ECONOMIC PROSPECTS FOR THE THIRD WORLD

The 1980s and beyond: industrialisation and growth

The 1987 Forecasts

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1. RETURN TO DEVELOPMENT AND INTERVENTIONISM

The 1987 reports remain puzzled by the 1986 performance of many of the countries and the economic variables which they examine, and this colours their analysis. The fall in the oil price stimulated developed countries' growth even less than they expected, but growth in the developing was higher. Commodity prices remain depressed, and the debt problem appears intractable through economic means. They respond by trying to understand the long-term path and structure of development, by looking further forward into the medium term and putting less weight on short-term forecasting, and by suggesting a more active and necessary role for intervention in economies. Trying to understand what happened in 1986 is accepted as necessary to test comprehension of the forces shaping the future, but some of the reports carry the historical analysis much further back and well away from conventional macro-economics.

The World Bank[1] looks particularly at the process of industrialisation and the role of trade. UNCTAD considers the role of technological change, and UNIDO, which has always taken a more industrial and structural approach, makes a general 'shift of emphasis' to industrial development as distinct from macro-economic concerns, and includes a detailed analysis of 28 manufacturing sectors. The UN includes a historical section on why some developing countries have grown particularly rapidly in the last few years.

Several of the forecasters raise the other question that this Conference is particularly concerned with of the impact of the depression, and in particular of the debt problems of both medium and low income countries, on the prospects for future development and on its pattern. The continued worsening of most indicators of the debt problem and the changes in attitude by some of the most important actors, have led to much greater

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[1] The principal publications are listed in the appendix, with definitions of the groups and assumptions used.

readiness to consider a variety of new ways of breaking the cycle of non-payment, with or without formal refinancing which leads merely to the accrual of higher liabilities, which cannot be paid. Studies are also now starting to show the effects of prolonged failure to resolve it.

Perhaps for similar reasons of frustration and impatience at the prolonged failure of the world economy to revive on its own, many of the organisations see other opportunities for intervention: the IMF (p. 17) accepts that 'the ultimate objective of macroeconomic policy in each industrial country remains to achieve sustained output growth and a lasting reduction in unemployment while maintaining reasonable price stability', placing this in a medium term context, and that 'policies in each of the major countries have an important role to play in sustaining non-inflationary output growth' (p. 21). This approach has been formalised in the adoption by the IMF and the Venice Summit of the use of 'indicators' to monitor trends and a general commitment to 'develop medium-term objectives and projections for its economy' (summit communique). This marks a return to belief that governments are not powerless in the face of unsatisfactory economic outcomes.

The BIS explicitly notes this change in approach: 'the idea of attempting to use fiscal policy to support economic growth seems to be gaining acceptance' (p. 5). On monetary policy, it comments that 'the existence of this stimulative effect [of lower real interest rates] seems to be taken more or less for granted, although very little empirical evidence has been gathered to support it'. The BIS welcomes the change: the US ending of 'benign neglect' of its exchange rate is 'encouraging' (p. 194). While scrupulously avoiding Keynesian references to what happens in the long run, it notes that 'in the end, market forces would establish a new pattern of current-account balances. But when? With what risk of causing another round of exchange rate misalignments? What lasting damage would in the meantime be inflicted on the free trading system? And what price would have to be paid in terms of output losses and financial upheavals for this market-led adjustment?'

Several forecasters call for policy action, with international coordination to restore growth in the international economy, including the BIS (p. 197), the World Bank (p. 22), the OECD, UNCTAD, and the UN (p. 8). The tension noted in last year's summary of the reports between intervention and efficiency seems to have been resolved, at least at the international level, in favour of coordination. In addition to domestic macroeconomic and international intervention, UNCTAD also sees a role for government in technological change, echoing trends seen in some industrial countries. But the major area where intervention is now accepted, and last year's attitudes have changed is in how to resolve the debt problem.

2. DEBT

The cost of servicing existing debt, relative to exports or GDP, continued to rise in 1986 (contrary to last year's forecasts) because of the fall in export prices. The IMF (p. 16 and table 1) draws particular attention to the different ratios for different types of country. It again forecasts a fall from the first year of the forecast period, but only a small and gradual one. The other forecasters agree that the situation continued to deteriorate, except for the World Bank which sees 'little improvement' (p. 19) by noting the small fall in the ratio of interest payments to exports (from 10.8 to 10.7) although it also emphasises the continued rise in amortisation ratios. The improvement that did occur in 1986 was, the forecasters agree, the result of the fall in interest rates, combined with the reduction in the rate of decline of commodity prices.

For both the short-term and the medium, the IMF, UNCTAD, and the World Bank see small falls in the ratio of amortisation and interest payments to exports and GDP, but the ratios remain extremely high. Interest payments alone (even if satisfactory roll-over arrangements could be assumed) continue to take up to 15 % of exports until the early 1990s for the most indebted, and almost a fifth for the Latin American countries, and about 1.5% (up to 3-4 % for the worst affected, table 1 and UN, p. 96) of GDP would need to be devoted to interest payments. As recently as 1980, the ratio of interest payments to exports was only 6.7% for all developing countries; it was 13% for those who are now considered 'highly indebted' and 18% for the Latin American. Relative to GDP, even for the most indebted, ratios were generally under 2%.

The poor prospects for the debt ratios are partly because of the expectations for prices and volume of exports which are discussed below, but the forecasters suggest that the falls in interest rates which brought the only improvement that was observed in 1986 have now come to an end. Although the 1986 outturn was lower than some expected (a LIBOR of 6.5 % corresponding to 3.6% real measured against US prices), little further change is now expected (table 5), and the IMF and World Bank in the medium term, and the OECD in the short, see some possibility of a rise. The real rates being forecast thus are in some cases above, and in all cases close to, the rates of growth expected for output. This explains the failure of the cost ratios of servicing debt to decline even in the medium term.

The forecasters, as they did in the 1986 publications, agree that for at least some countries the present situation is not sustainable (although UNIDO, pp. I,10-11, suggests that the long-run development prospects of the debtor countries and the resilience shown by the international financial system should limit creditors' concern over the crisis). In addition to the evidence from the figures for debt servicing, the UN like UNIDO quotes the early 1987 suspensions of payments by Brazil and Ecuador as examples of the unsustainability, and others have accumulated since then. The World Bank continues to emphasise adjustment policies for the most indebted, although it also mentions some of the new approaches that have been tried (pp.

Table 1
Debt Servicing (percentages)

	World Bank		IMF					UNCTAD	
	1986	1995 high/low	1986	1987	1988	1989	1991	1986	1987
Debt Service % GNP	5.3	4.1/4.5	5.3	5.1	4.9				
Debt Service % Exports	22.3	13/ 18	22.4	20.7	20.0				
Interest % GNP	2.5	1.4/1.7	2.7	2.5	2.3				
Interest % Exports	10.7	4.6/6.9	11.3	10.1	9.5				
Capital Importing Countries									
Debt Service % GNP			5.8	5.5	5.4				
Debt Service % Exports			24.7	22.6	21.7	20.7	19.4	27.7	27.0
Interest % GNP			2.9	2.7	2.6				
Interest % Exports			12.4	11.0	10.3	9.8	8.6	14.3	13.0
Exporters of Manufactures									
Debt Service % GNP	3.4	3.1/3.4	4.1	3.5	3.2				
Debt Service % Exports	12.7	10/ 13	12.6	10.0	9.0				
Interest % GNP	1.7	1.2/1.5	1.7	1.5	1.3				
Interest % Exports	6.4	3.9/5.6	5.2	4.2	3.8				
Highly Indebted									
Debt Service % GNP	7.1	6.0/7.3	6.8	6.7	6.5				
Debt Service % Exports	37.6	26/ 37	37.6	36.2	35.1	33.8	32.6		
Interest % GNP	4.3	1.8/2.7	3.9	3.6	3.4				
Interest % Exports	22.8	8.0/13.5	21.3	19.7	18.4	17.2	15.3		
Africa[a]									
Debt Service % GNP	6.6	4.2/4.3	6.8	6.5	7.1				
Debt Service % Exports	30.4	17/ 21	30.2	27	29.9	28.4	27.4		
Interest % GNP	2.6	1.5/1.4	2.8	2.8	2.9				
Interest % Exports	12.1	6.1/7.0	12.7	11.9	12.0	11.3	10.1		
Asia									
Debt Service % GNP			3.8	3.6	3.4				
Debt Service % Exports			13.0	11.2	10.6	9.8	8.9		
Interest % GNP			1.7	1.6	1.5				
Interest % Exports			6.0	5.0	4.8	4.4	3.9		
Western Hemisphere									
Debt Service % GNP			6.2	6.1	5.6				
Debt Service % Exports			45.6	44.9	40.9	40.0	38.9		
Interest % GNP			3.8	3.4	3.2				
Interest % Exports			27.8	25.3	23.1	21.3	19.0		

(a) Sub-Saharan only for World Bank

19-21), particularly in equity swaps, and describes the processes of debt-restructuring.

The other organisations discuss the need for new solutions to the debt problem. The UN (p. 97) and the IMF (p. 24) note that the high ratios forecast for debt-servicing costs even on present debts make new inflows of credits potentially risky, while the prospects for non-debt-creating inflows (discussed in the next section) are poor. The forecasters must therefore look for ways of reducing the burden of servicing existing debt. Most of the forecasters accept as a framework the 'menu' approach that has become generally supported in 1987. This implicitly moves away from the nominally 'case-by-case' approach of 1982 to 1986, which claimed to treat each debtor and its problems as distinct (although there were clearly common approaches) and effectively accepts that there is a general problem for the debtors and for the world economy, arising from international as well as domestic policy causes. It continues to reject an open role for general solutions (although the now generally accepted division of potential solutions between those suitable for middle income commercial bank borrowers and those for low income official debtors suggests some common elements within each of these groups). This is partly because the present circumstances of the debtors are different, and therefore the possibilities open to them vary, but also because creditors have different interests and constraints (the BIS notes explicitly the differences among banks according to the extent of their exposure and their regulatory position, p. 119). This approach also means a shift away from the principle of absolute equality of treatment among creditors (which was an asymmetry in the case-by-case approach) and therefore can permit more scope for bilateral debtor-creditor arrangements.[2] This

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[2] A recent study of Latin American debt has found that 'debtor governments have achieved better results when they have taken the initiative and put forward clear, specific proposals to the creditors. Though not all their suggestions have been accepted, a clear initial position...can serve as a basis for the package to be adopted.' Stephany Griffith-

can (in the case of official debts) include policy bargaining on both sides, whether formally in the form of the debt-development or debt-environment swaps that have occurred in the last few months, or through more informal pressures.

The UN has the most detailed recommendations. It notes the possibilities of repurchasing debt by the governments or debt-equity swaps, although it considers these are 'limited' by the foreign exchange available to the government and the prospects for direct investment. It suggests for the commercial bank debts that 'some version of partial debt forgiveness appears to be necessary, given the outlook for trade and non-debt creating financial flows' (p. 100). It also noted the proposal by Japanese banks for refinancing. UNCTAD cites the same existing approaches, and its report was published recently enough to include the increased provisions against bad debts made by some industrial country banks, but comments that they were continuing 'to require debtors to service their debts in full' (p. viii). The IMF comments that 'dealing effectively with the debt issue will require greater convergence between' the market value and the contractual value of existing debt, where these have diverged, without proposing how this should be done (p. 24). In early September Brazil proposed that part of the write off be transferred to its obligations, converting some of its debt to bonds with a value below that of the debt they replaced. At the time this proposal was rejected. It is significant that both it and an Argentine proposal in the same week included freezing interest rates, in the Argentine case at 'historic levels', apparently 2-3% real (Financial Times, 11 September 1987). Like the forecasters discussed here, the debtors apparently no longer believe that market interest rates will decline to the level implicitly assumed at the time the loans were made, and therefore wish assurance both that they will not rise and impose

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Jones, 'Debt Crisis Management in the early 1980s', to be published in Development Policy Review, 6, 1, 1988, March. This observation is useful background to examining the reaction to the latest Brazilian initiative.

unexpected costs and that what they pay will remain below the present high levels.

The UN pointed out that the preponderance of official debt to the poorest countries gave governments more direct opportunity to intervene, and suggested cutting interest payments, possibly with IMF subsidisation, and reducing the amortisation burden through permitting local currency repayment or writing off some loans.[3] It included debt to the multilateral lenders in its recommendation (p. 96) because it is such a high proportion of the total (3/4 of debt-servicing by 13 of the low-income African countries in 1986-88). Since the UN report, the principle of lower interest rates for such countries has been accepted by the Venice summit; the UK government has also proposed relief for low-income African countries, and Canada has announced such relief.

It is notable that one of the arguments given explicitly by the UN for formal debt relief is that 'both lenders and borrowers have an interest in "clearing the books" of the developing countries' debt in its present form', while UNCTAD (p. viii) comments that '"debt fatigue" is spreading among all the parties involved, and is leading them willy-nilly towards adjusting the terms on old debt'(p. vii). The writing down of debt by major lending banks, the initiatives for retrospective terms adjustment, and the demand for writing down and fixing the interest rates and maturities of debt by some debtors all show that many of the participants in the debt crisis are no longer prepared to continue the rounds of renegotiations and partial rearrangements of debt that have characterised the last 5 years. The costs of uncertainty and of renegotiation to the participants (including the possibility that the servicing costs change with renegotiation) have become unacceptable to private

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[3] This follows the precedent of retrospective terms adjustment in bilateral official lending in which loans were converted to grants.

and bilateral lenders and to debtors. This is in addition to the more serious costs discussed in section 9.

3. NEW FINANCING

The figures for the past and forecasts for the short and medium term show even fewer grounds for optimism than a year ago. The IMF expects official transfers to remain almost flat. The figure for official loans rises this year, but is then expected to fall back, and the real growth expected in official finance over the following years is under 5%; the forecast last year was 9%. The IMF still expects budgetary constraints on bilateral lending to restrain this. Although private investment is expected to rise slightly, total private flows are only expected to rise at 1 - 2 % throughout the period. It explains the change only by commenting that 'Banks appear to be simply unprepared to lend to a range of countries whose prospects for resuming normal debt service in the near future are considered remote. Countries with a stronger financial position appear to be determined to reduce their vulnerability to future difficulties by minimizing future borrowing and, in a number of cases, by seeking to repay part of their maturing liabilities.' (p. 16). (It does not explain why it believed in different responses in 1986.) This unwillingness on both sides to continue with the 1970s pattern of use of bank loans for general finance is one important reason for the effective failure of the 'Baker initiative' of 1985, and for all the forecasters' concentration this year on finding public sector solutions for the debt problem. The IMF notes that although World Bank lending to the 15 countries included in it has been 'substantially in line', private lending over the planned period of 1986-88 is projected at $5 billion, compared to the target of $24 billion (p. 77).

The medium term forecasts by the World Bank are also much more pessimistic than last year in total, although the forecasts for official flows have been raised. It expects transfers to rise by 3.5 to 4 % in real terms, in line with or above the growth of industrial country output, with official lending rising at almost 10% in the 'high' case and over 8% even in the 'low' (although most of these loans do not appear to be going either to Sub-Saharan Africa or the most highly indebted countries, p. 33). Private investment, however, is now expected to rise only slowly (at 4% or 2% a year), and net bank lending to fall, in nominal terms, to $11 billion (about the 1973 level) even under 'high' performance, and to 0 under 'low'. The high expectations for official lending probably make it in aggregate substantially more optimistic than the IMF, although even under its forecasts, the deficit of developing countries can only grow at 4 or 5%. The UN supports a large increase in official financing over the medium term, but does not state its expectations. It notes the difficulties that there have been in increasing the capital of various multilateral lenders in recent years, and discusses in particular the possibilities of co-financing, either between multilateral and bilateral official lenders or between official and private. It finds that this has had little net effect on mobilisation of resources (p. 87).

UNCTAD concentrates on assessing the consequences of low external finance rather than the prospects for the future, but this choice of topics suggests that it is not optimistic. As was noted in the introduction, the organisations appear to be turning increasingly to an approach of defining what it is needed, and the policies suitable for moving in that direction, rather than attempting to forecast what would happen in the absence of policies.

4. PROSPECTS FOR THE DEVELOPED COUNTRIES

Output

Although expectations about the favourable effects of the fall in the oil price in early 1986 were revised down through that year, the outcome proved even lower than expected, and was about half a point lower even than the 1985 growth, at about 2.4%. The forecasters had expected at least a small increase. It was also unusually similar in the US, Japan, and the major

Table 2
Industrial countries

percentages

	IMF	UN	UNCTAD	World Bank High	World Bank Low	UNIDO	OECD
1987							
World Output(GNP/GDP)	2.7	3.2	2.7				
Industrial countries	2.3	2.6	2.3				2.3
United States	2.3	2.8	2.4			2.7	2.5
Japan	2.7	2.6	2.5			3.0	2.
Germany	1.9	2.0				2.8	1.5
European countries	2.2	2.4	2.2			2.6	2.
Unemployment rate	7.9	8.1					8.3
Import volume	4.3	4.5	4.0				2.3
US import volume	1.8						.3
Export volume	3.4	3.5	3.4				3.3
World Trade	3.3	3.0	3.0				2.3
Trade in manufactures							3.5
1988							
World Output(GNP/GDP)	3.1	3.7					
Industrial countries	2.8	3.0					2.3
United States	3.1	3.5				3.1	2.8
Japan	3.3	3.0				3.3	2.
Germany	2	2.5				2.4	2.
European countries	2.2	2.4				2.6	2.
Unemployment rate	7.8	8.0					8.3
Import volume	4.6						4.
US import volume	4						3.3
Export volume	4.6						4.
World Trade	4.4	4.0					4.
Trade in manufactures		4.0					4.5

Medium term

	IMF 1988-91	IMF 1989-95 potential	World Bank 1986-95 High	World Bank 1986-95 Low
World Output(GNP/GDP)				
Industrial countries	2.9		4.3	2.5
United States		2.6		
Japan		3.1		
Germany		2.2		

European countries. In 1987, the forecasts now do not expect any great improvement on average (although last year, all expected some acceleration as the delayed effects of the oil price came through), but the performance becomes more differentiated, with Japan growing faster than average and the European countries, except the UK, more slowly (table 2). (The IMF forecasts for the Annual Meetings, published too late to be fully included here, have little change in aggregate, but with Japan even higher, and Germany lower.) The IMF has lowered its medium term forecast slightly, and it is now below 3% (even below pre-1986, high oil price expectations); this is, however, now an improvement on the current performance. The World Bank has the same figures for 1987 to 1995 including both end years as it had for 1986 to 1995 last year, implicitly a lower forecast on the 'high' assumption because it now excludes the lower than average 1986.

The UN expects some improvement in performance in both 1987 and 1988, although small, and expects better performance for the US than for Japan, a difference which can have important implications for different groups of developing countries. UNIDO has a similar overall forecast, but with Japan growing fastest. OECD has a much lower forecast for Japan for both 1987 and 1988. These divergences are unusual, and indicate the continuing uncertainty about how countries are responding to the new pattern of exchange rates and also about why performance in 1986 diverged so sharply from expectations.

The improvement in OECD terms of trade that was expected did happen in 1986, and although there was as a result fall in OPEC imports, this was also expected. What did not happen was the expected rise in OECD domestic demand because of the income effect, while OECD imports rose more than expected, so that the large negative shift in net exports was the major change in factors influencing output. The three related explanations which the forecasters offer for this are the failure of the fall in the world oil price to be fully passed through to consumers in the industrial countries, limiting the income effect; the failure of governments to respond to the potential to relax their fiscal stance (and some tightened it by increasing fuel taxes); the uncertainty and offsetting shocks created by the large changes in exchange rates (although the 18% fall in the effective rate of the dollar should have strengthened the effect of the fall in the nominal oil price on incomes in industrial countries excluding the US).

In contrast to fears last year that import demand in the industrial countries would respond more slowly than output, thus delaying the transmission of the effect of the oil price fall from the developed to the developing countries, the volume of imports rose by 8-9%, an unusually high ratio to output growth. As the fall in import prices caused a smaller than expected fall in prices to consumers (partly because some countries increased energy taxes, partly because importers of both oil and other commodities took some of the gain in profits), this difference from expectations cannot be explained within the forecasters' models: it appears that either their income or their price elasticities must have been much too low, or the lags assumed too short, or there was some other impulse increasing the share of imports in final demand. Savings actually rose in some countries, so that more than expected of the increase in income was saved. The IMF has a full description of where the errors in its forecasts arose, although it does not offer a full explanations. It does suggest that uncertainties about the duration and extent of the price changes could have caused all to react cautiously, but while this would explain the rise in savings, it does not explain that in imports. In the forecasts presented last April and given here, it suggests that some of these changes will come through later than expected, but the September revisions suggest that it now has less confidence in this.

The UN and UNCTAD also note the failure of importers to pass through the price changes in full, UNCTAD particularly comments on the increase in profits, and that this did not lead to any increase in investment. Its explanation (pp. xii, xviii) implies that private investors did not expect a surge in growth because of the oil price change; they were apparently right (and of course to some extent such forecasts by potential investors are self-fulfilling) but again there is no explanation for this failure of confidence. It does note that governments could have been 'more supportive', and suggests that until fiscal policy is altered confidence will not revive. The BIS, while suggesting large exchange rate changes as a negative factor, attempts a psychological explanation: 'a tendency for people not to trust their luck...A decade and a half's experience of frequent external shocks has served to strengthen this "wait and see" attitude (pp. 3-4). The OECD (p. viii) apparently agrees: an appreciating exchange rate (in Germany and Japan) has lowered investment intentions for normal reasons, expectations of reduced net exports (although growth in these countries was even worse than expected) without a corresponding 'surge of investment plans in depreciating countries', which apparently suffer from uncertainty, or expectations that the changes will be reversed (p. viii). Depreciation also leads to expectations of higher inflation, which can in turn reduce investment (although the reverse effect from appreciation does not apparently raise it).

It is evident that none of the forecasters can suggest an endogenous, modellable or forecastable, explanation for the very low (they no longer argue that it is merely slow) response to the changes of early 1986 which old-fashioned relationships would call favourable. Their forecasts therefore apparently simply accept that 'something' has happened to damp responses, and carry the pessimism forward. The pessimism extends to government policy, with the UN explicitly assuming a more restrictive fiscal policy in the industrial countries (p. 27). It does not apparently consider that any endogenous forces are likely to lead to an improved outcome: only 'major initiatives to radically change policies in the industrial countries' can 'allow improvements in the standard of living of a large number of developing countries' (p. 27). Given the view of the forecasters considered here that the behaviour of private economic agents, consumers and investors, has been either inexplicable or the result of fundamental changes in confidence and therefore behaviour, so that the economic system has stabilised at a very low rate of growth, starting from a low level of output relative to potential, it is not surprising that they have turned more to looking at policies to overcome or offset this unfortunate behaviour than to forecasting it. Whether the fundamental change has taken place, or economists have merely, once again, underestimated lags, or missed some new obstacle to growth is a serious uncertainty underlying this year's forecasts. But another uncertainty is whether the revived confidence in the efficacy of fiscal and other stimuli is more justified than the pessimism about the possibility of demand management which has been common since the late 1970s is well-founded. It may well be, as many would argue, that the pessimism has always been wrong, but none of the forecasters suggests why those who were sceptical in the past should now be less so (except in desperation that nothing else seems to work). The third related uncertainty, of course, is whether the governments that have failed to take reflationary measures (or have deflated) in the last 18 months, some of which have not yet been reconverted to demand management, will now reflate.

Trade

One result of the lower outturns and forecasts for output should be substantially lower forecasts for the industrial countries' trade, and in particular their imports from the rest of the world, because of the direct relationship between trade and output, because higher unemployment (under the 1987 forecasts the decline that was expected in the industrial countries last year no longer occurs) reduces the need for trade to meet unexpected shortages or surges in demand, and because of the potential danger from higher protectionist demands. The large changes in unit values, exchange rates, relative prices, and composition probably help to explain the divergences that still appear in the estimates of trade performance in 1986, but the major movements are clear: the industrial countries increased their imports exceptionally rapidly, at around 8%, while their exports rose less than 3%. As the UN (p. 51) points out, most of the growth in world trade was in oil, which it considers transitory; manufactures (unusually) grew less than the total, at perhaps 2%. Within this, however, there was a contrast between manufactures from the industrial countries, growing perhaps 1-2%, while those from developing countries may have grown 7%. In terms of geographical distribution, it was US imports and Asian exports that grew most rapidly, while exports by African countries changed little, and by Latin American apparently fell.

A rise in oil trade is not surprising given the price changes, but it would be surprising given the normal lags in trade and the longer lags in use of energy products if it were entirely transitory. The poor performance of other products, when output growth, although slow was still growing more than 2% is more surprising. All the forecasters expect the rise in US imports last year to be followed by stagnation this year so that total industrial country import volume slows this year, and then recovers slightly in 1988. Trade in manufactures is expected to recover, and with it industrial countries' export volume. By 1988, there is no further change in their net trade balance, and therefore no further impulse to demand in the rest of the world. Forecasts are not given for the medium term.

5. TRADE BY DEVELOPING COUNTRIES

Export volume growth in total is expected to fall sharply in 1987 (table 3) because the exceptional factors of oil and manufactures by the Asian countries are no longer present (the IMF expects in addition a reversal of the build-up of oil stocks), while other areas show little change (primary volume stops falling, although it is expected to grow very slowly). The forecasts for 1988 suggest a surprisingly even performance, with primary product exports growing as fast as manufactures (both are 6% on the IMF forecast). The IMF expects non-fuel exports to be able to continue to grow roughly twice as fast as

Table 3
Trade by Developing Countries

percentages

	IMF	UN	UNCTAD	World Bank High	World Bank Low	OECD
			1987			
Export volume	2.8	2.0	1.7			
Africa	1.6					
Asia	6.1					
Western Hemisphere	.1					
Import volume	-.2	0	-2.5			
Africa	-4.0					
Asia	4.9					
Western Hemisphere	-.8					
Oil exporters	-15.2		-9.9			-15
Non-oil developing	3.1		1.1			6
Indebted Dev.ctrs.	1.7					
Terms of Trade	-2.7	-6.3	-2.6			
			1988			
Export volume	5.8					
Africa	3.9					
Asia	6.3					
Western Hemisphere	7.2					
Import volume	2.9					
Africa	1.6					
Asia	4.3					
Western Hemisphere	2.4					
Oil exporters	-1.7					- 1
Non-oil developing	3.8					5
Indebted dev.ctrs.	3.5					
Terms of Trade	-1.0					

Medium Term

	IMF 1988-91	World Bank 1986-95 High	World Bank 1986-95 Low
Export volume	5.4	7.3	3.6
Africa	3.4	3.9[a]	2.0[a]
Asia	6.1		
Western Hemisphere	5.1		
Import volume	5.4	7.8	4.1
Africa	3		
Asia	6.4		
Western Hemisphere	5.4		
Indebted dev.ctrs.	5.4	7.5	4.4

(a) Sub-Saharan

their markets, with primary exports only lagging 'somewhat because of lower income elasticity (p.71) This would be an unusually close relationship.

The developing countries are expected to continue to increase their share of trade in manufactures, as they apparently did in 1986, but OECD expects this to come to an end in 1988. In terms of the detailed country-by-country analysis of imports of manufactures which they use (p. 139), the 1986 improvement followed two years of declining share. In 1988, their export growth is expected to be similar to that of the industrial countries. This would be a major change from recent years, but not from the more distant past. The developing countries have doubled their share in trade in manufactures over the last 15 years (table 4). The rise from 1970 to 1975 was small; then in the late 1970s and early 1980s they rose faster than the average by large, and increasing, margins. This table, which does not disaggregate markets by importing country, as in the OECD analysis, nevertheless confirms the OECD finding of a slowing and possibly a reduction in the last few years. Most of the increase thus occurred in only a very brief period. Asia's share of trade in manufactures began its rise in the early 1970s, and continued through the 1970s, but appears to have leveled in the 1980s, both relative to the world and to other developing countries, until its exceptional performance (at least in volume) in 1986. While it was gaining share, this appears to have been principally at the expense of the industrial countries: although there was a small fall in Africa's share, Latin America maintained its share. The UN points out the increasing concentration of exports of manufactures, with 80% of developing country exports of manufactures accounted for by 10 countries (p. 5). It was these countries which increased their exports rapidly in 1986. The 29 countries in table 4 accounted for only 62% of exports of manufactures by developing countries in 1970, rising to 85% in the early 1980s. Four countries now account for almost two thirds of the total: South Korea, Hong Kong, Taiwan, and Singapore. The rise in the aggregate share has effectively been

Table 4
Shares of selected countries in total LDC manufactured exports

	1970	1975	1980	1981	1982	1983	1984	1985	1969-73	1974-78	1979-83
					percentages						
Newly industrialising countries											
Argentina	1.94	2.07	1.91	1.75	1.49	1.50			2.18	2.36	1.80
Brazil	2.86	6.36	6.31	7.03	5.95	5.57			3.43	5.75	6.31
Hong Kong	18.24	16.13	17.33	17.49	17.88	16.30	15.27	17.77	18.50	16.10	17.04
India	7.13	5.26	4.17	4.22	4.22	4.22			6.73	5.57	4.38
Mexico	3.28	2.45	1.63	1.88	2.26	2.22	2.46		2.60	2.36	2.02
Singapore	3.24	6.15	8.43	8.53	8.63	8.00	7.92	7.92	8.14	5.86	8.17
South Korea	5.04	11.88	13.08	15.01	15.95	16.23	16.42	18.34	6.75	13.87	15.15
Taiwan	8.87	12.38	16.66	17.48	17.51	17.98	18.48	19.79	11.17	14.35	17.17
Total	50.60	62.68	69.52	73.39	73.89	72.02			59.50	66.22	72.04
New NICs											
Colombia	.51	.88	.74	.70	.66	.33	.33		.79	.88	.64
Malaysia	.83	1.89	2.30	2.00	2.42	2.76			.89	1.62	2.34
Peru	2.48	.98	1.52	1.22	1.28	1.00			1.99	1.23	1.37
Thailand	.91	1.28	2.21	2.17	2.28	2.00	1.81	2.09	1.08	1.51	2.12
Zimbabwe		1.05	.63	.49	.46	.38	.34		.17	.82	.50
Total	4.73	6.08	7.40	6.58	7.10	6.47			4.92	6.06	6.97
Other middle income countries											
Chile	.39	.37	.39	.25	.30	.30	.30	.30	.35	.38	.30
Costa Rica	.32	.32	.26	.24	.19	.20	.20	.20	.30	.29	.22
Egypt	1.62	1.29	.30	.23	.21	.29	.28	.26	1.53	.97	.29
Ivory Coast	.23	.38	.33	.20	.20	.17	.20	.20	.24	.27	.23
Kenya	.40	.37	.11	.11	.09	.10	.10	.10	.33	.27	.08
Morocco	.40	.56	.55	.56	.63	.62	.59	.60	.50	.53	.59
Pakistan	1.77	1.64	1.20	1.28	1.22	1.50	1.13	.11	1.96	1.49	1.31
Philippines	.52	.76	1.11	1.12	1.01	.94	1.00	1.00	.64	.94	1.08
Senegal	.23	.20	.06	.08	.10	.10	.10	.10	.21	.14	.08
Sri Lanka	.04	.06	.19	.20	.24	.24	.26	.25	.06	.08	.20
Tunisia	.28	.87	.78	.72	.72	.64	.50	.50	.31	.64	.71
Uruguay	.36	.32	.38	.31	.29	.24	.22	.20	.29	.37	.33
Venezuela	.37	.28	.66	.58	.60	.60	.60	.60	.37	.30	.59
Total	6.93	7.42	6.32	5.88	5.80	5.94	5.48	4.42	7.09	6.67	6.01
Listed countries by areas											
Africa	3.16	4.72	2.76	2.39	2.41	2.30	2.11		3.29	3.64	2.48
Asia	46.59	57.43	66.68	69.50	71.36	70.17			55.92	61.39	68.96
Latin America	12.51	14.03	13.80	13.96	13.02	11.96			12.30	13.92	13.58
Total of above	62.26	76.18	83.24	85.85	86.79	84.43			71.51	78.95	85.02
UN area totals											
Africa	19.54	9.27	5.83	4.47	4.71	4.40	3.65	3.85	17.69	8.08	5.17
Asia	52.40	62.79	71.79	73.51	74.39	74.40	75.09	76.99	56.80	65.94	72.82
Latin America	26.19	23.43	20.31	18.72	17.11	18.86	18.79	19.66	24.53	22.81	19.24
LDC Exports of Mfrs.											
Non-oil % total	7.03	7.42	10.03	11.18	11.49	12.70	14.01	12.78			
Value,$ million	12816	34899	104756	115112	112889	125635	149983	140834			

Source: UN, Monthly Bulletin of Statistics, May issues; UNCTAD, Handbook of International Trade and Development Statistics; IMF, International Financial Statistics; national sources.

the change in the shares of South Korea, Taiwan, Singapore, and Brazil.

By areas, Asia is expected to continue to grow most rapidly, and Africa most slowly, although the differences (as usual) are expected to fall in the future (table 3). The main improvement in exports in 1986 and therefore in trade balances went to those without severe debt problems, so that financing difficulties continue to depress the level of imports, and under the forecast for financing must be expected to continue to do so. Imports by the developing countries are expected to remain extremely sluggish to the end of 1988, permitting further strengthening of balances after the falls in terms of trade of the last two years (IMF, p. 72), although they are then expected to grow much more rapidly, in line with exports on the IMF forecast, rather faster (consistent with its more optimistic financing forecast) under the World Bank forecast. It is interesting that the IMF is now quoting and emphasising the usefulness of the index of the purchasing power of exports (changes in volume times changes in terms of trade) which has in the past been most used by UNCTAD. OECD expects particularly rapid import growth in the NICs, not only because of their relatively strong balances, but because of US protectionist pressures.[4] As their imports are largely of manufactures, this is an additional reason for expecting fast growth in trade in manufactures.

The greater pressure from the US is not explained by much higher increases in imports from these countries in 1986. The UN points out that in 1986 there was a 'significant diversion of exports of these countries from the United States', It estimates that the total rise in value of their exports which it puts at 13 % as split among the US and Europe (8% each), and (principally) Japan (24%). This change (and the US pressures)

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[4] The OECD puts it more delicately: 'Various pressures, not least from some OECD countries, are likely to encourage Asian countries to import more, in order to protect their own export markets.' (p. 53)

makes the change expected by some forecasters to significantly faster growth by Japan an important one for permitting continued rapid export expansion. There have been in the last 6 months the first moves by Japanese multinationals towards increasing their use of overseas subsidiaries to supply their home markets (in the past, unlike US companies, they have mainly supplied other industrial countries). The changes in exchange rates may be producing 'normal' changes in trade patterns, as well as the state of shock found by some of the forecasters.

6. PRICES AND EXCHANGE RATES

Inflation in the industrial countries has proved to be more moderate than was expected, and the IMF has projected this to continue into the future, with a small rise in 1988 as the effects of the falls in oil and other commodity prices cease to operate as strongly (table 5). For the medium term, the underlying rate is now expected to be slightly lower than was thought last year. The World Bank has reduced its medium term expectations much more, so that they are now in line with those of the IMF. In spite of the large reduction since last year (from 7% to 3.3% for the pessimistic path), it does not appear to draw any implications for output or policy. In contrast, the OECD has a slightly higher forecast, because of the same external forces and little further change in the underlying rate, but all the forecasts are now in agreement at around 3% from now to 1995. If private agents accept these forecasts, this should promote a sharp change in expectations about both the rate and the variability of inflation, with possible effects on confidence. It does, however, have less favourable effects on debtors, especially combined with the still high real interest rates, as the principal force which reduced debt burdens in the past has been removed.

The forecasters have all assumed that the dollar remains unchanged from a date suitable for their forecasts, end-February for the IMF, the first quarter for UNCTAD, and end-April for the OECD. The continuing fall in the dollar thus puts the OECD assumption below the IMF, and the early September figure was about 5% below the OECD assumption. If this is maintained, the fall on average in 1987 will not have been much less than in 1986 (about 14-15% in stead of 18%), and a further fall of 5% would follow arithmetically in 1988. The forecasts for both internal industrial country inflation and the trade prices must therefore be subject to some uncertainty, with the risks being in the direction of higher inflation. The forecasters do not, however, appear as concerned as they were in the early 1980s about the existence of large misalignments of exchange rates, and in consequence the potential for large changes in the future.

The price of manufactured exports rose sharply (by 20% in dollar terms) in 1986, for industrial country exporters, but preliminary estimates for developing countries suggest a much smaller rise. This is clearly one reason for their better performance, particularly in non-US markets. The forecasts assume that the dollar devaluation continues to give a high dollar rate of rise in 1987, but (given their dollar forecasts) that this falls back to approximately the industrial country inflation rate in the future.

The forecasters still differ in their explanations of how the oil price has been determined, and in their expectations for the future as discussed in the texts. The differences in table 5 for 1987 and other years for which they give numbers are, however, largely the result of the dates the forecasts were made. The IMF considers the 1986 fall the result of a deliberate attempt to regain share of the world oil market, not the result of a weakening of the OPEC cartel because of the collapse of expectations about the price and about potential demand as growth faltered. After a period of confusion, the OPEC countries have reinstated output agreements, although there is doubt about how well they are operating. With the help of some rise in demand, the IMF expects the real oil price to be maintained constant in real terms. UNCTAD thinks that there are still considerable uncertainties, because of the possibility

Table 5
Prices, Interest rates, and Exchange rates

percentages

	IMF	UN	UNCTAD	World Bank High	World Bank Low	OECD
1987						
GNP deflator indus.	2.9	3				3.3
Change US$ effective rate	- 9.3		-8.6			-13.4
6 month LIBOR	6.5		6.4			6.9
6 month LIBOR, deflated by US GNP deflator	3.6					3.3
Prices US$						
World export prices	9.2	10.6				11.3
Manufactured exports	11.0					12.3
Oil price	8.7	23.2	23.0			30.4
Oil price, real	- 2.1					16.1
Primary products	- 4.9		> 0			- 4.9
Food	- 1.5					- 1.2
Tropical beverages	-21.6					-11.8
Agric. Raw Mats.	6.4					0
Minerals, ores, metals	3.7					- 1.2
1988						
GNP deflator indus.	3.4	3.5				3.5
Change US$ effective rate	0					- 1.4
6 month LIBOR	6.5					7.6
6 month LIBROR, deflated by US GNP deflator	3.0					3.5
Prices US$						
World export prices	3.8					2.8
Manufactured exports	3.1					2.8
Oil price	3.1	0				0
Oil price, real	0					- 2.7
Primary products	5.1					1.0
Food	7.8					1.2
Tropical beverages	5.2					0
Agric. Raw Mats.	3.4					2.1
Mineral, ores, mtls	3.8					1.2

Medium Term

	IMF 1988-91	World Bank 1986-95 High	World Bank 1986-95 Low
GNP deflator indus.	3.2	2.7	3.3
6 month LIBOR	6.7	6.5	9.4
6 month LIBOR defl.US GNP deflator	3.4	2.5	4.6
Price US$			
Manufactured Exports	3.0		
Oil price	3.0		
Oil price, real	0		
Primary products	4.7		

of weak demand, the attitudes of non-OPEC suppliers, the strength of the cartel, and the 'lack of a long-term price strategy' (p. xi). It thinks that more rapid growth would contribute to a more stable price, and it argues again that oil price stability would promote growth. Given the uncertainties, it assumes no change from the first quarter of 1987. The UN also adopts an unchanged nominal forecast, which, it suggests, implies a rise of 6% a year in real terms (principally in early 1987). The OECD, starting from an even higher base ($18 instead of $17) again assumes no change. The World Bank does not give a forecast in the World Development Report, but its forecast that the imports of the oil exporters will expand more rapidly than their exports suggests that it expects a real rise in the price.

The problem of explaining the long and deep fall in other commodity prices, and then forecasting them continues to require much discussion in the forecasts. The IMF has published a separate study[5] and the World Bank prepared a major unpublished report. As was evident in last year's forecasts, the fall in prices in 1986 is exceptional by the standards of any period (in the IMF report, in the last century). A small recovery in nominal terms, and even smaller in real is forecast. The UN discusses the long-term changes in demand and supply trends, implying but not quantifying unfavourable prospects. UNCTAD sees a possible improvement in nominal terms, but a continued fall in real terms. Although it no longer gives aggregate forecasts, it does give a commodity by commodity discussion of prospects (pp. 164-168). UNIDO, however, expects some firming in prices (p. 9) because supply is being reduced by industrial country producers who are leaving the market, although it agrees that markets remain stagnant.

Even with the fall of almost 50% in the price of oil, the oil importing developing countries had no gain in their terms of

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[5] IMF, Primary Commodities Market Developments and Outlook, May 1987.

trade in 1986, and oil and non-oil countries taken together had a fall of perhaps 20%. The low level of export prices at the beginning of 1987 ensures a further fall this year, and the forecasts vary only marginally around 0 for the future, with the further fall in the dollar since most were prepared probably making the lower end more likely. The forecasters clearly do not understand why the falls in oil or other commodity prices happened, so that the prospects are also extremely uncertain. Although this could of course mean that there will be an equally unexpected rise, the explanations and trends which they have identified in supply and demand are not encouraging. This suggests that any improvement in the trade prospects of the primary exporting developing countries will have to come from structural changes in their exports, and economies, towards manufactures, in spite of the fact that there are only a few examples of countries that have been able to become substantial exporters of manufactures, and the limited evidence that it may be becoming more difficult for developing countries to displace industrial in exports of manufactures.

7. DEVELOPING COUNTRIES' OUTPUT

The unexpectedly rapid growth of output in 1986 was widespread among non-oil developing countries, including exporters of primary and manufactured goods, Latin America (4%) as well as Asia (6%), and high and low income (China is estimated at 7%). The exceptions were the heavily indebted, whether to the commercial banks or official lenders (3%), and the major oil exporters (0), helping to explain why Africa was relatively depressed (2.5%). Both the successes and the failures are difficult to reconcile with the view of last year's forecasts that the major positive effect from the impact of oil prices on developing countries would be from the developed countries through their imports on to the exports of suitable developing countries. Some exporters of manufactures may have gained in this way, and the IMF attributes the good performance of primary exporters on average to that of Brazil, and that to domestic expansionary policies. But other primary product exporters also had an improvement which 'primarily reflected domestic developments and occurred notwithstanding somewhat mixed external circumstances' (p. 65). The UN notes that it was the 'large and diversified economies' that did best: Bangladesh, Brazil, China, India and Pakistan (p. 3); within Latin America the average performance was also improved by Argentina, Chile and Colombia. It shows that size has persistently been associated with better performance in recent years: 'Large domestic markets and the more diverse natural and human resource base have, in general, provided the policy makers in the larger developing countries with more room for manoeuvre' (p. 34). China's performance, however, was in fact a decline from the previous year. UNIDO includes an analysis of how the slow down (in industrial production from 18% to 9%) was distributed among sectors, and in particular the role of domestic consumer demand (pp. 136-147) and the reforms of domestic and international economic policy.

The World Bank appears to explain good performance from the income effects of the terms of trade improvement of the manufacturers (p. 16), but this does not explain the improvement of some major primary producers. Its chart of developing and industrial country growth (p. 15) shows a divergence (even a 'delinking') between rates of growth similar to that in 1974 or 1977 when the developing countries did not follow the industrial into recession. It is clear that, unlike those periods, this was in spite of low external financing not because of its availability. The relative importance of domestic and external explanations for good performance is an important uncertainty for the forecast period, and the more important size and diversification of the economies are as explanations, the more weight must be attached to prospects for structural change in the medium term.

The oil exporters are expected to remain depressed in the short term, although the World Bank expects a sharp recovery in the early 1990s. For other developing countries, a slowing is

Table 6

Output in developing countries

percentages

	IMF	UN	UNCTAD	World Bank High	World Bank Low	UNIDO
1987						
All developing countries	3.0	2.7	2.9			
Oil exporting	-0.3					
Non-oil developing	4.0					
Exporters of Manuf.	5.0					
Exporters of Primary Products	3.9					
With debt servicing problems	3.1					
Without debt problems	4.4					
Western Hemisphere	3.3	3.3	3.6			3.6
Africa	2.5	-0.2				
Sub-Saharan Africa	3.2		0.7			2.7
Asia	5.1					
South		) 4.7	5.0			4.0
East		)	5.3			5.9
China		7.0	7.5			
1988						
All developing countries	4.1	3.8				
Oil exporting	2.1					
Non-oil developing	4.6					
Exporters of Manuf.	5.1					
Exporters of Primary Products	4.7					
With debt servicing problems	4.2					
Without debt problems	4.7					
Western Hemisphere	4.7	3.7				4.0
Africa	3.2	2.4				
Sub-Saharan Africa	3.7					3.4
Asia	5.4					
South		)5.0				4.7
East		)				5.2
China		7.0				

Medium Term

	IMF 1988-91	World Bank 1986-95 High	World Bank 1986-95 Low
Output	4.7	5.9	3.9
Oil producers		4.4	3.6
Exporters of Manuf.		6.9	4.3
With debt serv. prob.	4.4	5.4	3.5
Without debt serv. pb.	5		
Western Hemisphere	4.8		
Africa	3.2		
Sub-Saharan Africa		4	3.2
Asia	5.6		

expected in 1987, with only a small recovery in 1988, before they can resume growth at about 5% at the end of the 1980s and into the 1990s. The IMF attributes this to the terms of trade loss in 1986 and lower export demand in 1987. This applies broadly to all categories; although the reductions are slightly smaller for Asia and the exporters of manufacturers than for Latin America and primary exporters, the differences are trivial. Only Africa maintains a roughly constant slow growth, which implies a small recovery from last year to about 3% in the medium term. The UN and UNIDO are less optimistic for Latin America in 1988. The UN believes that as Brazil slows, the performance will be constrained by what it is possible for the major debtors to achieve, and UNIDO agrees that the performance in 1986 represents the maximum possible, with the risks of constraint from debt problems suggesting that its forecasts may be over-optimistic. All agree on the better than average performance of Asia and worse than average by Africa, but are less optimistic for Africa than the IMF. UNIDO cites the poor prospects for primary and the 'shallow industrial base' (p. 97) of the region. In the longer term, it thinks policies are now tackling these problems. UNIDO discusses the area forecasts both in terms of individual countries and through its forecasts for 28 industries (Chapters II and IV), and builds up a nationally based set of forecasts from these.

The World Bank is particularly optimistic for exporters of manufactures, in line with its trade forecasts, suggesting that it is now more pessimistic than it has been in the past about exporters of primary products. The differences in expected performance are explained principally by the impact of the industrial countries' demand and financing on different types of economy, and it notes that the African countries are likely to grow slowly under any circumstances of industrial country (or domestic) policy because of their dependence on primary products. It clearly does not see any immediate prospects of structural change altering this pattern. The most indebted countries are in a similar position, as it argues that many have already taken substantial adjustment measures, and the forecast is probably more pessimistic than the IMF because the 'Low' assumptions correspond more closely to those in the IMF 'scenario'.

8. THE MEDIUM TERM

Although there are even fewer quantitative forecasts for the medium term than in the past, all the forecasters except the OECD give extensive space in the text to discussing the nature of the changes which they expect. The UN considers that there is still a risk of 'dramatic changes' in the next three years because serious imbalances remain (p.1). For this reason, the imbalances and therefore the risks should be reduced (a further example of the current presumption that all big changes are harmful), and this can only be done through government coordination, although it recognises that there is a serious (and 'uncharted') difficulty because 'the Governments that command decisive influence over the world economy find themselves in dispute over the economic policies...to adopt' (p. 8). The BIS, while agreeing that large changes are more likely than not, draws the opposite conclusion: 'There have been other dilemmas in the past which resolved themselves faster than anybody had dared to imagine at the time, for example the "dollar gap" in the early 1950s.' (p. 7) (It does not, however, suggest that because the imbalances can settle themselves they must necessarily be left to do so.)

The medium term projected in these forecasts for the developed countries is of unspectacular but, by current depressed standards, acceptable growth (except for the European countries) and low inflation, probably with roughly constant terms of trade with the developing countries. This does not suggest that they will have a more obvious motive for taking policy action than they have had in the past. The arguments for action on the developing countries' especially the debtors', side are stronger.

The World Bank discusses the medium term through the framework of the type of general, efficiency-orientated, policies that will determine the growth of demand in the developed and developing countries, and trade between them. Growth can be improved through fiscal and monetary policies in the developed countries and more efficient labour markets, and suitable price incentives and more open trade policies in both developed and developing (pp. 24-32), but the precise mechanisms and quantities by which each of these operates are not spelled out. Although some of the more specific industrial discussion in the second part of the World Development Report considers more sectoral issues, and the possibility of sectoral policy (for example targeting, p. 71), it is clearly more sceptical about this type of analysis and policy than about the efficacy of general, non-sectoral, policies and goals.

The UN also looks at the scope for changing the medium term prospects for developing countries in terms of policy initiatives, particularly in the industrial countries, analysing and simulating quantitatively the effect of improved macro-economic policies and of one of its own proposals for improving the debt situation, reducing interest rates (pp. 30-33). Its results for the former are very modest: the level (not rate of growth) of developing country output is improved by .2% for an improvement of 1.2% in the level of industrial country output. Although this is partly explained by the assumption that developing countries' terms of trade are hurt because their prices do not respond to the reflation and the developed countries' do (an unusual result for relative prices when one trading partner reflates), this is a much lower estimate than the implications of the World Bank High and Low cases where developing country output grows 2 points faster for a 1.8 point acceleration in industrial country output. The terms of trade under the World Bank scenario probably improve for the developing because the rise in output in industrial countries is accompanied by lower inflation there and there seems no reason to believe that a relative increase in demand for developing country exports should lower their prices. A mechanism that is probably more important is that there is a sharp rise in the elasticity of demand for developing country exports (from 1.4 to 1.7) and an at least proportionate increase in external financing. The impact of the UN's debt relief scenario as described is larger (it is impossible to compare the two directly in the absence of information about the fiscal stances in the industrial countries and assumptions about their views on the equivalence of different types of cost), and more important, it is faster and concentrated on the countries whose output and imports are most constrained so that the second round effects are likely to be relatively large.

The IMF accepts that a supply-based analysis is more appropriate than demand for the medium term, at least for the industrial countries (p. 12), but bases this on past trends, rather than analysis of possible changes in industrial structure, and derives the medium term prospects for developing countries principally from demand and financing arguments.

The IMF does look at more long-term trends in the supply (and structural changes in demand) for primary products and oil (pp. 93-102), but principally to derive forecasts for trade and prices, as discussed above, rather than for suitable structural changes to promote development in the supplying countries. The other forecasters also look in some detail at the commodity price trends, although their conclusions do not in general advance on those reached in earlier analyses (most recently their own in the 1986 reports). UNIDO, as mentioned in the section on prices, does also see increased scope for transferring production to the developing countries and reducing the total number of producers (pp 31-32); unlike the other forecasters, it therefore expects a change in trend, without policy intervention, from the expansion in output and numbers of suppliers that characterised the late 1970s and early 1980s. It sees closures particularly in metals in Japan and the US.[6] It also expects the new phenomenon of transfer of production from Japan to overseas to supply Japanese markets to continue because of the change in the value of the yen (p. 17). The UN includes an analysis of changes in trade in services, suggesting that contrary to impressions gained in examination of domestic economies, trade in services may not be expanding rapidly, and even if constraints on trade are removed, it may not be a major source of growth. Several of the other forecasters also look at more fundamental structural problems, and these are discussed in the context of the effects of the debt problem in the next section.

9. THE MEDIUM AND LONG-TERM EFFECTS OF THE DEBT PROBLEM

One of the reasons that the forecasters are giving more attention now to medium term analysis is their perception that the exceptional pressure on countries' incomes and policies from the costs of servicing debt, and the different impact on different sectors or economic groups of both the direct costs and the measures taken to 'solve' or 'adjust to' the debt are large and long-lasting enough to have a permanent effect on the development of the major debtors; they are not merely causing a temporary diversion from their growth path. As well as being an additional reason for urgency in finding policies to alleviate the pressure, this change requires analysis of how the economies are affected.

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[6] These questions are also discussed in the context of medium term forecasting in George F. Ray, 'Natural Resources', <u>National Institute Economic Review</u>, 1986, 4, pp. 53-58, and 'The Decline of Primary Producer Power', 1987, 3, pp. 40-45. The latter also concludes that 'Market forces are likely to re-establish a balance between supply and demand even if only after some delay. If some producers find the price of a commodity too low they will stop producing it, switching to some other commodity or another activity altogether....The resulting price level may differ appreciably from whatever was considered "normal" at some earlier stage".' p. 45.

The types of effect which could expected over the medium and longer term include those from prolonging the effects on levels of aggregate demand that have influenced the short-term prospects. But there are also more structural ones on capital formation and the development pattern of the economies and potentially permanent ones on the population, the resource base and other environmental questions. Each of the forecasters analyses some of these, and the picture that emerges from looking at all the reports together is considerably more alarming than arises from each taken on its own. The forecasters acknowledge at least by implication the social and political effects of the debt on current policy, and these are one reason for the perceived urgency in finding a solution. The do not try to analyse the possible longer-term effects on the societies or politics of such pressures or the ways governments respond to them, although some are clearly aware of them.

Macroeconomic and other general economic effects

The IMF and UNCTAD give two reasons for expecting the debtors to suffer long-term declines in their investment and their productive capacity, through the impact on investment finance and through the need for particular imports of capital goods.

The IMF considers the impact on future production of the reduction in investment (external and domestic) one of the major effects, and also notes that it 'is needed as a vehicle for the structural changes' which are needed to maximise returns (p. 78). As was noted above, it attributes to the debt problem not merely the debt-related outflows, but an impact on future levels of finance: those with debt problems are unable to borrow; those without have been made more risk-averse than previous generations of developing countries. Not only is the supply of bank finance smaller; the demand for it by investors is also reduced. The IMF argues that direct investment is reduced not only directly by the need to transfer part of the return abroad normally through extra taxes to service the debt but because potential new foreign investors will not risk inflows into a country with severe balance of payments problems, and therefore the possibility of controls. Domestic investors will also be deterred by the prospects of low returns because of the need for high taxes to mobilise domestic saving to pay the debt (p. 22). These are both examples of how the private return is reduced to below the public if a high proportion of output must be transferred abroad; effectively the threshold of return on each project necessary to attract investment has been raised. The range returns actually available may have been lowered by the effect of adjustment policies on private and government demand.

The IMF notes that investment rates stopped rising after the early 1970s, and fell more than consumption in the early stages of debt adjustment. The fall has been concentrated in countries with debt problems; it is not characteristic of all developing countries in the period: commercial borrowers without problems had a range of between 27% and 29% of GDP devoted to investment from 1973 to 1986; those with problems fell from 26 in 1973-1982 to 18% in the last four years; official borrowers did not have a similar fall, but were already at a lower rate of about 13% (p. 79). It particularly criticises the continued pressure on public sector investment, noting that this is 'weakening the public sector's ability to ensure rising living standards in the future and, because of the complementarity between public sector infrastructural investment and private sector investment, inhibiting the latter as well' (p. 80). It expresses concern over the deterioration shown by statistics on health and education, as well as water supply and housing (p. 67). UNIDO also emphasises the need to avoid jeopardising long-term development by shifting resources excessively from the public to the private sector (p.58).

UNCTAD, starting from the impact on import capacity, also analyses the effect of the financing constraint on consumption and investment (pp. 197-204). It develops a model which provides a useful way of thinking about the various ways in which import compression affects an economy. There are immediate effects from the reduction in intermediate goods imports. Because of the importance of the initial level of non-essential imports and presence of domestic capital goods which are substitutable for foreign, the longer (and further) the compression of imports, the more likely are the effects to become serious for long-term development by affecting capacity. Larger or more advanced countries with more possibilities of substituting domestic capital goods for foreign will be, at least initially, less affected than smaller. But most are dependent on trade for supplying domestic capital goods, so that 'a compression of imports leads inexorably to reduced growth' (p. 202). Using data on some major Latin American borrowers, it presents various scenarios on different assumptions about substitutability and policy response. It suggests that 'there is reason to believe that many, if not most developing countries have by now eliminated all but the most essential imports and that current import compression is affecting imports that are vital to their economy and its long-term growth and development' (p. 201).

Prolonging the problem without settling it may also have more directly harmful effects. Particularly in the last few months, the process of debt renegotiation and rescheduling, which in the past was considered at worst pointless, has come under increasing attack as actually harmful to long-term development. UNIDO argues that lending to cover interest payments, and thereby increasing the burden of current costs, intensifies the damaging effects of low imports and low investment (p. III,56). If the new interest spreads are higher or accompanied by fees for renegotiation, or if the loans are converted into stronger currencies, all changes which have affected at least some developing countries, the increase in burdens and potential long-term impact are of course greater. It has been suggested that debt expedients like swaps for equity can cause distortions in investment within the private sector.[7] They may also do so between the public and private sectors. It must also be remembered that in the initial stages, the debt adjustment was presented as a temporary problem, after which growth of exports and new external finance would resume. The appropriate policies either for refinancing old debt or for investment adjustment within developing countries for this situation are not the same as those for a permanent cessation of new private inflows, and the longer policies based on the former are applied in the latter situation the more risk there is of permanent distortions in economies.

The UN notes another effect of the reduction of import capacity: countries dependent on import taxes for a significant proportion of fiscal revenue are less able to mobilise public savings (especially at a time when export taxes may have also been badly affected) (p. 37).

Structural effects

It is well accepted that slow growth, for whatever reason, makes structural change more difficult, in developed or developing countries, because changes are more likely to require large absolute reductions in sectors or activities. Rising investment brings a continuing supply of new technology, and the planning of appropriate sequences or balances is less difficult when over or under-investment can be quickly corrected. The need to constrain income in the debtor countries to repay debt and the consequent macro-economic effects on the rest of the world with which they trade will thus themselves have effects on the rate of change of structure. These may be increased by political responses to low growth or high unemployment, notably trade protectionism (the World Bank stresses this risk). But there are other direct effects on some industries or sectors.

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[7] David L. Roberts, Eli M. Remolona, 'Debt Swaps', in Group of 30, Finance for Developing Countries, New York: 1987.

Although in general the World Bank sees a limited role for the public sector, it does identify investment in infrastructure as a necessary public investment in the early stages of development (p. 14). The constraints on total investment and on government saving identified in the preceding section could therefore have a particularly serious effect on developing countries at this stage.

UNIDO moves further in the direction of a more structural approach by examining the impact of the external shocks on manufacturing sectors in developing countries. It is a methodological problem that the more analysis focuses on particular countries and periods, the more difficult it may be to isolate the particular impact of debt. UNIDO focuses on the more basic forces, falling commodity prices, recession and slow growth in the developed countries, high interest rates, volatile exchange rates, treating debt as an intermediate result of these, and even these forces as 'but the symptoms of fundamental disequilibria in the world industrial economy' (p. III,1). It combines statistical analysis of about 20 countries with more qualitative description of four. Its principal conclusion is that manufacturing, output and investment, has been worst hit, with reduced imports of capital goods an important mechanism.

In presenting its forecasts and its analysis it uses diagrams to show the uneven impact of the changes in output on particular sectors. Some of these are reproduced at the end of the paper. They indicate that the engineering industries have been most seriously affected, and in many cases these will not return to their previous levels by 1988.

The general analysis reaches conclusions similar to the other aggregate analyses. Like the UNCTAD model (and the UN's historical approach) it finds that size reduces vulnerability; China and India faced modest adjustment problems, and their rates of growth and forecasts for them are still strong. In discussing the importance of the changes in financial flows, it notes that the shift to a high share of private flows made them pro-cyclical, as public sector ones were not.

In looking at the composition of trade, it finds even by 1984 the reduction in imports of machinery suggested by the UNCTAD analysis (p. III,23: table). It points out that linkages can spread production falls in industries directly dependent on foreign inputs to the rest of the economy through reductions in their inputs to other industries and their demand for inputs from them, meaning 'a small saving in foreign exchange but much larger reduction in industrial output and often...a disproportionate increase in the import bill' (p. III, 26). Although the different types of external shocks are not distinguished, the analysis notes that three non-debtors, Taiwan, India and Singapore, maintained their investment relatively successfully (pp.III, 34, 54).

The report stresses that the importance of import compression cannot be measured only by the aggregate loss of potential output, even including the second round effects through the linkages with the rest of the economies. It is 'a forced reversal of the industrial development strategy that developing countries espoused in the 1970s' (p. III,56). As the analysis here, and in the other reports, shows, the more industrialised economies have been able to adjust more easily, domestically because they are more flexible, externally because manufactured exports have faced less serious price and quantity shocks, and their exporters have been able to improve their market position, not simply respond to changes in external demand.

The IMF agrees (pp. 23,87) that 'for many primary commodity exporters with some industrial base and manufactured exports, the path to higher growth probably requires expanding exports of manufactures' because of their higher income elasticity, while others may need to diversify into new primary exports or to import-substitute, all of which require investment.

One response to analysing the long-term effects of debt, or more generally the poor performance of the last 5 years, is to look more closely at the process of industrialisation. The World Bank devotes most of its report to this. Although it is not possible to summarise or review it here, its emphasis on the role of technology and trade, and also sectoral shifts, points to some processes that can be inhibited by the debt burden.

Its discussion of technology stresses the role of imports from abroad[8], and more generally of a liberal international environment for transferring it. UNCTAD also discusses the role of technology in industrialisation. Although it stresses developing domestic capabilities partly as part of development, but also because of the constraints on imports, it notes the new availability of a variety of foreign sources as an important change. It notes that much is embodied in capital goods (p. 85), and that it also can depend on direct foreign investment. The damaging effect of debt on both of these comes out of the IMF analysis, and UNCTAD comments that 'just as developing countries begin to find what appears to be a richer panoply of forms and sources of imported technology to choose from, the main indicators of the volume of international technology flows - foreign direct investment, capital goods imports, payments for licences and know-how, and official technical assistance - show either stagnation or a downward trend.' (p. 127).

Debt and resources

As with the effects on economic structure, it is difficult to distinguish one damaging external shock from another when looking at the impact within a country, and therefore it is necessary to rely on the aggregate analysis of where debt apparently makes shocks worse or more permanently damaging. The impact of reduced national incomes, the debt problem and the adjustment to it on human resources has been discussed

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[8] It should probably not treat Britain as an exception to this, particularly in early industries such as textiles and in agriculture.

increasingly in the last year, and is clearly one of the reasons that the present situation is not considered to be humanly or politically sustainable. The IMF now notes explicitly the damage to current standards of living in its discussion (quoted above) of damaging consequences of lower investment. More generally, most of the reports have since last year noted the decline in the level of per capita income in many countries, and the probable growth rates. The permanent damage of poor health, inadequate education and lack of income or employment for a substantial portion of people's lives must clearly be considered a direct loss to the well-being of the countries in addition to the damage it does to its productive capacity. It is directly linked to the duration of the debt problem.

Permanent damage to the non-renewable resources of a country, although clearly ethically less significant than to their population, may share this double impact, on future productive capacity and on the wealth that is the objective of economic activity. The question is raised in the Brundtland Report[9], which notes that pressure from debts can lead to inappropriate agricultural development which damages soils (p. 6). Countries under external pressure are less able to impose any conditions, including environmental ones (pp. 80, 83), on new investment, foreign or domestic. This can be seen as a consequence of the general lowering of the relative rate of return, implied by the IMF analysis of investment prospects, which requires offsetting cocessions to raise returns. The argument is plausible, although the report does not give hard evidence that it has occurred; it is normal, given the pressures of relative poverty, for developing countries to put greater weight on increasing income relative to preserving resources than richer countries. It is consistent with the potential difficulty of controlling foreign investment if it is promoted through debt swaps or other new forms of incentive.

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[9] World Commission on Environment and Development, Our Common Future, Oxford: Oxford University Press, 1987.

Even if exploitation of a particular resource is desirable, imposing short-term pressures on a country to meet unexpected external financial demands, as happens with unpredictably high financing costs and low external inflows, may increase the premium on short-term returns (distort the country's rate of time discount) which can lower the total return in some cases (mining offers examples).

10. THE ANALYSIS OF ECONOMIC PROSPECTS

It was already clear in 1986 that the forecasters were becoming less concerned with forecasting and more with discussing long term trends, policy implications and the needs for reform. Last year, it appeared in the presentation of large numbers of 'scenarios' on different assumptions. The scenarios have been cut down this year (notably by the IMF); only the World Bank preserves its usual Low, with no policy changes, and High, with every desirable change.[10] The forecasts, and the detailed discussion of the reasons for the numbers chosen, have, however, also been reduced. The two reasonably fully presented medium terms (the IMF and the World Bank) show signs of being based more on returns to normal paths after the shocks of recent years than a firm judgment that further shocks are unlikely. These changes are in sharp contrast to the development of country forecasting in the 1970s when there was a steady increase in the detail of forecasting and efforts to reduce the number of variables treated as exogenous or assumptions.

The turn to policy discussion thus certainly reflects (understandable) dissatisfaction with the expected outturn, but it may also be in part the result of dissatisfaction with the ability of forecasters to forecast major turning points (the

[10] The 'High' forecast of the World Bank is created not by modelling the way in which particular policy changes could improve the outcome, as the UN does for its simulations and UNCTAD for its discussion of import compression, but by 'assuming' policies that will give a specified outcome.

fall in the oil price in 1986) or even to understand not merely how quickly but how countries respond to them (the poor performance of the industrial countries since then), or to balance the influences of domestic and external forces on the performance of the developing countries. It is unfortunate that at a time when the forecasters agree that there are serious risks and uncertainties in the short term, and when they are arguing convincingly that elements of the present situation may have significant long-term effects on the path of development that they do not present a well-worked out forecast of what will happen. The descriptions of the performance of the world economy in 1986 do not give convincing explanations of the reasons for the apparently inconsistent set of errors in the forecasts for that year. For the future, there are no forecasts, only assumptions of no change, for the oil price or exchange rates. On trade, where the relationships of imports with output: their dependence on it in the industrial countries and their impact on it in the developing, and the determination of export market shares are clearly central to the outlook, there are no medium term forecasts which give all the trade and output variables necessary to understand these processes and most of the short and medium term forecasters do not explain how they have resolved the questions. The acceptance of a role for planning in the developing countries does not obviate the need for forecasting: it makes it necessary to take a more structural and detailed view.

There are three important questions which can become confused and be inadequately answered if the forecasters move too quickly away from forecasting into policy. Can the economic system produce a solution to the major imbalances that they observe or fear? Must we accept that solution, or can policy intervention produce a better one? How much do the developing countries depend on the economic or policy solutions found in the developed countries, and how much can they alter through their own changes, whether directed internally or externally?

None of the forecasters makes the mistake of answering no to the first, but their refusal to forecast seriously into the medium term suggests that they do not believe that they understand how the system will operate to produce the answer. But the intitiatives by banks and debtors of the last few months suggest possible directions on debt; the evidence suggested by UNIDO and others on changes in commodity output patterns show some possibilities for ending or mitigating the effects of the commodity price collapse; and the changes in trade and production patterns (for example on Japanese foreign investment) suggest that the exchange rate and current account imbalances are not permanent. Evidence of a resumption of normal growth is harder to find. Here the role of government in restoring confidence may be crucial. This is seen as one of its central roles by the BIS (p. 196). Most of the forecasters merely look at the undesirable prospects for the developing countries (and the industrial) and conclude that governments, in the developing countries and the industrial, and, on their behalf, the multilateral agencies should intervene to prevent them. Only the BIS states the choice and its nature clearly: the system could produce a solution to the imbalances, but the period of transition could impose unnecessary costs.

It is implicit that the forecasters all (except the World Bank) now believe that policy can be effective. The World Bank derives a very limited role for government from its study of industrialisation: 'it must sometimes intervene to achieve an efficient outcome'(p.7).

The UN attempts to find lessons for the future by looking at the fastest growing developing countries (Chapter VIII). Its summary of its conclusions is that 'the relatively fast growth of these countries did not result from an accidental combination of favourable factors....It was, in most cases, the result of a much better than average performance over a broad spectrum of factors.' (p. 167) It suggests, therefore that 'long-term development policies' were a crucial element in the success.

The reliance on historical views suggests that most of the forecasters do not see fundamental changes in the relationship of the developing countries to the industrial, or to the world economic system and therefore in their dependence on the developed countries (the third question). The World Bank reviews past histories of industrial change, and although it sees some threat from new technologies to labour-based comparative advantage it does not judge this to be an immediate threat. UNCTAD does see a central role for technology in growth, but its forecasting analysis explicitly excludes such changes, and although the UN emphasises that each successful country has its own characteristics, it does not suggest that the pattern of development which it finds would be significantly different in the future. UNIDO suggests that the pattern of improving the manufacturing sector will remain essential, and the IMF offers increasing manufactured exports as still the preferred way for developing countries to relax the constraints on their expansion.

Although all the reports see the dangers of protection and the possibilities of technological change reducing the relative demand for primary products, they do not consider the possibility that industrial countries may be able and may prefer to be much less dependent on imports as the share of not only raw materials but labour costs in the total value of products diminishes. This would not mean that developing countries could not develop advantages in particular products, but their success in exporting would become much more based on their own initiatives, and less subject to mechanical dependence on output in the industrial countries. This could have advantages when growth is slow (the experience of the exports of some of them in 1986 is an example), but it would require a different type of analysis of the relationships between different types of country, and of the appropriate role of policy intervention in the developing countries.

The emphasis on the scope for structural development and government policy in the developing countries is a useful supplement to the usual analysis of the need for stimulus (and action on debt relief) to come from the developed countries, but the forecasters do not allow it to be seen as a substitute. Whatever changes are desirable are constrained by the external situation, and the discussion makes this clear.

The reports do not, however, explain the apparent inconsistency between achieving the interventionist settlement of the debt problem which they support and the lack of action by governments and of confidence to take initiative by investors which they found in trying to explain the poor response of economies to the fall in the oil price. It is true that governments have shown some willingness to intervene in the last few months, and there have been initiatives by banks and debtors, but if attitudes are changing, then this may imply changes in other parts of the forecast, and therefore require a reappraisal of expectations more generally. This could be towards greater optimism, if it represents a revival of confidence or a return to a more cooperative view of international economic relations and acceptance of special responsibilities in relations with the developing countries. These could affect the efficiency of international markets and perhaps the quantity of financial flows. It could be towards greater pessimism, if it reflects trying to strengthen balance sheets and 'clear the books' of uncertainties in the face of serious risks of recession. There is perhaps a possibility that the former is the correct interpretation.

Charts of Industrial Structural Change

Key:

ISIC code (industries):

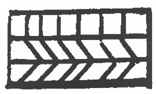
31 (Food products)
321, 322 (Textiles)
323, 324 (Leather industries)
33 (Wood and furniture)
34 (Paper and printing)
351, 352 (Chemicals)
353, 354 (Petroleum and coal)
355 (Rubber products)
356 (Plastic products)
36 (Non-metal mineral products)
371 (Iron and steel)
372 (Non-ferrous metals)
381 (Metal products)
382 (Non-electrical machinery)
383 (Electrical machinery)
384 (Transport equipment)

Constant prices of 1980

g Average annual growth rate, 1970-1988 (percentage)

e Index of structural change, 1970-1988.

1985-1988 forecast
1980-1985
1975-1980



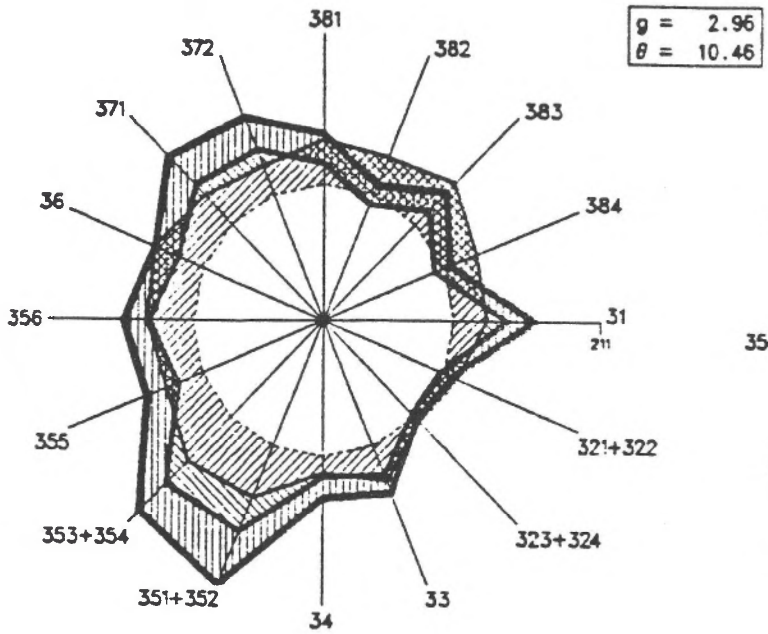
Sources: United Nations Industrial Statistics, estimates and forecasts by UNIDO/SR/GLO.

These charts are reproduced by permission from UNIDO, *Industry and Development Global Report*, 1987.

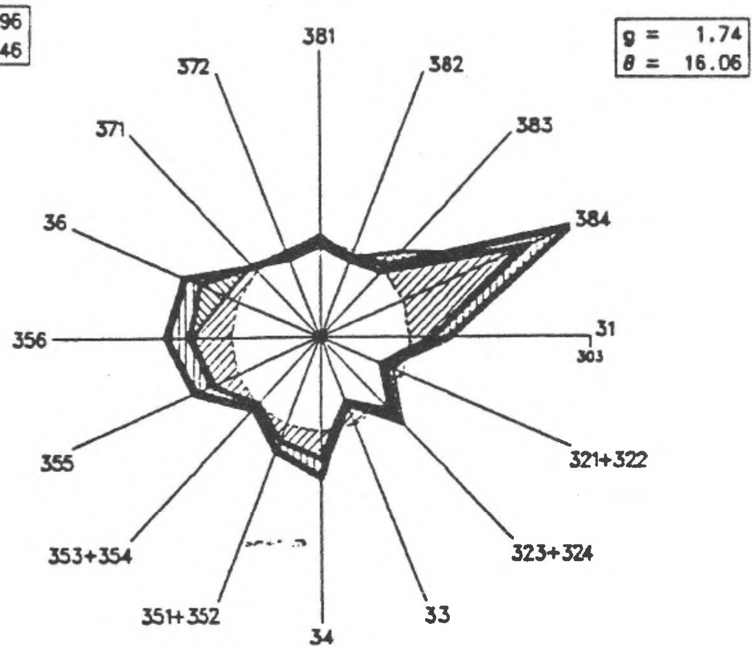
Industrial Structural Change

(Index of value added: 1975 = 100)

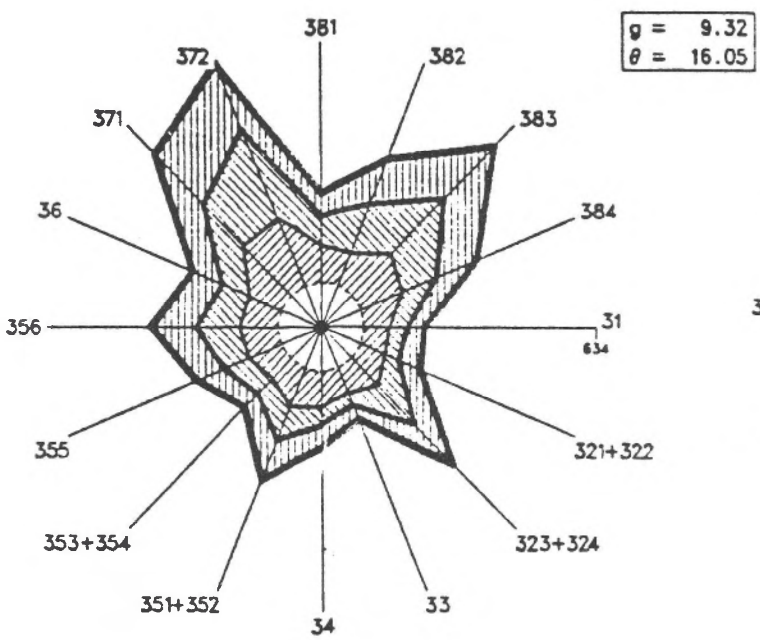
Latin America



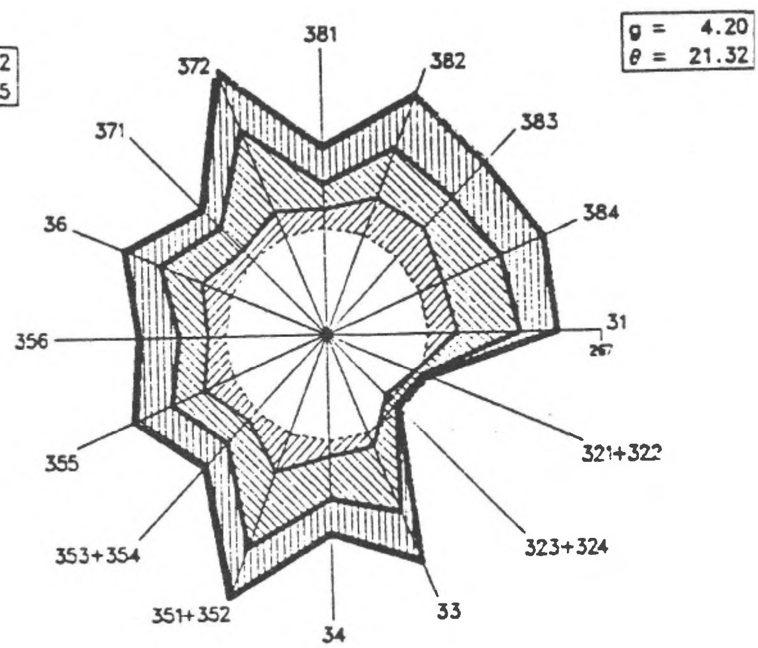
Tropical Africa



South-East Asia



India Sub-Continent



APPENDIX: DOCUMENTS DISCUSSED AND DEFINITIONS

Forecasts and other reports used

Bank for International Settlements, Annual Report.

GATT, International Trade.

International Monetary Fund, World Economic Outlook, Primary Commodities, Market Development and Outlook, 1987.

Organisation for Economic Co-operation and Development, OECD Economic Outlook, (June issue),

UN, World Economic Survey.

UNCTAD, Trade and Development Report.

UNIDO, Industry and Development Global Report.

World Bank, World Development Report.

Definitions

For full definitions see individual reports.

Developed countries: differences among forecasters not significant in relation to developing countries.

Oil price: average OPEC official export price; 'real': deflated by price of manufactured exports.

Price of manufactured exports: UN index for developed countries.

Price of primary exports: UNCTAD or IMF index of market prices of developing country exports.

Major oil exporters: Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Oman, Oatar, Saudi Arabia, United Arab Emirates, Venezuela.

Non-oil developing countries (and area sub-totals): as defined by IMF but excluding South Africa, with minor differences for some reports.

Secondary oil exporters: Angola, Bahrain, Bolivia, Brunei, Congo, Ecuador, Egypt, Gabon, Malaysia, Mexico, Peru, Syria, Trinidad and Tobago, and Tunisia.

Exporters of manufactures: Brazil, China, Hong Kong, India, South Korea, Singapore.

Market borrowers: countries that obtained at least two thirds of their external borrowing from 1978 to 1982 from commercial creditors.

Major borrowers: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Indonesia, Ivory Coast, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela.

Official borrowers: countries that obtained at least two thirds of their external borrowing from 1978 to 1982 from official creditors, except China and India.

Notes

The IMF September revisions were published too late to be included.

The World Bank has two medium term scenarios.

Low: No major policy changes

High: Assumes:

1. Fiscal imbalances in industrial countries 'reduced in a way that maintains growth'.

2. 'Unemployment in the industrial countries is reduced substantially.'

3. 'Governments halt the recent advance of protectionism in the industrial countries and thereby increase international trade flows and improve the efficiency of their economies.'

4. 'The developing countries themselves adopt adjustment programs to restructure their economies and spur employment and income growth.'

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