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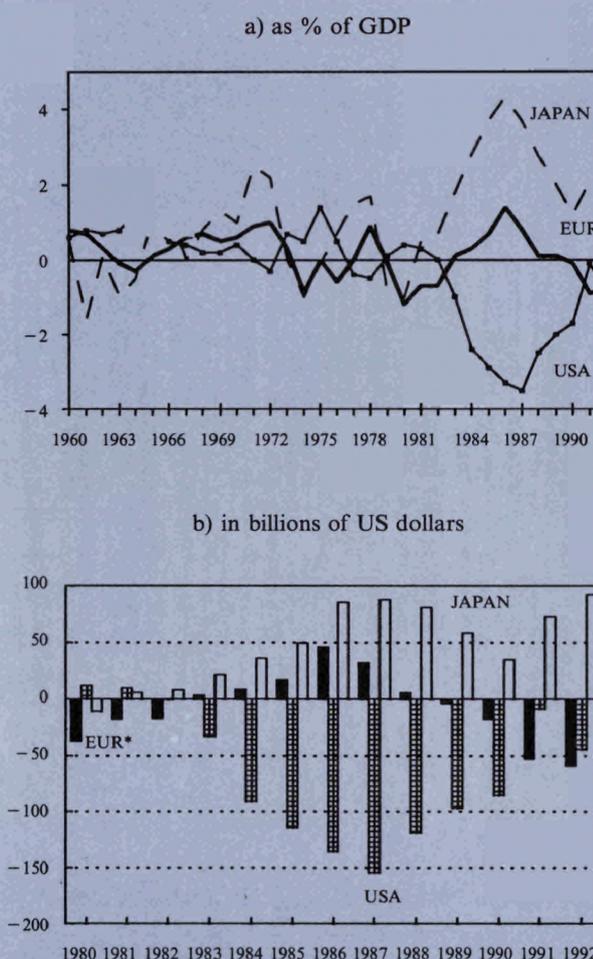


*In this number:
Recent progress in the
international adjustment process*

SUMMARY

- The balance-of-payments positions of the three main economic areas in the world changed significantly in 1991 following a reduction in external imbalances in 1988, 1989 and to a lesser extent in 1990. In the Community, the current-account deficit more than doubled compared with 1990 (\$18 billion) while, in the United States, the 1990 deficit (\$85 billion) was virtually eliminated. In Japan, the current-account surplus did not contract as in previous years but, on the contrary, showed a twofold increase compared with 1990, to stand at some \$73 billion in 1991.
- The balance-of-payments developments in 1991 were attributable in large measure to exceptional cyclical factors: the substantial transfers to the United States in connection with the Gulf War, the fall in oil prices and other commodity prices, the recession in the United States and the United Kingdom, and the substantial growth in domestic demand in Germany following unification.
- The trends underlying the balance of payments positions of the three economic areas call for certain policy orientations to be adhered to. For the Community it is important that Member States budget deficits are reduced in line with the demands of economic and monetary union. For the United States it appears that only a significant reduction of the budget deficit will permit the achievement of a durable equilibrium, whereas in the case of Japan a combination of factors, such as a relaxation of budgetary policy, an appreciation of the Yen and a strong growth of internal demand, could halt the present trend.
- If the present policies and trends are maintained, the expectation is for a further accentuation of the existing disequilibria in 1992, both in absolute terms and as a percentage of GDP.

GRAPH 1: Balance of current transactions



* Included unified Germany from 1991.
Source: Commission services, OECD.

CURRENT ACCOUNT BALANCES — RECENT DEVELOPMENTS AND OUTLOOK FOR 1992

The current-account imbalances between the main economic groupings in the world diminished significantly in 1990 and 1991 (cf. Graph 1 and Table 1). However, this was attributable on the whole to exceptional cyclical factors. In 1991 large transfers from Japan and Germany to the United States following the Gulf War and from Germany to the USSR contributed to a substantial reduction in the current-account positions of the three leading industrialized countries, notably the United States and Germany. In turn, divergent cyclical conditions assisted this development. This is why, as the effects of the specific circumstances obtaining in 1991 diminish, current-account disparities are expected to re-appear in 1992.

Main developments in 1990 and 1991

The main changes in the current-account positions of the different economic groupings in 1990 and 1991 are summarized below:

In the *Community*, the current-account surplus peaked in 1986 (\$46 billion). The situation then deteriorated before moving into deficit in 1989. The further worsening in the overall situation in 1990 (deficit of \$18 billion) and 1991 (deficit of some \$50 billion) was due essentially to the consequences of German unification.

In Germany, growing domestic demand from 1990 onwards led to an increase in imports that turned the healthy current-account surplus of \$58 billion in 1989 into a deficit of \$18 billion in 1991. This reversal in the situation was also due to the transfers made by Germany to the United States¹ and to other countries affected by the Gulf War as well as to the assistance made available by Germany to the USSR.

The change in the trade balance was a major factor in the worsening current-account position in the Community. The trade balance moved from 0 % of GDP in 1990 into a deficit equivalent to some 0.5 % of GDP in 1992². This was again due in large part to the rapid contraction in the German trade surplus from one year to the next (from \$65 billion to only \$12 billion).

An analysis of the changes in the volume of goods traded (cf. Table 2) shows that the marked resurgence in exports outside the Community as from 1988 (following sharp declines in 1986 and 1987) came to a halt in 1991. This resulted essentially from the slowdown in the world economy and, to a lesser extent, from German unification. European businesses actually sold on the new German market some of their products intended for export outside the Community.

However, these factors must not be allowed to obscure the fact that, throughout the second half of the 1980s, when export volumes fluctuated, import volumes continued to expand at a rapid rate, something which the cyclical slowdown in 1991 impeded only in part. As a result, from 1986 onwards, the external balance made a negative contribution to growth. It would seem therefore that, since 1987, the Community has been losing out on its own market to competitors. This development, which was conducive to international adjustment when the Community was in surplus, continued in 1990 and 1991.

¹ The Commission estimates that the United States received \$44 billion in transfers, with Japan providing \$13 billion and Germany \$9 billion.

² In the interests of comparability with the data for Japan and the United States, Graph 2 gives the balance in goods and services as a percentage of the GDP of the OECD area, and not the trade balance as a percentage of Community GDP.

TABLE 1: Current account balances¹

	1984	1985	1986	1987	1988	1989	1990	1991*	1992*
	(billion US\$)								
EUR**	8.3	16.9	45.9	31.8	5.7	-3.6	-17.8	-53.3	-59.6
D**	8.5	15.0	38.0	45.8	50.8	57.5	47.2	-17.6	-16.4
E	2.2	2.3	3.7	0.3	-3.7	-12.3	-18.2	-16.0	-17.9
F	-0.1	0.3	3.5	-1.6	-3.0	-3.3	-7.7	-8.1	-9.6
I	-2.7	-3.9	2.9	-1.7	-6.3	-11.6	-16.5	-15.3	-18.5
UK	-1.0	2.3	-4.6	-13.4	-38.4	-42.5	-34.7	-11.1	-15.3
USA	-90.9	-114.4	-135.8	-154.6	-119.2	-96.8	-84.9	-8.6	-44.9
Japan	35.7	49.1	85.2	87.9	80.9	58.6	35.0	72.6	92.0
PECE²	—	4.8	9.8	15.2	11.8	0.4	-5.6	-14.8	-10.0
OPEP	-5.8	2.7	-22.2	-10.6	-24.8	-0.5	23.8	-31.8	9.1
EAD³	2.9	8.0	23.1	31.8	29.3	21.4	5.9	1.7	0.2
PVD	-20.5	-19.9	-35.2	-0.4	-22.1	-11.8	-1.5	-66.1	-29.4

* Commission Services' forecasts, November 1991; for the US and Japan, historical figures for 1991.

** Unified Germany starting from 1991.

¹ National Accounts figures for the EC and for its Member States, balance of payments figures for the other countries and groups of countries.

² Countries in Central and Eastern Europe: Bulgaria, Hungary, Poland, Romania, Czechoslovakia, USSR and Yugoslavia.

³ Dynamic Asian Economics: Korea, Hong Kong, Malasia, Singapore, Taiwan, Thailand.

Sources: Commission Services, IMF, World Bank.

The situation with regard to the individual Member States' trade balances showed very little change, except in the special cases of Germany and the United Kingdom. The latter's trade balance improved in 1991 mainly under the impact of the pronounced slowdown in imports in volume terms attributable to the domestic recession.

In the *United States*, the contraction in the current-account deficit, first discernible in 1986, continued in 1990 (\$85 billion) and particularly in 1991 (\$9 billion). Even so, the distinct improvement in 1991 was the result of an exceptional factor, namely, the transfers made by the countries of the Middle East, Germany and Japan to finance the Gulf War.

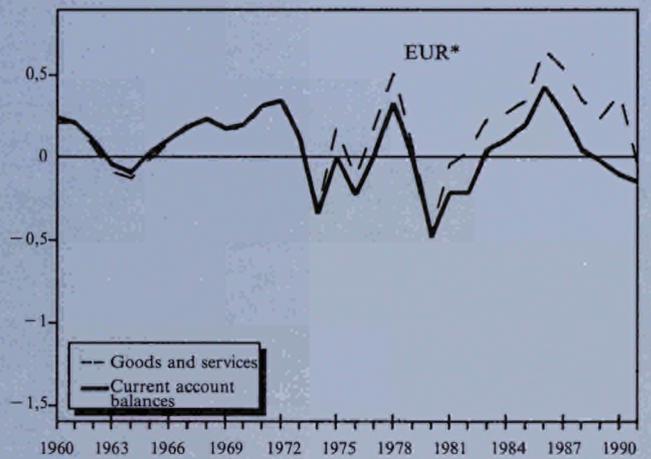
The marked decline in the US deficit and, for that matter, in the overall deficit for the industrialized countries probably also reflects the improvement in the terms of trade attributable, among other things, to the fall in oil prices and in other commodity prices.

Although recent developments in the US balance of payments are largely explained by transfers, the trade balance has continued to play a significant role in the continuing adjustment process, which began following the fall in the dollar in 1985. With the dollar's depreciation, US exports have risen sharply, particularly in 1987 and 1988, and the relative stabilization in the dollar since 1989 has had only a small adverse impact on the buoyancy of exports. Against this, the cyclical slowdown in 1990 and the recession in 1991 have led to a pronounced slowdown in the rate of imports. Overall, the contribution of the external balance to growth has remained positive since 1987, making for a steady improvement in the current-account balance.

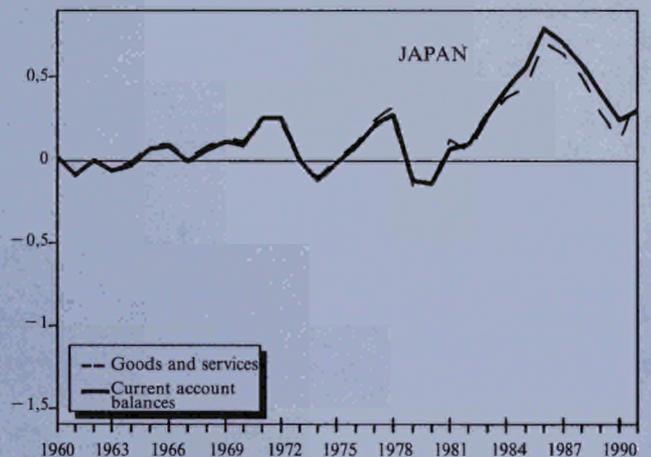
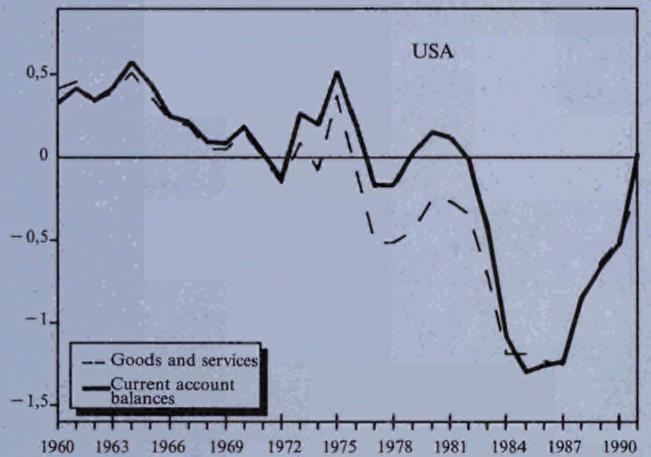
The reduction in the current-account surplus in *Japan* in 1988, 1989 and 1990 (\$35 billion) was followed by an improvement in 1991 (\$73 billion). This was reflected in the trade balance. Between 1987 and 1989, the rapid growth in imports in volume terms easily exceeded that in exports on account of the appreciation of the yen, which remained strong until 1989. In 1991, however, the rate of imports slackened.

Apart from the further appreciation of the yen in 1991 (J-curve), several factors account for the mounting Japanese surplus. First, the slowdown in imports is due largely to the contraction in imports of luxury goods (especially from Europe), the import

GRAPH 2: Goods and services and current account balances (national accounts) as a % of OECDs GDP



* Including unified Germany from 1991.



Source: Commission Services.

TABLE 2: Merchandise exports and imports (% change in real terms)

	1987	1988	1989	1990	1991*	1992*
European Community**						
Exports	-1,9	3,8	4,6	4,3	-3,0	4½
Imports	9,2	10,0	8,1	4,7	4½	5
United States						
Exports	8,3	20,7	10,6	8,1	6,6	6
Imports	3,4	4,1	3,9	1,3	-0,4	5½
Japan						
Exports	0,4	4,4	4,2	6,4	2,9	6½
Imports	9,0	16,7	7,9	6,1	3,0	6½

¹ In terms of national accounts.

* Commission forecasts, November 1991.

** Extra-Community trade; unified Germany included as from 1991.

Source: Commission Services, ESA (European system of integrated economic accounts).

volumes for other goods remaining unchanged in 1991¹. This slowdown can be explained by the diminution in the wealth effect brought about by a restrictive monetary policy aimed at reducing what was deemed to be the excessive value of financial and immovable assets in Japan. Second, the rapid growth in exports, notably to Europe, stemmed largely from the buoyant expansion of exports to the five new German Länder and to the other countries of the former socialist bloc through subsidiaries located in western Germany, the Netherlands, Belgium, etc. Lastly, as regards services, the Gulf War led to a collapse in the number of Japanese tourists travelling abroad, and this made for a notable improvement in the balance of payments on services, which, historically, had always been in deficit.

In the case of the *other economic groupings*, the current account has been marked, first of all, by the sharp deterioration recorded in the countries of Central and Eastern Europe, which, after still being in balance in 1989, showed a deficit of some \$15 billion in 1991. The break-up of the former Comecon bloc, together with the economic, administrative and political crisis in the USSR and the changeover to a market economy, led to a severe contraction in trade in that area. To differing degrees, all the Comecon countries were affected by the collapse of the Soviet economy, which was both their main export market and their main supplier.

The improvement in the external position of the EFTA countries is due mainly to the contraction in imports which took place against a background of severe recession.

The developing countries, where the situation was relatively stable in 1990, all suffered a very pronounced deterioration in their current accounts in 1991 that was due both to the contraction in trade and to the decline in net transfers. This deterioration affected not only the countries of the Middle East, which had to contend with the fall in oil prices, with the increase in imports necessary for reconstruction and with the transfer payments to be made in connection with the Gulf War, but also the industrialized countries in Asia and certain Latin American countries whose trade surpluses narrowed as a result of the sharp increase in domestic demand.

The factors at play

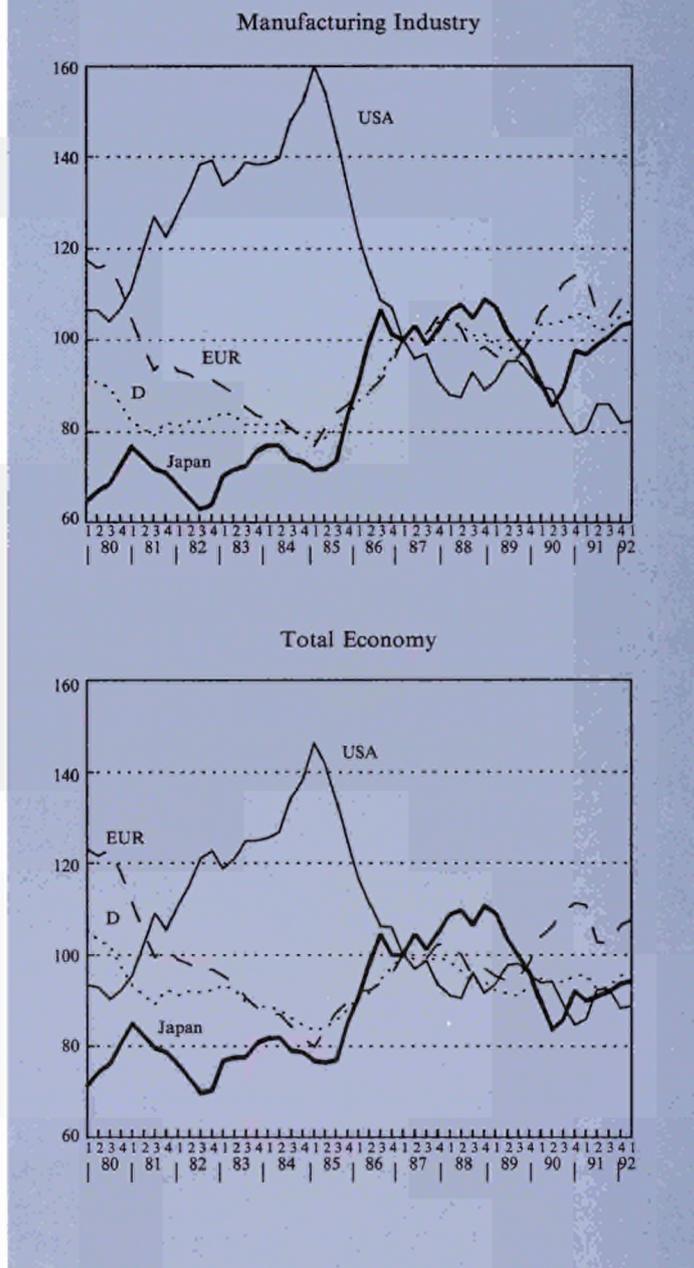
As a general rule, current-account balances are examined in the light of relative changes in the following:

- (a) the exchange rate and competitiveness;
- (b) the relative growth in domestic demand.

(a) Changes in the exchange rate and competitiveness

Graph 3 shows that the external competitiveness of the different groupings has remained stable in recent years compared with the situation in the period 1980-87. This serves to underscore the important role played by international cooperation in stabilizing exchange rates (Louvre Accord of 22 February 1987). In the case of the Community, external competitiveness measured

GRAPH 3: Real effective exchange rates (unit labor costs; 1987 Q1 = 100)



in terms of unit wage costs in the economy as a whole has deteriorated since the beginning of 1989 by 12 %. Measured in terms of unit wage costs for manufacturing alone, the figure is 13 %. The main factor in the deterioration has been the appreciation of the Community currencies, with changes in wage costs accounting for only 3 % as regards the economy as a whole and for 4 % as regards manufacturing. The deterioration in Community competitiveness between 1989 and 1990 doubtless contributed to the the Community's worsening external position.

In the United States, the real exchange rate remains on a downward trend. As compared with the period covered by the Louvre Accord, the aggregate depreciation amounts to 18 % when measured in terms of the unit wage costs in manufacturing and 12 % if we take the economy as a whole. In 1990 and 1991 the aggregate figure was 13 % and 8 % respectively. The decline in real effective exchange rates during that period certainly stimulated the recent marked expansion in net exports.

¹ Bank of Japan — Recent balance-of-payments developments in Japan, November 1991.

TABLE 3: Growth differential vis-à-vis trading partners

	1984	1985	1986	1987	1988	1989	1990	1991*	1992*
(a) Growth in domestic demand vis-à-vis trading partners³									
European Community¹	-3,5	-1,7	0,1	-0,3	0,0	-0,2	1,0	1,2	0,0
United States	5,8	0,6	-0,2	-1,1	-1,9	-1,8	-2,2	-1,9	-0,4
Japan	-1,9	0,8	0,2	1,6	3,5	2,8	4,4	3,7	1,7
(b) Contribution of the external balance to GDP growth⁴									
European Community²	0,5	0,1	-1,1	-1,2	-0,9	-0,4	-0,1	0,1	-0,1
United States	-1,5	-0,3	-0,3	0,3	1,0	0,5	0,4	0,5	0,0
Japan	0,8	0,9	-1,0	-0,9	-1,2	-1,1	-0,2	0,9	-0,2

* Commission forecasts, November 1991.

¹ Germany excluding the five new Länder.

² United Germany as from 1991.

³ For the Community vis-à-vis its eleven major trading partners.

⁴ % change in the balance on goods and services as a proportion of GDP in the previous year.

Source: Commission departments.

In Japan, competitiveness followed a contrasting trend. The distinct improvement in 1989 and 1990 was offset by the ensuing appreciation of the yen. All in all, the currency's real effective exchange rate is not all that different from what it was at the time of the Louvre Accord.

The relative improvement in Japanese competitiveness between 1988 and 1990 would seem to explain the renewed increase in the current-account surplus in 1991, in the same way as the contraction in the surplus in the years 1988-90 was doubtless influenced by the sharp deterioration in competitiveness between 1985 and 1988. The time-lag between changes in Japanese competitiveness and changes in the current-account position could be explained by the coexistence of two opposing J-curves producing the same effect: the first, the result of the earlier depreciation in the yen, represents the marked increase in net exports while the second, the result of the appreciation of the yen, represents the improvement in the nominal balance that took place before the volume effects caused by that increase made themselves felt.

(b) Relative growth in demand

The relative changes in demand seem to have played an important part in the changes recorded in the external positions of the Community and the United States. By contrast, in Japan, the wide growth differentials in domestic demand compared with the situation in its major trading partners have been offset by other factors (price competitiveness and productive capacity).

In 1990/91 the growth in domestic demand in the *Community* exceeded that in its trading partners although, in both cases, growth rates were much the same between 1986 and 1989 (Table 3). It should also be noted that the figures given do not include the five new German Länder even though domestic demand there has expanded very rapidly over the last two years. If this fact were taken into account, the growth differential in domestic demand in the Community compared with the situation in its trading partners would probably be more pronounced.

TABLE 4: Saving/investment equilibrium in the main sectors (as % of GDP/GNP)

		Gross capital formation			Current account	Statistical discrepancy	Gross national saving		
		Private	Public	Total			Total	Private	Public
European Community	1981-89	17,4	2,8	20,2	+0,3	+0,2	20,3	21,2	-0,9
	1990	18,5	3,0	21,5	-0,3	+0,2	21,0	21,1	-0,1
	1991*	17,8	3,0	20,8	-0,4 (1)	+0,2	20,2	20,8	-0,6
United States	1981-89	15,8	2,2	18,0	-2,0	-0,2	16,2	16,8	-0,6
	1990	13,5	2,5	16,0	-1,6	0,0	14,4	14,7	-0,3
	1991*	11,9	2,5	14,4	+0,1	+0,2	14,3	15,0	-0,7
Japan	1981-89	23,1	6,2	29,3	+2,6	+0,1	31,8	26,7	5,1
	1990	28,1	5,1	33,2	+1,3	0,0	34,5	26,1	8,4
	1991*	26,5	6,2	32,7	+1,5	-0,4	34,6	24,8	9,8

* Commission forecasts, November 1991.

¹ Germany excluding the five new Länder.

Source: Commission departments.

In the *United States*, the maintenance of a negative growth differential in domestic demand facilitated a continuation of the adjustment process. The cyclical slowdown in 1990 and the recession in 1991 paved the way for a decline in the growth rate of imports to 2% and 0% respectively from the level of 4% recorded between 1987 and 1989.

In the case of *Japan*, domestic demand remained buoyant and was much higher than in its trading partners, but it did not lead to the expected contraction in the surplus in 1991, contrary to what had happened in 1990. Alongside the gains in competitiveness recorded between 1988 and 1990, two other factors may help to account for this development, viz. the improvement in Japan's relative position in terms of productive capacities and the wealth effect mentioned above, which led to a fall in imports of luxury goods.

Mismatch between saving and investment

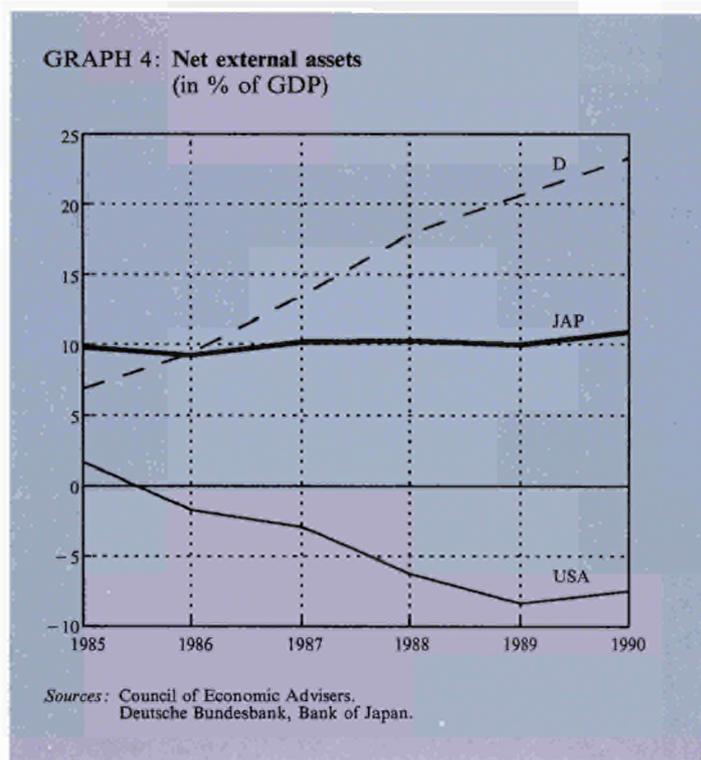
In order to better assess balance-of-payments developments, trends in saving and investment in the three main economic areas should be examined (cf. Table 4).

In the *Community*, there was a slight fall in investment as a proportion of GDP in 1991. This was attributable to private investment since public investment remained unchanged.

Nevertheless, investment has remained relatively high compared with its average level during the 1980s. The share of total saving has fallen and is equal to the average recorded in the 1980s (20.2%). This development is due not to private saving, which has shown little, if any change, but to public saving, which has contracted sharply, giving rise to an overall external financing requirement. This albeit small imbalance shows that the level of saving within the Community is clearly inadequate to meet the increased needs for investment attributable to German unification. Traditionally, Germany was in a position to 'export' surplus saving to the rest of the Community and to countries outside the Community. At the moment, this surplus saving is being absorbed by domestic needs, thereby accentuating the global shortfall in saving. What is more, the Community, as a grouping of developed countries, should normally be a source of lending for the developing countries.

In the *United States*, gross fixed capital formation as a proportion of GNP has continued to decline, with private investment falling from an average of 15.8% in the 1980s to 11.9% in 1991. This steady erosion of investment, even if it can be explained in part by the cyclical weakness of the economy, may give rise to concern regarding the structure of the US economy and its future export capability. In this respect, the situation in the United States is in marked contrast to that in the Community and especially in Japan. In the United States, saving rose between 1987 and 1989 before falling back in 1990 and 1991 as a result of the economic slowdown. In particular, public saving became negative again in 1990-91 after expanding in 1989. However, with saving declining less rapidly than investment, the mismatch between the two has become much less pronounced.

In *Japan*, investment as a proportion of GDP has climbed steadily since 1986 and stood at 32.7% in 1991. The very high level of investment is bound to lead to an eventual improvement in the structural competitiveness of the Japanese economy and hence in its potential to generate current-account surpluses. The saving ratio continued its upward trend, but at a less rapid rate. The overall situation does, however, mask the contrasting movements in private saving, which is tending to decline, and public saving, which is increasing all the time. The Japanese saving surplus is making a substantial contribution to the financing of investment



projects abroad and hence to easing constraints associated with the relative scarcity of long-term capital.

Outlook for 1992

The forecasts made at the end of last year suggest that the international adjustment process might soon come to an end as the effects of the exceptional factors at play in 1991 are no longer felt (see Table 1).

The current-account balance in the *Community* is expected to show a slight deterioration both in value terms and as a percentage of GNP during 1992. This will be attributable to two main factors. First, the external performance of Germany is set to stabilize at its 1991 level. The country's exports are expected to expand once again as a result of more dynamic growth on the world market and a slowdown in domestic demand. Imports should rise somewhat, notably as final demand increases following unification. Second, the deficit in the United Kingdom is expected to widen again as the economy recovers.

In the *United States*, the current account will probably show a further sharp deterioration in 1992 mainly as a result of the non-recurrence of the exceptional transfers received in 1991 and, to a lesser extent, a further increase in imports engendered by the upturn in growth. Even so, notwithstanding the worsening in the situation since 1991, the external position expressed both in value terms and as a percentage of GNP is set to show an improvement compared with 1990 and earlier.

Turning to the current-account position in *Japan*, a further increase in the surplus can be expected in 1992, both in value terms and as a proportion of GNP. The parallel development predicted for changes in export and import volumes will automatically add to the trade surplus, which should, in any event, benefit from the cessation of transfers in connection with the Gulf War. By contrast, the deficit on services will probably widen further as Japanese tourists begin to venture abroad again. The net overall effect is expected to be equivalent to the amount of transfers made in 1991 in connection with the Gulf War.

STATISTICAL DISCREPANCY IN THE WORLD CURRENT-ACCOUNT BALANCE

By definition, the current account for the world economy should be in balance. Even so, it is currently showing a large deficit. Until the end of the 1970s, the deficit was of modest proportions and had no major implications for economic analysis. However, in the early 1980s, the statistical discrepancy widened very sharply.

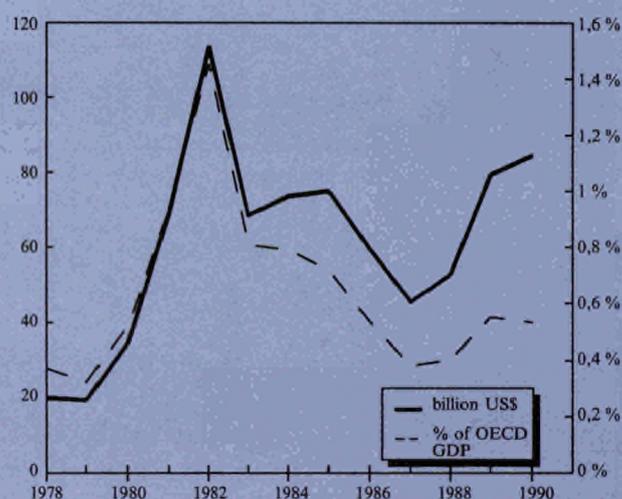
The present discrepancy in the world current-account balance may have a quite significant impact on economic analysis. After touching \$114 billion, it fell to \$45 billion in 1987 before growing once again (Graph 5). In 1990 the debits in the world current-account balance exceeded the credits by \$84 billion, producing an unexplained deficit equivalent to some 0.5 % of GNP in the OECD area.¹

Since the statistical discrepancy is not shown in the national accounts of the individual countries, this means that global economic growth is being underestimated. A further implication for analysis that is particularly important when it comes to assessing the international adjustment process is that global saving too appears to be underestimated and that the analyses of the behaviour of the financial market are less precise. Lastly, it is clear that the extent of the pressures on a country's reserves and exchange rate is not independent of the analysis made by operators of the present and anticipated balance in that country's external accounts.

The size and trend of the statistical discrepancy since 1979 have been determined mainly by changes in 'investment income', 'transport' and 'official transfers' (cf. Table 5). However, while the discrepancies due to 'transport' and 'official transfers' have remained virtually constant over time, the discrepancy in 'investment income' has followed an

uninterrupted exponential trend since 1979. Moreover, since 1987, the deficit on 'other investment income', which includes all portfolio investments, has alone exceeded the overall statistical discrepancy.² It should be noted that the deterioration in the world current-account deficit has been accompanied by a sharp increase in the surplus on capital movements.

GRAPH 5: World current account deficit (statistical discrepancy)



Source: EC Commission, FMI, OECD, World Bank.

TABLE 5: Breakdown of the World Current Account

(bn US\$)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Trade balance	18.0	20.3	28.2	24.9	-2.1	3.8	10.6	7.1	3.4	23.5	32.3	12.6	18.1
Services Balance ¹	-24.8	-29.1	-49.1	-80.5	-100.9	-69.9	-78.3	-76.2	-54.4	-63.6	-76.9	-83.6	-83.9
Shipment	-24.3	-27.4	-32.0	-34.6	-33.8	-28.6	-28.7	-24.5	-25.5	-30.9	-32.7	-33.4	-35.0
Other transportation	-1.8	-1.2	-3.4	-6.1	-4.4	-3.3	-2.3	-0.7	1.3	0.2	-0.4	-1.7	-1.4
Travel	-0.3	-1.9	-0.9	0.8	1.5	5.8	2.6	3.0	3.3	0.6	-4.6	-2.0	-3.7
Reinvested earnings on direct investment	6.6	11.8	11.2	10.4	7.5	14.7	18.5	15.6	16.8	27.7	25.1	38.0	51.0
Other direct investment income	-4.6	0.1	-7.5	-10.7	-11.3	-10.2	-11.7	-9.2	-1.8	-2.6	3.5	-2.5	-4.4
Other investment income	-6.1	-7.2	-11.2	-22.4	-36.0	-34.8	-47.0	-53.2	-55.6	-68.9	-74.4	-87.1	-97.6
Other official goods, services, and income	-4.0	-9.7	-11.5	-18.4	-24.1	-19.2	-18.5	-13.0	-10.5	-8.8	-11.1	-14.5	-12.7
Other private goods, services, and income	9.6	6.5	6.2	0.5	-0.4	5.7	8.8	5.8	17.6	19.1	17.7	19.6	19.9
Private Transfers	4.4	5.8	7.0	5.7	3.9	9.4	10.6	9.5	10.2	14.1	12.6	14.9	16.7
Official Transfers ¹	-17.5	-16.3	-20.7	-19.0	-14.8	-11.8	-16.4	-15.3	-18.8	-19.4	-20.8	-23.1	-35.1
Current Balance ¹	-19.9	-19.3	-34.5	-69.0	-113.9	-68.5	-73.5	-74.9	-59.6	-45.4	-52.8	-79.2	-84.2

* Source: International Monetary Fund, Balance of Payments Statistics, Vol. 36 (1985), Vol. 41 (1990), and Vol. 42 (1991) Part. 2.

¹ Data for International Organizations are included for the years 1983-1989.

Note: Figures come from Vol. 36 for the years 1978-1982, from Vol. 41 for 1983, and from Vol. 42 for the years 1984-1990.

TABLE 6: Current Account Balances
Selected IMF Adjustments to Discrepancies 1990
(bn US\$)

	Industrial countries	Developing countries
1. Unadjusted Current Account Balance	-95.8	3.8
2. Exceptional Financing	—	5.0
3. Adjustment, Total	10.6	45.8
Reinvested earnings on Direct Investment	-21.8	-3.5
Other Direct Investment Income	2.8	-2.2
Other Investment Income	35.0	32.0
Official Unrequited Transfers	-5.4	19.5
4. Adjusted Current Account Balance	-85.2	54.6

Source: I.M.F., Balance of Payments Statistics Yearbook.

A detailed analysis carried out in 1987 by the International Monetary Fund³ attributed the changes in investment income to the increase in the velocity of capital movements made possible by the greater degree of financial integration and the development of offshore financial centres. This development was further accentuated by the increase in interest rates, which has boosted the value of such income. A major role has also been played by capital flows associated with drug trafficking.

It is extremely difficult to give a geographical breakdown of the world discrepancy. Since the discrepancy is made up primarily of interest flows, it is necessary to know the structure of claims and debts, together with the corresponding interest payments, and to track developments over time accurately. Table 6 shows clearly that the bulk of the discrepancy in 1990, for which the IMF managed to give a geographical breakdown, was attributed to the developing countries. After adjustment, the IMF arrived at a surplus of \$54.6 billion, and not \$3.8 billion, for the developing countries. For the industrialized countries, the deficit fell only slightly (from \$96 billion to \$85 billion).

(1) In view of the fluctuations in the dollar's exchange rate, it would be more correct to express the statistical discrepancy in relative terms. Since no figures are available for world GNP, the GNP of the OECD area has been used.

(2) Only the International Monetary Fund provides detailed statistics for each item. Unfortunately, these statistics are available only up to 1990.

(3) International Monetary Fund, World Current Account Discrepancy, September 1987, Final Report of the Working Party on the Statistical Discrepancy in World Current Account Balances.

The developments described above call for the following observations.

First, the slight worsening in the Community's current-account position, stemming among other things from the growth differential vis-à-vis its main trading partners, is not in itself particularly worrying. However, in view of the investment needs in the Community and the scarcity of long-term capital at international level, it seems that saving should be stepped up in the medium term. For this reason, it is important that the budget deficits in individual Member States should be eliminated in line with the requirements of economic and monetary union.

Second, it would seem that the improvement in the external position of the United States is at an end. The headroom for improving price competitiveness afforded by a decline in the dollar is very small. The low level of investment could jeopardize the growth potential and lead to a deterioration in the United States' position as a net borrower, thereby making more difficult any return to a more balanced payments situation in the medium term. Admittedly, the monetary policy of low interest rates that has been pursued for over a year should permit a recovery in investment but it might also give a strong boost to

private consumption, which has a steadily rising import content. It would seem, therefore, that only a significant reduction in the budget deficit would create the conditions for a sustainable equilibrium.

Lastly, there is little chance that the Japanese surplus will be absorbed in the short run, even if the yen continues its appreciation against the currencies of its main trading partners. The competitiveness of the Japanese economy is essentially structural: high levels of investment have facilitated the development of technologically very advanced products that have few rivals elsewhere in the world. Furthermore the present Japanese policy mix, characterised by an expansive monetary policy and by a very tight fiscal policy (in 1991 the general government ran a surplus equivalent to 1.8 % of GNP), would not point to any immediate absorption of its external disequilibrium. In so far as the Japanese surplus helps to finance development and assistance for the major geopolitical and economic transformations which Europe is undergoing at the moment, it is an additional factor of flexibility in the world economy.

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