(Average annual percentage change in volume)

	1980	1981	1982	1983	1984
PRODUCTION					
All commodities	1	1	-2	3	5
Agriculture	0	3½	2	0	3½
Mining	-1½	-3	-3½	½	3
Manufacturing	1½	½	-2	4	6
EXPORTS					
Total	1½	0	-2	2	9
Agricultural products	5	3	1	1	5
Minerals[a]	-6	-12	-7	-1	5
Manufactures	5	3½	-1½	4½	12

[a]Including fuels and non-ferrous metals.

Due to the continued appreciation of the US dollar, many export prices again declined when expressed in dollars, causing dollar unit values to fall an estimated 2½ per cent in 1984. As a result, the dollar value of world exports increased 6½ per cent in 1984 - as compared to the 9 per cent volume increase - reaching $1,955 billion (Annex Table 1), close to the 1980 peak.

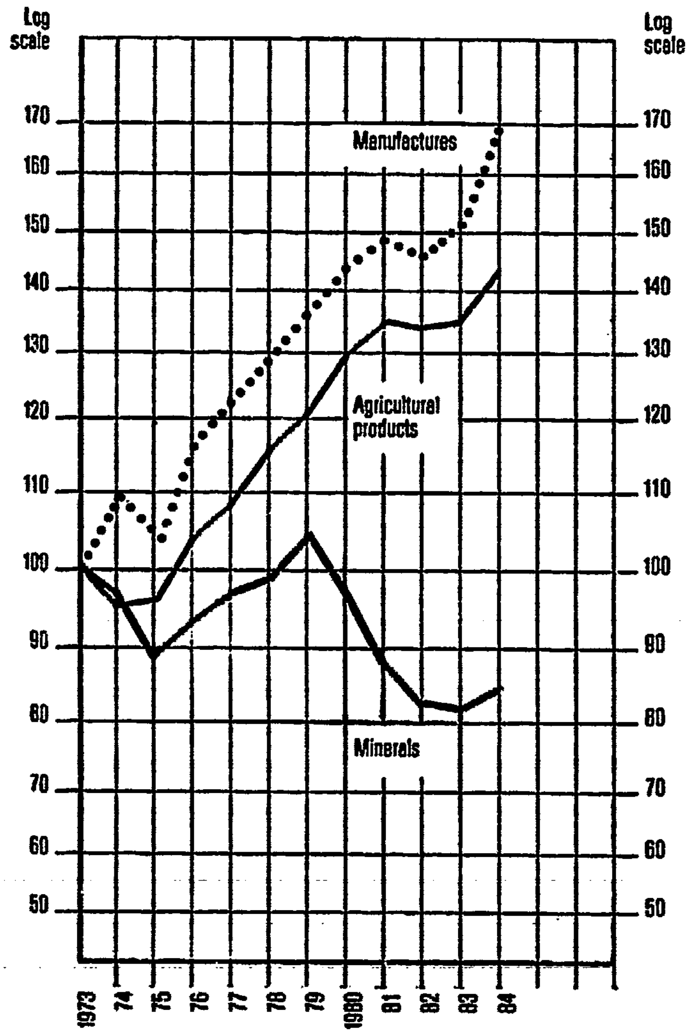
The developing countries increased their total export earnings by 7½ per cent in 1984, with exports of all products except fuels up 15 per cent.[1] This compares favourably with the export gains recorded by the industrial countries and the Eastern trading area in 1984 (6½ and 4 per cent, respectively).

[1]Beginning with this report, the distinction between "traditional oil-exporting developing countries" and "other developing countries" will no longer be used in the presentation of basic GATT trade statistics. This change is being made because the earlier analytical usefulness of that distinction has been largely eroded by the emergence of new oil exporters among the developing countries, as well as by the sharp decline in the trade surplus of the traditional oil exporters from the levels recorded during most of the years 1974-81.

It is not enough, however, to present only figures for the total trade of developing countries, since fuels currently account for nearly 50 per cent of their exports and nearly 20 per cent of their imports. For this reason, data on aggregate developing country trade will include, along with figures for total trade, separate figures for trade in non-fuel products and trade in fuels.

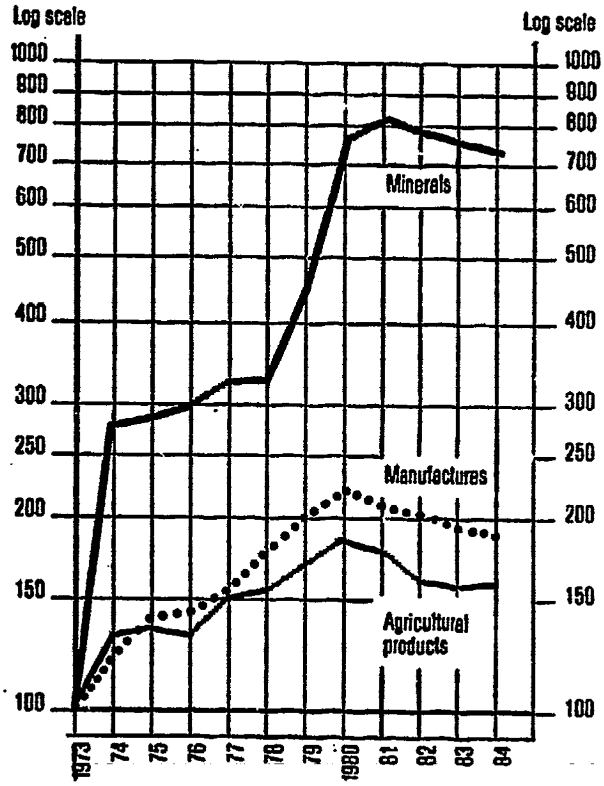
A combination of strong export growth and stagnant imports caused the developing countries' trade deficit on non-fuel products to decline by an estimated $32 billion in 1984; their surplus on fuel trade, in contrast, remained virtually unchanged. The industrial countries' overall merchandise trade deficit increased by an estimated $33 billion in 1984, while the trade surplus of the Eastern trading area was unchanged.

CHART: I
World Exports, 1973-1984
(Volume Indices, 1973 = 100)



Source: GATT, International Trade.

CHART: II
World Export prices, 1973-1984
(Indices, 1973 = 100)



Source: UN, Monthly Bulletin of Statistics and IMF International Financial Statistics.

1. Production and Trade by Product Groups

World production of goods is estimated to have increased by 5 per cent in volume terms in 1984, well above the 3 per cent gain recorded in 1983.[1]

World agricultural output recovered by 3½ per cent in 1984. The 4 per cent volume increase in the industrial countries came after a 7 per cent decline in 1983. In the developing countries, agricultural output growth accelerated moderately in 1984, reaching 3 per cent, while in the Eastern trading area the increase in output was smaller than the 1983 gain. World trade in agricultural products is estimated to have increased at a slightly faster pace than output in 1984.

World mineral (including fuels) production and trade increased by 3 per cent and 5 per cent in volume terms, respectively, in 1984. Following four consecutive years of decline, world trade in fuels recovered by about 4 per cent in 1984. Exports of crude oil and oil products expanded less than trade in other fuels, and oil exports from the members of OPEC recovered less than overall oil trade as shipments from new suppliers increased strongly.

In 1984 the volume of world manufacturing production increased by about 6 per cent. The rate of expansion was slightly faster in the developing countries, and somewhat slower in the Eastern trading area. The volume of manufactured exports by the industrial countries was up by 12 per cent in 1984, while those from developing countries expanded by 14 per cent and those from the Eastern trading area by 4 per cent. In terms of the dollar value of exports, Japan became the world's largest exporter of manufactured goods in 1984, edging out the Federal Republic of Germany which had held this position since 1970.

Looking at the value of trade by products, exports of electronic products expanded by nearly 25 per cent, more than twice the average rate for all manufactured goods; shipments from the developing countries rose by about one-third. The most dynamic sub-group in electronics was again computers and related equipment. Exports of automobiles rose at about the average rate of 10 per cent for manufactured goods as a whole, as the surge in automobile imports into North America (including intra-trade) of about 30 per cent was partly offset by stagnating or declining dollar import values in Western Europe and a number of oil-exporting developing countries. Exports of textiles and clothing by the industrial countries increased less than 5 per cent, whereas exports of the developing countries recorded gains well above 20 per cent. Developing countries' exports of clothing, which had stagnated in dollar value since 1980, rose by more than 25 per cent in 1984, exceeding for the first time those of the industrial countries.

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[1] In this section production refers to the combined output of agriculture, mining and manufacturing, that is, it excludes services and construction.

Imports of clothing into the United States, which absorbs roughly one-half of the developing countries' total exports of clothing, increased by nearly 40 per cent. World trade in iron and steel products, which had declined for three consecutive years, is estimated to have increased in 1984 at a rate somewhat above the 7 per cent increase in world steel output.

2. Developments in Main Areas

Industrial countries

The growth of the combined real GDP of industrial countries accelerated from 2½ per cent in 1983 to nearly 5 per cent in 1984. To a large extent this gain reflects an increase of almost 7 per cent in the GDP of the United States. GDP growth also increased in Japan and in Western Europe, from 3 per cent and 1½ per cent, respectively, in 1983 to 6 per cent and 2½ per cent in 1984. Although external demand - chiefly from the United States - contributed significantly to this increase, domestic demand also picked up in Japan and Western Europe.

Industrial production, which had recovered by 3½ per cent in 1983, increased by 6½ per cent in 1984 in the industrial countries. In Western Europe, however, the rise was limited to about 3 per cent, compared to 10 per cent in the United States and Japan.

In 1984 total employment rose by some 4 to 5 per cent in the United States, through a combination of growth in the labour force and declining unemployment. The increase in Japan was less than 1 per cent, and in Western Europe there was no increase in total employment in 1984. At the end of 1984, unemployment was slightly above 7 per cent in the United States - 1 percentage point less than end-1983 - while in Western Europe unemployment increased by about 1 percentage point between December 1983 and December 1984, reaching more than 11 per cent of the labour force.

Inflation in the industrial countries taken as a group was on the order of 5 to 5½ per cent in 1984, a rate comparable to that of the preceding year, as a further slowdown in Western Europe was offset by a slight acceleration of inflation in the United States.

According to many forecasters, economic growth in the industrial countries will continue in 1985 at the pace recorded in the second half of 1984, which implies a growth rate in 1985 somewhat below 5 per cent. It should be kept in mind, however, that as the interplay of factors operating on the economy has become more complex, the accuracy of economic forecasts has declined.

Developing countries

On the basis of the limited amount of information available concerning domestic developments, it appears that several developing countries improved their overall economic performance considerably in 1984. For the group as a whole, there was a recovery of mining and a vigorous expansion of manufacturing. In addition to increased exports pulled by expanding demand in the industrial countries, domestic spending also increased in some cases.

A number of countries in Far-East Asia, the Middle East and the Caribbean managed to keep inflation below 5 per cent, whereas in most of the highly indebted countries inflation accelerated further. For the developing countries as a group, the inflation rate approached 50 per cent in 1984, a new record in the post-war period and more than twice their average annual inflation in the 1970s.

Developing countries recorded a marked acceleration in their exports of non-fuel products, to nearly 12 per cent in volume terms, primarily due to a sharp increase in exports to the industrial countries, in particular the United States. But this increase reflects also a modest recovery of intra-area trade from the very depressed 1983 level. Manufactures maintained their leading position in the expansion of exports, and the suppliers with competitive manufacturing exports, in particular in South-East Asia and Latin America, were able to take advantage of the growing demand; the volume of imports into these countries also increased significantly in 1984 (in value terms, imports increased by 6 per cent but remained well below the 1981 record level).

The developing countries' terms of trade improved moderately in 1984. These gains were weaker in the second half for those exporting mainly primary products whereas they improved further in others exporting mainly manufactures.

Eastern trading area

In Eastern Europe (excluding the USSR) the economic upturn which began in 1983 continued in 1984. All countries experienced a moderate acceleration of their economic growth. On average, aggregate production is estimated to have increased by 4½ per cent in 1984 as compared with 3½ per cent in the preceding year.[1] Eastern Europe's exports and imports are both estimated to have increased in dollar value by 4½ per cent in 1984, leaving the trade surplus unchanged at about $5 billion.

In the USSR, in contrast, the growth of aggregate production is estimated to have declined from 4 per cent in 1983 to about 3½ per cent in 1984. Industrial production grew by about 4½ per cent, while agricultural output stagnated. According to preliminary estimates, the dollar value of exports rose marginally in 1984, while imports declined by about 2 per cent. The overall merchandise trade surplus, which had already reached an all-time high of $11 billion in 1983, increased to about $13 billion in 1984.

The growth of China's industrial production was about 13½ per cent in 1984, the second year in a row with a double-digit growth rate. Agricultural output also continued to increase at a sustained pace, although less than in 1983. The dollar value of exports and imports expanded by 17 and 28 per cent, respectively, in 1984. As a result, the $0.8 billion trade surplus in 1983 turned into an estimated deficit of more than $1 billion in 1984.

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[1] In this section, production refers to net material product, defined as the combined output of agriculture, mining, manufacturing and construction, plus those services directly linked to the production of goods, and the services linked to the repair, transportation and distribution of goods.

3. Prices and Exchange Rates

Dollar export prices of primary commodities (excluding crude petroleum) were virtually unchanged in 1984, following a very modest increase in 1983 (Table 2) and a sharp decline in 1981-82. Dollar export prices of crude petroleum dropped for the third consecutive year, by about 3 per cent. In 1984 the dollar unit values of manufactured exports also declined by about 3 per cent, despite a slight increase of those originating in the United States.

TABLE 2. - DOLLAR EXPORT PRICES OF PRIMARY COMMODITIES

(Percentage change in annual average over previous year)

	Food		Agricultural raw materials		Non-ferrous metals		Total primary products (excluding crude petroleum)	
	1983	1984	1983	1984	1983	1984	1983	1984
Developed countries	-2	-3½	+1½	+3½	+½	-1	-1	-1
Developing countries	+4½	+2½	+11½	+5½	+3½	-10½	+5½	+2
World[a]	-½	-1½	+6	+4	+1½	-4	+½	0

[a]Excluding the Eastern trading area.

Source: UN, Monthly Bulletin of Statistics.

Comparing average annual figures, the US dollar's trade-weighted effective exchange rate appreciated by 8 per cent in 1984, while that of the Japanese yen appreciated 5½ per cent. The effective exchange rates of the other industrial countries' currencies depreciated, generally in the range of 3 to 6 per cent. Adjusted for inflation differentials using price indices of non-food manufactures, the US dollar's average real effective exchange rate in 1984 was 6 per cent above the preceding year.

PART II - THE NATURE OF THE RECOVERY OF WORLD TRADE

ITS STRENGTH

The rebound of world trade in 1984 was one of the key features of the cyclical recovery of the world economy from the 1980-82 recession. This suggests that it would be instructive to compare the 9 per cent trade expansion last year with the trade expansion during the recoveries from the two previous post-war recessions.

MORE

It is apparent from the figures in Table 3 that, while strong, the 1984 recovery of world trade was not exceptional. A comparison with the developments in world trade during the years 1968 and 1976, the years following the two previous worldwide recessions, indicates that:

- In 1984 the overall volume of world trade expanded less rapidly than during the 1968 recovery, and at about the same pace as during the 1976 recovery.

- With the exception of mineral exports, the broad product pattern of the recent export expansion resembled those of earlier recoveries. Once again, the growth in the volume of exports of manufactures led the recovery. Trade in agricultural products expanded at a rate comparable to earlier experience. Trade in minerals expanded distinctly less than in 1968 but at about the same rate as in 1976.

TABLE 3. - THE GROWTH OF WORLD TRADE, 1964-84

(Average annual percentage change in volume of exports)

	1968	1976	1984	1964-73	1973-79	1979-84
Total	12½	10	9	9	4½	2
Agricultural products	3½	6	5	3½	3	3½
Minerals[a]	12	6½	5	7	½	-4
Manufactures	14½	11½	12	10½	5½	4

[a]Including fuels and non-ferrous metals.

Source: GATT secretariat estimates.

If differences in the growth of world real income during the recoveries are taken into account, the most recent trade recovery reveals a little less vigour than the two previous ones. As my be seen in Table 4, in 1984 each one per cent increase in world real income was associated with a 1.8 per cent increase in the volume of world trade; in 1968 and 1976, the corresponding figure was 2 per cent.[1]

[1]See the footnote to Annex Table 2 for an explanation of the methodology behind the estimates in Table 3.

TABLE 4. - PERCENTAGE CHANGE OF WORLD TRADE VOLUME ASSOCIATED WITH EACH ONE PER CENT CHANGE IN WORLD REAL INCOME

	1967-68	1975-76	1983-84
Total exports	2.0	2.0	1.8
Exports of manufactures	2.3	2.3	2.1

Source: GATT secretariat estimates.

The sharp 1984 rise in the volume of world exports followed an unusually long period of weak growth in world trade. Since the last peak in world economic activity (1979), world trade volume has expanded at an average annual rate of only 2 per cent (Table 3), less than half the rate achieved during the preceding business cycle (1973-1979, peak to peak), and less than a quarter of the average annual rate achieved in the years between the 1964 and the 1973 peaks.

Much of this slowdown in trade expansion has to be seen against the background of a general decline in economic growth rates in the world economy over the past business cycles. Yet even if allowance is made for this factor, world trade expanded more slowly per unit of increase in world output between 1979 and 1984, as compared with 1964-73 and 1973-79; on the other hand, the strength of the expansion of trade in manufactures has shown little or no change over the three cycles (see Annex Table 2).

It is of course true that the growth of world income and the growth of world trade interact with each other. At least a part of the decline in average GDP growth rates during 1979-84 must be attributed to the observed deceleration of trade expansion during the same period. It is also likely that certain factors, including increasing uncertainty about future access to foreign markets, acted to reduce income and trade growth simultaneously.

MORE

THE REGIONAL PATTERN OF TRADE RECOVERY

The following analysis of interregional trade flows is based on preliminary estimates of trade flows measured in US dollars.[1] Thus the figures reflect not only changes in trade volumes, but also changes in foreign trade prices in national currencies, and changes in the value of national currencies vis à vis the US dollar. Because it is not possible, at this stage, to separate out the individual influence of each of these components, the following conclusions must be treated with caution - especially as regards the implications for the level of production or employment. On the other hand, the figures are fully relevant as far as the trade balance aspects of the recovery are concerned.

[1]For a brief discussion of some of the practical and conceptual problems raised by the need to express world trade data in a common currency, see GATT International Trade 1973/74, pp. 172-173; and International Trade 1983/84, pp. 191-192.

As an illustration of the extent to which growth rates of trade value depend on the currency unit chosen, consider the following figures expressed in US dollars and in ECU (which has depreciated against the US dollar in the more recent of the two periods shown):

	Growth of export value (Average annual percentage change)			
	1973 - 1979 measured in		1979 - 1984 measured in	
	US dollars	ECU	US dollars	ECU
- EC	18.2	16.1	0.3	10.1
- United States	16.3	14.2	3.3	13.4
- Japan	18.6	16.6	8.7	19.4

TABLE 5. - REGIONAL SHARES IN THE INCREASE IN THE VALUE OF WORLD TRADE,[a] 1968, 1976 AND 1984

(Percentage shares)

<table>
<tr><th></th><th colspan="3">Exports</th><th colspan="3">Imports</th></tr>
<tr><th></th><th>1968</th><th>1976</th><th>1984</th><th>1968</th><th>1976</th><th>1984</th></tr>
<tr><td>North America</td><td>20.0</td><td>12.1</td><td>24.1</td><td>29.3</td><td>23.3</td><td>63.0</td></tr>
<tr><td>Japan</td><td>10.8</td><td>9.7</td><td>18.6</td><td>3.7</td><td>6.3</td><td>8.4</td></tr>
<tr><td>Western Europe</td><td>43.4</td><td>32.6</td><td>19.5</td><td>41.1</td><td>49.3</td><td>12.6</td></tr>
<tr><td>South-East Asia[b]</td><td>2.7</td><td>7.8</td><td>14.4</td><td>4.3</td><td>5.3</td><td>9.1</td></tr>
<tr><td>OPEC</td><td rowspan="2">13.0</td><td>19.4</td><td>1.5</td><td rowspan="2">10.3</td><td>6.2</td><td>-13.0</td></tr>
<tr><td>Other developing areas</td><td>9.8</td><td>11.7</td><td>2.6</td><td>9.0</td></tr>
<tr><td>Eastern trading area</td><td>9.0</td><td>7.3</td><td>6.7</td><td>8.2</td><td>3.9</td><td>6.0</td></tr>
<tr><td>Other</td><td>1.1</td><td>1.3</td><td>3.5</td><td>3.1</td><td>3.1</td><td>4.9</td></tr>
<tr><td>Total increase in world trade</td><td>100</td><td>100</td><td>100</td><td>100</td><td>100</td><td>100</td></tr>
</table>

[a]Change over preceding years in US$.

[b]Four rapidly developing areas in South-East Asia.

<u>Source</u>: GATT secretariat estimates.

Preliminary estimates indicate that the regional pattern of the recent growth of world trade deviates markedly from past experience (Table 5):

- Imports into North America (<u>including</u> intra-North American trade) alone accounted for almost two-thirds of the increase in the dollar value of world trade. During the recoveries of world trade in 1968 and 1976, the North American contribution on the import side amounted to less than one-third and less than one-quarter, respectively, of the increase in world trade. It is interesting to note that on the export side the North American contribution to the growth of world trade in 1984 was larger than usual as well (double that of 1976); this is partly explained by the strong increase in Canada's exports (especially to the United States).

- The share of West European imports in the increase in the value of world trade (<u>including</u> intra-West European trade) dropped sharply from the 40 to 50 per cent recorded in the two previous recoveries to less than 13 per cent in 1984. At the same time, West European exports, traditionally the largest gainer among the regional trade flows analyzed, just edged out Japan for second place (behind North America) in 1984.

- Japan participated, on the import and (especially) the export sides, more strongly in the current recovery than in the two previous trade recoveries.

MORE

- Similarly, from recovery to recovery, there is a sizeable increase in the importance of developing areas (other than the members of OPEC) in the growth of world imports and exports. This trend is particularly pronounced in the case of South-East Asia.

- Increased exports by the members of OPEC, one of the leading factors in the 1976 increase in the value of world trade, added only marginally to the 1984 growth of world exports; the value of their imports actually declined in 1984.

As may be seen from the data in Table 6, trade within Western Europe, which accounted for more than a quarter of the increase in the value of world trade in the 1968 and 1976 recoveries, contributed only 7 per cent to the increase of world trade in 1984. As in the past, trade among developing areas remained a minor source of the 1984 increase in world trade (for the period 1979-84, however, trade among developing countries not only contributed a much larger share of the increase than in 1984 alone - 13.9 versus 3.3 per cent - but also contributed a larger share than in 1973-79 or 1964-73; see Annex Table 3). Trade within the Eastern trading area also made a relatively minor contribution to the expansion in world trade in 1984. Trade between industrial and developing areas contributed once again strongly to the recovery (but substantially less than in 1976, because of the weak trade performance of the OPEC members in 1984, and import constraints in the heavily indebted developing countries). However, in contrast to 1968 and 1976, the 1984 recovery of world trade was dominated by the dynamics of inter-continental trade among the industrial areas.

TABLE 6. - THE SHARES OF INTRA- AND INTER-CONTINENTAL TRADE IN THE INCREASE IN WORLD TRADE VALUE,[a] 1968, 1976, 1984

(Percentage shares)

	1968	1976	1984
Trade within North America	11.0	5.9	17.2
Trade within Western Europe	28.6	27.7	7.2
Trade among North America, Western Europe and Japan	19.6	12.4	34.6
Trade between industrial and developing areas	24.5	35.8	21.9
Trade among developing areas	2.5	5.9	3.3
Trade within Eastern trading area	6.8	3.1	4.7
Other trade	7.0	9.2	11.1
Total increase in world trade	100	100	100

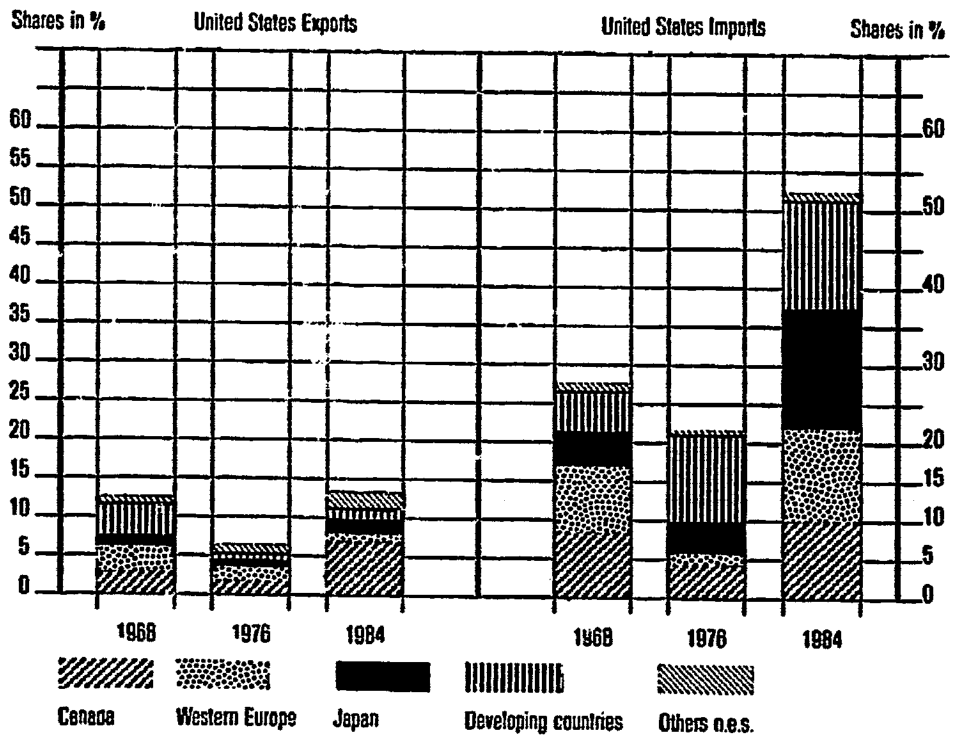
[a]Change over preceding years in US$.

Source: GATT secretariat estimates.

The engine of 1984 world trade growth was, of course, the brisk recovery of the United States economy. Coupled with an increasingly strong US dollar, the vigorous revival of economic activity triggered a broadly based surge of imports into the United States. Those imports alone accounted for more than half of the 1984 increase in the value of world trade, compared with a share of roughly one quarter for previous recoveries (Chart III). Imports into the United States from Canada, Western Europe, the developing areas and Japan made up, individually in ascending order, for between 10 and 15 per cent of the 1984 increase in world trade. Exports from the United States accounted for nearly 13 per cent of the increase in the value of world exports in 1984, about the same as in 1968 but double the proportion in the 1976 recovery.

CHART: III

The share[a] of the United States in the increase of World Trade Value in 1968, 1976 and 1984



a: Contribution of United States to the increase of World Trade; the sections of the bar charts show the relative importance of each main destination or origin in United States Exports and Imports.

Source: GATT, International Trade and Secretariat estimates.

North America aside, the focus of trade expansion has been shifting, over the longer term, from Western Europe to the Northern part of the Pacific Basin (see Annex Table 4).

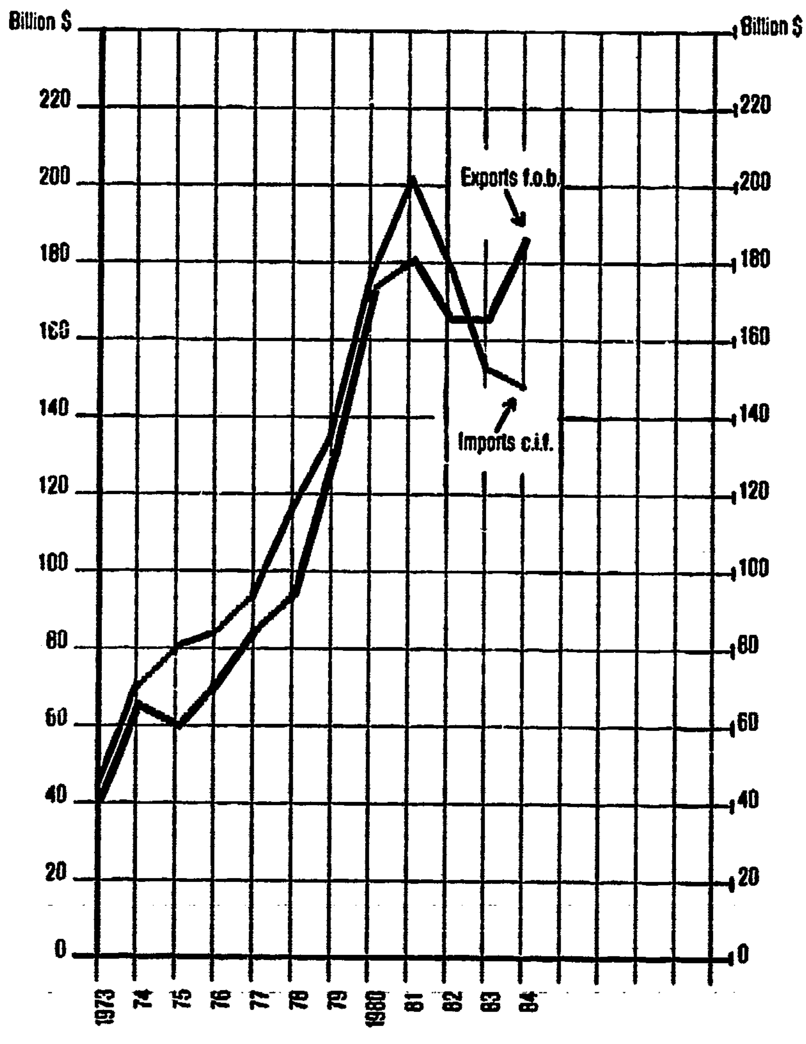
TRADE PERFORMANCE OF THE HEAVILY INDEBTED COUNTRIES

Monetary and fiscal restraint at home, coupled with the recovery in the industrial countries, brought about a resumption of export growth in sixteen heavily indebted countries in 1984.[1] Picking up by an estimated 12 per cent in value terms, the combined exports of these countries expanded less rapidly than in 1976, but more rapidly than during the 1968 recovery. Their combined exports surpassed the previous peak of 1981 (Chart IV).

CHART: IV

Merchandise Trade of sixteen indebted countries[a], 1973-1984

(Billion of dollars)



a: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Korea, Rep. of, Philippines, Thailand, Egypt, Morocco, Turkey, Yugoslavia, Indonesia, Nigeria and Venezuela.

Source: GATT, _International Trade_ and Secretariat estimates.

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[1] Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela, Egypt, Morocco, Nigeria, Indonesia, Republic of Korea, Philippines, Thailand, Turkey, Yugoslavia. This group corresponds to the sample whose trade performance has been analyzed in previous issues of this report.

The aggregate 1984 figure, of course, conceals a wide range of individual performances within the group. Yet export expansion was a fairly general feature. According to preliminary estimates, only two or three of the sixteen countries experienced a fall in export earnings in 1984. On the other hand, about half of the remaining countries appear to have recorded two-digit growth rates of their US dollar export earnings, with Brazil, the Republic of Korea and Turkey taking the lead.

As opposed to developments on the export side, the combined imports of the sixteen countries declined further in 1984, albeit at a much less rapid rate than in the two preceding years. The experience of the individual countries is more mixed than on the export side. Nine countries can be assumed to have experienced a fall in import value, ranging up to as much as about 30 per cent. The remaining seven countries maintained their 1983 import level or increased it.

Export and import developments combined to produce a sizeable increase in the aggregate merchandise trade surplus of the sixteen countries. The 1984 trade surplus may be well on the order of $35 to $40 billion, that is, more than twice the amount recorded in 1983.

PART III - TENSIONS OVER POLICIES PERSIST IN SPITE OF TRADE GROWTH

The brisk expansion of world trade in 1984 offers an improved climate for trade policy actions that would serve to consolidate the economic recovery and to promote further trade growth. In past cyclical expansions, the rebound of world trade helped to ease tensions between countries over trade issues. This was the basis for the belief, widespread during the 1980-82 recession years, that recovery would arrest the rise in protectionist pressures and eventually make it possible to bring levels of protection down again. But thus far in the current recovery that belief has been disappointed.

While a number of factors have contributed to this situation, the most visible one is the lopsided nature of the economic expansion. The impressive growth of output and employment in the United States contrasts with the weak growth and further increase in unemployment in Western Europe. An even greater disparity in economic performance in 1984 is evident among the developing countries. International differences in the strength of the economic recovery were reflected in trade, with the United States providing a disproportionately large share of stimulus to the expansion of world trade in 1984.

In the United States, the economic recovery has been accompanied by a steady appreciation of the US dollar and an unusually large increase in the US current account deficit. Both developments are posing an increasing threat to international trade relations by adding to protectionist pressures.

While the economic recovery in the United States has been much more vigorous than in Western Europe, not all sectors of the US economy have shared equally in the growth. Following the sharp decline in farm output in 1983, production recovered in 1984. However, this gain failed to prevent a worsening of the financial strains on many farmers caused by high levels of indebtedness and high interest rates. In addition, a number of basic industries have found, like their counterparts in Western Europe, that the end of the recession did not mean an end to their economic difficulties. Granting that the high exchange rate of the US dollar could have played a role in the United States, this suggests a decline of a more fundamental nature in the international competitiveness of these basic industries. It is not surprising, therefore, that the recovery failed to allay demands by a range of such industries on both sides of the Atlantic for additional protection. In the United States growing demands for protection in favour of specific industries have become intertwined with demands for across-the-board measures against imports.

Policy makers in any country whose current account is moving into substantial deficit are familiar with claims that the trade deficit is "costing us jobs", slowing economic growth and generally "undermining the economy". In the United States it is being argued, in particular, that the stimulus provided by the budget deficit is being drained off by imports. The implication is that an increase in import restrictions would reduce the deficit and expand employment.

However, this view is based on a misunderstanding of the problem.

A current account deficit means that the country is a net recipient of goods and services from abroad. In general, this situation occurs when domestic savings are not sufficient to finance the current level of domestic investment. The shortfall in domestic savings relative to investment is made up by borrowing abroad and using the funds to finance the net inflow of goods and services.

In the case of the United States, these developments are reinforced by the combination of factors that account for the strong appreciation of the dollar. These include high interest rates associated with the strong fiscal stimulus provided by the Federal budget deficit, and a monetary policy designed to prevent an acceleration of inflation; changes in tax laws that encouraged business expansion; and a general confidence at home and abroad in the future growth prospects of the US economy. As a consequence, outflows of US capital declined and inflows of foreign capital increased. Thus the current situation in the United States differs from that of the typical country with a balance-of-payments problem, in which the current account deficit is aggravated by private capital outflows - both factors leading to a weakening of the currency.

In the present situation, if the government wishes to reduce the current account deficit, the principal option available to it is to reduce the Federal budget deficit in order to reduce the government's demand for borrowed capital.

MORE

In contrast, increased restrictions on imports can, at best, have only a short-term impact on the current account deficit. It is widely recognized that increased restrictions on imports of particular products are ineffective as a way of dealing with a serious current account deficit. The fact that more general import restrictions are equally ineffective is less evident.[1]

Sometimes an import surcharge is advocated as a fiscal measure, on par with a surcharge on, say, gasoline or liquor. But even from a purely fiscal point of view a surcharge is a very poor policy. For example, while it causes the prices of both imports and domestically produced close substitutes to rise, the government collects revenue only on the imported versions. And, since it is necessarily temporary, an import surcharge only postpones the need to take more permanent steps to reduce the imbalance between government expenditure and revenue.

More fundamentally, whether in the form of quantitative restrictions, import licensing or a surcharge, general import restrictions reduce economic efficiency and thus economic growth at home and abroad. They stimulate inflation. Not only do they fail to help the export industries, they actually penalize them by increasing their production costs. The burden on exporters would be even greater if the restrictions caused the exchange rate to appreciate further, not to speak of possible retaliation abroad.[2]

In addition to changes in domestic policies in the United States, an increase in confidence in investment prospects in other countries - as a result of either the spreading economic recovery or the removal of obstacles to structural change - would both reduce inflows of capital into, and attract capital from, the United States (provided there is not an offsetting rise in US interest rates). This could be expected to result in a depreciation of the dollar and a reduction in the current account deficit.

Despite the recovery in Western Europe, job creation remained stagnant and unemployment continued to rise. This experience has strengthened the view that inadequate flexibility is at the heart of Western Europe's disappointing economic performance - that is, that Western Europe's economic problems are primarily structural rather than cyclical.[3]

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[1]The effects of industry-specific restrictions of imports have been analyzed at length in previous issues of GATT's annual report. Some basic considerations relevant to the analysis of more general trade measures were discussed in International Trade 1982/83, pp.15-17.

[2]Under normal conditions, a reduction in the supply of the country's currency flowing abroad to pay for imports would cause the exchange rate to appreciate. In addition to the impact on the export industries, an appreciation would offset a part of the impact of the surcharge on competitiveness of import-substitute industries.

[3]For more on this point, see International Trade 1983/84, pp. 9-10, and the references cited therein.

The imbalance in growth rates between Western Europe and the United States is clearly an important source of tension in the world economy. Some convergence of economic growth rates between the two areas is widely expected to develop during 1985. But this development will be, for the most part, the result of lower growth in the United States. On the basis of current indicators, economic expansion in Western Europe, while accelerating somewhat, is anticipated to fall short of the standards achieved in past recoveries and unemployment will remain high.

The outlook for a return to healthy economic growth in Western Europe depends on a determination to consolidate and expand recent progress in increasing structural flexibility and the pace of adjustment. Such efforts will be even more productive if they can take place in a liberal trading environment, since liberal trade policies often lead to the reform of other policies and regulations which interfere with smooth structural adjustment.

Japan responded more strongly than Western Europe to the stimulus from the United States. Exports expanded in 1984, by about 16 per cent in volume, and triggered an upswing in overall economic activity. In its course, imports picked up as well. In particular, the volume of imports of manufactures, which in 1983 was about 13 per cent above its 1979 level, increased by another 18 per cent in 1984. Notwithstanding, Japan's current account surplus increased strongly. Among other factors, the large current account surplus reflects not only the strong import demand in North America (Japan's most important export market), but also the continuing emphasis on reducing the government's budget deficit, and the traditionally high private savings rate.

The 1984 trade performance of the heavily indebted countries represented a switch from an import-contracting to an export-expanding adjustment path. Increased export earnings, along with rescheduling activities, provided a welcome breathing space.

In 1984, industrial production in countries like Argentina, Brazil and Mexico, while having recovered somewhat from the depressed 1983 levels, was 5 to 20 per cent below that of 1980. Meanwhile, population pressure is steadily adding to the strains on labour markets. Accumulating social hardship, and social unrest, make it difficult to maintain, let alone increase, fiscal and monetary restraint in most of these countries. Clearly, the ability of the heavily indebted countries to service their debts depends not only on increased efforts to improve economic efficiency at home, but also on the success of the industrial countries in countering protectionist pressures and sustaining non-inflationary economic growth in the medium term.

Even more disturbing than the problems confronting the heavily indebted countries is the situation created by the economic decline in large parts of Africa. Leaving aside the question of the causes of, and cures for, these problems, it is evident that an expanding world economy would greatly increase both their export opportunities and the prospects for aid.

In summary, the recovery of world trade in 1984, brisk as it was, is no reason for complacency. Tensions over trade issues are at least as strong as during the recession years. Even more so than in the past, substantial progress in improving trade policies will require joint efforts, with each country's resolve being strengthened by the knowledge that it is a cooperative effort.

ANNEX TABLE 1. - VALUE OF WORLD TRADE BY AREAS IN 1983 AND 1984

(Billion dollars and percentages)

	Exports (f.o.b.)				Imports (c.i.f.)			
	Value		Changes over previous year		Value		Changes over previous year	
	1983	1984	1983	1984	1983	1984	1983	1984
WORLD	1 835	1 955	-2	+6½	1 896	2 020	-2	+6½
of which:								
Industrial countries	1 135	1 210	-1	+6½	1 212	1 320	-1½	+9
Developing countries	452	486	-6	+7½	452	451	-6	-½
- all products except fuels	223	256	+7	+15	369	370	-5½	0
- fuels	229	230	-16	+½	83	81	-8	-2½
Eastern trading area[a]	204	213	+5	+4	190	199	+5	+4½

[a]Imports f.o.b. except for China and Hungary.

Sources: IMF, International Financial Statistics; UN, Monthly Bulletin of Statistics; OECD, Monthly Statistics of Foreign Trade; national statistics.

ANNEX TABLE 2. - PERCENTAGE CHANGE OF WORLD TRADE VOLUME ASSOCIATED WITH EACH ONE PER CENT CHANGE IN WORLD REAL INCOME

(Apparent income elasticity of world trade)[a]

	1964-73	1973-79	1979-84
Total exports	1.6	1.4	0.8
Exports of manufactures	1.9	1.7	1.7

[a]Calculated as $ATE = [(X_t - X_{t-1}) \cdot (Y_t + Y_{t-1})] / [(X_t + X_{t-1}) \cdot (Y_t - Y_{t-1})]$ where ATE = apparent income elasticity of world trade; X = volume of world exports; Y = world real income; t = end-year of period under investigation; t-1 = beginning year of period under investigation. The benchmark years were chosen so as to capture peak years in world economic activity.

Source: GATT secretariat estimates.

ANNEX TABLE 3. - THE SHARES OF INTRA- AND INTER-CONTINENTAL TRADE IN THE INCREASE IN THE VALUE OF WORLD TRADE,[a] 1964-1984

(Percentage shares)

	1964-73	1973-79	1979-84
Trade within North America	5.7	3.5	13.8
Trade within Western Europe	33.1	28.5	-2.4
Trade among North America, Western Europe and Japan	13.6	9.4	29.5
Trade between industrial and developing areas	24.8	34.8	16.8
Trade among developing areas	3.8	7.0	13.9
Trade within Eastern trading area	4.8	4.4	9.5
Other trade	14.2	12.4	18.9
Total increase in world trade	100	100	100

[a]Change between end-year and beginning year of period under investigation in US$.

Source: GATT secretariat estimates.

ANNEX TABLE 4. - REGIONAL SHARES IN THE INCREASE IN THE VALUE OF WORLD TRADE,[a] 1964-1984

(Percentage shares)

	Exports			Imports		
	1964-73	1973-79	1979-84	1964-73	1973-79	1979-84
North America	15.3	12.6	23.0	16.4	15.2	44.7
Japan	7.5	6.2	22.4	6.9	5.7	8.2
Western Europe	46.6	41.9	10.7	47.5	44.5	-1.1
South-East Asia[b]	3.5	4.2	17.0	3.8	4.8	13.4
OPEC	8.0	16.1	-9.2	3.7	7.4	4.3
Other developing areas	7.5	8.3	15.3	8.8	11.6	12.5
Eastern trading area	9.2	8.9	19.0	9.1	8.5	11.9
Other	2.4	1.8	1.8	3.8	2.3	6.1
Total increase in world trade	100	100	100	100	100	100

[a]Change between end-year and beginning year of period under investigation in US$.

[b]Four rapidly developing areas in South-East Asia.

Source: GATT secretariat estimates.