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UNCLASSIFIED/NONCLASSIFIE

THE FAILURE of the Venice summit has made no visible dent in the complacency expressed in its communique. Everyone has agreed on policy co-ordination—even though only Japan is actually doing anything about it—the Louvre accord on exchange rates is in good order, West Germany is forecasting stronger growth, and we are soldiering on with the debt problem. Everything, by implication, will gradually come right.

This is not a mood which will survive an open-minded reading of the annual report of the Bank for International Settlements, which makes it plain, in clear and even witty language, that the world economic situation is deteriorating and fraught with grave risks, and points the way to safer ground.

The central bank governors, whose collective wisdom it is supposed to represent, are no doubt familiar with the report. It should be obligatory reading for any ministers or senior officials who have not yet seen it. They may find that it entails some quite painful revision of fixed ideas, but in a literary sense the task should be almost a pleasure.

The risks are so familiar that they need only be listed briefly: a disorderly collapse of the dollar, a retreat into protectionism and a cumulative world recession, and quite possibly all three.

Buck-passing

What the BIS stresses is that the present strategies, relying on monetary policy and exchange market intervention, cannot for long reduce these risks unless they are supported by policies which the market sees as likely to set the world on a path back to equilibrium. This is because there is no evidence that lower interest rates will offset the effect of declining demand in the high-exchange rate surplus countries, while intervention against the wind of market sentiment has limited credibility. It can buy time only for as long as the market believes that the time is being used constructively.

The current debt strategy is also designed to buy time, and the BIS detects "signs of fatigue" with it among both bankers and debtors. While the time has been used to some purpose in terms of debt reconstruction and the development of new policies for recovery, these measures will work only if the world market is growing at a reasonable rate. Meanwhile monetary policy in the US is partly paralysed by the risk of imposing any further burden on the debtors.

The solution, according to the central bankers, must involve an active use of fiscal policy. The surplus countries should be stimulating demand for purely selfish reasons; their economies have slowed sharply, and they face rising unemployment. The US should be taking active steps not only to cut its fiscal deficit, but to stimulate personal saving. Recent evidence suggests that the private sector in the US is doing much more to reduce that national tendency to overspend income than the Government has yet achieved.

The stress on enlightened self-interest rather than the rhetoric of co-ordination is shrewd; as the report points out, the attempt to harmonize policies often ends in misunderstanding and irritation—and, we might add, a great deal of co-ordinated buck-passing.

Starker language

The message will still be unpopular in many quarters, because fiscal rectitude is a general objective and has all too often been over-simplified to mean deficit targeting as the primary aim of policy. This can have a deadly effect when growth and revenues fall short of expectations and governments respond with deflationary measures.

As the BIS argues, one purpose of abandoning fine-tuning in a period of high inflation was to restore the cutting edge of fiscal policy. This is a pointless exercise if the weapon remains unused when it is needed.

Ministers may be tempted to see the whole report as an exercise in buck-passing by the central bankers and cling to their doctrines. They should ask themselves instead one simple question: do the facts support the BIS's gloom over growth; and if they do, how can confidence be restored?

Because the question is one of confidence, rather than of filling some measured hole in world demand, the required policy changes could prove quite modest; as the report argues, once a change of trend is visible, so that private capital flows will willingly finance the remaining imbalances, the correction can proceed, quite slowly and calmly.

There is dangerously little time, however, to initiate it. It can only be hoped that this report—and others, yet to be published, which may put the warning in starker language—will create the sense of urgency at the September IMF meetings which was so lacking in Venice.