# Chapter 1
# THE INTERNATIONAL ECONOMIC ENVIRONMENT

## Canada and the international economic environment

Led by vigorous expansion in the United States, the economic recovery which had begun in 1983 spread throughout the OECD area in 1984, and began to have a positive effect on developing countries. At the same time, an absence of cost pressures on wages and commodity prices kept inflation rates under control — OECD countries experienced 4.7 per cent inflation in the 12 months ending March 31, 1985. The OECD ministerial meeting in May 1984 and the London Summit in June, noting the strengthening of recovery and better inflation performance, reaffirmed the medium-term policy framework being pursued, and stressed again deficit reduction and structural adjustment as the best paths to sustained non-inflationary growth.

Nevertheless, as the year progressed, a number of strains and imbalances began to overshadow the progress which had been made. Foremost among these was persistent and high unemployment in Europe and Canada (approximately 11 per cent in both cases as of March 31, 1985), despite two years of recovery and, in Canada at least, respectable total employment growth. In the US, the economic recovery led to a decline in unemployment (to 7.3 per cent) while in Japan unemployment remained low.

Another area of concern was the international effects of US macro-economic policies, particularly the large budget deficit, declining but still high interest rates, the US dollar exchange rate and a large and growing current account deficit. While the US' trading partners profited from the rapid increase in US imports, thereby helping their own recoveries, the surging US dollar and high interest rates restricted their macro-economic policy flexibility. This combination of circumstances limited prospects for making the recovery more secure, by basing growth more on domestic consumption and investment and less on exports. Consequently, calls for urgent action to reduce the US budget deficit, seen by many observers as the source of these imbalances, became louder and more insistent throughout the year.

Finally, it was worrying that, after two years of recovery, protectionist pressures continued to build in all the OECD economies. The rapid rise in imports to the United States subjected several sectors of the economy to severe competitive pressure. This and the growing US trade imbalance with Japan led to demands in Congress for an import surcharge and other trade restrictive legislation. While the US Administration and other governments were generally successful in resisting these pressures, little progress was made in "rolling back" previous protectionist measures, which they had undertaken to do at the OECD and elsewhere. Given the serious consequences that a surge of protectionism would have for the multilateral trading system and the benefits to be derived from a new trade round in terms of improved market access, the US, seconded by Canada and Japan, began to build momentum towards a new round of multilateral trade negotiations in the General Agreement on Tariffs and Trade (GATT).

## International financial and investment issues

Following the considerable concern in 1983 about the debt problems of developing countries, encouraging progress was made in 1984 in dealing with these problems. The case-by-case strategy developed at the 1983 Williamsburg Summit and augmented at the London Summit, involving International Monetary Fund (IMF)-supported adjustment programs coupled with the provision of debt rescheduling agreements and new financing from official and commercial sources, worked well.

Many of the Latin American economies with heavy debt burdens benefited from a rapid expansion of exports, mostly to the US, and were able to reduce their current account deficits. While the structural adjustment programs of certain debtor countries entailed import restraint and other demand-side measures which required considerable political courage to implement, those countries were able to achieve some GNP growth. However, inflationary pressures in a number of countries failed to abate during the year. The IMF was forced to suspend a number of its programs and renegotiate the performance criteria.

An important new element in the debt strategy was the willingness of the commercial banks to negotiate multi-year rescheduling arrangements with a number of Latin American debtor states. Official creditors also agreed to do so in appropriate circumstances.

While in gross terms the debt burden was lower in African states and did not pose such a threat to the international financial system, there was a growing recognition, shared by Canada, that the debt problems of these and other low income countries should not be overlooked. Despite the economic recovery in industrialized countries and the improved economic performance of some large debtor countries, the persistence of relatively high real interest rates, depressed commodity markets and protectionist pressures during 1984 indicated that debt-related problems would continue to rank high on the international economic agenda for some time.

Canada supported the case-by-case debt strategy in various multilateral meetings and participated in debt-rescheduling negotiations in an informal group of official creditors known as the Paris Club. As the debt problems of developing countries were likely to persist for some years, Canada urged its Summit partners in London to support international consideration of a stronger role for the World Bank as well as discussions in the IMF/International Bank for Reconstruction and Development (IBRD) Development Committee on the medium-