INTERNATIONAL TRADE IN 1982 AND CURRENT PROSPECTS

First Assessment by the GATT Secretariat

This is the GATT secretariat's first summary and assessment of world trade and major economic developments in 1982. Part I summarizes the main facts, while part II analyses the policies required to deal with the current strains in the international financial system and to secure a sustained non-inflationary recovery in the major industrial countries.

PART I - DEVELOPMENTS IN 1982

The volume of world trade declined by an estimated 2 per cent in 1982, which means that it was running at about the same level as in 1979. The estimated 1 per cent increase in the volume of agricultural trade in 1982, well below 1981's 4 per cent gain, was the only source of strength in world trade last year (see Chart I). Trade in manufactured goods registered a 1 per cent decline (compared with a 3 per cent increase in 1981), while trade in mineral products was down 7 per cent, somewhat less than the 9 per cent decline recorded in 1981; as in the previous year, the decline was mainly due to sharply lower petroleum exports.

1Later in 1983, when more complete information is available, these preliminary indications will be elaborated in greater detail in the GATT annual report International Trade 1982/83.

2Trade statistics covering all of 1982 are available for most industrial countries. For other countries, data referring to the year 1982 are rough estimates based on the months available and on the returns of those of their trading partners for which complete data are available.
Corresponding figures for the value of world trade are heavily influenced by the decline in dollar unit values stemming from the appreciation of the US dollar. Ranging from -3 per cent for manufactured goods to -7 per cent for agricultural products, the fall in dollar unit values averaged 4 per cent for world trade as a whole. The combination of lower volume and lower dollar unit values pushed the value of world trade down to an estimated $1,800 billion in 1982, 6 per cent below the 1981 level (see Table 1).
### TABLE 1. - WORLD TRADE BY AREAS, 1981-1982

(Billion dollars and percentages)

<table>
<thead>
<tr>
<th></th>
<th>Exports (f.o.b.)</th>
<th>Imports (c.i.f.)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value</td>
<td>Change over previous year</td>
</tr>
<tr>
<td>World</td>
<td>1 970</td>
<td>1 840</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial countries</td>
<td>1 210</td>
<td>1 145</td>
</tr>
<tr>
<td>Traditional oil-exporters&lt;sup&gt;a&lt;/sup&gt;</td>
<td>271</td>
<td>215</td>
</tr>
<tr>
<td>Other developing countries</td>
<td>268</td>
<td>255</td>
</tr>
<tr>
<td>Eastern Trading Area&lt;sup&gt;b&lt;/sup&gt;</td>
<td>183</td>
<td>190</td>
</tr>
</tbody>
</table>

<sup>a</sup>Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libyan Arab Jamahiriya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.

<sup>b</sup>Imports f.o.b.

Note: Figures for 1982 are based on incomplete returns and are subject to revisions.

**Sources:** IMF, International Financial Statistics; UN, Monthly Bulletin of Statistics; national statistics.

1. **Production and Trade by Product Groups**

Preliminary estimates indicate that world agricultural output increased by 2 per cent in 1982; in 1981 it had increased by 3 per cent. The slowdown in production was less pronounced than the slowdown in the growth of agricultural trade (from 4 to 1 per cent). The volume of imports of foodstuffs into developing countries and the Eastern trading area did not show any further substantial growth. In addition, imports by the industrial countries of agricultural raw materials were held down by the weakness of final demand, as well as by high interest rates which forced some reduction in stocks.

Developments in world production of minerals were again dominated by the petroleum sector. World demand for energy declined in 1982 for the third consecutive year. The decline was no longer limited to the industrial countries; consumption was also reduced in most East European countries as well as in several developing countries, especially in Latin America. The brunt of the fall in overall energy
demand was again taken by petroleum. The further sharp decline in consumption of petroleum reflected a continuation of the trend towards conservation and substitution by consumers, as well as the cyclical downturn in economic activity.

World production of crude petroleum declined by about 5 per cent in 1982, while coal and gas output is estimated to have declined only marginally. Crude oil production by the members of OPEC fell by 18 per cent in volume terms, in contrast to the 3 per cent increase in production outside the OPEC area. As a result, the share of OPEC members in world production, which was nearly one-half in 1979, was about one-third in 1982, the lowest in more than twenty years. In the industrial countries as a group, oil production increased by 2 per cent in 1982, largely as a result of a 15 per cent increase in the output of the United Kingdom. The 16 per cent increase in Mexico's production, together with the sharp rise in the oil output of several smaller producers, raised the oil production of the non-OPEC developing countries by 11 per cent. Oil production in the Eastern trading area, which accounts for somewhat more than one-quarter of the world total, increased only marginally in 1982.

World exports of petroleum (including petroleum products) are estimated to have declined by about 9 per cent in volume in 1982. The sharper fall in world petroleum trade than in production can be explained by (i) an increase in production in the net oil-importing areas and (ii) a sizeable run-down in stocks. The latter development appears to have been a key factor behind the fact that while crude oil exports declined by more than 10 per cent, early estimates suggest that exports of oil products actually increased in 1982.

In contrast to the agricultural and minerals sectors, where production out-performed trade in 1982, the estimated 1 per cent decline in manufactures trade was less than the 2 per cent decline in production. In the traditional oil-exporting developing countries there was a marginal decline in the volume of manufactured imports, while imports by other developing countries declined by about 8 per cent. Trade in manufactures among industrial countries, which is still the major trade flow, appears to have stagnated in volume, while industrial countries' imports of manufactures from developing countries expanded.

Prices

Dollar export prices of primary commodities (excluding petroleum) declined by 9 per cent in 1982, following a 7 per cent decline in 1981 (see Chart II). The largest declines were recorded in prices of non-ferrous metals (12½ per cent) and foodstuffs (11 per cent). Export prices of petroleum declined by about 5 per cent in 1982, less than those of other primary commodities, but slightly more than dollar export prices of manufactures. As in the preceding year, prices of primary commodities (other than fuels) exported from developing countries declined more than the prices of commodities exported mainly
CHART II
Export Prices, 1970-1982
(indices, 1970 = 100)

*Primary products excluding crude petroleum exported by developing countries.*

*bPrimary products excluding crude petroleum exported by developed countries.*

*cUnit value of manufactures exported by developed countries*

*Source: UN, Monthly Bulletin of Statistics.*
by the developed countries, by $13\frac{1}{2}$ and 8 per cent, respectively (see Table 2). Some recovery of world export prices for primary commodities was apparent early in 1983.

**TABLE 2. - EXPORT PRICES OF PRIMARY COMMODITIES**

(Percentage change over previous year)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Agricultural</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>raw materials</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developed countries</td>
<td>$-7\frac{1}{2}$</td>
<td>$-10$</td>
<td>$-6\frac{1}{2}$</td>
<td>$-6\frac{1}{2}$</td>
<td>$-11$</td>
<td>$-12$</td>
<td>$-4\frac{1}{2}$</td>
<td>$-8$</td>
</tr>
<tr>
<td>Developing countries</td>
<td>$-16$</td>
<td>$-16$</td>
<td>$-12\frac{1}{2}$</td>
<td>$-13\frac{1}{2}$</td>
<td>$-17$</td>
<td>$-14$</td>
<td>$-13$</td>
<td>$-13\frac{1}{2}$</td>
</tr>
<tr>
<td>World $^b$</td>
<td>$-11$</td>
<td>$-11$</td>
<td>$-8\frac{1}{2}$</td>
<td>$-9$</td>
<td>$-12\frac{1}{2}$</td>
<td>$-12\frac{1}{2}$</td>
<td>$-7$</td>
<td>$-9$</td>
</tr>
</tbody>
</table>

$^a$ Excluding crude petroleum

$^b$ Excluding the Eastern Trading Area.


The appreciation of the US dollar in 1982 resulted in divergent trends in dollar unit values of manufactured exports. In Western Europe and Japan, unit values fell an estimated 10 per cent, while in the United States there was an increase. On the average, dollar unit values of manufactured exports from the developed countries declined by about $3\frac{1}{2}$ per cent in 1982.

2. Trade by Main Areas

Industrial countries

Following two years of growth averaging about 1 per cent, the combined GDP of industrial countries fell by about $\frac{1}{2}$ per cent in 1982. This resulted primarily from a decline in fixed capital expenditure and stockbuilding, as well as a contraction of external demand. Industrial production, which was more or less stagnant in the two preceding years, declined by about 4 per cent in 1982. A further increase in unemployment raised the average unemployment rate in industrial countries to about 9 per cent by year end.

The rate of growth in consumer prices in the industrial countries declined for the second consecutive year. Inflation amounted to 8 per cent in 1982, compared with $10\frac{1}{2}$ per cent recorded in 1981 and 13 per cent in 1980. The deceleration was particularly pronounced in the United States and the United Kingdom. There were also sizeable movements in exchange rates in 1982. The US dollar continued to appreciate strongly through most of the year, before weakening in
December. The pound sterling also appreciated until the last quarter of 1982, when it abruptly declined.

In the fourth quarter of 1981 nominal interest rates declined sharply in the United States from the peak levels reached earlier in the year. This was followed by further sharp declines during the second half of 1982. In Canada and also in the United Kingdom, both short and long-term interest rates fell sharply in 1982, while in other industrial countries the decline was more moderate. Real interest rates remained relatively high in most countries, including the United States.

The dollar value of industrial countries' exports and imports fell by about 5 and 6 per cent respectively in 1982, having declined by 1\(\frac{1}{2}\) and 5\(\frac{1}{2}\) per cent in 1981. In volume terms, both exports and imports are estimated to have fallen by about 1 per cent. The decline in the volume of industrial countries' trade mainly reflected reduced purchases of fuels and a decrease in shipments to non-oil developing countries.

Developing countries

Although information on trends in the developing countries' economies in 1982 is still fragmentary, available indicators suggest that, for the second consecutive year, there was a noticeable deterioration in the economic performance in a majority of these countries.

As already noted, production and exports of petroleum in the traditional oil-exporting developing countries fell sharply last year. Coupled with lower prices, this caused their aggregate export receipts to fall about 20 per cent below the 1981 level, double the rate of decline between 1980 and 1981. As a result, the combined imports of the traditional oil-exporting developing countries, which in 1981 had increased by 20 per cent in value and even more rapidly in volume, declined by 3 per cent in value, implying only a slight rise in volume. Preliminary estimates suggest that the area's current account surplus, which stood at $115 billion in 1980, declined to about $20 billion in 1982.\(^1\)

In the other developing countries as a group, the overall expansion of GDP slowed down further to probably no more than 1 per cent. This was the lowest rate of growth recorded in the post-war period and on a per capita basis represented a decline even larger than that of the preceding year. The slowing down in aggregate production was partly due to a deceleration in agricultural output growth, from nearly 4 per cent in 1981 to 1\(\frac{1}{2}\) per cent in 1982, and partly to a slowdown in the growth of industrial output.

\(^1\)Because of a rapidly increasing statistical discrepancy in world current account statistics, current account estimates represent at best very rough orders of magnitude.
The volume of imports into these countries declined in 1982. Export volume was essentially constant, as a modest increase in manufactured exports and a strong increase in exports of crude petroleum (mainly from Mexico) were offset by a decline in exports of non-petroleum primary products. The terms of trade declined, mainly as a result of the previously mentioned decline in export prices of primary commodities (see Chart III). The aggregate value of exports declined by 5 per cent, and that of imports by 10 per cent for this group of

CHART III

Terms of Trade Indexes\(^a\), 1970-1982

(1970 = 100)

\(^a\)Ratio of dollar export unit values to dollar import unit values.

developing countries. As a result, their aggregate trade deficit (f.o.b.-c.i.f.) is estimated to have declined from about $60 billion in 1981 to around $40 billion in 1982. The current account deficit also declined in 1982 from its peak level of $85 billion in 1981.

Eastern trading area

In Eastern Europe (excluding the Soviet Union) aggregate production, after a decline of 1 per cent in 1981, is estimated to have declined marginally again in 1982. In both years, the figures were influenced by production declines in Poland, of 12 per cent and 8 per cent, respectively. Production continued to increase in 1982 in the other countries of the area at rates ranging between 2 and 4 per cent, with the exception of Czechoslovakia where production stagnated. The area's aggregate exports can be estimated to have levelled off in 1982, while imports were cut by 8 per cent, with the result that the import surplus, of about $2.5 billion in 1980, was converted into an export surplus of nearly $4 billion in 1982.

In the Soviet Union production is estimated to have risen by roughly 3 per cent in 1982, about the same rate as in the preceding year. The growth of industrial output slowed down again, to 2.8 per cent, whereas agricultural output recovered partly from its setbacks of the preceding three years. The trade turnover increased by about 8 per cent in value terms in 1982. As the growth of exports slightly exceeded that of imports, the overall trade surplus rose to roughly $8 billion. Exports to the developed countries showed a strong rise, mainly due to a substantial recovery in exports of petroleum (including refined products) which had declined in the preceding three years.

In China imports declined in 1982 by 12 per cent, while exports rose by 3.5 per cent. As a result, the export surplus increased again, reaching an estimated $4.6 billion.

PART II - CURRENT POLICY ISSUES

Two issues have dominated economic policy discussions in recent months. The first is that of cyclical recovery in the main industrial countries, which many observers expect to be weak and/or threatened by a possible resurgence of inflation. Several indicators suggest that a spontaneous upturn may be expected now that inflation has declined much more rapidly than originally expected, with interest rates declining in parallel fashion from February into December 1982. Inventory levels are low, financial balances of households have improved, construction is experiencing a gradual revival of orders. There is little doubt that

1The Economic Commission for Latin America estimates that for Latin America as a whole, but excluding the two traditional oil-exporters, Venezuela and Ecuador, the current account deficit declined from $41 billion in 1981 to $30 billion in 1982, largely due to the sharp fall in the trade deficit, as imports were cut by 25 per cent, while the net deficit on interest payments rose from $26 to $34 billion.
many firms and households can no longer postpone the replacement and improvement of durable equipment. Another encouraging development, especially for employment, is the improved relationship between real wages and real interest rates; for much of the 1970s, low or negative real interest rates and high real wages combined to give business investment a strong labour-saving bias. The potential created by these favourable conditions will, however, be realized only in an appropriate policy environment. What constitutes "the right policy environment" is thus the key question.

That also applies to the second issue, which concerns the short-run situation facing the most indebted developing countries and their creditor banks. An almost exclusive pre-occupation of all the actors involved with the short-term aspects of the problem, mainly with mobilization of emergency credits, is the most worrisome aspect. Debtors see their indebtedness growing (through the capitalization of interest due) but little in the way of new resources flowing in, while creditors are asked to provide additional funds to countries which are behind in servicing existing debts. Although neither party is likely to find this situation tolerable for long, the question of a long-term solution has hardly been raised.

A sustained recovery in the major developed countries is, clearly, an important condition for a successful solution of the international financial problem. It would be a mistake, however, to consider it a sufficient condition. The difficulty under which the international financial system has been labouring in recent years is of a more fundamental nature. Overcoming, instead of merely allaying, it will require additional policy changes in both the creditor and the debtor countries. It is now urgent that both sides, in a joint analysis, agree on the underlying causes of the problem and appropriate solutions. Only such an agreement can provide the realistic perspective needed to maintain cooperation among the many actors involved. The policy changes required would be easier for each government to implement if they were identified through such a joint and agreed analysis.

In this regard, it is regrettable that for the last six months or so economic policy discussion has been concerned almost exclusively with the macroeconomic (demand management) aspects of the two problems. The awareness of the rôle played by microeconomic (structural) distortions — an awareness which seemed to be growing as recently as a year or year and a half ago — has almost completely disappeared again. The macroeconomic view fails to take account of the enormous changes that have occurred on the microeconomic level in the last decade or two. The extent of these changes is such that most economic relations and reactions that used to be taken for granted no longer hold. Market, and even mixed, economies must rely on prices to ensure an efficient use of resources through a continuous, orderly adjustment to changing conditions, including macroeconomic conditions. This consideration applies with equal force to both the problem of securing a sustained recovery and the problem facing the financial system. It is therefore necessary to consider explicitly the extent to which the price system in contemporary market and mixed economies is prevented from discharging its vital guiding function. Even a brief reflection on the state of the private economy suggests that one should, indeed, ask: What remains of the price system?
Government services, now a substantial part of total output everywhere, are clearly not priced by the spontaneous interplay of supply and demand. The bulk of agricultural output is marketed at prices set entirely by the political process. Textiles and clothing, industries with vigorous internal competition, are effectively sheltered against low-cost foreign competition in most countries while steel, without significant competition on the national level, is also extensively regulated in international trade. Shipbuilding in industrial countries continues to exist only by virtue of subsidies. Energy supply, subject to non-competitive pricing, has been a major source of instability. Petrochemicals are largely cartelized, the world's most efficient producer of automobiles is severely constrained in foreign trade, an extensive and increasingly acrimonious international political negotiation is going on about where and under what conditions the latest technological innovations will be produced, and most services (such as transportation, insurance and communications) are both politically regulated and protected against import competition.

Thirty-five years ago we were reminded of the importance of structural flexibility for macroeconomic stability:

Surely a competitive economy would be extremely sensitive to monetary controls and relatively easy to stabilize by fiscal devices. That the same should be true of a highly monopolized or syndicalist system is improbable on its face and, on reflection, appears quite impossible. Monetary remedies can cure monetary ills. That they should counteract and greatly ameliorate the consequences of wholesale organization of producer groups to exploit one another (and the unorganized) by rising their prices relatively and restricting their respective outputs is certainly not to be anticipated on the basis of any reasoned analysis.

If relative prices are not flexible, the price signals which businesses rely on to identify changing patterns of demand are weak and often unintelligible. Investment in plant and equipment, and in developing labour skills, fails to keep pace with the changing demand. In such a situation, even "prudently" expansionary policies designed to lift an

---

1 The malfunctioning price system, coupled with inflation differentials and unpredictable policy changes in the major countries, explains the instability of exchange rates in recent years. If prices are flexible, adjustments to changing economic conditions occur relatively quickly, with a minimum of uncertainty. When prices are rigid or can change only very slowly, changing conditions generate increased uncertainty and groping adjustments, with frequent "under" or "overshooting" in all markets, including the foreign exchange market. The widespread demands for measures to stabilize exchange rates ignore or evade the crucial question: who in this situation can say what pattern of exchange rates should be stabilized? Stability in exchange rates can be expected only after (a) national price levels in the major countries have been stabilized and (b) relative prices have regained a greater degree of freedom to react to all kinds of economic change.

economy out of a recession are likely to lead to a resurgence of inflation, as the nascent recovery soon encounters supply bottlenecks. In a similar way, bringing down the inflation rate in an economy whose structures have grown rigid is bound to be unnecessarily costly in terms of unemployment and lost output if the restrictive monetary policy is not coupled with microeconomic reforms designed to loosen up the economy's price structure.

These propositions find ample support in the experience of industrial countries since the late 1970s. In 1978, with inflation in the industrial countries down to 7 per cent from the peak of 13½ per cent in 1974, macroeconomic restraint gave way to "finely tuned" demand management policies, coupled this time with calls for coordinated expansion among the leading countries. Meanwhile, the extent of the rigidities at the heart of the unemployment problem had been growing as a result of increased protection, including direct subsidies to uncompetitive industries. The result was two years of rapid inflation (beginning well before the second round of increases in petroleum prices) that erased the costly gains of 1975-78 and brought the annual inflation rate back to 12 per cent in 1980. On the downside there is the experience of 1981-82, when resolute anti-inflation policies, unaccompanied by measures to restore microeconomic flexibility, resulted in a much sharper curtailment of economic growth than had been anticipated.

It is also clear that adequate investment incentives can be maintained only when relative prices are flexible and free of inflationary distortions. As long as the present distortions persist, investment incentives will be not only weak but distorted as well, so that even such mild cyclical upswings as occur will involve a considerable misallocation of investment in both creditor and debtor countries. In the former, for example, highly protected and subsidized industries such as textiles and clothing, steel, shipbuilding and others will continue to attract scarce investment capital, for projects of a strongly labour-saving kind. These are not the building blocks of a sustained recovery in output and employment.

The problems created when the price mechanism's incentive function is impaired extend beyond the simple macroeconomics of full employment and price level stability. For the past fifteen years growing dissatisfaction with the overall performance of the Western economies has included concern with declining productivity growth, insufficient innovation and difficulties in developing an appropriate mix of labour skills. Persistent failures to deliver the right goods, with the right quality, at the right price cannot be remedied simply by manipulating the rate of interest and the budget balance.

Recent developments in the "new political economy" - a discipline analyzing the way in which special interest groups influence the policy making process - help explain the neglect of the microeconomic changes needed to restore stable growth. The objectives of macroeconomic fine-tuning are, of course, policy goals to which no economic interest group can effectively object. In contrast, it is the nature of microeconomic policy - deciding questions involving subsidies, trade restrictions, regulation and so forth - that it nearly always affects the interests of well-defined and organized groups. Here it can be
observed that even those industry groups which proclaim their allegiance to the free market in principle, seldom hesitate to demand interventions where their particular interests are involved. It is not surprising that when the policy makers are under great pressure to improve the general performance of national economies, the thorny microeconomic causes of unemployment and inflation are left aside.

Against the background of the general economic deterioration caused by the extensive impairment of the price system, it is easy to understand why demands of individual lobbies for special treatment continue to aggravate the problem. As new restrictions are piled on top of the existing ones, the situation can only worsen. When imports of clothing or consumer electronics are restrained, the illusion may persist that the government is helping national industry since such protection redistributes income from consumers to domestic producers of those items. There are, however, many ways in which protection tends to spread from industry to industry, the most important of which is the creation of political precedents giving other industries a claim to equal treatment. Once import restrictions are extended to such producers' goods as steel and machine tools, industrial protectionism may be said to have acquired an outright suicidal aspect.

Microeconomic distortions - long-term distortions of relative prices and wages which underlie the rigidity of economic structures - and the policies responsible for them play an equally important rôle in the second major problem, that of managing the international debt situation.

The lending institutions' concern with the ability of the debtor countries to service their debts is understandable, but threatens to become self-defeating if the perspective is too narrow. Debt service made possible by reduced activity levels could not be maintained for long. Thus the first concern of the creditor banks, their governments and the international organizations must be the improvement of the general economic performance of the indebted countries.

In essence, the problem is to ensure both a level of debt service needed to keep the international financial system functioning, and a net inflow of new resources to the debtor countries sufficient to keep their economies on a reasonable growth path. At current stages of development, after decades of being net importers of capital, the indebted countries would find it impossible to become net exporters of capital without exposing their political systems to an extreme strain. Such an attempt would also create serious problems for the export sector in the creditor countries, as it would inevitably involve a sharp reduction in their exports to the debtor countries. The trade figures for 1982 already point in this direction, as the percentage decline in the value of imports into the oil-importing developing countries was double the decline in their exports (-10 versus -5 per cent), resulting in a sizeable reduction in the current account deficits of several of the most heavily indebted countries.

The debtors' need for capital can be satisfied to only a limited extent by governments and international organizations. Securing domestic political approval in the industrial countries of these
additional public credits will be easier if it can be demonstrated that the funds represent a good "investment". A multilateral agreement on the true causes of, and remedies for, the current problems obviously would be very useful to this end. The two other sources of additional funds are private foreign lending and, possibly, the repatriation of assets held abroad by citizens of the indebted countries. In both instances, the extent to which funds will be forthcoming depends importantly on policy changes designed to raise the creditworthiness of the indebted countries by providing, among other things, predictability of future price level developments and flexibility of relative prices. Through reforms of this kind, the debtor countries would create sound investment incentives and opportunities to which private funds would then flow voluntarily.

Without going into more detail, it is evident that the necessary policy reforms in the debtor countries can only be articulated on the basis of explicit assumptions with respect to the near- and longer-term development of the world economy and its institutional and policy framework. Developments in international economic policy, and in the international economy itself, are still shaped mainly by the economic policies of, and the resulting levels of economic activity in, the industrial countries. It is fairly obvious that if the industrial countries remained preoccupied with "safeguarding vital industries", "reconquering domestic markets" and "eliminating intolerable bilateral deficits", the best policy reforms that the debtor countries could devise for themselves could not be considered very promising. In that case, the prospects for both the management of the international debt problem and a sustained recovery from the current recession would have to be viewed with considerable caution if not skepticism. In short, if they are to lead to an improvement in the general economic performance, the inevitable domestic policy reforms in the debtor countries must be complemented - accommodated, so to speak - by corresponding policy changes in the creditor countries.

One can understand, even sympathize with, the politician or policy maker who says: "Let's wait. We need a boom of some strength and duration, a decline in unemployment, before we can start talking about making basic policy reforms". In this case, however, what may seem practical politics is impracticable economics. It should be clear that simply muddling through has, at this juncture, only a very small chance of success because the economic situation keeps evolving and demanding important policy decisions.

To begin with, a reform of fiscal policies is obviously required. In most industrial countries public budget deficits, which offset private sector savings, are so large that an upswing in investment would be likely to lead, in a short time, to a shortage of investible capital and a renewed rise of interest rates or inflation. Furthermore, protectionist pressures still continue to intensify. So far they have been generated mainly by high levels of unemployment in the economy at large, and by demands from industries in a particularly weak competitive position. Now there is a prospect of a third factor emerging to intensify the pressures in the near future. Should the recovery proceed at different rates in different countries, current account imbalances would tend to widen, and this could become an additional argument for
protection. Thus another task of policy concerned with sustaining the recovery is to prevent a further deterioration in trading conditions.

As the whole preceding analysis suggests, however, budget reform and holding the line against increased protection, necessary as they are, are by themselves not sufficient to ensure a sustained recovery. Many issues are involved, but they all ultimately reduce to a need for a new, more coherent conception of trade policy. There is no denying that this area of policy has in the recent past degenerated to what might best be described as "systematic ad hocery."

In an open economic system, a major function of trade policy is to ensure that all national economic policies will be consistent, with each other as well as internationally. To take an example touching on the two issues discussed here - sustaining the recovery and dealing with the debt problem - it is urgent to obtain a better coordination, within each capital, between officials dealing with the international financial problem and the national trade policy-makers. So far, the former have been urging the indebted countries to "tighten belts, export more and import less" so that their current account imbalances can be redressed. At the same time, however, trade policy-makers have been urging the opposite, "export less, buy more from us - to make it easier for you, we shall throw in a few subsidies". No wonder the whole world is worried about the outcome of the international debt problem.

Next, it should be clear that the microeconomic rigidities and distortions which are the root cause of the unsatisfactory macroeconomic performance can persist only because trade policy effectively shields them, through quantitative restrictions and numerous other, by and large equivalent arrangements, from world market pricing and competition. Trade policy reform therefore represents the most effective approach to a rehabilitation of the price system. Given the complex interlinkages between different sectors and industries in each economy, the phasing out of the GATT-incompatible restrictions can best be achieved on a linear basis, simultaneously across all industries.¹

In principle, there is nothing to prevent any one of the major countries from undertaking the needed trade policy reform on its own. But it is difficult to see how governments, which have been retreating before the pressure of innumerable lobbies for so long, could summon the strength to reverse the situation in the time needed to avert a crisis unless they act in concert with one another. It was the original purpose of the GATT - and of the broader concepts of multilateralism, or international economic cooperation - to strengthen governments against

¹These linkages tend to cause the spread of protection from one sector or industry to another in the first place, as a downstream industry is weakened by dependence on a protected upstream supplier. For this reason, no industry would be willing to forego protection without all the others doing the same. On this point, see GATT's International Trade 1980/81, p. 12.
the particularist pressures emanating from national economies. This purpose has almost been lost; a new joint initiative is needed to retrieve it.

Conclusions

To summarize, trade policy reform can make a three-fold contribution to the solution of the pressing problems described at the beginning of this section. First there is what may be called the macroeconomic aspect: trade liberalization, at least a credible move towards it, is needed to sustain what may be an incipient but fragile recovery. In the long period of prosperity between 1948 and 1973, when world production was increasing by roughly 5 per cent, and world trade by roughly 8 per cent per annum in volume, between one-quarter and one-third of aggregate investment in the industrial countries was related to production for export. Since then, narrowed trading opportunities and unsettled import policies in the main trading countries have cast a heavy pall of uncertainty over all potential investment projects whose profitability depends on access to foreign markets or supplies. It is difficult to see by what measures "purely home market" investments could be made to expand sufficiently to offset this disincentive effect, not only in individual countries but in the world economy at large. In important respects the current situation parallels that which existed in the late 1940s. Then, too, there existed a large backlog of structural adjustments, widespread unemployment, inflationary bottlenecks and an attitude on the part of many that important policy reforms should be postponed until the more immediate difficulties were overcome. Yet a general liberalization of trade in Western Europe did take place, triggering rapid economic growth and more than two decades of unprecedented prosperity.

Second, there is the microeconomic aspect of trade liberalization — its crucial contribution to restoring the efficiency of the price system. Most of the price rigidities making for inefficient resource allocation and insufficient flows of aggregate investment in national economies can persist only because they are shielded by quantitative restrictions from the influence of world market pricing. In the immediate sense, the effect of lower trade barriers would consist of avoiding both a waste of capital implied by investment in industries facing an inevitable shrinkage of their market share and the appearance of inflationary bottlenecks at the first sign of economic recovery. Allowing a bigger role to competition in the determination of relative prices implies, at the same time, a stimulus to the expansion of each country's export industries. It has been customary to view this stimulus as operating mainly through one country's exports benefiting from a lowering of other countries' barriers. In the present context, however, it is more important to emphasize the stimulus which the removal of import restrictions will provide to the liberalizing country's own exports.

1See GATT's International Trade, 1981/82, pp. 15-18, for an explanation of the process that causes a country's import restrictions to be converted into taxes on its exports.
Last but not least, a serious rethinking and reform of trade policy by the creditor countries is, as already mentioned, a necessary component of the urgently needed joint programme for coping with the unstable international debt situation and thus for stabilizing the whole international financial system. It is the necessary counterpart to the search by the debtor countries for more efficient economic policies. Also, the advice which the developing countries have been receiving from the more advanced countries for so long, as to the great advantages of liberal economic policies, would become more convincing.

It is impossible, of course, to be certain that the old demand management policies will not start working again this time; that is, the monetary stimulus which the economy has received since last summer may well be translated predominantly into increased output rather than predominantly into increased prices. Here we are dealing in probabilities only. But we shall know soon enough; and if the incipient recovery fizzles out in a new wave of inflation we shall, at least, finally know that microeconomic distortions – rather than anything that can be remedied by macroeconomic policy – have been the main obstacle to stable non-inflationary growth. It will be a simple lesson very dearly bought.