

Chapter 3

The effects of restructuring

Chapters 1 and 2 have examined tendencies to imbalance in world trade and shown how those tendencies combine with financial constraints to depress growth in the world economy. We turn finally to consider structural adjustments that might improve prospects for the world as a whole or for particular blocs.

The main area in which restructuring policies would assist world expansion is energy. Given present energy trends and the low response of spending in oil-surplus countries to increases in their revenue, there is a likelihood that widening imbalances in energy trade and continuing increases in oil prices will cause prolonged recession in the rest of the world. But expansion of spending and income in oil-importing countries could be accelerated by energy saving and by development of additional energy supplies outside the oil-surplus bloc. The possible effects of such energy restructuring are discussed in the first section below.

The second section considers the implications of industrial restructuring, including strategies of trade liberalisation and preferences in favour of exports from developing countries. The binding nature of the constraint now imposed by energy imbalance implies that industrial restructuring can have little effect on growth in the world as a whole. But it can certainly alter the distribution of growth between countries and blocs.

The final part of the chapter assesses 'go-it-alone' strategies for accelerated growth of individual countries or blocs through protection, examining in particular the circumstances under which such strategies will or will not harm other countries. It will be shown that protection need not have 'beggar-my-neighbour' consequences provided that it is used to secure faster expansion within the protected region and that consequent energy problems are solved internally or covered by external borrowing.

3.1 Energy restructuring

The technical dependence of modern economies on energy input, particularly oil, and the great disparities between energy supply in different countries and blocs, are the principal reasons why trade imbalances tend to widen when growth of spending accelerates.

Since 1973 the high price of oil has helped to induce energy saving and to renew efforts to increase supplies in most parts of the world. These efforts have been promoted not only by higher internal energy prices in each country but also by government policies.

Here we examine the consequences of intensified efforts to restructure energy demand and supply. Such restructuring will affect rates of economic expansion and may alter conditions in the world oil market, including the price of oil. Our estimates are designed to show the distribution of benefits from energy restructuring taking these indirect effects into account.

Chapter 1 examined what might happen in the early 1980s if all blocs in the world economy achieved accelerated growth of spending. Our estimate was that trends of energy supply would be inadequate to stabilise world prices under conditions of faster world economic growth. By 1985 a 60-70% rise in the world price of oil from its present level (relative to prices of manufactures) would be needed to eliminate excess demand for oil. This very high price (nearly 200% above the price in 1975) would induce further energy saving and additional supply, but would imply deficits in the energy trade of the USA, Japan and Western Europe reaching over 300 billion 1975 dollars (about \$450 billion in today's money). The Middle East's surplus on oil trade would, correspondingly, reach \$250 billion (in 1975 values) and it seems impossible that imbalances of this magnitude could be compensated through non-oil trade.

In these circumstances financial constraints, considered in Chapter 2, would depress growth in spending in the world as a whole; this would diminish pressure on the oil market and slow the rise in oil prices. With lower world prices, the incentive to save energy would be lessened and expansion of non-OPEC supplies might be less rapid. The recession and the smaller price rise would however bring the oil deficits of developed blocs down to more manageable levels. The correction of imbalances in energy trade through reduced economic growth is, for most parts of the world, damaging if not disastrous.

Suppose that the main oil importers — the USA, Japan and Western Europe — were to make strenuous efforts at energy saving without having to be forced to do so by a very high world price. 'Voluntary'

Table 3.1 Alternative energy projections for the USA, Western Europe and Japan

	Growth of real spending per capita, 1979-85 (% per year)	Balance on energy trade 1985 (\$1975 billion)	Ratio of physical energy consumption to real spending, 1985 (1973 = 100)
<i>USA</i>			
<i>Ex ante</i>	2.5	— 81	78
With financial constraints	0.6	— 53	83
With energy saving	2.1	— 33	72
With higher internal energy supply	1.0	— 46	83
<i>Western Europe</i>			
<i>Ex ante</i>	3.0	—148	82
With financial constraints	1.1	—105	87
With energy saving	2.5	— 79	75
With higher internal energy supply	1.4	—100	88
<i>Japan</i>			
<i>Ex ante</i>	4.0	— 84	68
With financial constraints	3.8	— 69	72
With energy saving	6.5	— 56	63
With higher internal energy supply	4.0	— 68	73

	World oil price (1975 = 100)	Projection assumptions
<i>Ex ante</i>	294	Unconstrained expansion in all blocs (Chapter 1)
With financial constraints	226	Growth inhibited by financial constraints: base projection (see Chapter 2)
With energy saving	192	Additional savings at 3% per year (for given real spending and world oil price) in all developed blocs.
With higher internal supply	218	Faster growth of domestic energy supply (for given world oil price) by 1% per year in all developed blocs.

energy saving could be achieved by government regulations or subsidies designed to encourage the efficient use of energy. Governments could also raise internal energy prices relative to world prices to stimulate internal supply and reduce demand.

The general effect would be to reduce the energy deficits of energy-saving blocs, accelerate their economic growth and their non-oil imports, raise the non-oil exports of other blocs and weaken world oil prices. Our illustrative projection (see Table 3.1) shows growth of spending increased by 1½% per year in the USA and Western Europe and by over 2½% per year in Japan, with a consequent reduction of \$60 billion in their combined 1985 deficit on energy trade and a 15% reduction in the 1985 real price of oil. But to secure this, they would need to

accelerate their energy saving from the 1½-2½% a year achieved between 1973 and 1978 to 4-5% a year from now on — and that without much further increase in the world price. By 1985 they would need to have cut their energy consumption relative to real income by about 30% compared with 1973. This is a much more ambitious target than is now officially envisaged*. Only Denmark has so far planned rigorous energy conservation on such a scale.

If such accelerated energy saving is implausible, what about intensified efforts to increase supply? Domestic energy sources in the United States alone easily exceed total Middle East production; deve-

*See IEA, 1980, *Energy Policies and Programmes of IEA countries*.

Table 3.2 Energy restructuring in developed blocs: the implications for others

	Trade balance, 1985			Growth of real spending per capita 1979–1985		
	Base projection	Energy saving ^a	Higher energy supply ^a	Base projection	Energy saving ^a	Higher energy supply ^a
	(\$1975 billion)			(% per year)		
USA	–12	– 2	– 9	0.6	2.1	1.0
Western Europe	–15	– 5	–13	1.1	2.5	1.4
Japan	+ 2	+11	+ 3	3.8	5.4	4.0
Other developed	– 7	– 3	– 6	1.3	2.5	1.7
Latin America	–16	–17	–16	3.6	3.3	3.5
Africa	– 6	– 8	– 6	7.3	5.8	6.9
Asia	–22	–21	–22	3.3	3.8	3.4
Middle East	+84	+51	+76	4.5	4.5	4.5
Centrally planned ^b	– 6	– 7	– 6	3.4	2.9	3.2
World total ^b	0	0	0	1.3	2.1	1.4

^a In developed blocs only (not including centrally planned). See Table 3.1 for assumptions.

^b See Table 2.8, footnote d.

developed countries together produce about 40% of world energy output. The problem is that exhaustion of traditional oilfields and the longstanding rundown of deep-mined coal have caused a depressed trend in their total energy supply which is only gradually and with difficulty being turned round. The long gestation periods for development of most new energy sources in the developed blocs mean that little more could be done to raise their supply by 1985. However even a 1% per year addition to supply would offer some appreciable benefits. Our calculation is that this would raise economic growth in developed blocs by ¼–½% per year while cutting the combined energy deficit of the USA, Western Europe and Japan by \$15 billion in 1985.

The consequences for developing countries of energy restructuring in developed countries depend on the former's own energy positions. Their non-oil exports may rise with the improvement in developed countries' markets but countries with substantial oil production will lose from the lower world oil price. At the level of continental blocs our estimate is that only Asia would achieve a net gain and this because of its position as a significant exporter of manufactures. Africa and even Latin America would lose income overall although individual non-oil countries within those blocs would benefit. (See Table 3.2.)

These results serve to emphasise that the world cannot simply be divided into two groups of oil-exporting and oil-importing countries. Only a few oil-producing countries are wealthy enough to be free from external financial constraints. Among countries which now import oil, some are better able to adjust to high prices than others, while those with chronic oil deficits vary in their ability to profit (or

lose) from changes in non-oil trade induced by the world energy situation. Energy restructuring is especially beneficial for Japan and Western Europe since their dependence on oil imports is so great and their shares of world markets for manufactures are so high. It is of little benefit to countries with a low dependence on oil imports and negligible manufactured exports.

3.2 Industrial restructuring

Among policy-makers in Western Europe and the USA the belief in free trade, especially as applied to manufacturing industry, has often seemed virtually unshakeable. There is therefore a widespread view that the present recession in these blocs could be mitigated by persevering with trade liberalisation and internal restructuring of their industries to accommodate a 'new international division of labour'. As the Brandt report puts it:

'as developing countries accelerate the pace of their industrialisation, the old industrial countries will have to deploy their capital and labour increasingly into the production of skill intensive and technically advanced goods'.

North-South: A programme for Survival,
1980

The implication is that the old industrial countries should cede less advanced industries to developing countries.

The general argument in favour of wide-sweeping international specialisation in a free trade framework is that it will maximise efficiency and thereby improve

Table 3.3 Effects of trade liberalisation and preferences in favour of developing blocs

(comparisons with base projection)

	Changes in balance of trade in manufactures 1985 (\$1975 billion)			Change in growth of real spending per capita 1979-85 (% per year)		
	Liberalisation All blocs ^a	USA, Europe & Japan only ^b	Preferences to imports from developing bloc ^c	Liberalisation All blocs ^a	USA, Europe & Japan only ^b	Preferences to imports from developing bloc ^c
USA	+20	-14	-3	+0.6	-0.5	-0.1
Western Europe	+39	-12	-8	+1.3	-0.4	-0.2
Japan	+11	-13	-4	+1.2	-1.0	-0.3
Other developed	-11	+12	-2	-1.2	+1.2	-0.2
Latin America	-26	+ 3	+6	-2.3	+0.2	+0.5
Africa	-19	0	+2	-4.5	+0.1	+0.4
Asia	- 1	+17	+6	0.0	+1.6	+0.5
Middle East	+ 1	+ 1	+3	0.0	0.0	0.0
Centrally planned ^d	-12	+ 8	-1	-0.3	+0.2	-0.1
World total ^d	0	0	0	+0.1	-0.1	-0.1

^a Assumed ratios of imports of manufactures (including intra-bloc trade) to domestic spending:

	Actual 1978	(per cent) Base projection 1985	Liberalisation 1985
USA	4.5	5.6	7.9
Western Europe	12.3	19.4	28.7
Japan	2.5	3.2	7.9
Other developed	13.3	12.9	22.9
Latin America	9.5	9.5	16.9
Africa	21.1	21.1	35.2
Asia	16.9	20.3	30.1
Middle East	27.1	32.9	32.9
Centrally planned	7.3	6.9	12.2

^b Import ratios for other blocs same as in base projection.

^c Manufactured export shares of developing blocs increased by 8% per year relative to 1979 levels at the expense of shares of all other blocs: import ratios for all blocs same as in base projection.

^d See Table 2.8.

world welfare. It is also often implied that free trade will raise employment, at least in the long run, in both developed and developing countries together.

Industrial efficiency is undoubtedly, of itself, a benefit and trade liberalisation has no doubt contributed to improvements in efficiency in the past two decades. But the distributional consequences cannot be ignored since there is no guarantee that industrial restructuring induced by free trade will uniformly benefit all countries. On the contrary there is a strong

presumption that in the present energy-constrained situation changes in the pattern of industrial trade will have little or no effect on total world income but may cause substantial redistribution of income between countries outside the oil-surplus group.

To explore shifts in income which might conceivably take place we have calculated several projections embodying different assumptions about import ratios and shares of export markets for manufactures (see Table 3.3). Consider, first, the effects of trade

liberalisation everywhere except in the already 'saturated' Middle East. In the interests of balance we assume that Japan would encourage imports on such a scale as to catch up with the level of import penetration in the USA. World trade would certainly grow rapidly relative to income and spending. In the absence of changes in the pattern of market shares it is evident that the bulk of export gains would accrue to already-established exporters — Western Europe, the USA and Japan. Blocs in deficit on trade in manufactures, notably developing countries, would find those deficits worsening (unless, as we assume for the Middle East, their markets were already so flooded with imports that they had nothing more to lose). The scale of existing deficits reflects the great difficulty developing countries have had in establishing industries and implies that few can yet hope to gain from participating in a universal liberalisation.

On the other hand suppose that it is really only the main exporting industrial blocs — the USA, Japan and Western Europe — which liberalise fully. In this case the distribution of gains would be reversed. However the main beneficiaries would not be the large majority of developing countries which have little hold on developed country markets, but rather the small group of newly industrialising countries, mainly in Asia, which have an established position in those markets. These are in reality the countries to which developed blocs are least likely to offer improved terms of access precisely because they present the greatest threat.

Another widely advocated policy is the award of preferences to developing countries in the form of tariff reductions or exemptions. This was decided in principle by the United Nations and legalised by modification of GATT rules in the 1960s. Developed blocs have felt sufficient need of third world goodwill to take at least some steps to implement the principle. For example the EEC introduced a Generalised System of Preferences (GSP) and has given special concessions to the African, Caribbean and Pacific countries with which it negotiated the Lomé Convention. Motives on the EEC's side include not only the political aim of securing alliances, particularly in Africa, but also commercial objectives such as long-term access for European industries to third world markets and continuation of supplies of raw materials imported from those countries.

The effect of preferences is limited by many factors. One is the low level of industrial tariffs in developed blocs vis-à-vis other developed countries which reduces the value of tariff exemptions in favour of developing countries. Another is that Europe, at least, has little interest in accepting imports from export-orientated industrialising countries in the Far East. A third is that the domestic industries most vulnerable to third world imports are precisely those which have already lost through exclusion from third world markets. For all these reasons the concessions awarded in practice have been strictly limited and almost ineffective. Indeed they have been more than offset by new restrictions under the Multi-Fibre Agreement specifically designed to hold back textile imports from the third world.

However, preferences do have the advantage in principle that they are a selective instrument. They could be distributed in proportion to need or in inverse relationship to existing export levels in order to spread benefits more widely among developing countries. They might be more practicable and effective if developed countries attached less importance to free trade among themselves.

If developed blocs could readily maintain high employment, the award of preferences in favour of developing countries might not encounter much objection. Indeed if there were no binding energy constraint, the surpluses of the strongest industrial countries rather than those of oil-exporters would become the main problem limiting world expansion. In such circumstances preferences in favour of developing countries would be virtually costless for the strongest industrial countries as a group. But that is not the present situation. Redistribution of industry now has to be achieved mainly by unilateral efforts in developing countries themselves — and there is clearly a limit to the amount of redistribution which the USA and Western Europe, with their own economies in recession, will tolerate.

3.3 Protection

One aspect of the efforts of less industrialised parts of the world to improve their share of world income has been the use of tariff or quota systems of protection as well as tax concessions and subsidies in favour of new industries. North America and Western Europe have thus been almost alone in attempting to practise free trade policies. As the balance of competitive advantage has begun to shift first to Japan and then also to some other newly-industrialising countries, enthusiasm for free trade has perceptibly waned in the old industrial countries and increased in those which now challenge them.

But although protection is generally regarded in the West as a dangerously negative policy, its role need not necessarily be that of resisting change or preventing redistribution.

When global solutions to recession are so difficult protection becomes a significant option for a constrained country or bloc because it may increase the scope for unilateral efforts to maintain or accelerate economic expansion within the protected area. Is it correct to regard protection in these circumstances as a 'beggar-my-neighbour' policy or, worse still, as an inherently destructive act reducing world income as a whole?

The logic of our argument that the level of world income is now determined by energy trends and financial constraints implies that industrial protection unaccompanied by other policy changes should have purely redistributive effects. That this is so within our model is demonstrated by a simulation of a large cut in manufactured imports to the USA, sufficient to restore 2½% a year growth of per capita spending in the early 1980s (see Table 3.4). The cut would have to be quite drastic because the USA would need a much increased surplus on trade in manufactures to finance its additional imports of oil and raw materials.

Table 3.4 Effects of US protection^a under alternative assumptions about other policies

(comparisons with base projection)

	Change in balance of trade in manufactures 1985 (\$1975 billion)			Change in growth of real spending per capita 1979-85 (% per year)		
	No change in other policies	Energy saving ^b	Increased financial deficit ^c	No change in other policies	Energy saving ^b	Increased financial deficit ^c
USA	+68	+12	+9	+1.9	+1.9	+1.9
Western Europe	-18	- 5	+3	-0.6	0.0	+0.1
Japan	-20	- 4	+1	-1.7	-0.2	-0.4
Other developed	-13	- 2	-3	-1.3	-0.2	+0.3
Latin America	- 3	0	-2	-0.1	-0.1	+0.6
Africa	- 2	+ 1	-6	+0.3	-0.4	+1.4
Asia	-10	- 3	-3	-1.0	-0.1	+0.4
Middle East	0	0	0	0.0	0.0	0.0
Centrally planned ^d	- 2	0	0	0.0	-0.2	+0.5
World total ^d	0	0	0	0.0	+0.4	+0.7

^a Reduction in US imports of manufactures so as to achieve 2.5% per year growth in US domestic spending per capita.

^b Energy saving in USA at the rate necessary to leave the US non-oil trade deficit the same as in the base projection.

^c Additional US financial deficit sufficient to leave the US non-oil trade deficit the same as in the base projection.

^d See Table 2.8.

Note:

US protection with:	Reduction in 1985 US manufactured import ratio	Effect on 1985 world oil price
no change in other policies	70%	+ 3%
energy saving	21%	- 4%
increased financial deficit	16%	+12%

Other blocs, particularly exporters of manufactures, would suffer losses in industrial trade and would cut back their spending to secure compensating savings on imports of oil and primary commodities. The world price of oil, the Middle East's trade surplus and overall trade deficits of other blocs would show little change *ex post* but there would have been a large shift of economic activity to the USA from all other developed blocs and from developing Asia.

This result does not entirely dispose of the issue since the loss to other blocs caused by US protection would arise from what may reasonably be regarded as a side-effect — namely, the rise in US oil imports. The point can be illustrated by supposing, somewhat hypothetically, that the USA took precautions in the form of extra energy saving to prevent a rise in its oil deficit, thereby eliminating the need for an improve-

ment in its non-oil trade surplus. In this case US imports of manufactures need only be cut, *ex post*, to the degree necessary to finance higher raw material imports. The only loss of income to the rest of the world would arise from the weakening of pressure on US institutions to incur financial deficits now that their income had improved.

More plausibly, suppose that instead of procuring greater energy saving, the US government were to borrow money specifically to finance higher oil imports made necessary by faster internal expansion, while still preventing deterioration of its non-oil trade balance through restriction of imports of manufactures. The world oil price would rise and there would be complex distributional effects in the rest of the world induced by this as well as by the shift in composition of US non-oil imports from manu-

Table 3.5 Effects of protection and increased financial deficits in USA and Western Europe^a

					(comparisons with base projection)
	Changes in 1985 trade balance				Change in growth of real spending per capita 1979-85
	Food and raw materials	Energy	Manufactures	Total	
	(\$1975 billion)				(% per year)
USA	- 2	-32	+ 2	-32	+1.9
Western Europe	-14	-40	+14	-39	+1.9
Japan	+ 2	- 8	+ 5	- 2	-0.5
Other developed	+ 3	+ 1	- 2	+ 3	+0.9
Latin America	+ 4	+ 6	- 4	+ 6	+1.2
Africa	- 1	+16	-10	+ 6	+2.6
Asia	+ 7	- 1	- 3	+ 3	+1.2
Middle East	+ 1	+53	0	+54	0.0
Centrally planned ^b	0	+ 3	- 1	+ 2	+0.9
World total ^b	0	0	0	0	+1.3

^a Reductions in growth of imports of manufactures in USA and Western Europe so as to achieve growth rates in per capita domestic spending equal to 2.5 and 3.0% per year respectively: additional financial deficits of USA and Western Europe sufficient to leave the non-oil trade balances of both blocs unchanged.

^b see Table 2.8, note d

Note: reductions in 1985 manufactured import ratios - USA 9%, Europe 11%; effect on 1985 world oil price + 22%.

factures to raw materials. Overall, the level of real spending in the rest of the world would rise with a larger US deficit and a higher price of oil (despite restriction of US imports of manufactures). The only bloc to lose out would be Japan which is the most vulnerable to higher oil prices and the most dependent on exports of manufactures to the US market.

This combination of protection and external borrowing could hardly be termed a 'beggar-my-neighbour' strategy since growth rates in most other blocs would actually be increased (see Table 3.4). There is in fact a very important point implicit in the result. With inflexible free trade policies, the industrial economies of North America and Western Europe not only externalise damage caused by inappropriate policies but also externalise gains from good policies. Thus with free trade any stimulus to expansion in the USA tends to 'leak out' to other countries as US imports rise. This, however beneficial to others, increases the cost and difficulty of deficit financing for any US administration which attempts to provide such a stimulus.

The generality and magnitude of the gain which could be achieved by borrowing to cover increased

oil deficits combined with protection to prevent a spill-over into non-oil trade balances is illustrated by a final simulation of the effects of such policies, introduced independently but simultaneously, in the USA and Western Europe (Table 3.5).

All blocs except Japan would gain substantially and the USA and Western Europe could achieve assumed growth targets in full. In such an environment, with adequate internal growth and general import-control mechanisms operating, it becomes more realistic to suppose that the USA and Western Europe might be willing to assist non-oil developing countries through preferences and grant aid.

Blanket prohibition of protection in developed blocs is now both unrealistic and unhelpful. The more constructive approach is to see what rules are necessary to ensure that developed countries use protection to overcome their internal recession without causing damage to others. The main rule suggested by our analysis is that they should finance any rise in their oil deficits by external borrowing. The criterion, which would need to be monitored, is that they should *not* increase their surpluses on non-oil trade.