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Report Measures Impact of Global Recession on U.S. Trade Balance

by LADB Staff

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According to the annual report of President Reagan's Council of Economic Advisers (CEA), delivered to Congress on Jan. 29, increased foreign domestic demand is necessary for sustained non-inflationary global growth. The report provides considerable detail on the causes and possible solutions to the burgeoning US trade deficit. Major improvements will derive from only the convergence of improved US economic performance and coordination of economic policies among leading industrial nations. The report also contained discussion of developing nations' economic problems and their effects on the US trade balance.

Highlights of this discussion follow: With the exception of developing countries in Asia, growth in the developing world has been weak in the 1980s. Between 1980 and 1986, annual real GNP growth in Latin America averaged 1%, less than one-fifth the average growth rate during the 1970s. Real GNP grew equally slowly in Africa over this period; in the Middle East, real GNP declined. Developing nations' sluggish economic growth has depressed US exports. In 1981, developing nations purchased 41% of all US merchandise exports. By 1985, their trade share had fallen to 34%. Recession in industrial countries during the early 1980s reduced demand for many developing nations' exports.

Exporters of primary commodities were particularly hard hit, as the shift from the inflation of the 1970s to the disinflation of the 1980s, combined with sluggish world growth, depressed prices for these products. With the appreciation of the dollar, the real burden of the dollar-denominated debt of many developing countries increased considerably.

Much of this debt was contracted at floating interest rates, making debt service payments highly sensitive to the sharp rise in nominal and real interest rates in the early 1980s. Lenders became doubtful of several developing countries' capacity to meet their obligations. Access to international capital markets was abruptly shut off. The policies of many developing countries were an important cause of the interruption of voluntary lending flows.

Overvalued exchange rates, price controls, and schemes to boost real wages by legislative fiat made the production of many goods unprofitable and reduced the international competitiveness of many developing countries. Maintenance of substantially negative real interest rates, as well as tax and regulatory policies that discouraged investment, induced capital flight instead of encouraging the inward flows of capital needed to promote more rapid development. Reliance on inefficient public enterprises to produce a wide variety of goods and services continued to be important drains on government budgets.

These drains further increased fiscal deficits in these countries while failing to engender the productive investment needed to increase their capacity to service associated external debts.
Whatever the cause, the cessation of voluntary lending forced developing countries with debt-management problems to rapidly cut back on import spending in order to reduce their borrowing needs. Between 1981 and 1983, the value of US merchandise exports to Mexico fell $9 billion, a drop of almost 50%. Exports to the rest of Latin America fell nearly 37%, or about $9 billion. In contrast, US exports to industrial countries fell 10%. Since 1983, exports to Latin America have recovered somewhat, but remain below 1980 levels.

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