last half of 1985 has seen some highly interesting developments pointing to a possible breakthrough in international economic co-operation. I want to talk about this tonight. First, however, to put these developments in perspective, let me sketch the economic background.

The world economy is now in its third year of recovery from the 1981-82 recession. But it is a recovery characterized profoundly by assymetry and imbalance. The place and nature of the up-turn differed markedly among the major "blocs" of the Organization for Economic Co-operation and Development (OECD) – North America, Europe and Japan. This divergence, apparent in 1983, was even more marked at the peak of the recovery, in 1984, when the US grew at nearly three times the pace of Europe and a full percentage point more than Japan. The present and projected convergence in growth rates is largely due to a slowing in US growth rather than a compensatory acceleration in the other two blocs.

The divergent growth pattern – especially marked across the Atlantic – was itself both the consequence and the cause of the serious imbalances in the OECD economy.

The most visible manifestation of divergent recovery has been the dramatic imbalance in current account positions within the OECD, as exemplified by unprecedented current account deficits in the US and growing surpluses in Japan, Germany and some other European countries. Differential growth rates accounted for perhaps a third of the US current account deficit. The other major factor (in addition to the loss of dynamic less developed country (LDC) markets) was the stunning appreciation of the dollar. The US locomotive had an extra engine.

The exchange rate misalignment itself was a function of capital rather than trade flows (an indication of how the trend to global integration of capital markets has turned the external "adjustment process" upside down). These capital flows, in turn, were at least in part attributable to another fundamental imbalance in the OECD economy – the stark contrast in fiscal policy between the US on the one hand and Europe and Japan on the other. While the cumulative swing to fiscal ease between 1982 and 1985 in the US amounted to nearly 4 per cent of its gross national product and was the primary force pulling the world economy out of the deep recession of the early 1980s, the comparable change in the direction of fiscal restriction was 2.5 per cent in Japan and over 3 per cent in Germany.

The fiscal imbalance and consequent high real interest rate was, obviously, one major cause of the dollar's rise. Yet, at a deeper level, there is a more ominous disequilibrium. The gap between US savings and US demand (including the massive budgetary deficit) has been filled by drawing on savings from abroad. A mirror image of this basic savings-investment gap exists in Japan. There, net savings are not fully absorbed by domestic demand but exported as capital flows, mainly to the US, matched by a huge and growing flood of manufactured exports. The Japanese structural savings surplus is the root cause of the enormous and growing Japanese current account surplus.

Finally – to complete the catalogue of imbalance – the recovery has produced dramatically different results in employment as betwen Europe, on the one hand, and the US and Japan on the other. The European unemployment problem goes back 15 years and is most vividly revealed by a startling statistic: