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# Annual financial and economic review 1

## Boom reverses into world recession



by Peter Jay
Economics Editor

A year ago the major problem of the world economy did not even exist. Nor was it foreseen. The increase in oil prices, although it may well have been inherent in the progress of inflation in the industrialized countries, interacting with their extreme dependence on this valuable commodity, was not regarded as imminent by almost everyone generally concerned with the management of the world economy.

This should be a sobering lesson to pundits, although it does not quite entail total agnosticism about world economic prospects. It is not every year that an event of comparable magnitude disturbs reasonable prognoses of economic trends; and there are not so many groups with the—until last winter—unused monopoly power of the oil producing countries to create such extraordinary changes.

The consequences are by now well known. The oil-producing countries have begun, from the beginning of the year, to move into a massive balance of payments surplus with the rest of the world. The OECD has estimated the effect on the balances of payments of its members—mainly the industrialized countries of the so-called West (including Japan and Australia) at a deterioration of about $50,000m, in a full year.

This has been coming through fast; and it has by no means been proportionately distributed between the main oil-using countries according either to their economic size or to their capacity to handle a balance of payments deficit. The Bank of England, in its September *Quarterly Bulletin*, has provided a convenient summary of the experience in the first half of 1974 compared with 1973.

In 1973 the three strong countries in terms of currencies and balance of payments were the United States, Canada and West Germany. In addition the category "all other OECD countries" (excluding North America, Japan and the four larger members of the EEC) were in strong surplus in 1973; but jointly these countries enjoyed no special currency or financial strength. The turn-round in the joint balance of payments positions of the United States, Canada and West Germany between 1973 and the second quarter of 1974 (at an annual rate) was from a surplus of $5,000m to a surplus of $5,000m—in other words, no change at all.

The turn-round of Japan, the four larger EEC countries and the "other OECD countries" was thus equal to the whole of the deterioration in the total OECD balance, from a surplus of $2,800m to a deficit of $40,500m. Of this total deterioration of $43,300m the "other OECD countries" suffered $15,800m, Italy suffered $8,100m, Japan suffered $6,900m (after an even worse experience in the first quarter), Britain suffered $6,700m and France $5,800m.

The important consequences were threefold: to exacerbate world inflation, to trigger off a world recession and to pose the world financial system with formidable difficulties in matching the flow of capital (short and long-term, private and official) to the incidence of these new extraordinary surpluses and deficits.

The impact on inflation was obvious. In 1972 consumer prices in OECD countries rose 4.7 per cent, a worrying increase on the average of 3.7 per cent during the decade 1961-71. In 1973, which included some effects of the oil-price rise only at the very end of the year, the rise in consumer prices over the average for 1972 had jumped to 7.7 per cent, which was partly why last year's International Monetary Fund meeting in Nairobi was dominated by the question of inflation. In the 12 months to July, 1974, the rate had reached 13.3 per cent, almost equal for the first time in many years to the rate of inflation among the European members of the OECD.

Second, the world economic boom of 1973 went abruptly into reverse so that by now the signs of recession are clearly to be seen in most of the major OECD countries. So clearly are they to be seen, indeed, that there is already near unanimity among the member governments that countervailing reflationary action needs to be taken, if not at once, as Britain, France and the United States have already begun to do, then early in 1975, as West Germany and others are clearly going to do.

The recession may none the less be a severe one, despite the fact that world trade proved surprisingly robust up to the middle of this year. There is only one way that the sudden appearance of a balance of payments surplus as large as $50,000m or more in one group of countries can fail to precipitate a sharp contraction in the countries with the counterpart balance of payments losses. That is, if those countries offset the deflationary effects on increasing external deficits by equal increases in their budget deficits.

The deficit countries have been reluctant to take such action, despite promptings from Mr Denis Healey and to some extent from international agencies like the OECD itself—in the guise of its formidable economic staff. The strong countries were reluctant to move because they attached high importance to combating inflation.

It may indeed be because the United States and West Germany have always had a very low threshold of tolerance of inflation, by international standards, that they are the strong countries: strong in currency and in ability to handle balance of payments problems despite the huge actual payments deficits which the combination of the Vietnam war and the mercantilist pursuit of payments surplus by other industrial countries caused the United States to suffer in the 1960s and early 1970s.

Domestic politics no doubt also played a part. During the political paralysis of President Nixon any form of prices and incomes restraint became almost impossible to operate. In Britain this would have meant runaway inflation at once, of the kind we suffered when restraint of collective bargaining power collapsed in 1969. But in the United States the effect was different.

That grand old eighteenth-century concept, the separation of the powers, albeit in a modern guise, came to the rescue. If the Federal Government would not counter inflation either by fiscal restraint or by an effective prices and incomes policy, then the Federal Reserve would, by monetary policy. And that is exactly what Dr Arthur Burns and his fellow-Governors of the Federal Reserve did, at least until a new President had been sworn in.

The consequences were very important in the first eight months of this year. Monetary conditions tightened in New York. High United States interest rates naturally created a magnet for foot-loose world funds, including the accruing surpluses of the oil-producing countries. This acted as a brake, not only on the economy, where the consequences of monetary stringency rapidly produced a recessionary mentality at first in financial quarters and then in industry, but also in other countries which dared not let their interest rates fall too low.

The weak countries were particularly inhibited by this factor, combined with the general balance of payments effects of the oil surpluses and the lack of any sure mechanism for recycling those surpluses to the countries with the greatest need to borrow.

So both the stronger and the weaker oil-consuming countries were for a while inhibited from taking the countervailing reflationary action which might have offset the recessionary effects of the new oil surpluses. Not surprisingly—indeed entirely in accordance with textbook economics—the world economy began to contract, or at least to expand more slowly.

That trend is now well established. Even if the major governments act to arrest it over the next six months, as seems likely, it will take at the very least until the end of 1975 to reverse the trend, assuming normal time lags between policy action and economic reactions and assuming no new major disturbance to the world economy. With inflation running at anything like recent rates and industrial confidence as badly bruised as it has been both by sharp reversals in official monetary policy and by other pressures on their profitability, the resulting increases in unemployment may well be much greater than in the usual recessions.

If and when the industrial countries do decide to reflate they will do so, as so often in recent years, from a higher basic rate of inflation than at the comparable point of the previous economic cycle. The consequences for inflation and for those great questions of political stability which depend on stability of prices can easily be foreseen by anyone who lacks confidence that incomes policies will suddenly begin to prove effective antidotes to inflation in all of the major economies.

It remains to consider the implications of the new situation for the world financial system, which some may recall was this time last year officially due for permanent reform not later than July of this year. No such reform has been agreed, although a number of the more mechanical devices which Mr Jeremy Morse's Committee of Twenty Deputies had been studying have now been adopted.

Amazingly, when it is considered that the less developed countries stand to suffer more acutely than the industrial countries from the new oil prices, the rich countries have managed to shuffle off tiresome arguments about linking monetary reform to aid and suchlike matters to a new special forum of the IMF, so that they can concentrate in the new permanent advisory committee on monetary and payments problems, the questions which really bother the rich countries.

The Special Drawing Rights has now been given a new official valuation in terms of the average rather than the alternative "strong" basket of currencies, although it has not yet been found a new name despite *The Times* helpful suggestions of "Fundor" and "Fundador" (also the name of a coarse Spanish brandy) and Professor Harry Johnson's suggestion of "Ordure". But in the main, monetary reform, in the sense of imposing radically new rules for balance of payments adjustment or finding a new foundation for reserve assets, has been shelved.

Essentially this is because Finance Ministers are busy practical men and floating exchange rates have stood up extraordinarily well to the exceptional shocks and pressures which world payments have suffered in the past 12 months.

The mind boggles when it tries to imagine what would have been the consequences of trying to handle the ups and downs of the dollar and of the oil surpluses and deficits in the context of the old so-called "fixed" exchange rate world. This meant that rates were fixed until sufficient speculative positions had been taken and sufficient world publicity had been built up so that they could be abruptly changed with the maximum loss to central banks, embarrassment to governments and shock to domestic economies.

It would, however, be wrong to lose sight altogether of the need in an age of accelerating inflation for a secure foundation for the world's reserve assets and the world's currencies. It may seem odd to suggest it after the past two years' experience. But commodities still offer the most promising basis, as is so persuasively argued by L. St Clare Grondona in his powerful paper, *Economic Stability is Attainable*.

# Oil prices

**by Tim Congdon**

The steep rise in oil prices between October, 1973, and January, 1974, was greeted with dismay at the time and has since been a continuing source of concern. It implied one of the largest changes in the pattern of trade and payments in economic history, a redistribution of income from non-oil-producing countries to oil-producing countries of about $85,000m. It also meant that this change had to be effected in a fairly short time if it was not to cause permanent dislocation of international capital markets.

It was also one of the most awkward moments in the world economic cycle. Last year was a boom period for all the major economies—with the exception, in part, of West Germany. There were signs of imbalance, with rising inflation and all the other symptoms of excess demand, including the unusual spectacle of the prices of raw materials outpacing the prices of manufactured goods in world markets. Even without the jump in the oil price the problem of adjustment would have been abnormally severe.

But the oil crisis compounded the problem. There were two main new difficulties, both demanding concerted policy responses from the leading Western economies. The first was that the higher price of oil gave another twist to the inflationary spiral, pushing up costs and at the same time reducing demand because it meant increased expenditure on oil and, therefore, less expenditure on everything else.

Second, it seriously aggravated the payments problems of the leading economies. The distribution of payments surpluses and deficits between them already had, towards the end of 1973, a familiar and rather disappointing aspect.

West Germany's refusal to be pushed into strong reflationary action, despite criticism from its trading partners, obliged them to deflate their economies in an unusually vigorous way. The vigour of the deflationary measures was increased by the oil deficits—partly because some governments, notably the French, have regarded it as prudent to eliminate the whole oil deficit. The result is that world trade this year is expected to grow at less than half the rate in 1973 and OECD output may stagnate.

In this context the need to transfer a significant part of the unchanged cake to the oil producing nations is proving extremely difficult. Real incomes have decreased in most of the advanced countries and, although the falls are small in relation to total income and do not amount to a radical upheaval of life-styles, the experience of declining living standards is new to most people in the West.

Moreover, there has been little evidence that the oil deficits in the balance of payments of the leading economies have been substantially reduced. In the British case the oil deficit grew month by month in the spring and early summer.

There have, however, been a number of adjustment mechanisms in operation and they are likely to become increasingly effective. The first is the channelling of enormous sums of "petrodollars" to the capital markets of the West, especially those of London and New York. This has taken two forms—direct investment in certain assets, such as government stock, property and certificates of deposit; and leaving money on deposit with international banks, particularly those in the Eurodollar market.

European governments have been forced for the first time to borrow in the Eurodollar market. The large loan facility arranged by the London clearing banks at the time of the March Budget is only the most spectacular example. Much of this borrowing has in practice turned out to be unnecessary, as private inflows of capital have sometimes, notably in the British case, been adequate to cover the current account deficit. Nevertheless, the option of using the loan facilities has been valuable as a safeguard in case the private inflows suddenly become private outflows.

The second major adjustment mechanism has been the increase in imports by oil-producing countries. Three oil producers—Iran, Nigeria and Venezuela—have ambitious development plans which require imports of industrial equipment from the advanced economies. Even Saudi Arabia, with a smaller population, is said to be considering spending £4,000m a year on internal development. There is also the military rivalry in the Persian Gulf, which has prompted both Arab governments and Iran to increase arms purchases.

A more positive contribution to world development could come from the third adjustment possibility. This is the sending of Arab money to the poorer economies—either directly in the form of aid or indirectly through the Eurodollar market—to assist with their plans for economic growth. The underdeveloped countries would probably use a large part of these funds on purchases of equipment from the West, which would significantly ease the West's payments problem.

There are several drawbacks to this form of "recycling". The first is that the oil producers would be accumulating assets throughout the Third World on a scale almost as extensive as the United States has done up till now. But it is not clear whether Third World countries will always be willing to accept their liability and the temptation to expropriate may be too strong. Furthermore, most of the oil producers do not have the diplomatic and military influence that the Americans have to safeguard their assets in other countries.

The second follows from this. Arab oil producers are happier to grant aid to other Arab countries rather than the Third World as a whole. This has already led to diplomatic manoeuvring — with the United States pressing for a more universal distribution of aid, and Iran, the leading non-Arab oil producer, seeking favour with non-Arab underdeveloped countries, notably India.

The oil crisis has, therefore, caused a substantial realignment of trade and international finance. The main problem has not been that incomes have had to be redistributed between one group of nations and another, but that the institutional structures for effecting this redistribution have at times looked fragile. But the Eurodollar market has survived and both sides of the redistributive process have recognized the new channels of communication to monitor and stabilize the growing body of debt which it has created.

# Commodities

by Melvyn Westlake

After two and a half years of rising prices, the most spectacular world commodity boom ever seen appears to be over. For many weeks the prices of some raw materials and primary products have been declining from the peak levels reached earlier this year. Totally confounding most of the economic soothsayers, the end of the boom finally came, a full six months later than generally predicted, and only after the quadrupling of world oil prices last winter had prompted another surge of commodity buying.

The economic, social and political repercussions of this boom may prove to be profound. When *The Economist* commodity index, which covers 34 items, reached its peak last May, it stood some 200 per cent higher than at the end of 1971. The more narrowly constituted commodity index compiled by Reuters recorded a rise of about 175 per cent when it registered its peak in February.

The effect of this rise in prices has been to push up the level of inflation throughout the world and to reverse completely the previous 20-year slide in the relative value of foodstuffs, fuels and basic materials compared with the price of manufactured products. Over the two decades to 1971, the export prices of manufactures increased by about 37 per cent (according to United Nations figures), while the prices of primary products, other than oil, rose by a mere 6 per cent.

The commodity boom was the result of an interaction of several factors. The most important was the simultaneous increase in economic activity in all the world's major industrialized countries during the second half of 1972 and most of 1973. Output of the 24 member countries of the Organization for Economic Cooperation and Development, which covers all the main industrialized nations outside the socialist block, grew at the fastest rate since the Korean war. During 1973 industrial production of these countries rose by an estimated 9.6 per cent, compared with an annual growth of some 5.5 per cent from 1962-72.

This large increase in industrial activity created a huge demand for raw materials. However, because of the earlier weak price levels for most commodities, there had for years been an insufficient level of investment in the producing countries. As a result of this and of other local supply difficulties, producers were unable to meet the sudden increased demand for industrial raw materials.

This situation coincided in 1972 with unfavourable climatic conditions in many parts of the world. Extreme winter frosts, droughts during the summer and rain during harvests led to a sharp fall in the production of many staple crops.

The notorious Russian grain purchases from America and the partial dishonouring of United States export contracts for soya beans exacerbated the problem, together with the much-reduced anchovy crop off Peru, which pushed up the prices of animal feedstuffs. Even previously, the increasing affluence of countries like Japan had led to a rising demand for beef, and contributed to pressure on the grain market because of the high consumption of grain feedstuffs in cattle breeding. The result of all this was a dramatic rise in world food prices.

There were other factors contributing to the commodity boom. The increasing awareness of the dangers of over exploiting the world's non-renewable resources, and increasing emphasis on conservation of these resources were leading towards pricing policies that reflected this limited potential. The Teheran-Tripoli oil agreements between the producers and the oil companies in 1971 were especially significant.

It was a turning point. Before the 1971 agreements the crude oil price had been declining in real terms since 1963. From 1971 it began to rise. Increases in the oil price ultimately push up the cost of basic industrial stocks such as petrochemicals, plastics and artificial fibres. This in turn drives up the values of alternative natural products.

The success of the oil producers' cartel gave rise to similar ambitions among producers of other commodities who aspired to form cartels of their own. Coffee, the world's second widest traded commodity after oil, was the vehicle for further attempts at price control. Finally, widespread stockpiling of commodities by some countries, notably Japan, and much private speculation added fuel to the fire.

Against this background commodity prices achieved their phenomenal rise, food increasing by more than 200 per cent, and fibres and metals by more than 250 per cent. By comparison the commodity boom caused by the Korean War was a modest affair with prices rising by some 50 per cent between 1949 and 1951.

The impact of the latest boom on British wholesale prices has been severe, contributing substantially to the 40 per cent rise since 1972.

The gross domestic product of OECD countries is forecast (by the National Institute) to rise by only 1.3 per cent this year and by about 3.5 per cent next year.

As a consequence, the price of industrial raw materials will probably continue to fall in coming months, but this decline is unlikely to be substantial. Metal values could start to pick up again by the end of 1975, particularly if there is a full recovery of motor industry production. Food prices clearly depend on harvests, but the immediate outlook appears to be quite hopeful.

Even so, rapidly rising world population and the low level of world food stocks might be expected to put continuing pressure on food production in spite of the development of higher yielding varieties of grain. The ability of the oil cartel to maintain current prices, or even push them up farther, will also be of crucial importance in the future level of other commodity values.

Not until North Sea oil begins to flow ashore at the end of this decade and Alaskan and other promising oil wells come into operation will the present producers be under pressure to reduce prices. This could effectively place a floor under many other primary products for some years to come.

The priority now seems to be a period of greater stability, in the interests of both producing and consuming nations, which, it is hoped, would provide regular supply in exchange for a steady income. One thing seems certain: only a major world slump of dramatic proportions will drive commodity prices back to 1971 levels.

## Trade talks

For 12 months the fate of the promised world trade negotiations has hung in the balance. Since being launched with a great fanfare in Tokyo by ministers from some 100 countries in September, 1973, the seventh and most ambitious round of international trade negotiations in postwar history has been waiting for the blessing of the American Congress.

Meanwhile the world economic situation has deteriorated dramatically. This has led some experts to argue that another round of trade discussions is now irrelevant. For while trade tariffs in general are only about 8 per cent, inflation is running in many countries at twice that level and, in addition, floating exchange rates can change by several percentage points in a single day.

Thus, according to this line of argument, the international competitive situation can be altered more dramatically by such factors than by even the wholesale abolition of existing import duties. This view, however, is not shared generally by influential government officials and leaders of industry in the major countries.

The secretariat of the General Agreement for Tariffs and Trade—the Geneva-based international trade agency under whose auspices the negotiations will be conducted—insists in its latest annual review of the world situation that the reasons for pushing ahead as planned are as compelling as ever.

It says the world talks will be a reaffirmation of the stability of the world trade system, whch is a necessary condition of economic recovery. Trade liberalization will also increase international specialization, with the resulting benefits of increased efficiency and better use of resources.

New opportunities for productive investment will be created, reducing some of the uncertainty during the extensive industrial adaption forced upon oil consuming countries by last winter's quadrupling of the oil price. Just as important, a reduction in import duties offers a direct way of countering inflation by lowering import prices.

In spite of these potential benefits, and the continuing official faith in the necessity of negotiations, the priority attached to them by a number of countries has appeared to diminish in the face of more immediate problems.

Some disillusionment with the proposed world talks has also been caused by the troubled passage of the United States trade Bill through Congress. This Bill will give the American negotiators authority to offer reciprocal concessions. Among America's partners, it has not been forgotten that after the Kennedy Round negotiations in the early 1960s, the United States Administration failed to secure legislation needed to implement the full bargain arrived at, and had to withdraw the concessions it had agreed to make on some chemicals.

Unhappily, since April, 1973, when President Nixon first presented his Bill to Congress, it has become entangled in the political imbroglio of Capitol Hill. The House of Representatives imposed anti-Soviet clauses which would have both restricted cheap credit to the Russians and stopped them getting equal treatment with America's traditional trade partners unless the Soviet Union changed its Jewish emigration policies. This prompted President Nixon to threaten to veto the amended Bill. The Watergate affair brought further delays for the Bill, because of the rising tide of anti-Nixon feeling that was developing in 1973-74.

However, the mood seems to be changing. The resignation of President Nixon and the apparent willingness of the Soviet authorities to permit increased Jewish emigration (according to Senator Henry Jackson, the leading antagonist in Congress) could enable the Bill to complete its passage through the Senate before Congress adjourns in October. Many American government officials are now cautiously optimistic that their negotiators could have their mandate in time for the next meeting of the Gatt council on October 24.

The Tokyo Round of trade talks could then begin very quickly. Gatt officials believe that fresh enthusiasm would be engendered by the ending of the 12-month hiatus caused by Congress inaction. As the Gatt secretariat has done a huge amount of the detailed technical work already—collecting and collating more information about trade tariffs and non-tariff barriers than ever before—it is hoped that the central negotiations could be brought to a successful conclusion by the end of next year, although this seems likely to prove an unrealistic target.

However, improved relations between the European Community and the United States could help towards getting the talks off to an early start. There have, in recent months, been three favourable auguries for the talks.

First, there was the successful conclusion by some 50 countries last December of a new agreement to regulate world trade in textiles. This was followed by the signing in Paris last May of an interim pledge binding all the main industrial countries from taking unilateral measures harmful to international free trade. Finally, in June, after months of wrangling, the European Economic Community agreed with the United States on a package of trade concessions designed to compensate America for lost trade as a result of the enlargement of the Community. Under Gatt articles of membership, the Community was obliged to make some such concessions, and the United States regarded them as a precondition for participating in the forthcoming world trade talks.

Not only does this remove a major obstacle in the way of the negotiations, but clearly indicates an appreciation of the dangers which a failure to cooperate presents to the prosperity of the industrialized nations.

There have been some signs already that governments confronted by daunting problems have begun to countenance policies to restrict imports or artificially generate exports. Earlier this year Italy imposed a surcharge on some imports.

Anxiety that Italy might be emulated by other nations led Mr Denis Healey, the British Chancellor, to give a warning in a speech to the American Chamber of Commerce last July that "if each country attempted rapidly to achieve an overall balance in its external payments it would cause a "period of cut-throat competition in world trade from which all would lose and none would gain".

M.W.

## Interest rates

by Geoffrey Bell

The question is: can we look forward to a period of lower interest rates within the next year? The answer seems to be yes, but not by much. Until inflationary pressures all over the world subside there is no basic reason to believe that interest rates can fall much, even in the face of a reduction in worldwide activity.

The starting point for any analysis of international interest rates is what will happen in the United States. Interest rates in that country are the prime, but not the only, determinant of Eurodollar rates. In turn, Eurodollar interest rates are a critical factor in the interest rate policy of the Bank of England and other European centres, especially those with balance of payments deficits.

While sterling remains vulnerable and the United Kingdom needs to borrow substantial funds from overseas, the Bank of England is unlikely to allow British interest rates to fall below Eurodollar rates for equivalent maturities.

Interest rates in the United States have been rising steadily since late February with the exception of rates on United States Treasury bills. Rates on certificates of deposit for three months have at times exceeded 12.5 per cent, and a critical indicator of Federal Reserve policy, the federal fund's rate, has been about 12 per cent in recent weeks. The only exception to this trend until early August was the short-term Treasury bill, where the demand has increased because of investor preferences for absolute security.

At one time in the early summer the gap between United States Treasury bill rates and three-month certificates of deposit issued by prime banks rose to 5 per cent, which was unprecedented. In recent weeks the interest rate on Treasury bills has been adjusted upwards, partly because fears of a widespread banking collapse have subsided and partly because of the weight of new issues of Treasury bills adding to supply.

During the last week of August there was some relief in interest rates in New York, with a fall in certificate of deposit rates and money market rates generally of about 0.5 per cent, which heralded a new wave of optimism in the market. There seems little doubt that the Federal Reserve decided in late August to ease monetary policy to a slight degree and this prompted the market reaction.

The Federal Reserve's policy now appears to be that of maintaining a rate on federal funds at about 11½ per cent rather than the previous target of keeping interest rate at about 12 per cent. This slight shift in policy was not surprising in the light not only of the advent of a new President but of the fact that the money supply has been rising at an annual rate of less than 3 per cent in the two months to the end of August.

Thus, given all the criticisms of what is regarded as an ultra-tight monetary policy and in the light of a recent slow growth in the monetary supply, the Federal Reserve Board felt that it could afford some rather faster growth in the quantity of money without impairing its anti-inflationary drive.

However, it would be optimistic to believe that there is going to be any early and major change in monetary policy in the United States. The Federal Reserve will not repeat its mistake of 1972 and allow the money supply to expand at a rate almost in double figures.

On the other hand, the United States economy is poised on the edge of a serious drop in activity and so the Federal Reserve has a delicate balance of objectives to pursue. So far the employment rate has not risen to any significant degree, and so long as employment remains buoyant the ability of the Federal Reserve to put almost total emphasis on the fight against inflation will remain.

However, looking ahead to 1975, and expecting an economic fall with little or no growth in real output in the first half of next year, the time will come when the political pressures on the Federal Reserve to ease up will increase.

The trend for Eurodollar rates is, at best, for only a gentle fall until 1975. Moreover, it is possible that Eurodollar rates will in general remain at a premium over United States domestic rates because of the serious uncertainties clouding that market.

To talk about Eurodollar rates can be misleading, as the rate of interest paid by banks for deposits varies substantially between the prime United States banks at the one extreme and Italian and Japanese or smaller non-American banks at the other.

The branches of the major United States banks are finding no difficulty in attracting Eurodollar deposits, and unless there is a major return of confidence to that market, promoted by the action of governments and central banks guaranteeing the viability of all banks in the Eurodollar market, there seems little reason to suppose that this trend will not continue.

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# Eurodollars



**The Eurodollar market is undergoing its most severe test. The future of the market is clouded with uncertainty, with some bankers believing there will be a big reduction in the size of the market and a possible widespread banking collapse. Even the most optimistic feel there will be a period of retrenchment over the next year.**

Already the size of the Eurodollar market has begun to contract, triggered by the bankruptcy of Bankhaus I.D. Herstatt on June 26. A number of banks found themselves with totally unexpected foreign exchange losses as a result of this failure and because of the serious mishandling of the situation by the Bundesbank, which closed the bank's doors before the end of trading that day.

But the Herstatt collapse was only one of a series of difficulties that have caused banks to be more selective in their dealings. Actual and rumoured foreign exchange losses have raised the question of bank failures in almost every European country and the Franklin National debacle in the United States hardly helped matters. It has always been previously assumed that central banks would bail out any banks operating in this market, but now this assumption has been proved false and there are certainly cases under which a central bank will allow smaller banks to fail.

Consequently, banks have pruned their list of banking "names" with which they will place deposits and the scale of activity in this market has fallen sharply, reducing the size of gross deposits.

Until now there has not been any substantial shift of deposits away from the Eurodollar market to New York, but this may well take place as concern grows about the economic situation in Western Europe.

A basic problem facing non-American banks in the Eurodollar market is what might be described as the "country risk". Most banks operating in the market have conducted their affairs in a prudent and conservative manner and there is no question about their financial strength.

But already we have seen one country, Italy, run out of private credit and it is possible that other countries face the same problem. The danger then becomes that of depositors deciding that they prefer to put their funds in dollars with banks that have access directly to domestic United States dollars in the event of an international financial crisis.

This concern can easily be exaggerated. For example, if the United Kingdom ran into serious balance of payments difficulties and depositors chose to switch their Eurodollar deposits away from British banks into United States banks, there is no doubt that the Bank of England would provide dollars to British banks to meet their commitments.

These dollars, in turn, would be provided in the last resort by the Federal Reserve to the Bank of England as the alternative is another 1930s crisis and a collapse of the international system.

Already 1974 has seen banks paying different interest rates to gain deposits. At one end of the spectrum are the branches of major United States banks which are taking in deposits at interest rates below the London Interbank deposit rate. At the other extreme are the Italian and Japanese banks which have been paying up to 2 per cent over the Interbank rate for deposits.

Smaller banks, and especially the smaller consortia banks where there is no obvious parent central bank behind the institution, have found it difficult to attract deposits at all except on an overnight or very short-term basis. Until confidence returns to the market and the spectre of another 1930s vanishes, this differential is likely to continue and could become even more acute.

G.B.

# Third World

**by Melvyn Westlake**

Unless the unprecedented rescue operation being mounted by the United Nations proves successful, the financial position of many of the world's poorest nations is likely to become as desperate during the coming months as it has ever been. The mounting trade deficits caused by the quadrupling of the oil price present a far graver dilemma for most of the Third World countries than for the industrialized nations. The soaring cost of food and fertilizer import bills is compounding the already daunting issues besetting much of Africa, Asia and Latin America.

There is at least an extra \$8,000m a year needed to finance higher oil payments, and perhaps an additional \$6,000m to meet the increased cost of food, fertilizer and other vital imports. The aggregate current account deficit of the developing world (excluding oil producers) could much more than double from its level in the early 1970s, at any rate if living standards are not to fall. By contrast, the benefits of higher export earnings enjoyed by some developing countries as a result of the recent spectacular commodity boom are likely to prove inadequate.

There has been a progressive improvement since 1972 in the terms on which producers of primary products trade with the industrialized world. In 1972-73 prices of raw materials (excluding oil) and foodstuffs increased well over three times faster than prices of manufactured goods. This reversed the position of the previous 20 years when manufactures rose some six times faster than primary products.

However, production difficulties in many countries meant that the actual volume of their exports was in some cases below normal levels, disqualifying the producers from fully benefiting from the trend. In addition, commodity prices have now begun to fall again while high inflation in the industrialized nations has resulted in a sharp increase in the cost of their exported manufactures to the Third World.

Thus, the old trends of the 1950s and 1960s have begun to be reasserted. Indeed, prices of imported manufactures by developing countries now appear to be rising twice as fast as the average rate of domestic price inflation within the industrial countries.

Equally important, producers of raw materials have themselves to buy other primary products on the world markets if they are to maintain their economic development. What a producer of bauxite gains in higher international prices for his exports, he may lose because of the greater costs of his copper imports.

In the case of oil and food imports, the increased cost is a heavy burden. There are three ways in which the resulting trade deficits can be financed. Developing countries can run down their national reserves; they can borrow or they must cajole the richer nations into providing a higher level of foreign aid.

The last course is unlikely to prove fruitful. As the principal industrialized countries are faced by large trade deficits caused by the oil price increase, they will be reluctant to increase their overseas aid.

Indeed, West Germany, the country most successfully placed to deal with its oil-related problems, has already announced that its aid will be reduced. Even in 1973 there was a 6 per cent decline, after allowing for inflation, in the real value of overseas development aid from the 17 rich nations which constitute the Development Assistance Committee of the OECD.

This is despite a rise in nominal terms of 9 per cent in their aid to $9,400m. Perhaps more significantly, measured as a percentage of the rich countries' gross national product, their overseas aid has fallen almost consistently, from an aggregate 0.51 per cent in 1963 to 0.30 per cent in 1973.

The two bright spots in this otherwise gloomy picture are a promise of increased aid from Sweden and the apparent greater willingness of the European Community to achieve a better balance in its aid policies. This should result in more assistance to countries like those of the Indian subcontinent which are not directly associated with the Community and need help more desperately than most other Third World countries.

As yet, it is not clear how generously the EEC, Japan and the United States have responded to the United Nations' call for contributions to the special fund which was set up as part of the emergency operation launched last April at the United Nations General Assembly's three-week special session on raw materials. However, their contributions are likely to prove very inadequate.

The Arab oil producers and the international agencies, like the World Bank and the International Monetary Fund, represent the only other potential source of increased aid. The IMF has successfully raised $3,360m from seven oil-producing states, and this money, the so-called "oil facility", is being made available to those developing countries suffering the most severe balance of payments problems as a result of the rise in oil prices.

The World Bank has also been trying to raise more cash from the oil producers which can be channelled to the poorest of the developing nations. Additionally, several oil-rich states have promised to make loans directly to the hardest-hit countries. However, as much of the total aid programme takes the form of loans rather than straight grants, the debt position of some poor countries is likely to deteriorate further.

# United States

**by Frank Vogl**
US Economics Correspondent 

President Ford sees inflation as the United States' greatest problem and so do the American people. At least that is the verdict of the opinion polls.

The United States faces its most serious economic crisis in more than two decades and it is no consolation to learn that other countries have problems of a similar nature. Consumer prices are surging ahead at an annual rate of well over double figures. Wholesale prices are accelerating at more than 40 per cent a year. Unemployment is rising and may well exceed 6 per cent by the end of 1974 and the external payments position is deteriorating. The first two quarters of 1974 both saw negative real growth in gnp.

The situation has given rise to deep anxieties, even among men noted for keeping cool in times of crisis. Such internationally respected experts as Dr Arthur Burns, Dr Paul McCracken, and even Mr William Simon, the Treasury Secretary, have publicly said that the future of democracy itself is threatened.

The present economic troubles result from past expansionist monetary and fiscal policies, serious supply shortages, partly produced by the overlong maintenance of wage and price controls, the almost simultaneous ending throughout industrialized countries of what was a fairly short boom, serious food and raw material shortages, producing exceptional rises in commodity prices, the massive escalation of oil prices and the imposition, for several months, of an embargo on oil shipments to the United States.

The present difficulties are also due to the failure of the United States Administration and the Federal Reserve to respond quickly enough to these problems. There was a tendency to see them as solely the product of oil and commodity developments.

The danger now consists of a possible failure to recognize fully the time lags involved when taking action over the economy and to overreact, on the basis of recent data, rather than steer policy in line with evident longer-term trends.

There is already evidence that the Federal Reserve's policies of monetary restraint are starting to bite. Many banks are being forced to reduce the loan volume they grant, interest rates are at record levels, many companies are having difficulty in financing large inventories, the stock markets are experiencing a serious slump, produced largely by the liquidity squeeze, companies are laying off workers, new entrants to the labour market are not finding jobs, and the housing market is drying up.

One factor that appears to have been neglected by many Administration leaders is the impact on capital spending of the oil crisis. Some economists believe that corporations will be forced to reduce their capital spending to digest the substantial increases in energy costs. So far there is little evidence of this happening, but the months ahead may show this development more clearly, just as it may well show the recession's breadth and depth to be greater than Mr Simon and his colleagues have expected.

Despite such warning signals some members of the Administration are now calling for still tougher action to deal with inflation. Dr Burns and the Federal Reserve are under pressure to ensure that the money supply expansion rate, narrowly defined on a currency and demand deposits basis, is kept at the 5 per cent rate, or less.

At the same time, strong efforts are being made to curb federal spending. These actions reflect both a neglect of the increasingly evident recessionary trends and too much anxiety over inflation, partly resulting from failure to take firm action to ensure wages and prices restraint.

The present worries on inflation centre partly on the expected rises in food prices in months to come, resulting from the serious drought in the mid-West. The Administration is seeking to curb rises in wages and prices by means of pleas for voluntary restraint, supported by a cost of living council, which is supposed to monitor developments but has been given no powers.

An incomes policy does not exist and the anti-inflation screw is being tightened, while no policies are being constructed to soften the blows that these tough deflationary policies will produce. The real danger today is that the lack of these policies will produce the sort of crisis that may break the resolve of the Administration to maintain long-term anti-inflation strategies.

What happens when the number of bankruptcies starts accelerating, when unemployment tops 6 per cent, when the budgets of the ordinary consumer become so strained that spending levels really decrease, producing actual declines in prices?

There is a lack of balance in the policies of the Administration that is seriously worrying many businessmen, politicians and economists. Mr Simon is probably right in saying that it will take up to five years, and quite a few budget surpluses, to restore price stability. But there is a distinct possibility that the continuation of one-sided policies may lead to sharp policy reversals.

The sort of stop-go course, of which Britain has long been a victim and which produced stagflation, may emerge and the British disease, as Americans call it, may be imported into the [States].

# Soviet Union

by Edmund Stevens

The stability of the Soviet economy stands in sharp contrast to the runaway inflation, the energy crisis and other ills that afflict so much of the world. According to Mr Leonid Brezhnev, the Communist Party chief, the 1974 industrial production growth rate is 8.1 per cent compared with the 6.8 per cent projected in the plan. Labour productivity is reported at 6.8 per cent over 1973, against the planned target of a 6 per cent increase.

The overall production plan for the first seven months of 1974 was fulfilled 102 per cent. The highest growth rates were for electronic computers and accessories, 28 per cent, and 24 per cent for passenger cars (3,171,000 vehicles in the seven months).

Light industry continued to trail badly despite constant lip service to the importance of increasing stocks of consumer goods in all categories. Growth rates listed were: cotton textiles, 1 per cent; woollens, 4 per cent; knitted goods, 2 per cent; leather shoes (396 million pairs), 2 per cent; washing machines (1,749,000 units), 1 per cent; electric refrigerators (3,171,000 units), 0.7 per cent. The food industry did much better at 12 per cent.

Official percentages tend towards optimism. The executives involved naturally prefer their reports or plan fulfilment to look well, like the shoe factory manager who did not deduct a very sizable quantity of his output which was rejected as defective by the distributors. Production norms on paper are sometimes inflated or completely false.

However, if errors sometimes get into the equation, this does not alter the fact that the Soviet economy is growing. The national income has increased by 23 per cent since 1970. The gross national product this year is expected to be £270,000m and apart from the figures, a steady improvement in the appearance of people and things is evident.

This does not mean that Soviet living standards are nearing the millennium. They are still below prevailing levels in the West. But the average wage or salary is said to be 135 roubles (about £76) monthly. Rent and utility charges are almost token by Western scales. Transport is cheaper and there is free medical service.

The Soviet Union has been spared unbridled inflation mainly because prices in the state shops, as well as those for services, are strictly controlled. However, the Government's main source of internal revenue is from the retail price mark-up, a kind of hidden sales tax, and the pressure of expanding commitments impels it to squeeze more from this source by the simple mechanism of increasing the mark-up on certain articles. For instance, the price of vodka jumped two years ago by 50 per cent to the equivalent of £2 a half litre, without affecting consumption.

The retail price of vodka bears no relevance to its production cost of one or two kopeks a litre. The procedure used at the time was to discontinue the familiar brand names and substitute new ones as if a different product was being introduced, thereby justifying the price rise, although the content of the bottle was identical.

Apart from Pepsi-Cola, the sustained effort the Kremlin has been making through detente to draw upon western, especially American, financial and technical resources has not yet had a serious impact on the Soviet internal economy.

One of the main projects in which foreign firms are involved, the giant Kama river lorry plant, was originally supposed to start production by the end of this year. Owing to hitches and delays, however, it is at least two years behind schedule and it may take even longer for its subsidiary plants and facilities to become operational. By 1978, if all goes well, scores of joint projects in various fields should start yielding tangible results.

While grain growing conditions in the European areas of the Soviet Union appeared to have been generally favourable, yields in the virgin lands of Siberia and Kazakhstan were extensively damaged by intense rain during cutting. None the less, it is expected that the total volume will be close to 210 million tons, only 15 million tons short of target, and that the Russian people will not need large quantities of imported grain to meet their commitments.

The short harvest of 1972 forced the Russians to scrape the barrel of their foreign currency reserves to buy grain from the United States, Canada and Australia.

As a result, in December of that year some of the goals of the ninth five-year plan had to be revised downwards. The state planning commission is now drawing up the draft of the tenth five-year plan, which should be ready for submission to the party and government leadership by mid-November. After that it will be formally approved by the Supreme Soviet in December. The plan will doubtless include provisions to recoup the 1972 setbacks.

In this context the world energy crisis, far from cramping the Russian programme, is proving an asset. At present world price levels the Russians are exporting oil and natural gas for three times as much as a year ago. Soviet export of gold has also profited from the increased value of that precious metal. As a result, the Russians are sitting pretty when it comes to foreign currency reserves. They are in a position to pay off more of their external borrowings but they probably prefer to wait and let inflation erode the value of their obligations.

# Japan



by John Greenwood

Inflation, the balance of payments, and supply shortages have dominated the economic news during the past year in Japan. On the political front these events have contributed to the declining popularity of Mr Kakuei Tanaka, the Prime Minister, and were in large measure responsible for the disappointing performance of the ruling Liberal Democratic Party at the House of Councillors election of July 7, which has culminated in a process of intense soul-searching over the question of the political funding activities of big business.

In the postwar era Japan has experienced three major bouts of inflation. On all three occasions common factors have been in operation, but the key to understanding the remarkable inflation of the past year lies in their peculiar timing.

The excessive inflation of 1945 to 1949 was caused first by the sharp drop in industrial production in Japan due to war damage and the end of military production. Even if the quantity of money had remained unchanged, the lower level of economic activity to be financed would probably have meant some inflation. Secondly, the money supply was in fact increased at an extraordinarily rapid rate until 1949, aggravating an already serious situation. Thirdly, as inflation accelerated—at one stage to more than 400 per cent a year—the Japanese withdrew bank deposits, substituting real goods and services for depreciating currency until by 1949 the Japanese held only one yen of bank deposits for every yen of cash currency.

In 1950-51 two of the same factors were at work, but the third was working in the opposite direction. When the Korean war broke out in June 1950, wartime and postwar shortages were fresh in the mind of every Japanese. Consequently consumers hurried to stock up on those goods that might run short, while producers raised their selling prices in expectation of inadequate supplies and higher raw material prices. It was this desire to convert money into goods and services that sparked off the inflation.

The second contributory factor was monetary expansion. But although the money supply grew rapidly after 1951, it did not do so until after the outbreak of war. Moreover in the Korean war the allied demand for equipment and munitions far outstripped American productive potential and Japanese industry was called upon to fill the breach. The ensuing industrial resurgence helped to absorb some of the excessive creation of money.

In the present inflation the same three factors, production, money supply, and the flight from depreciating currency, have operated, but once again the order is different. First came the enormous monetary expansion of 1971-73. Initially the growth in the money supply occurred because, with the recession of 1970-71, the Government was anxious to restore the rate of economic growth to the 10-12 per cent levels of the preceding decade. Subsequent attempts to avert revaluation of the yen, together with higher levels of government expenditure aimed at increasing Japan's social welfare programmes, added to the monetary fuel. By mid 1972 the economy was reaching full capacity, and, with monetary expansion still at a 25 per cent rate, wholesale prices started to climb.

The second factor in the current inflation has been the desire to convert excess holdings of money into real goods. This process has had two phases. The first incorporates the enormous boom on the stock market and the explosion of land prices in 1972 when the Tokyo Stock Exchange index doubled, and land prices rose by nearly 40 per cent. The next phase was the huge jump in the prices of many basic industrial materials and consumer goods caused by the oil crisis.

Finally, the third factor, industrial production, had a dual role this time. Until November, 1973, Japan's industrial output continued to rise strongly, thus absorbing some of the monetary expansion as increased supplies held down the rate of price increase. However, since production reached a peak in November, it has actually declined in five of the eight months to July, and remains below its peak. Thus, while rising production initially stemmed the inflation, more recently declining production has tended to aggravate it.

If this analysis is valid, next year should see a sharp reduction in Japan's inflation. In the first place the money supply has been growing at a rate which, by Japanese standards, is exceptionally low, just over 10 per cent a year for the past year. The effects of this slowdown are already evident in lower stock prices, high interest rates, and the weak demand for plant and equipment investment. Ultimately these forces must show up in the consumer price index.

Meanwhile, the effect on companies has been dramatic, and may yet become more intense. Sales volumes are declining, industrial investment is static in real terms, borrowing costs for the highly-geared Japanese companies are enormous, and inventories of raw materials and manufactured goods are at record levels. Wages have also soared, although recently with the cutback in overtime and shorter working hours some of the impact of this year's 32 per cent rise in wage costs has been alleviated. Typically the medium and small enterprises which supply components to larger companies in the motor, electronic, or electrical appliance industries have been hardest hit, and bankruptcies are running well above average.



# China

**by David Bonavia**

Since China publishes no figures regarding its financial reserves, and only the most vague statistics on production, deductions about its economic performance have to be based largely on its foreign trade.

Last year witnessed a spectacular increase in China's trade to more than $9,000m from less than $6,000m the previous year. Much of the extra, of course, was accounted for by inflation of world currencies and by rising prices. But there seems no doubt that the rapidity with which China's relations with most other countries are returning to normal, after the reconciliation with the United States, has spurred her to trade more actively.

This is the fourth year of the present five-year plan and is referred to by Chinese officials as the vital year. The planned targets are not known, however, nor is the planning mechanism in detail, so the knowledge of its existence is of little help to would-be analysts.

The characteristics of China's trade last year were large imports of advanced equipment, particularly civil aircraft, paid for mainly by increases in the amounts and prices of the country's traditional exports.

This year, the shifts in world commodity prices and currency values show signs of bringing about changes in China's trading patterns. While striving to export more oil, for instance, at its new and favourable price, it is encountering difficulties in obtaining badly needed supplies of chemical fertilizer, whose price and availability have been affected by the oil crisis.

The biggest feature this year is expected to be the massive rise in China's grain imports, which are thought likely to reach 10 million tons, mostly consisting of wheat. This will increase her huge deficits with the United States and Canada, which she makes up largely by exports of rice and assorted foodstuffs and consumer goods to Hongkong and South-east

With Japan, her biggest individual trading partner, China achieved an almost evenly balanced trade of about $1,000m each way last year, an increase of some 80 per cent over the year before. In the first five months of 1974, exchanges were running at about 70 per cent more than in the same period of the previous year, but it was doubtful whether this rate of increase could be sustained, even if almost half were seen as a result of higher prices and the falling value of the dollar.

While striving to maintain an overall balance of trade, China is not always particular about bilateral balances, though her officials may recall the need for them whenever they feel that their exports are not receiving the consideration they deserve at the hands of a large trading partner.

With the EEC countries, for instance, China had a surplus of some $50m in 1972, which changed to a deficit of about $70m in 1973. This was due partly to aircraft imports from Britain, and China remained in surplus in her trade with France and Italy.

Trade with the EEC has remained at about 15 per cent of China's total trade in 1973, as in the year before, despite the large increase in absolute figures. And Peking still considers it worthwhile to conduct about 25 per cent of its trade with Eastern Europe and the Soviet Union.

Domestically, the Chinese economy continues to make steady, if not startling progress. Increased exports to finance more imports are obviously a drain on domestic capital accumulation, despite the contribution made to the latter by imports of advanced technology. The importance of these to the progress of the economy is perhaps less than it might seem, because of the high proportion of goods bought for strategic purposes.

Unreliable weather in the past three years has held back China's harvests so that they no longer seem to be keeping pace with, let alone outstripping, population growth. However, there are good reasons to believe that the difficulties in this vital sector are temporary and will be overcome.

More problematic is the continued insistence on the principle of self-reliance in industry, a cornerstone of the governing ideology.

Although stimulating in the early stages of heavy industrial development, such a principle may be a bar to rapid progress in advanced fields such as electronics and chemical engineering.

The search for a balance between autonomous development and reliance on the technological achievements of other countries as a basis for further development is one of the keys to China's economic progress in the 1970s.

# West Germany



**by Dan van der Vat**

Seen from the outside, the West German economy is as much the envy of the world as ever, with its low inflation rate, its huge export surplus and vast reserves, and the pessimism over the growth rate already shown to have been exaggerated.

Internally, however, there is a great deal of dissatisfaction because unemployment is unusually high (for West Germany), inflation is running at a record level, hundreds of thousands of workers are on short time and a new round of price and wage rises is expected before the end of the year.

How one assesses the West German economy therefore depends upon where one happens to be standing, and whether one compares West Germany with other countries or with its own record over the years of the "economic miracle".

Herr Helmut Schmidt, Minister of Finance until he became Chancellor in May, naturally tends to make comparisons with the outside world. One of his favourite observations in recent months has been to point out that "our inflation rate is even below that of Switzerland".

This is perfectly true. But his opponents inside and outside the Bonn Parliament point out that an inflation rate approaching 7.5 per cent for this year is unheard of in West Germany and is no ground for complacency or self-congratulation.

Yet the country does stand at the bottom of the OECD's "league table" of inflation in the industrialized countries. Seen from that angle, West Germany is getting off lightly compared with 29 per cent inflation in Japan, its major competitor, and rates well into the double figures in Britain, France and elsewhere.

But one thing appears clear beyond doubt, whether one makes internal or external comparisons in seeking to assess the national economy, and that is that West Germany has already overcome the effects of the oil crisis and the attendant steep energy price increases.

With a remarkable demonstration of calm and confidence, the Bonn Government allowed the West German free market in oil to continue to operate throughout the crisis from the moment it began in the wake of the October War last year.

In recent weeks, prices of petroleum products have fallen appreciably, to such an extent that petrol is some 10 per cent cheaper now than at the height of the crisis. Undoubtedly government threats to use the federal cartel office, its anti-monopoly mechanism, against profiteering by oil companies (the office did act against some oil firms) helped here. So did its decision to acquire a large stake in the oil refining and distribution industry through a new, state-dominated company. But in essence the economy itself was more than strong enough to digest oil price rises with little more than a hiccup.

All the indications are that West Germany's gnp will be more than 2½ per cent higher in real terms this year than it was last. This year gnp will exceed DM 1,000,000m for the first time.

Wages in almost all sectors of the economy are keeping ahead of inflation. Large rises awarded in the public sector in the spring after an unprecedented series of strikes appear to have been absorbed without opening too many floodgates. Fears of a record round of pay claims have for the time being receded.

Unemployment, at about 550,000, or more than 2½ per cent, appears to have stabilized itself for the time being, and official forecasts expect it to stay about this mark for the rest of the year. But it should not be forgotten that West Germany has become accustomed to as near full employment as makes no difference, and there are more than four times as many out of work now as before the oil crisis. This is a high figure for West Germany, and nobody feels complacent about it.

That West German citizens continue to save money with remarkable steadfastness against a background of inflation unprecedented in their own country for decades argues that a certain confidence in the future remains very much alive.

But the sharp drop in new car registrations, the expected fall this year in the numbers going abroad for holidays (and thereby assisting neighbouring economies) and the collapse of several private banks provide evidence of a certain hesitancy, a slight pulling in of horns and a levelling off of private prosperity. But these clouds are fairly small.

Against them has to be set a new export boom which is beating all previous records by a large margin. In the first six months of 1974, West Germany attained an export surplus of DM25,200m (£4,200m). There is all-round confidence (and every reason for having it) that the total for the year will pass DM50,000m, far ahead of last year's surplus of DM33,000m, itself a record.

In earlier years, the export surplus was largely wiped out by outflows of currency in the form of expenditure by West Germans on foreign tourism and remittances home by foreign workers. These and other factors left the country with a healthy but fairly small and unembarrassing balance of payments surplus.

This pattern has changed to such an extent that the balance of payments surplus itself for the first six months of this year reached the embarrassing level of DM 13,400m.

Small wonder therefore that Bonn's political credibility came under fire until Herr Schmidt advanced the deeply troubled Italians $2,000m at the end of August. Before that, the suspicion was growing that West Germany was "exporting itself out of trouble" and had become exclusively dedicated to preserving its own interests.

But Bonn does recognize the damage which could be done to the national economy by a world recession, with 22 per cent of the country's jobs dependent on exports. It is realized that economic collapse among its neighbours would hurt export potential in West Germany, and the Government says that it is prepared to use its reserves to help others, provided they first show the will to help themselves.

# France

by Michael Parrott

France will remain Europe's fastest growing economy this year despite the oil crisis. Whereas West Germany is expected to show a real growth of less than 2 per cent, France is still expecting nearly 5 per cent. But if the French economy still enjoys strong business activity and high employment, the quadrupling of oil prices has had a dramatic effect on the balance of payments and inflation.

A 1973 trade surplus of nearly £600m is likely to turn into a trade deficit of about £2,000m. The franc has been forced to leave the European currency snake to float with the pound and the lira and the French inflation rate is among the worst in Europe at about 15 per cent.

France and Germany both import about the same amount of oil, but the two countries pursue different economic policies. Whereas the French have traditionally opted for strong economic growth and high employment, even at the price of internal inflation and an undervalued franc, the Germans have been ready to sacrifice expansion and even jobs to maintain price stability and a strong currency.

Until last year few people would have criticized the French way of handling the economy. In 1973 the country was enjoying its fourth consecutive year of uninterrupted expansion with higher growth than anywhere else in Europe.

Industry was booming, money was still fairly cheap, the Bourse was hitting record levels, the franc was fairly strong and French companies were vying with the Japanese for third place in the world export league.

However, last autumn French inflation became more serious than that of other countries. The Gaullists started clamouring for a prices and incomes policy, while the unions called for a price freeze and value-added tax cuts. But the consequences of the Arab oil embargo were still unclear and M Valéry Giscard d'Estaing, then Finance Minister, opted for a mild anti-inflationary package.

During the first part of the oil crisis the French Government was more concerned with maintaining its oil supplies and keeping the economy going than with fighting inflation, but when oil deliveries were resumed and oil prices had been increased a second time, it realized that the main problem was going to be inflation and the balance of payments.

In January the Government announced across-the-board price increases of oil products, thereby setting off a sharp increase in France's inflation rate. In the same month M Giscard d'Estaing suddenly floated the franc as a means of preventing speculation against the French currency.

In March the Government introduced measures aimed at keeping 1974 and 1975 energy consumption at 1973 levels and announced a massive nuclear construction programme designed to create 50,000 MW of nuclear power by 1985. At the same time M Giscard introduced a second anti-inflationary package, but it never really took effect because of the death of President Pompidou.

During the months just before and after M Pompidou's death, France went through a somewhat unreal period.

But by the time of the presidential elections it had become obvious that something would have to be done to slow the 18 per cent inflation rate and reduce the trade deficit running at £2,000m a year.

M Jacques Chaban-Delmas, for the Gaullists, suggested deflationary measures in the context of a prices and incomes policy, while M François Mitterrand, for the left, advocated nationalization income nationalization schemes, in-prices freeze.

M Giscard was less precise, but after five years as Finance Minister his approach to economic problems was well known. More flexible and less doctrinaire than the others, he has always argued that France must maintain a high growth rate if it is not to run into serious labour problems.

However, it was inevitable that M Giscard's first measures as President should be unpopular. Inflation rather than economic growth had become the first priority and the sooner it was tackled the better. Nevertheless the form of the anti-inflationary package presented in June by M Jean-Pierre Fourcade, the Finance Minister, seems to have come as a shock to French industrialists and investors.

Not only did M Fourcade slap a supplementary 18 per cent on company tax, worth some £450m, and reduce depreciation allowances on investments, but he clamped down sharply on credit, pushing interest rates to record levels. Instead of introducing a prices and incomes policy along Gaullist lines, he announced that a new tax would be imposed on company profits earned through inflation rather than productivity. In effect, companies were to be asked to control prices and wages themselves.

The objectives set by M Fourcade were ambitious, even unattainable. The Finance Minister hopes to reduce inflation by two thirds within 12 months, wipe out France's trade deficit by the end of 1975 and limit real wage increases to 2 per cent, while maintaining the high growth rate needed to maintain full employment.

M Fourcade's measures are not the only ones which are worrying French managers. The election of M Giscard was originally welcomed as some guarantee of the status quo, but the new President is proving much less conservative than expected. In his first two months his Government tightened up measures against tax fraud, adopted a tougher stand against property developers and announced plans for an across-the-board capital gains tax.

After introducing substantial increases in welfare payments and the minimum wage, the Government is considering proposals which would give greater power and protection to workers.

The new Government has tried to make its measures appear as fierce as possible, but morale has also been affected by the uncertain international situation. The French Bourse has not suffered as much as London or New York, but it has fallen 40 per cent from last year's high points to reach its lowest point since 1968.

France's famous growth shares have experienced falls of 60 per cent to 70 per cent on their highest points. Property development has come to an abrupt halt.

It is still too early to judge the effectiveness of M Giscard's economic measures. The franc is now almost back to its parity before the float. Business activity remains strong and unemployment has not increased, but no improvement is yet detectable on the prices and trade front. And those problems may take a little longer to tackle than M Giscard will publicly admit.

The difficult period is not likely to come until the beginning of next year when the austerity programme really starts to bite, oil imports have to be increased for winter heating and demand for exports may fall off.

## Middle East

CPYRGHT

**by Elizabeth Collard**
chairman, *Middle East Economic Digest*

The great surge in oil revenues is less than a year old but our eardrums are already shattered by the extremely high figures being bandied about. The average person has a shrewd idea of what can be bought by £1m, but £1,000m, what does that represent? And when we learn that between now and the mid-1980s the accumulated surplus oil revenues of the Middle Eastern and North African oil-producing countries will amount to no less, and probably a great deal more, than $800,000m, it is almost impossible to envisage just what that sum represents.

Apart from the increase in oil revenues, the past year has seen another great change—the greater ownership by the governments of the oil-producing countries of their oil industries. Iran has achieved total ownership, while most other countries have moved towards at least a majority participation in the oil-producing companies operating in their territories.

It is not only the oil-producing countries that will benefit from the oil revenues, as the past few months have seen a number of new development funds and agencies, in addition to the long-established funds such as the Kuwait Fund for Arab Economic Development, that will be channelling the revenues to other countries in the area and also further afield to Africa and Asia. During the period to 1985 it has been estimated that the oil producers themselves will absorb $150,000m for their own development.

The latest available figures of development budgets being spent are: Bahrain (1974-75), $44m; Oman (1972), $92m; Kuwait (1974-75), $340m; Qatar (1974-75), $159m; Saudi Arabia (1974-75), $4,122m; United Arab Emirates (1973-74), $29m; Abu Dhabi (1973-74), $245m.

The Iranian budget for the current year, announced before the latest price rises, was running at $11,700m, and there have been supplementary allocations more recently. The most recently revised development plan comes from Algeria, where it is proposed to spend $26,000m on development from 1974 to 1977. Iran, with a population of 32 million, and Algeria with 16 million, are the two oil-producing countries that are able to absorb the whole of their oil revenues for their own development and indeed are still actively seeking additional funds for development in the international loan markets.

There is also the special situation of Egypt, with a population of 35 million, also an oil producer but not in the same league as the giants, and with great tasks of reconstruction in the Suez region as well as the normal target of industrial development. Since the war of October 1973 Egypt has been offered more than $7,500m for reconstruction and development and can certainly absorb many times that amount.

Iran and Saudi Arabia are two countries with phenomenal growth, although in both countries a large proportion of the annual budget is spent on the Armed Forces. Communications of all kinds, from roads to complex telecommunications projects, are being given priority.

With the Shah of Iran as the driving force of his country, a vast industrialization programme gathers force year by year, and Iran has already grown out of the stage where manufacturing industries concentrate on consumer goods and import substitutes. There is now concentration on heavy industry as well as making fuller use of natural gas resources.

Up and down the Gulf there is a tremendous surge of activity. Abu Dhabi shows perhaps the fastest development, with new office blocks, roads, hotels, health centres, schools and power and water projects being speeded up.

Bahrain and Qatar, with their oil revenues accumulating for some years now, are growing apace. Qatar is in the throes of a 10-year plan with emphasis on industrialization as a means of diversifying the economy. Bahrain, as well as diversifying, is emphasizing its position as an entrepot airport.

Once the Dhufar war is over in Oman, and the Sultan is determined to make an all-out effort this year, there will certainly be the most spectacular development in that country.

Kuwait has already completed many organizational plans but continues her steady development with the most complete, and still developing, social services in the world. Kuwait institutions and leaders continue their stabilizing influence through the Arab world.

Along the North African coast, while Algeria forges ahead in her economic development, Libyan development has not kept pace, since President Gadafi has been more concerned with political purism, but there are signs that this phase of its independence is receding.

Tunisia and Morocco also continue their steady development, and both countries continue to expand their tourist industry.

## Australia

CPYRGHT

**by Herbert Mishael**

The great issues of today in Australia are the issues of inflation. Yet, while the strikes roll on, inflation soars, unemployment mounts, union leaders issue inflammatory statements and business confidence declines, the long-term prospects for the Australian economy suggest there are reasons for guarded optimism.

The best authorities for such an outline of the future are the very people who are the Whitlam Labour Government's sternest critics, the non-Labour premiers of the states. In a recent nationwide survey these premiers, one after another, spoke of solid achievement and hopeful progress.

Mr Bjelke-Peterson, Premier of Queensland, despite his ritual doubts about the economic future "under the heavy hand of a restrictive socialist federal government", placed on record how proud he was to catalogue the performance of an impressive variety of projects in his own state.

These predictions seem at

variance with the foreboding and bleak pronouncements issued from time to time. Could it be that these are influenced more by political considerations than based on sound judgment and specific evidence? Or is it that the Australian economy, which includes the economies of the states, has certain underlying strengths that ensure continued improvements in the quality of life in the widest sense for all members of the community?

The main debate centres upon two theories. One is that a healthy economy is impossible in a climate of full employment and that the degree of unemployment needed to reduce the rate of inflation is perhaps 2.5 per cent. (It is now 1.6 per cent.)

The second theory is that, if unemployment is the key ingredient in the anti-inflationary policy it should not be adopted as part of a Labour government's policy. Dr Cairns, the Deputy Prime Minister and Minister for Overseas Trade, a powerful influence in the Government's thinking and planning, put it in these words: "If we are going to go out at the next election, it should be upon failure to control inflation, not upon establishing unemployment as an alternative weapon against inflation. We have no right as a Labour government to adopt massive unemployment as a weapon to bring down the rate of inflation."

If reports prove correct, Dr Cairns has persuaded the Government and the party to accept this view, and it will find expression in the mildly deflationary moves the country will face in the coming months.

Where the Government can exert further direct influence is in wages and prices. Both Mr Whitlam and Dr Cairns have called on unionists to modify wage and salary demands and to some extent the success of the Government's efforts to put the economy on an even balance must rest on the response to these appeals. The Government is also putting teeth into the Prices Justification Tribunal in an effort to control prices.

Perhaps the final word on the state of the economy in Australia should come from the man who is right at the eye of the storm, Mr Frank Crean, the Treasurer. He said that he did not expect any short-term easing of the inflation rate.

# Italy

by John Earle

It is a matter of opinion whether Italy or Britain is the sicker man of Europe. Italians lack the prospect of North Sea oil but have had more experience from history in the art of personal survival under economic adversity. The coming winter certainly threatens to be the bleakest for the Italian economy for many years. In the past 100 years only during and immediately after the two world wars has the cost of living risen more quickly than the annual rate of 19.3 per cent revealed in the latest statistics for July.

The economy's structures have been nearly bowled over by international inflation and last year's escalation in oil prices. A real fear of national bankruptcy in Italy exists.

Except for a brief period in July when the balance of payments swung towards surplus, most recent figures have been depressing. Signor Gino Bertoldi, the Labour Minister, has spoken of a million unemployed this autumn. The balance of payments for the first six months of this year chalked up a deficit of 2,924,000m lire (about £1,900m) compared to one of 915,000m lire for the same period of 1973.

That represents an annual deficit of $9,000m. Somehow the Government hopes this can be reduced next year to $5,400m. For this it will be essential to narrow the trade gap, which between January and June registered a 3,941,000m lire excess of imports over exports.

Even more ominous than the 20 per cent rise in retail prices was a jump in wholesale prices in June to 41.8 per cent over 12 months before. Interest rates have been allowed to rise as high as any in Europe. Yet the prospect of record remuneration for capital at home has been unable to staunch its persisting clandestine outflow.

This is an old malady—the economy is estimated to have been bled of 9,000,000m lire in this way over 10 years—and depends as much as anything on lack of confidence in the ability of government and the politicians.

Signor Mariano Rumor's centre-left coalition is no exception to the run of 35 other usually weak administrations which Italy has had since Fascism. His previous coalition fell in March over internal squabbles about conditions attached to a $1,200m standby credit subsequently obtained from the International Monetary Fund.

His present team is in office only because President Giovanni Leone rejected its resignation in June, and it may fall this autumn. This lack of confidence has played its part in the gradual decline in Italian creditworthiness abroad, which has become evident as the authorities borrowed to the hilt to bolster the lira. Foreign borrowing between June, 1972, and July, 1974, has totalled about $10,000m.

Some commentators have seen in the professed desire to resign of Signor Guido Carli, the authoritative Governor of the Bank of Italy, a sign of his dissatisfaction, though he has emphasized that his 14 years are long enough in any post. He has, in any case, been prevailed upon to stay on.

As usual, the weakness of the politicians left Signor Carli with an important role this year in fighting inflation and defending the lira. The result was a severe credit squeeze which by the summer had aroused a general outcry in the business world.

To the Government's credit, however, it has tried to take incisive action. In May a temporary (six months) 50 per cent non-interest bearing deposit was imposed on about 42 per cent of imports, though, after opposition from other European Economic Community countries, notably West Germany, this had to be relaxed.

Then in mid-August Parliament approved a mini-budget designed to take 3,000,000m lire out of the economy. It was criticized on the grounds that its concentration on indirect rather than direct taxes was inflationary and that it was considerably watered down in its passage through Parliament. Nevertheless it represented an achievement for the Rumor Government.

Not only smaller firms have been running into difficulties. The vast state-owned IRI (Istituto per la Ricostruzione Industriale) group has made known that some of its companies are accumulating heavy losses, and the Government faces the problem of how to aid if not rescue them.

Recent months have seen the fall of the empire on both sides of the Atlantic of Mr Michele Sindona, the Sicilian-American financier. Though his troubles started with his Franklyn National Bank in New York, they were followed by difficulties for his Italian banks, Banca Unione and Banca Privata Finanziaria (now merged into Banca Privata Italiana), as well as for the Rome-based international property company, Società Generale Immobiliare.

To prevent contamination of the Italian banking system, the state-owned Banco di Roma intervened with an estimated $200m of aid and took over management of the main Sindona Italian interests.

On the other hand, Italian industry is by no means down and out. In the first six months of this year industrial production was 12.1 per cent above that of January-June, 1973, though this progress has been tapering off.

If an admittedly difficult autumn can be lived through without unforeseen surprises, there are grounds for a more hopeful outlook further ahead.

# Canada



by Richard Mackie
financial editor,
*The Ottowa Citizen*

Inflation is expected to be Canada's main economic problem in the next year, although the country also faces a continuation of the slowing in output which began during the latter part of the second quarter. In addition, an increase in work stoppages by labour unions is likely as they attempt to catch up with past rises in the cost of living.

On the positive side, Canadians on July 8 elected a majority government that will be able to take strong economic action which the previous minority government had avoided. Further, unlike many nations, Canada faces no immediate shortages of energy or increases in the outflow of dollars because of rising oil prices.

Inflation has been the

chief concern of Canadians for several months. This concern became the central issue during the election campaign when the Liberal Government was attacked for its failure to cope with increasing wages and prices. The official opposition, the Progressive Conservative Party, campaigned on a promise that it would carry out a programme of price and income controls, if elected.

This promise was rejected by Canadians who gave the Liberal Party 141 of the 265 seats in the House of Commons. Before the election the Liberals had held 110 of the seats and thus any action they took, especially economic action, had to be moderate enough to win the support of at least one of the smaller parties. When the Government tried some strong anti-inflation measures in its budget of May 6 it was defeated.

Although the Government is in a position to take some strong action, its possibilities of success in fighting inflation are limited by economic developments in other nations. Canada relies heavily on trade and is especially closely tied to the United States economy. Weakened demand in its trading partners is soon reflected by a deterioration in Canada's economic performance.

At the consumer level Canada is experiencing double digit inflation on an annual basis for th first time since the Korean War. The Consumer Price Index rose 0.8 per cent between June and July, 1.3 per cent between May and June and 1.7 per cent between April and May. Between July, 1973 and July, 1974 the cost of goods rose 13 per cent and the cost of services rose 8.1 per cent.

The Wholesale Price Index dropped slightly—0.2 per cent between May and June. But for the 12 months ending in June the index was up 23 per cent. This index mainly covers raw and semi-manufactured products. Over the same period the Industry Selling Price Index, which covers manufactured products, was up 20.1 per cent, having climbed 0.8 per cent in June.

Corporation profits before tax continued strong in the first quarter, with all industry profits up 7.9 per cent on the quarter and manufacturing profits up 10.7 per cent. There are indications that wages and salaries will increase more rapidly over the year than in 1973 in view of wage settlements of 12.7 per cent in manufacturing and 10.8 per cent in all industries during the first quarter.

The seasonally-adjusted rate of unemployment moved from 4.9 per cent in June to 5.1 per cent in July. This was better than in July 1973 when it was 5.3 per cent and July 1972 when the rate was 6.4 per cent.

By the end of the year the unemployment rate is expected to be about 6 per cent, mainly as a result of minimal growth in the number of jobs in the manufacturing sector.

However, there will still be a shortage of skilled workers, with high-technology industries and many parts of the construction sector seeking more employees. Part of this shortage may be attributed to the more attractive unemployment benefits available.

Interest rates in Canada have generally followed those in the United States and risen steeply during the first half of the year. There is still evidence of some upward pressure on them, but most forecasts suggest a pattern of declining short-term rates over the last few months of this year and into 1975. Nevertheless, continued high demand for loans and persistent rapid rates of inflation may keep any retreat of short-term rates fairly modest, and long-term interest rates can generally be expected to remain at a high level and may even see some further upward movement before the end of the year.

The Government's fiscal position has deteriorated dramatically over the past few months. In May, its deposits at chartered banks had dropped by about $1,500m from December, 1973, and outstanding Canada Savings Bonds were down $700m, about three times the normal rate of attrition for these bonds.

High government expenditures, coupled with these low cash balances and continuing pressure on the Canadian dollar, are expected to require a net financing of more than $2,000m. The Government's borrowing needs will impinge on an already crowded bond market and will inevitably provide additional upward pressure on the interest rate structure.

In international trade Canada's position was worsening at the end of the second quarter. The trade surplus of $800m at the end of 1973 had declined to $600m at the end of June. Commodity exports continued to be high, but sales of manufactured goods dropped as the Canadian dollar remained strong compared with the United States dollar and as nations found themselves paying more for oil and less for other imports. At the same time, with strong demand and weak supply within Canada, imports were at a high level. This pattern was expected to continue into 1975.

Overall, the fate of the new Canadian economy in the next 12 months will be determined largely by developments in the United States. Assuming some recovery in the United States economy during the second half of 1974, Canada's real gross national product is likely to grow by about 5.5 per cent during the whole of 1974 followed by a similar advance next year.

# Switzerland



by Alan McGregor

The Swiss economy resembles an aircraft encountering patches of turbulence. A few of the full complement of passengers are making apprehensive noises but the majority, unperturbed, have hardly noticed anything and the crew, though uneasily aware of other aircraft being buffeted all around and making some course alterations, have not as yet found it necessary to switch on the seat belt signs.

The noises are mostly in the nature of warnings of worse to come. Even if inflation is so far being contained at about 10 per cent the growth rate is falling, the labour market is tighter than ever and terms on the capital market are tougher than Swiss business has long been accustomed to.

Some of the more sombre forecasts involve indexation, the automatic wage increases in line with the cost-of-living index. For example, Mr Gustav Schilplin, president of the Geneva Union of Metal-Working Industries, says: "We must recognize that every increase that exceeds the rise in productivity rebounds ultimately against the wage-earner. We must have the courage to admit that Switzerland is at present living beyond its means."

He and other employers must have permitted themselves a sigh of relief, all the same, when the labour federation for the metal and watch-making industries voted at the end of June for a four-year renewal of the no-strike collective labour convention.

This was in the face of strong opposition from unions in French-speaking Switzerland, which objected, among other things, to the employers' refusal to have written into the contracts a clause giving equal pay to women, who are particularly numerous in the watch factories.

The crucial importance of this renewal lies in the fact that the metal-working sectors, headed by the machinery industry, account for over half the industrial labour force, a third of which is foreign.

Manpower scarcity is an element of cardinal political, as well as economic, importance. Four years ago a national referendum on reducing the number of foreigners, the Schwarzenbach initiative, was narrowly defeated.

But the advocates of putting an end to foreign dispossession, whose ranks include the occasional unabashed xenophobe, have succeeded in obtaining a further referendum, to be held on October 20.

If their proposals were accepted, the total number of foreigners, more than a million, would have to be reduced by almost half over a three-year period. Even if foreigners are being blamed by some as one of the factors contributing to inflation, the new initiative, sponsored by the National Action Group, is not expected to secure the necessary straight majority.

But, because a progressive reduction in the number of aliens is now widely regarded as justifiable, the Government has had to shape its policies accordingly, by imposing its own limitations.

So Swiss industry is probably confronted in the long term with the prospect of having to adapt itself to a smaller work force, instead of this being variable, in the event expandable, as has been the case since the Second World War.

Some economists foresee, therefore, a further concentration on products requiring advanced technology and skilled labour, the demand for which, they hope, would be fairly immune to price increases.

Despite some slackening in domestic demand, export orders have been holding up well, having risen about 10 per cent in volume over the first half year. In growth the chemical industry is a front runner, although there is a marked trend to relocate more production centres abroad. After extensive rationalization, the watch industry is forging ahead, with the prestige of its main names being maintained head and shoulders above the best that its many vigorous competitors can do.

While the plastics and leather industries are mostly in a cheerful mood, textiles, clothing and footwear are experiencing difficulties attributable in part to their labour-intensive pattern. Here, too, reorganization has been the order of the day.

Building is suffering severely, being the most vulnerable of all to manpower shortages, in conjunction with the delayed repercussions of restrictions originally conceived for taking the steam out of the earlier boom.

It all adds up, however, to a picture of an economy in a fairly sturdy condition, particularly when set against the yardstick of circumstances in Western Europe as a whole.

## Netherlands

**by Sue Masterman** CPYRGHT

It looks as though the Dutch will emerge this year, when the final accounts are drawn up, with a continuing healthy balance of payments surplus, a currency which is the strongest of those in the north European "snake", rising exports and productivity, and a relatively successful record in the battle against inflation.

For the stock market, as in the rest of the western hemisphere, it has been a pessimistic year. Amsterdam has close ties with Wall Street, and tends to register the slump there each time a presidential decision shakes national confidence faster than other European financial centres. Other nations have tended to speculate in Amsterdam because international stocks hit a lower price there than in other centres, and local shares were dragged down too.

The current Dutch economic philosophy is the opposite of that now being preached in America. The five-party, centre-left coalition which presented its second annual budget to Parliament on September 17, believes that the economy should be stimulated by pumping government money into investments. They have reserved 600m guilders from the Treasury for this purpose, concentrating on areas of high unemployment.

These reserves are once again drawn from the 2,000m guilders extra income which the Treasury expects to receive in the next two years from increasing the price of natural gas. Contracts for the exploitation of natural gas and oil wells in The Netherlands have been constructed in such a form that between 70 and 90 per cent of the revenue ends up in the Treasury in various forms of concession payments and taxes.

The main government worry is unemployment, which threatens to double within a year from about 100,000 to 200,000, and is already more than 150,000. This still means that the proportion of unemployed does not approach what is considered a normal level in Britain, but the Dutch are scared of unemployment, as they are of inflation, and have sharp memories of the prewar hunger marches, the days when the price of a cup of coffee rose between the time it was ordered and the time it was served, and the collapse of the West German mark.

Mr Willem Duisenberg, Minister of Finance, was deeply offended at not being invited to the financial discussions in Paris early in September and, with his Belgian colleague, promptly let it be known that he does not consider the Dutch bound by any financial decisions taken there, such as the possible devaluation of the "green pound".

The Dutch have tackled inflation radically this year. Despite a rise in price of raw materials of some 30 per cent and a forecast rate of inflation of 13 to 16 per cent, the eventual figure will be closer to 9 per cent, putting The Netherlands in the first five OECD countries with a "low" rate of inflation. Although there was a rash of strikes, mainly in the metal industry, in the spring, wage agreements within the Government's limits were reached in all major branches of industry, and prices were strictly controlled by a variety of measures, mostly based on the freezing of profit.

One of the most controversial aspects of the Dutch economy is the high level of taxation and of social security premiums. Half the average wage earner's pay packet is deducted at source in taxation and a percentage premium to cover pension and other national insurance schemes, including basic health insurance. The top level of a tiered system of VAT is 16 per cent, and applies to most consumer goods and almost all services.

The result has been a thorough shakeout, a trend to automation, and a record number of bankruptcies of labour-intensive firms. The textile industry in particular is tending to pack its bags and move from Holland altogether, and firms like Philips now locate their television and radio assembly lines in countries where the cost of labour is not so high.

Unemployment and inflation thus remain the leading public enemies in The Netherlands, while the prospects for the national economy as a whole do not look unhealthy compared to those of the rest of Europe. As the home of the multinationals and the owner of its independent sources of energy, The Netherlands continues to be a picture of relative stability.

## South Africa

**by Ray Kennedy** CPYRGHT

Next to oil, the world's most wanted commodity is gold. South Africa, which produces 70 per cent of the western world's supply of the metal, has seldom, if ever, had it so good.

It is small wonder that in August, when the world's financial leaders were looking gloomily at forecasts of serious recession and as stock markets tumbled, Dr Nico Diederichs, the South African Finance Minister, was able to produce a budget which he modestly described as "a remarkable fiscal achievement."

He reported that an expected deficit on revenue account had turned into a total surplus of 418m rands, aided mostly by gold output, which was worth 1,245m rands in the first six months of 1974, compared with 1,769m rands for the whole of 1973.

Dr Diederichs announced cuts in individual income tax, company tax and increases in social benefits and housing subsidies. He also announced a huge 48 per cent rise in defence spending to 700m rands—about 18 per cent of the total budget—which means that South Africa is now spending more money per citizen on defence than any other country in Africa south of the Sahara.

However, the most important and consequential of Dr Diederichs's budget measures, according to economists, was his announcement that government spending in the next 12 months will go up by 23 per cent.

The Government's policy is apparently growth at almost any cost, and the cost is already being shown in forecasts that domestic inflation will spiral by 17 per cent this year.

The Standard Bank of South Africa gave warning in its September review published three weeks after the budget: "A deteriorating balance between domestic demand and supply is making itself felt in many spheres of the economy. This has become apparent from an excessive pressure of demand for and the high cost of finance, increasing production bottlenecks and the reduction of spare industrial capacity, the lengthening of delivery periods, a tight labour market, a strained transport system and a worrying deterioration in the country's balance of trade."

In its annual economic report, also published after the budget but on which Dr Diederichs apparently based his own review of the past 12 months, it suggested that while existing credit controls might not be tightened, there was little prospect of any easing of them.

The report said: "The high rate of increase in private consumption expenditure during the last two years was facilitated to an important extent by the extensive use made of consumer credit."

The Governor of the Bank, Dr T. W. de Jongh, said: "We have now reached the stage where the economy is growing at a very high rate... while at the same time demand-pull inflation has begun to play a part again. It is therefore certainly not necessary to stimulate further growth deliberately but rather a matter of trying to maintain a relatively high rate of growth to the extent that available resources permit and without feeding inflation."

There is no doubt that the South African economy is at present growing at an exceptionally rapid rate in real terms. The expected rate of increase of 7 per cent in real gross domestic product for 1974 far outstrips the average annual rate of 5.75 per cent envisaged in the economic development programme.

But most economists feel that now that the cyclical upswing has brought the economy to a point where most of the previously existing surplus capacity has been absorbed, it is both inevitable and desirable that the rate of real economic growth should slow down at some stage to a more maintainable figure.

## Scandinavia

CPYRGHT

**by Geoffrey Smith**

One of the ironies of this year of economic gloom is that the one Scandinavian country to have joined the EEC is the one with the worst economic record, facing the most daunting economic perils. This is not cause and effect; it is simply a reminder that membership of the Community cannot by itself set all other factors on one side.

Denmark has suffered because the fundamental weakness of its position over a period of years had left it in no condition to face the sudden onset of the oil crisis. Nor does it have the compensation enjoyed by the other Scandinavians of the forest industries whose products continue to sell in a boom European market.

Unemployment has been about three times higher than a year ago, with the construction industry particularly badly affected.

Finland's situation is the next worst. There, too, inflationary pressures have been strong and the balance of payments deficit has increased. Finland was among those countries most severely affected by the oil crisis. But in this and in other respects there are special factors in the Finnish situation.

Most of Finland's energy imports are obtained from the Soviet Union, with whom trade is on the basis of regular bilateral agreements. Before the international price of oil was raised so dramatically the main limitation on Soviet-Finnish trade was the inability of the Soviet Union to sell Finland enough goods that she really wanted. It was political considerations which kept this trade as high as it was, which was well below a fifth of Finland's total international trade. Now Finland is having to sell more to Russia to pay for the higher price of oil and for the natural gas which began flowing from the Soviet Union to Finland this year.

This has limited Finland's capacity to export to the rest of Europe, so that the bilateral trade agreement with the Soviet Union has only partly shielded Finland from the full effects of the oil crisis. The limiting factor on the growth of Finnish exports has been the capacity to produce, not the capacity to sell. There is a persistent shortage of skilled manpower for the main industries, at any rate in the south of Finland.

In some respects this is a comforting position as the international economic winds blow more harshly. The combined effects of buoyant international demand for forest products and Finland's need to sell more to the waiting Soviet market should ensure continued high activity in the Finnish economy.

Finland will also benefit from the continued strength of both the Swedish and Norwegian economies. They provide the real Scandinavian success stories over the past year. Both have had a relatively low rate of inflation by today's extravagant standards, though inflationary pressures have been steadily increasing.

Neither continued to advance at the same pace as in the previous year but neither could expect to do so in the harsher international economic climate. Both had enjoyed boom conditions in 1973 and the first half of this year, with the Swedes having one of their best years on record in 1973.

However, of all the Scandinavian countries Norway has the most glowing prospects. The boom there has been slowing down and may do so still more, depending on the level of general European demand. The good export performance of the past year has been due largely, however, to the strength of the demand for paper, which is unlikely to slacken.

## South-east Asia

CPYRGHT

**by Petar Hadji-Ristic**

England's bewilderment over its economic plight is in marked contrast to the current mood in South-east Asia; every country in that region is keen to develop and the world recession is not deflecting them from their course. Compared to a year ago short and medium-term expectations have been rapidly revised downwards, but the gloom-and-doom syndrome we know in Europe is not yet to be found.

The fourfold increase in crude oil prices has not left the region unscathed, however. The additional boost this gave to already soaring inflation and cost increases in 1973 has caused some development projects to be temporarily shelved.

The export growth rate has been temporarily reduced because of the adjustment strains in industrial countries created by the energy crisis and a few manufacturing companies have collapsed.

The general view is that this is nothing more than a temporary setback. According to most government officials and bankers, South-east Asian nations are better placed than most developing countries to survive, and even thrive on, the current economic difficulties. Not least of the reasons for such optimism is the fact that the energy price rises are bringing big amounts of new international investment in the development of alternative energy sources in the region.

The best place from which to take a first look at the financial prospects of the region is Singapore, the tiny republic on the regional crossroads. This city-state is gambling on becoming the region's financial and technical nerve centre.

That Singapore is moving fast to do just this can be seen from the Government's single-minded efforts to build the republic into a regional financial centre.

The fast-expanding Asia dollar market based in the republic, now worth some $9,000m, has become a major source for development finance for the oil search.

The Government's Economic Development Board is now concentrating on attracting into the republic foreign investment in high-technology industries, particularly in metal and aerospace engineering and chemicals. It is not surprising that against this background of intense activity, Singapore is expecting, perhaps a little over-optimistically, a 10 per cent real growth rate this year.

Government officials in Malaysia, just across the causeway from Singapore, are also predicting a high rate of growth this year, probably about 7 per cent. In the industrial sector, into which foreign investment continues to flow at a high rate, the growth rate should be nearly triple this.

There is no evidence to show so far that this healthy growth in the industrial sector will be halted next year as a result of the energy crisis. Rather, this seems to have been encouraging the relocation of companies from the high-cost industrialized countries to developing countries such as Malaysia, which have lower labour costs and a big pool of young unemployed in the urban areas.

This process is likely to be given a considerable boost by the massive investment now going into the search for petroleum in the Malaysian offshore waters. Nine foreign oil companies are prospecting for oil and gas and some 120 others are competing for new prospecting licences.

Estimates based on existing finds suggest that Malaysia should be producing a million barrels a day, 10 times its present domestic needs, by 1980.

Apart from stimulating the development of the country's energy resources, the oil price rises have brought about a revival in the fortunes of the natural rubber industry, for more than a generation struggling against competition from the cheaper synthetic rubber substitute. The price of synthetic rubber soared after the energy crisis and this has stimulated an expansion in production of natural rubber.

Natural rubber is not the only commodity that has benefited from the boom in commodity prices. Palm oil prices have also rocketed, as well as the price of metals, such as tin, bauxite and iron ore, all of which Malaysia now produces in reasonably large quantities.

Any discussion of the region's natural resources must turn to a discussion of the fabled wealth of Indonesia, the archipelago facing Singapore and Malaysia. To a much greater extent than in Malaysia, the energy crisis has hastened the development of Indonesia's petroleum reserves, which are estimated to equal at least 2 per cent of the total world's supply.

Oil production is expected to rise substantially this year, from 489 million barrels to 550 million, and will rise even more spectacularly in the second half of the decade as the new finds are brought into production.

Big earnings will also accrue to the country from the development of natural gas resources.

Apart from the increase in petroleum exports, a big boost in the output of other primary products can also be expected later in the decade. Major mining projects are now under way or in the planning stage to exploit new finds of tin, bauxite, copper and, the largest of all, coal.

As for industrial production, this is expected to expand by at least 15 per cent this year as the difficulties due to inadequate transportation and shipping begin to ease following big spending on infrastructure.

Over the long term, the key to the continuing financial stability of the region rests on regional political stability rather than the success of the world economy in adjusting to the changed economic circumstances. All indications are that the political situation in Singapore, Malaysia and Indonesia is stable.

With these conditions in mind, most economists in the region maintain a cautious optimism about the future.

## India



by Michael Hornsby

Oil, food and raging inflation have dominated the economic scene in India this year, as also, in varying degrees, in Bangladesh, Ceylon and Pakistan. The huge rise in oil prices at the end of last year, which was only part of a whole range of import cost increases (the prices of copper, tin, zinc and lead all rose by more than 100 per cent), and the need for continuing imports of food combined to create a situation of acute foreign exchange shortage as India launched its fifth five-year economic development plan (1974-75 to 1978-79).

The oil picture is still not completely clear. It appears, however, that the import of crude oil will be held to a level slightly less than that of last year, when India imported 13,890,000 tonnes of crude and 3,830,000 tonnes of refined products. This is bound to have an adverse effect on industrial and agricultural production, since the demand for crude oil had been expected to raise India's consumption from 20,500,000 tonnes in 1973 to 24,840,000 tonnes in 1974 and to 40,390,000 tonnes by the end of the fifth plan.

Even with reduced imports, the cost of oil purchases in 1974 is likely to run out at not less than Rs11,200m (about £600m), an increase of between 300 and 400 per cent over the previous year. The oil bill in 1974 will be equal to more than two-thirds of India's total import bill in 1973 and will probably consume between 40 and 50 per cent of the country's foreign exchange earnings.

Some relief has been obtained by special agreements with the oil-producing countries.

One positive aspect of the foreign exchange crisis—though necessarily a long-term one—is that it could compel India's planners to devote more vigour and resources to the exploitation of the country's great stores of known mineral and possible oil wealth. India's known metals, minerals and fuel reserves are of the order of 405,000 million tonnes, and those not yet measured could be of equal magnitude.

At a conservative estimate India should now be extracting annually 225 million tonnes of mineral raw materials with a value equal to about 6 per cent to 8 per cent of the gross national product (compared with an actual mineral extraction value of less than 1 per cent).

India meets about one third of her requirements of crude oil from fields in Assam and Gujarat, but these are likely to be exhausted by the end of the decade. This prospect, coupled with the high prices of imported crude, has imparted a new urgency to the need to increase indigenous production. The record to date of the Government-owned Oil and Natural Gas Commission (ONGC) has been highly erratic and inefficient. Its performance in onshore development and exploration has shown a consistent downward trend. The ONGC's new offshore drilling programme, however, presents an altogether more encouraging picture.

The most promising development was the discovery, in February, of oil in the Bombay High structure in the Arabian Sea.

The oil crisis has also severely affected food production because of the increased cost and reduced availability of petroleum-based fertilizer, of which India has to import about 50 per cent of her requirements. Plans to expand the indigenous production of coal-based fertilizer have yet to bear much fruit.

The huge rise in import costs has overshadowed the one apparent success story of which India's economic planners can boast, namely the growth in exports, which rose by 22 per cent in 1972-73, by 25 per cent in 1973-74 and, reportedly, by 40 per cent in the first three months (April-June) of the current financial year.

These figures, however, tend to reflect the steep rise in the unit value of many of India's traditional exports (such as coffee, cashew nuts, cotton textiles, sugar and jute) rather more than an increase in their volume.

At an optimistic estimate, the total value of India's exports in 1974-75 might amount to Rs 26,000m. The total import bill, which is difficult to calculate because of the uncertainty about how much food will have to be bought abroad, could be anything from Rs 37,000m to Rs 40,000m, leaving an uncovered gap of between Rs 11,000m and Rs 14,000m. The next inflow of foreign aid, after debt servicing, in 1974-75 is likely to be about $675m (Rs5,400m), which will still leave a substantial gap to be filled. But the assumption of these calculations is that with the aid of drawings on the International Monetary Fund and oil credits India will scrape through.

An important proviso of this assessment is not only that export trends continue to be favourable but also that Congress approves the crucial American contribution to the International Development Association, the World Bank's soft-loan affiliate, which is scheduled to provide about $600m of the total aid commitment of $1,400m pledged this year by the Indian Aid Consortium.

On the domestic front, the Government has been struggling, though not so far effectively, to contain a highly inflationary situation. Fuelled by stagnant or declining industrial and agricultural production, deficit budgetary financing and the existence of a parallel "black" economy (mainly the product of massive tax evasion), the general price level rose during the first six months of this year at an annual rate of 30 per cent.

An emergency supplementary budget—enacted in July—sought to close the budgetary gap by raising extra revenue through increases in a wide range of taxes, levies and excise duties.

## Eastern Europe



by Kurt Weisskopf

The oil crisis of the West, rising commodity prices and inflationary price trends have affected the economies of the Comecon countries. The impact of these trends may have varied from country to country. It was less marked in East Germany, strongly felt in Hungary and Yugoslavia, the communist country outside Comecon, and less perceptible in Bulgaria. Yet none of the European Comecon countries escaped unscathed. Their plans to control their economies during 1976-1980 and to include an element of supranational integration are still under consideration, Comecon sources indicated at the Leipzig Fair early this month. Some of them admitted that in view of the upsetting effects of western inflation, these plans are once again in the melting pot. Up to a point there has been a convergence of problems between East and West.

In terms of overall economic growth little has changed. Growth rates still vary between 6 per cent and 8 per cent. But overall growth is a general term. More specifically, the Comecon countries are passing through a process of planning readjustment which will delay realization of the goal proclaimed at the Bucharest meeting of the council in July, 1971—full planning integration, possibly by 1980.

The past 12 months, but particularly the events after the Yom Kippur war, as well as intimations by the Soviet Union that prices of Russian crude oil will be raised to world market levels while the volume of deliveries to the Comecon countries may be limited to a maximum of perhaps 50 million tonnes annually, have forced East European states to reappraise their own oil situation.

All of them are committed to the expansion of their petrochemical industries as one of the main planks of their economic programmes. Therefore, all of them have been searching for new sources of oil, generally Middle Eastern and North African. This entails not only contracts with Middle East countries but also physical preparations that have already started.

East Germany is constructing a major oil port at Rostock. Poland is expanding the oil port and refining capacities at Gdynia. Possibly the most ambitious and expensive project is the new Adria oil pipeline from Omysal in Rijeka bay to the Hungarian border and Czechoslovakia, with the possibility of an eventual extension to Poland.

Commodities have been another worry for the Comecon countries. But prices could now be turning downwards. This trend, coupled with a campaign for economical use of commodities and fuel saving, seems to hold a chance of easing the pressure.

Oil and commodities are not the only factors of concern to the economic and planning authorities of the Comecon countries. Planning integration as originally envisaged under the Bucharest charter, known as the Complex Programme, entailed joint development of science-based industries. It was soon found that this process could be profitably accelerated by the purchase of western equipment, licences and experience.

As a result of western inflation, however, such purchases have become more expensive than was originally calculated. The time schedule has therefore been revised and the date envisaged is 1990.

This delay is probably welcome to Comecon planners who have realized that integration, since it involves cooperation and specialization, will have to be based on links between enterprises or industrial groupings. This in turn requires the existence of enterprises with corporative status in the legal sense.

It is not just Comecon internal integration which requires the establishment of enterprises with cooporative status in the Comecon countries. The matter is even more pressing in view of the emphasis on cooperation deals with western firms.

Such deals are seen as a means to transact business outside the monetary sphere and therefore more or less unaffected by inflation. Generally they will involve part-production by both the Comecon and the western partner, assembly of the product by one, and eventual delivery of a share of the assembled product to the non-assembling partner or joint disposal on third markets.

In recent months all Comecon countries have expressed themselves in favour of cooperation deals, which not so long ago some viewed with reservation. Yugoslavia, not a member of Comecon, sees in cooperation rather than in conventional deals the best opportunities for foreign trade expansion. This view is shared by Romania.

Joint ventures, which were started in Yugoslavia in 1967 and in Romania in 1971, are only one step forward from cooperation, but it could be a long step.

Recently Hungary has started to take an active interest in joint ventures on its territory, having taken part in them abroad for some years, and Poland is cautiously considering the possibility.

The rapid advance of the idea of cooperation deals and the serious preoccupation with joint ventures in recent months is part of the Comecon reaction to western inflationary trends. It is this approach, the economic authorities of the Comecon countries appear to hope, that will enable them to minimize the effects of imported inflation and to proceed eventually with their integration plans.

The main feature of the economic policies of East European countries in the past 12 months has been the definite reappraisal of the time-scale of integration. They received an object lesson demonstrating that they are dependent on cooperation with the western world, and that one social system's crisis is by no means the other system's boom.

The lessons, it seems, have been learnt and, if political utterances in the press of the Comecon countries, with high propaganda content for home consumption, are disregarded, the language of economic policy and action in the recent past is fairly clear and points to a long period of willingness to cooperate.

# Latin America



by John Rettie
editor, *Latin America*

Chileans have been variously told that their cost of living went up during the past 12 months by 550 per cent or, from another statistical source, nearly 700 per cent. To the average man in the street, the odd 150 per cent makes little or no difference.

Although Chile, floundering in the chaos of the Allende and post-Allende governments, is by far the worst case in Latin America this year, not a single country has escaped the scourge of inflation. Even the best managed and luckiest governments in the region can expect inflation of 25-40 per cent in 1974.

Perhaps the most striking feature is the shift in the balance of economic power in the continent. Until this time last year Brazil, with a population over 100 million, was the unquestioned economic giant, forging ahead of its Spanish-speaking rivals Argentina and Mexico, as well as the six-nation Andean group formed by Bolivia, Chile, Colombia, Ecuador, Peru and, belatedly, Venezuela.

Oil has changed all that. Brazil, of course, is still a giant; its economy is too dynamic to come suddenly to a halt. But power is now in the hands of Venezuela, with an oil income which has suddenly jumped from about $3,000m to something like $10,000m a year. This is a lot of money by anybody's standards, and certainly far too much for Venezuela to absorb at home. The Government has therefore set up development funds under which about half this income will be used at home, and the rest reserved for aid and investment in other developing countries. Naturally enough, priority will be given to Latin America and, in particular, the Andean group.

The effect of this, at a time when the industrialized nations are drawing in their horns as a result of the oil crisis, may well be to make Venezuela replace the United States as the major supplier of capital and credit to Latin America, and certainly to the Spanish-speaking nations. This will have profound implications for economic relations, not only within Latin America but also between Latin America and the rest of the world.

It was the oil crisis that brought concern about the Brazilian miracle to a head, but nagging doubts had existed for some time.

Despite a massive inflow of about $3,000m the first half of 1974 saw a balance of payments deficit of $190m. Inflation, artificially held down to 15½ per cent by the outgoing Medici Government last year, is likely to be 30-40 per cent in 1974.

All this is clearly serious, but not yet catastrophic. Some corrective measures have been taken by General Ernesto Geisel, the new President. The state oil concern Petrobrás is stepping up its exploration programme, and more attention is to be paid to agriculture, whose products seem to have the best export prospects at a time of imminent world industrial recession. Clearly, however, the Brazilian miracle will be problematical for the next few years.

What is really worrying about Mexico is the political situation. After 40 years of political stability and 20 years at low rates of inflation, serious social tensions have been created by the very uneven distribution of wealth, and exacerbated by an unprecedented rise in the cost of living. The private sector has poor relations with both the Government and labour, and in spite of initial good intentions President Luís Echeverría has so far been unable to adapt and modernize either the political system or the country's social and economic structure. This will certainly be the main task of his successor in two years' time.

Politics, too, are the biggest cloud over Argentina's economy. Things have improved out of all recognition since the return of Perón 16 months ago, thanks to the Argentinian version of the "social contract" he was able to impose. Inflation has gone down from an annual rate of 80 per cent to a mere 22-23 per cent, though it may now be rising again.

This year exports may reach $3,600m, but rising imports gave a surplus of only $490m in the first six months. With the death of Perón at the beginning of July, however, the Government's ability to maintain peace and calm at home must be in some doubt.

# Black Africa



by Alan Rake
editor,
*African Development*

The drought, the commodity boom and the energy crisis have vitally affected Africa's economies during the past year.

The drought was not a sudden phenomenon that descended on the Sahelian states and Ethiopia in 1973 but came after a long and painful build-up following five years of sub-normal rainfall. Breaking point was reached when 100,000 people were estimated to have died in the states fringing the Sahara and another 100,000 in Ethiopia. At least three million head of cattle were eliminated and the quality of millions more in the remaining herds deteriorated seriously.

The Food and Agriculture Organization has estimated that the gross national product of the entire Sahel region fell last year by 50 per cent. Landlocked Niger, Mali and Chad were worst hit, but Mauritania, Senegal and Upper Volta suffered too.

The drought is of fundamental importance to the economic performance of Africa. It has reduced the Sahelian countries to beggar status, has temporarily destroyed their productive capacity and has made them totally dependent on external aid.

The oil crisis has wreaked its own havoc among those countries with more advanced economies where economic development and industrialization were beginning to take hold.

The sudden increase in prices of oil, raw materials, fertilizers and food, closely followed by increases in manufactures, machinery and transport equipment, dealt a severe blow to African countries with struggling modern sectors and consumer goods industries that are heavily dependent on imports of raw materials and machinery.

Sometimes it is argued that Africa may have lost from the oil price explosion but at least it has gained from the upsurge in commodity prices in 1972-73. This is true but the boom in commodity prices only restored the terms of trade between raw materials and manufactured exports which existed in 1950.

In Africa, Zambia and Zaire have been blessed by two years' strong copper prices. Mauritania, Sierra Leone and Liberia have enjoyed better iron ore prices. Ghana and the Ivory Coast have gained from the cocoa boom but, after two years of buoyancy, all these prices are in retreat in expectation of a world recession.

**ETHIOPIA.**—The sudden rise in petrol prices followed by the strike of the taxi drivers and the general escalation in retail prices, particularly of food after the drought, was one of the prime causes of the coup in February and the trouble that has simmered since.

Ethiopia, which finances almost all its economic growth from slender balance of trade surpluses now finds these in jeopardy, despite the boom in commodities which increased the value of exports of coffee, meat, cereals, oil seeds and hides and skins. With the commodity boom running out, Ethiopia finds itself saddled with a bill of $100m or more to meet pay increases for its armed forces and teachers. This figure is more than the total Ethiopian capital budget.

**TANZANIA.**—Despite its emphasis on self help, labour intensive development and the use of local raw materials, the country has been badly hit by petroleum and grain price increases and by drought. In his budget speech, Mr Cleopa Msuya, the Finance Minister, called on the people to tighten their belts. He said economic problems were getting worse and the prospects for the country's foreign exchange reserves for 1974 and 1975-76 were grim.

In the words of one of Tanzania's top economic advisers, "1974 is certain to be economically the most difficult year which has confronted independent Tanzania".

**KENYA.**—This is a classic case of a developing country with a relatively advanced level of industrial development and a strong private sector heavily dependent on road, rail and air communications which are thirsty for oil.

Mr Mwai Kibaki, the substantially from the upsurge in oil prices. With oil production running at just over two million barrels a day and being maintained at this level, Nigeria expects oil revenues of some $7,000m in 1974-75 compared with only $1,000m in 1971-72.

The posted price for a barrel of Nigerian crude oil in August 1973 was $4.29. By January 1974 it was $14.69. The effect will be to triple royalty earnings and put at least $5,000m more into the Treasury for the financial year ending in April 1975.

But Nigeria has by no means escaped the consequences of the oil crisis and inflation has become a major problem. General Gowon's budget announced a whole series of anti-inflationary measures and cuts in import duties.

While the oil boom has stimulated the manufacturing, trading and construction sectors, it has had the reverse effect on agriculture. The younger people see that there is more money to be made in the oilfields and the thriving cities than in tending their farms.

The Government is now trying to stimulate agricultural production by paying higher producer prices to farmers by abolishing all export duties and by spending more on assistance to farmers and on research.

Finance Minister, introduced his toughest budget since independence because, though agricultural production, manufacturing and exports were at record levels, the price of imports had risen by 15 per cent.

Increased prices of oil, manufactures and capital equipment would almost certainly result in an overall balance of payments deficit of as much as £K50m this year.

**GHANA.**—Buoyed by two years of high cocoa prices, Ghana seemed on the point of breaking out of the recurrent pattern of balance of trade deficits, foreign exchange losses, devaluations and crises over accumulated debt.

The oil crisis, however, is expected more than to triple costs of petroleum product imports from 40m to 132m cedi. In addition, there are price increases of all related products.

Instead of cutting back on development Colonel Acheampong has been forced to take the unpopular measure of removing food subsidies, which amounted to 42m cedi over the past two years, and passing on the cost of inflation to the consumer. Even so this will be insufficient to save the economy if a serious decline in cocoa prices continues.

**NIGERIA.**—This is the only African country to benefit

substantially from the upsurge in oil prices. With oil production running at just over two million barrels a day and being maintained at this level, Nigeria expects oil revenues of some $7,000m in 1974-75 compared with only $1,000m in 1971-72.

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