ECONOMIC PROSPECTS FOR DEVELOPING COUNTRIES

Their place in the new international economy of the 1990s

The 1990 Forecasts

Sheila Page

odi Overseas Development Institute

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Contents

1.	**Sustainable but Unequal Growth?**	1
2.	**A World in Stable Equilibrium?**	2
	Output and inflation in the industrial countries	2
	Trade prices	5
	Interest and exchange rates	9
	World trade	11
	Developing country output	15
	Capital flows	20
3.	**The Effect of the Transformation of the International System**	24
	Trade and trade policy	25
	Eastern Europe	30
	Democracy	34
4.	**Oil**	35
5.	**Poverty**	38
6.	**Assessing the Prospects for Developing Countries**	40
Appendix		47

Tables

Table 1: Industrial Countries	3
Table 2: Prices, Interest Rates, Exchange Rates	7
Table 3: Export Volume by Developing Countries	13
Table 4: Output in Developing Countries	18
Table 5: Human Development Index	44

1. Sustainable but Unequal Growth?

In 1990, at least until August, the performance of both industrial and the developing countries followed the pattern of the last few years. The industrial are better than forecast, in spite of any shocks: the restructuring of Eastern Europe only reinforced their strong growth. But their healthy growth has not prevented another disappointing year in the developing: slow growth continues in Africa; the virtual stagnation in Latin America is only partially offset by faster growth in Asia. Even there, weaker performance by the NICs has meant slower growth than in 1989. World trade has continued to grow roughly twice as fast as output, although it is now the imports of the developing countries which are growing relatively rapidly, and their exports which are lagging, even in manufactures. The problems of high real interest rates, debt, and weak commodity prices, which are now clearly systemic, not cyclical, remained. Although the reports take note of the contrast[1], none of these trends appears to be understood or properly analysed in the international institutions' annual reports:[2] instead, their attention was directed to new issues: how to reform the economies of Eastern Europe, and reintegrate them into the world economy, and how the international trading system is changing, globally in the Uruguay negotiating round of the GATT and through regional arrangements. These questions clearly could have important implications for the developing countries in particular, as well as for international prospects, not least because they have also brought a renewed interest in the relationship between economic and political institutions and decisions, and section 3 of this paper will discuss the issues which they

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[1]'The stagnation and decline in much of the developing world were not reversed, after seven years of sustained growth in the industrialized countries, after solid growth of international trade for three consecutive years, and after major adjustment efforts in Africa and Latin America.' UN, p. 1; 'The problems of high interest rates, external debt and trade in primary commodities thus remain issues of central importance on the international agenda.' UN p. 166.
Taking a longer view: 'Looking back on the 1980s, much of the world can count itself fortunate...Yet millions of the world's most vulnerable people must take a far gloomier view of the past ten years.' World Bank, p. 7

The BIS takes a more analytic view of the decade balancing growth against labour market rigidities; lower inflation against continued pressures; and stressing low savings rates, current account imbalances, volatile exchange rates, and the 'fragility of financial markets', and the poor position of middle income debtor countries and the poorest developing countries (pp. 226-7).

[2]The publications used in the comparisons of forecasts are listed in the Appendix.

raise and how they affect the forecasts. But it is essential to consider whether the forecasts are right to assume that the basic pattern of industrial countries largely immune to shocks, and resistant to high interest rates is sustainable and internally consistent, and that the developing countries which have not yet been able to return to pre-1980s performance will do so. (Once again Latin America will grow 'next year'.) The various special topics and new forces in the international economy on which the reports prefer to concentrate should not distract attention from these central questions.

Section 4 will consider how the change in the prospects for the oil price and supply affects the pre-August forecasts considered here. The BIS had suggested that there had been fewer unfavourable shocks in the 1980s for the industrial countries (p. 227), while the World Bank described it as a 'decade of disasters that never happened' (p. 7).

Reflecting the implicit view of 1989 and early 1990 that the world (at least in the West) had reestablished a normal growth path, several reports take a longer perspective, on poverty and development. Although the events of Eastern Europe are not responsible for such studies, they do bring a new interest to them as well as new concern for the question of how to define as well as how to achieve development. Section 5 will consider these studies.

2. A World in Stable Equilibrium?

Output and inflation in the industrial countries

Once again the industrial countries are forecast to slow down in the current year, but recover in the medium term (table 1). Although quantitatively there is little difference among most of the forecasts, the UNCTAD discussion is the most pessimistic, asserting that 'the world....seems to be slipping into recession' (p.I). Its rather lower numbers for the medium term assume that production growth will remain low. In contrast, UNIDO has a sharp recovery in 1991. Its forecasts for all the industrial countries are high, but it emphasises the continued lead of Japan. Europe benefits both from this (through Japanese investment) and from the effects of German reunification and Eastern Europe restructuring. These, with 1992, sustain the investment boom, and mean 'that the rapid growth which was experienced in North America and Japan earlier is at last

<u>Table 1</u>: Industrial Countries percentages

	IMF	UN	UNCTAD	UNECE	UNIDO	OECD	Asian DB	World Bank
1990								
World Output (GNP/GDP)	2.3	2.2	2.5			3.1		2.9
Industrial Countries	2.7	2.7	2.8		2.8	2.9	2.7	3.0
United States	1.7	1.9	2.0	2.3	2.5	2.3	1.8	2.2
Japan	4.4	4.3	4.1	5.0	4.7	4.6	4.4	
Germany	3.5			3.5	4.4	3.9	3.5	4.0
European Countries	2.7	3.4	2.9	2.7	3.3	2.9		
Import Volume	6.7		6.2	<6		5.8		6.4
Export Volume	7.2		6.9	>6		6.6		6.7
World Trade (volume)	6.6	5.9	6.2	6		6.3	5.2	6.5
Trade in Manufactures (volume)	7.0					6.6		7.0
Eastern Europe Output[a]	-1.7	-1.2	-1.2		0.4		0.0	-3.4
1991								
World Output (GNP/GDP)	3.1	3.0	2.9		3.7		2.9	
Industrial Countries	2.9	3.1	2.9		3.2	2.9	3.1	
United States	2.3	2.7	2.5		3.2	2.5	2.5	2.1
Japan	4.2	4.1	3.7		6.1	4.0	4.5	3.8
Germany	2.7				5.0	3.4	4.0	3.7
European Countries	2.7	3.5	2.9		3.8	2.8		
Import Volume	5.4		6.7			6.5		6.5
Export Volume	6.3		7.4			6.9		6.9
World Trade (volume	5.8	6.0	7.2			6.9	5.5	6.8
Trade in Manufactures (volume)	6.5					7.3		7.4
Eastern Europe, Output[*]	2.0	0.2	0.2		0.6		0.5	-0.1

Medium Term

	IMF 1992-95 Base	Alt[b]	UNCTAD 1990-2000	World Bank 1989-2000 Medium	Low
Output					
Industrial Countries	3.1	2.1	2.7	3.0	2.6
United States				2.7	
Japan				4.1	
Germany				3.3	
European countries					
Eastern Europe[a]				1.9	

[a] includes USSR

[b] Elimination of inflation in industrial countries

coming to Europe'. The medium term consensus has moved nearer to 3% p.a. than to 2.5%. The BIS (p. 225) notes what must lie behind others' forecasts: 'It would appear that their [industrial countries'] potential growth was in fact greater than was assumed in the early 1980s; what was then thought to be an intractable structural weakness of "mature" industrial economies can now be regarded as having been a temporary condition that should not have been extrapolated.' The IMF (p. 30) simply asserts that its medium term forecast of 3.1% p.a. is in line with 'current estimates of potential GNP growth'.

Although a recession is still implicit for the US, it is largely confined to 1990 and to North America; Germany and Europe in general are expected to continue to grow strongly. With the US and Japan slowing (except in the UNIDO forecast), this marks a shift in the centre of industrial country growth. Japan may be an important uncertainty, as the more recent forecasts (the Asian DB as well as UNIDO) tend to be higher than the earlier for 1990, and previous years' experience would suggest that it could well out-perform the more cautious forecasts. The Japan Center for Economic Research (August forecast) expects 4.8% for calendar 1991.

The forecasts are consistent with the better-than-expected performance by West Germany in recent years, and the effects of reunification: opportunities for investment and, possibly, less resistance to inflationary growth (discussed further in section 3), could reinforce growth there and in the rest of Europe. The World Bank also mentions the recent high levels of investment. Although some forecasters mention the estimates of a half to one percent extra growth p.a. from the EC's moves to a single market, they do not tie these to the current good European performance. The UN does suggest that 1992 and other trade liberalisation prospects help explain the high level of investment in Europe (p. 179) and asks more generally if policy coordination has had a role. The BIS cites stabilisation policies and the mid-1980s fall in the oil price, but adds 'unexplained changes in business sentiments' (p. 225). If the EC estimates for '1992' are right and are part of the explanation, however, it would be wrong to assume that the effects will continue indefinitely into the future (the World Bank 'medium term' lasts until 2000). (The original EC analysis suggested a period of 5-7 years.) The same would be true of any effects from the 1986 fall in the oil price: while the BIS is probably right to remind us of these, which have been greatly neglected by the other forecasters in their reports in the last five years, by now they should have come through completely. Nevertheless, the high growth of both output and investment are expected to continue in spite of high real interest rates although the World Bank notes that these are higher than the expected growth, and UNCTAD explicitly assumes this.

Although the forecasters did not expect inflation on average to rise further than 1990 levels, and most expected at least small falls (table 2), they expressed concern at the continuing high level. It is interesting that the BIS notes recent political initiatives for 0 inflation (p. 229) and the IMF takes this as its alternative medium-term scenario (p. 32). The IMF claims that 'monetary authorities of several industrial countries have identified the achievement of price stability as the key long-term objective of monetary policy', although the quotations it adduces as evidence are only for the US and the UK, and fall well short of calling it 'the key'. As the BIS notes, this objective has not in the past been taken seriously. If it does start to be seen as a target, perhaps as part of moves towards more stable exchange rates as well as a way of bringing down nominal if not real interest rates, the adverse consequences for developing countries need to be pointed out. For developed countries, the BIS puts more emphasis on the costs and difficulties of transition ('shock treatment involves too many risks to find much support'); the IMF produces a scenario embodying its current assumptions about wage and price rigidities, and giving a cumulative loss of about 6% of GDP in the industrial countries over 7 years (for comparison, this is slightly more than the Cecchini estimates of the net gain to EC countries' output over a similar period in the 1992 exercise), requiring a temporary rise in real interest rates as well as in unemployment, but puts more stress on the possibility of lower costs 'provided that nominal wage flexibility was sufficiently high'. A reduction in industrial country output of this scale, higher real interest rates, and the probable consequence of lower terms of trade for primary commodity producers would be likely to have seriously damaging effects on developing countries, especially net debtors (as shown in table 4). Compared to this, the IMF's estimates of the fall in output if industrial countries cut military expenditure are small (and perhaps less likely now than they seemed before August).

Trade prices

The forecasters have different expectations about the effect of the fall in the dollar on manufactured goods prices (and, for timing reasons, different forecasts had very different bases on which to build). Most expect a significant rise in dollar prices this year, although one that would still imply little rise or a fall in terms of other currencies, followed by a rise in line with industrial country inflation in 1991. The first estimates for the dollar price rise in early 1990 support this. For commodities, in contrast, the dollar price is still expected to fall. This happened in the first half of 1990: in spite of a small recovery in April and May, the index in June and July was more than 5% below the average for 1989 but the fall may be substantially less than the most pessimistic forecast. Metals seem to be responsible for much of the difference, explained by the World Bank as the result partly of strikes, but also by strong demand in Europe and East Asia. Even the most optimistic forecasts for 1991 expected only a small improvement relative to manufactures. Only the IMF shows some optimism for the medium term.

The UN stresses that although there are special factors affecting each commodity, the general ones of slowly growing demand, especially in the industrial countries, and high supply are a problem for most. It shows (p. 64) that in spite of the growing share of exports of manufactures for many countries, and the high shares of primary products in some developed countries' exports, the result is that, except in the Asian NICs, the terms of trade of developing countries have performed badly in the 1980s. These experiences and current expectations are unlikely to encourage primary producers to want to base future growth on further dependence on commodities, as advocated in some recent unofficial reports. The African DB, although expecting commodity prices to fall, argues that such a strategy is necessary in the short run, because of the absence of other products, but that countries should diversify as soon as possible to new agricultural products and then light industry. But the prospects for all these are poor.

In these spring and early summer forecasts, the assumption for oil prices was for at most a small rise in 1990 (implying maintenance of the price at the end of 1989 and in early 1990), and then little real change. The rise in 1989 had been largely unforecast (about 10% was forecast except for the OECD at 16%, compared to an actual rise of about 20%), and should have prompted a reexamination of assumptions about the oil market and/or the operations of the OPEC cartel even before August. UNIDO expected little change in the short-run for the real oil price unless supply was disrupted, but did expect a sharp rise 'around 1996'. The World Bank was exceptional in forecasting a continuing real rise, apparently mainly in the second half of the 1990s, consistent with the IMF's reasoning. The IMF devoted a special

Table 2: Prices, Interest Rates, and Exchange Rates percentages

	IMF	UN	World Bank	OECD	Asian DB
1990					
GNP Deflator, Industrial Countries	3.9		3.9	4.4	
Change US$ Effective Rate	-2.3		-2.3	1.0	
Six Months LIBOR	8.6		8.8	8.9	9.1
Six Months LIBOR Deflated by US GNP	5.0		3.9	4.5	
Prices US$					
Manufactured Exports	4.5		3.5	6.8	2.2
Oil	2.7		0.0	4.2	5.0
Oil, real	-1.7	5.0	-3.4	-2.4	2.7
Primary Products	-10.1	-5.0	-8.5	-4.8	-1.5
Food	-4.6	2.5	-6.1	2.9	
Tropical Beverages	-18.4	-19.0	-15.7	-15.3	
Agricultural Raw Materials	-2.0	2 -2.5	-1.3	3.9	
Minerals, Ores, Metals	-18.3	-17	-16.5	-10.2	
1991					
GNP Deflator, Industrial Countries	3.6		3.8	4.4	
Change US$ Effective Rate	0.3		-1.0	1.0	
Six Months LIBOR	8.3		8.4	8.8	8.9
Six Months LIBOR Deflated by US GNP	4.5		3.6	4.1	
Prices US$					
Manufactured Exports	3.6		2.4	3.1	3.0
Oil	3.6		4.9	2.9	3.3
Oil, real	0.0		2.5	0.0	0.3
Primary Products	2.1		3.3	3.5	3.7
Food	1.1		7.5	2.8	
Tropical Beverages	>13.2		15.8	2.7	
Agricultural Raw Materials	4.0		4.2	3.6	
Minerals, Ores, Metals	-4.6		-3.6	2.3	

Medium Term

	IMF 1992-95 Base	Alt[a]	World Bank 1989-2000 Medium	Low
GNP Deflator, Industrial Countries	3.2		3.2	3.0
Change, US$ Effective Rate	0.0		-1.0	-1.4
Six Months LIBOR	8.3	5.0	8.0	9.3
Six Months LIBOR Deflated by US GNP	3.9	4.2	3.7	5.3
Prices US$				
Manufactured Exports	4.0		4.4	4.8
Oil	4.0			6.8
Oil, real	0.0		2.3	2.0
Primary Products	4.8		2.9	2.1

[a] Elimination of inflation in industrial countries

section to showing the effect of recent rises in oil consumption and falling non-OPEC production on the demand for OPEC exports. A demand rise attributed to the 1986 fall in the oil price and a supply fall, due to largely temporary difficulties, explained the price recovery in 1989. Therefore, 'normal' production was expected to slow exports of OPEC oil and reduce pressure on the price, although the rising consumption in developing countries and possible lower production in the USSR would bring more pressure on the market in the medium term. This analysis would seem to lead to a rising price rather than their forecast of no change. The latter should probably, therefore, be taken as more an 'imposed assumption' than a 'forecast'. This suggests that the medium term forecast, and especially the 0 inflation scenario, must be considered unrealistic, because of internal inconsistency, even in the eyes of their authors.

On the other hand, the analysis does not consider the possibility that USSR output could rise and its allocation among domestic, Eastern European and other export markets could change in favour of the last as a result of its shift to world market pricing. As poor technical conditions are one reason for present USSR production problems, greater availability of outside advice and assistance could also affect the trend. Higher exports to the rest of the world therefore seem likely. The UN gives a much more detailed analysis of the demand and supply trends, but without deriving a medium term price forecast.

The OECD also expected falling USSR exports, but expected only a levelling of OECD production, and small rises for other non-OPEC, giving a substantially slower rise in demand for OPEC exports in 1990 and 1991 than in 1987-9. It does not give a medium term view. The NIESR's analysis of oil demand and supply, after the Iraqi invasion of Kuwait, appears to take a lower view of likely demand, and therefore did not expect a rising relative role of OPEC.

In summary, the implication of the analysis in the major forecasters, not always embodied in their numbers whether because of timing, failure to make a medium term forecast, or forecasting conventions, was that (unless the 0 inflation goal was really pursued), inflation within the industrial countries would continue at about 3.5-4% a year, on average (with the US coming down and Germany perhaps rising a little), and that this would be reflected in prices of manufactured exports (although the effect of such a severe fall in the effective rate of the dollar as occurred after most had written was not explicitly analysed). The prices of most primary products would remain depressed, even in dollar terms with a low valued dollar, and in spite of the continued growth in the industrial countries and the growing weight of Japan and Europe which are more dependent on primary imports than is the US. Several of the changes expected in the international economy discussed in section 3, as well as the evidence of recent data, are additional reasons for treating these forecasts with caution. The experience of the last few years appears to have convinced forecasters that the response of commodity prices to demand is now even weaker than before the 1980s. Oil prices would not come under immediate pressure, because 1990 would not be subject to the same short-term demand and supply pressures that brought the 1989 rise, but might do so by the end of the decade. This gave poor prospects for most developing countries' terms of trade, with oil producers (eventually) and those with a surplus in manufactures trade (at present, mainly Asian) the only gainers. In the short run, it meant low external inflation pressure for the industrial countries, becoming more serious in the long run.

Interest and exchange rates

Forecasts for dollar interest rates have come down slightly since last year, but the actual rate has come down further (table 2). The real rates forecast, however, are still high. These forecasts may now even imply a rise, and certainly no further fall from present real rates. This would in fact be in line with the discussion in some of the forecasts of the probable effects of trying to accommodate increased investment in Eastern Europe or tighter monetary policy to contain inflation, but this seems to be more coincidence than intention. The forecasts were intended to embody unchanged or falling real interest rates (except under a more pessimistic World Bank variant), compared to those at the end of 1989. It is thus difficult to know how to interpret the relationship between the interest rate forecast and the output (and any implied investment) forecasts. Although low by 1980s standards, a real rate of 3.5-4.2%, extending over a 5-year medium term when economies' 'productive potential' is believed to be growing at about 3% does need some justification. If this combination is to be achieved by diversion of capital to profitable new opportunities in Eastern Europe, and perhaps the NICs and new NICs, the consequent restructuring of industry and trade needs further analysis.

The OECD which does attribute the rise in long term interest rates in part to Eastern Europe (p vii-viii) draws the conclusion that what is needed is a rise in world saving, but that the rise in interest rates is not sufficient to bring this forward: it 'should be a policy concern in most countries' and it makes explicit recommendations not only to reduce public sector claims on national savings, but, in an unusually specific recommendation on instruments of fiscal policy, it recommends shifting taxation to expenditure rather than income, and modifying income taxation. As it does not make a medium term forecast, the full implications of this for the rest of the world are not presented.

One important change that should be noted is in the international structure of interest rates. The dollar rate is of course the standard in forecasters' tables and many variable rate contracts. But since mid-1989, the traditional differential of 3-4 points between the dollar and DM rates, reflecting different inflation rates and, normally, exchange rate expectations, has virtually disappeared (and even at times reversed). As the DM has remained stronger than the dollar (showing as of August a 3% rise over 1989, compared to the dollar's 10% fall) this will create further difficulties for debtors who switched part of their debts into DM or DM-linked currencies (deflated by dollar export prices of 0-4, a dollar interest rate of about 8.5% gives a real rate of 4-8; a DM rate of this level with a DM revaluation against the dollar since 1989 of 20% gives about 25%.)

The World Bank continues to boast that it shifts the interest-rate risk from itself to its borrowers by using floating rate lending (World Bank News, 19 July 1990). It also used swaps to double the share of its new borrowing in DMs to 29%. It argues that 'as long as real interest rates remain constant, floating rate debt should impose no additional burden on debtors' (p. 15). This is misleading both because the risk from changed interest rates is itself an important additional burden on debtors, and of course precisely the one from which they suffered in the late 1970s and 1980s, and because higher nominal rates, whether because of an increase in inflation or an increase in the underlying real rate, have real cash flow costs for debtors. UNIDO takes a much more critical view:

> 'interest rates are not determined by policy makers in debtor countries, but by central bankers of developed countries...This prospect is appalling especially because many highly indebted countries have a large

> part of their debt on variable interest rates....Thus, the financial market risks and uncertainties are disproportionately borne by debtor countries, and the negative impacts of instability accrue largely to industrial sector investment in debtor countries'.

Finally even if the level of the real rate forecast for the medium term does now represent an increase, which can embody the discussion by forecasters of the 'Eastern Europe effect', although their original forecasts did not, and may therefore seem more credible than when the forecasts were made, this would be true because of a set of compensating changes and mis-forecasts. This raises questions both about the consistency now of that level and the output and other forecasts and about the stability, and forecasters' understanding, of the interactions between real and interest/exchange rate variables. Combined with the very large changes in relative interest rates that have been observed in the last year, as well as in exchange rates which by convention are not normally forecast by the international institutions, these must cast some doubts on the medium term forecasts which do not embody structural as well as conventional macroeconomic elements. If the fluctuations in exchange rates reflect some retreat from the strict management and coordination of the mid-1980s, this could itself help to explain the reduction in real interest rates with which it coincided. As the interest rate implications of exchange rate management were a threat to developing countries excluded from the G-5 cartel, any such change might be favourable to them.

<u>World trade</u>

Although world trade once again out-performed expectations in 1989, growing 7% in total and 8% for manufactures, there appears on preliminary evidence to have been a slowing in the first quarter. The estimates for manufactures and for total world trade, however, are very different (although they agree on the slowing). Volume changes are particularly difficult to estimate in the face of rapidly changing exchange rates and market shares. The forecasts (including GATT at 5.6%) once again expect a lower outcome for the current year than the last; the Asian DB (it and OECD are probably the only ones which had first quarter figures available) is the lowest. It expects the slowing to continue into next year, while most other forecasters still agree on a 'normal' figure of about 6%, although this is in fact lower than any of the last three years, and is in contrast to the somewhat greater optimism on world output than in the past. On the 'pre-August' basis of these forecasts, it is difficult to understand what justifies this elasticity pessimism. The OECD's figures by half years suggest that it is only the early 1990 data which lowered its expectations; trade thereafter grows at a rate of 7%.

As GATT points out, 1989 was the first year since 1983 in which developing country imports apparently grew faster than their exports. Although the growth rates were all quite close, this means that the developed countries were no longer giving a significant net stimulus to the rest of the world. This situation is expected to continue in 1990-1, although such a forecast is clearly dependent on the elasticity pessimism questioned above. Preliminary estimates do suggest that developed country imports are continuing to rise more slowly than their exports. GATT also notes that 1989 is the first year since 1985 in which developing country exports did not grow faster than average. Although other estimates do not show this as clearly, the trend reflects the slowing of exports and output growth in the NICs, only partially offset by increasing growth in the 'new NICs'. The IMF estimates that the growth of exports of manufactures by developing countries slowed from 12% in 1988 to 8% in 1989, with the NICS' exports slowing from 14% to 9.5%.[3] This may mark at least a pause in the remarkable (and exceptional) performance of developing country exports relative to world, particularly in manufactures.

Developing countries accounted for only 7% of total trade in manufactures in 1970; their share had risen only to 7.4% by 1975. Then it rose to 11% by 1980 and 15% by 1985. Although it has continued to rise, the rate has been slowing, giving 17% for 1988, and (on the IMF estimates) the same for 1989. Much, but not all of this rise has been Asian: the Asian DB's figures for its members show a rise in their share of world trade from 9% in 1981 to 13% in 1988, and the same in 1989, mainly attributable to Hong Kong, South Korea, Taiwan, and China.

Although the alternative approach of looking at the share of manufactures in their total exports is subject to serious fluctuations (the changes in oil and other commodity prices give marked changes in the values to which they are being compared), it is now clear that they reached 50% in about 1986-7 (depending on whether OPEC is included in developing countries). Including OPEC, this means a rise from 21% since 1980. Although the numbers for 1989

[3]The OECD estimate of 4.5% for their trade (p. 157), giving a significant loss of share, must be wrong.

Table 3: Export Volume by Developing Countries percentages

	IMF	UNCTAD	OECD	Asian DB	World Bank
1990					
All Developing Countries	6.6			5.5	6.7
Oil Exporting	4.6	5.1	5.0		6.0
Exporters of Manufactures	7.0				8.3
Exporters of Primary	7.8				
Four Asian NICs	7.5		5.0	9.4	7.8
Asia	9.4	4.5	8.6		8.0
Western Hemisphere	3.8	7.4	5.0		5.5
Africa	5.6	5.4	2.0		4.0
1991					
All Developing Countries	6.4	6.3	9.0	6.7	7.0
Oil Exporting	4.1		5.0		3.7
Exporters of Manufactures	7.2				8.1
Exporters of Primary	6.0				
Four Asian NICs	7.4		7.0	8.8	8.5
Asia	8.2	6.1	8.0		8.0
Western Hemisphere	5.0	7.4	6.0		7.0
Africa	3.6	5.3	4.0		3.0

Medium Term

	IMF 1992-95		World Bank 1989-2000	
	Base	Alt[a]	Medium	Low
All Developing Countries	6.7	5.6	6.0	4.9
Asia	8.0	6.1	8.0	
Western Hemisphere	5.5	4.8	4.9	
Africa	4.2	3.8	3.0	

[a] Elimination of inflation in industrial countries

and later will be affected by the rise in the price of oil (and in the opposite direction for non-oil producers: by the collapse of other commodity prices), these two series clearly indicate a significant shift in their role in the international trading system, and in trade's effect on their own economies, as well as having obvious implications for forecasting their terms of trade, trade volumes, etc. They also directly affect their interests in trade policy and trading arrangements. The World Bank (p. 13) notes the rise in share, but gives the period between 1965 and 1988, which does not stress how sudden and recent the rise has been. It does indicate the differences for different areas (p. 125), with manufactures accounting (in 1988) for more than three quarters of the total for East and South Asia (thus, this is true at individual country level not only for the NICs, but for China, Bangladesh and India). They are only approaching a half for Latin America as a whole (Brazil is 46%), while still around a quarter for Sub-Saharan Africa. Food is the major alternative category for Latin America and Africa.

Given these compositions, it is not surprising that forecasters expect a low elasticity for African exports (the World Bank expects them to rise in line with industrial country GDP), slightly higher for Latin America (1.5) and highest for Asia (about 2.5) (table 3). This last implicitly expects Asian exports of manufactures to increase their share over the medium term, treating the recent performance as an interruption, not a change of trend. The IMF is more optimistic for Africa (at over 4%, an elasticity of 1.4) and Latin America (1.8), but the same for Asia. The Asian DB only gives value figures, but expects a slowing for the NICs and Asia as a whole this year, compared to 1989,and only a partial recovery in 1991. In general, the forecasts are rather more cautious than in previous years, particularly for the NICs.

The Asian DB attributes the slowing in NIC exports to erosion of competitiveness, from currency appreciation and rising wages, especially in South Korea. Most recently, they have been further damaged by the fall in the yen. Their decline in turn is one explanation for the rise in Southeast Asia's exports. Those countries' exchange rates have moved in the opposite direction, and they have been helped by recent export-oriented foreign investment (pp. 38-9). This investment is not only from outside the region. The NICs (as discussed below) are also involved, helping to explain the intra-regional reorganisation of trade flows. Their exports have expanded to the NICs (and Japan) as well as outside the region, as whole industries (the Asian DB cites 'footwear, plastic products, toys, and some basic consumer electronic products' p. 42) have moved from the NICs to new NICs. The Asian DB also sees the trends as policy-motivated: to reduce dependence on increasingly protectionist industrial country markets.

The UN finds the elasticities of trade to output surprisingly high; it is not clear to what period it is comparing them. It therefore tries to explain them by the growth of regional trade agreements (although those it cites followed the rise in rates of growth, and earlier it characterised these as 'antithetical to multilateralism' [p. 5]). It thus joins several other forecasters in examining the way in which the growth in trade has been reflected among and within regions (discussed further in section 3). In spite of the preconceptions of some analysts, the principal increases in flows correspond most closely to the markets in which growth has been strongest: Japan, the Asian NICs, and Europe, a process which does not require special factors to explain it. The UN figures (p. 54) for intra- and inter-bloc trade show that trade outside 'blocs' has increased as a share of most areas' trade (the EC is an exception). For the Asian countries, expanding to the fastest growing markets is of course an increase in intra-area trade; the Asian DB members' trade among themselves rose by 39% in 1988; to Japan 28%; but it also rose 30% to the EC, particularly trade from the new NICs; it was trade with the US, at 13% which lowered the average. In view of the Asian DB's comment that intra-regional trade was being actively promoted, this seems if anything a surprising lack of bias towards it.

<u>Developing country output</u>

After slower than expected growth in 1989, which is now seen as continuing into 1990, the UN, World Bank and IMF have all moved the recovery to above 4% forward another year to 1991 (table 4). The World Bank and IMF expect it to recover further in the medium term. It did not in 1989, and will probably not this year, do better than forecast as did industrial country output and world trade, so the improvement in the medium-term forecasts for industrial countries should not explain the developing countries' increasingly belated recovery. In Asia (which unlike the others did better than expected in 1989), all regions are expected to do relatively well, led by the East Asian countries (especially the new NICs of South East Asia). Forecasts for Africa (including the African DB) remain around 3%, just enough to avoid presenting a prolonged further fall in per capita income, although 3% may not have been achieved in 1989-90, and will be difficult in 1991. Latin America was virtually stagnant last year, and little improvement is expected this year;

the UN and UNCTAD expect a fall in output. The complacent assumption (presented even by the UN which has questioned it in past years) that the recovery will come 'next year' remains, with again no arguments to justify it. The IMF at least qualifies its forecast with a 'could begin to pick up' (p. 9). Although UNIDO's forecasts are relatively high, they do not embody a sharp recovery in 1991.

The IMF forecasts are explicitly based not just on present policies (as in other variables), but on 'prospective implementation of stabilization policies', p. 1. It suggests that high inflation is a major explanation for the poor performance in 1989-90, but in 1990 also blames slower world trade, higher interest rates, and weaker primary commodity prices (p. 9). As two of these now seem questionable, and did not apply in 1989, this explanation seems inadequate. For the medium term as well, 'the increase in growth...rests heavily on the assumption that adjustment policies are successful in bringing down inflation and improving the climate for domestic savings and investment' (p. 50). Under the 0 inflation scenario, growth would be lower; consistent with the relationships reported last year for a 1% p.a. increase in growth in the industrial countries, the 1% decrease would have most effect on the exporters of manufactures (about 0.8% p.a.) and least on primary producers (0.2%). For Latin America, the effect (on the IMF's assumptions about price and interest rate adjustments) of lower nominal interest rates would balance lower exports to give unchanged growth (pp. 52-53).

The UN also assumes that adjustment continues, although not necessarily increasing, and assumes also an increase in financing (discussed in the next section), unlike UNCTAD which explicitly expects no new capital for Latin America. The UN expects slightly slower growth for Asia this year because of poorer domestic and export demand as the transition to dependence on domestic demand is made. The decrease in Latin America is explained by a forecast of -5% for Brazil (the World Bank has 0% and UNIDO 0.5%). Its analysis draws attention to the dependence of the Asian countries on the rest of the world through trade in manufactures, which in 1989 and in the future gives a strong, although slowing, impulse. The African link through primary commodities has proved less stimulating. The debt crisis has made financial dependence more important than trade for Latin America (pp. 21-2) (a point that comes out in the analyses of how the oil effects are transmitted, discussed in section 4). For Africa, it offers good weather and the effects of policy reform as

Table 4: Output in Developing Countries — **percentages**

	IMF	UN	UNCTAD	UNIDO	OECD	Asian DB	World Bank
1990							
All Developing Countries	3.2	3.1	2.8	3.9	5.0	3.9	3.2
Oil Exporting	3.7	2.5		2.9			3.5
Exporters of Manufactures	3.2						3.7
Exporters of Primary	1.9						2.9
Four Asian NICs	5.7			6.8		6.2	7.0
Asia	5.4	5.5	5.2			5.9	4.9
South				4.4		5.3	4.9
East				7.3		7.2	6.9
China		5.0		5.2		5.5	3.5
Western Hemisphere	1.4	-1.0	-0.4	2.4		2.0	1.6
Africa	2.7	3.0	2.9	3.5[a]		2.5	2.3[a]
1991							
All Developing Countries	4.5	4.5	4.0	4.1	6.0	4.8	4.2
Oil Exporting	3.9	3.5		3.3			3.9
Exporters of Manufactures	4.8						4.8
Exporters of Primary	4.1						3.3
Four Asian NICs	6.9			7.1		6.8	6.7
Asia	5.7	6.0	5.3			6.3	5.6
South				4.9		5.2	5.1
East				6.6		7.3	6.7
China		5.0		5.2		6.5	5.0
Western Hemisphere	4.2	4.0	2.7	2.9		3.8	3.0
Africa	3.0	3.0	2.4	3.1[a]		2.7	2.9[a]

Medium Term

	IMF 1992-95		UNCTAD 1990-2000	World Bank 1989-2000	
	Base	Alt[b]		Medium	Low
All Developing Countries	5.0	4.7	3.6	5.1	4.3
Asia	5.3	4.7	4.5	6.2	5.5
South				5.1	4.5
East				6.6	6.0
China				6.8	
Western Hemisphere	5.5	5.5	2.6	4.2	3.2
Africa	3.5	3.7	2.4	3.7[a]	3.1[a]

[a] Sub-Saharan Africa
[b] Elimination of inflation in industrial countries

alternative explanations to explain the apparent improvement of performance. It is clearly necessary to make a clear choice between these in order to forecast.

The World Bank emphasises macroeconomic factors, stability, low inflation and a low deficit, with a 'microeconomic environment...favourable to new investment' as a subordinate factor, as explanations for growth (p. 11). This is in contrast to the more structural analysis found in UNIDO and the Asian DB. Although planning is accepted as a way of improving performance, it is, again, at the macroeconomic and regulatory, not industrial, level. It takes a much simpler view of the link with developed country output than the UN, plotting their industrial production against developing country exports (although, puzzlingly, the chart appears to indicate that changes in developing country exports lead rather than lag industrial country output).

The UNIDO short-term forecast appears to be based on a more optimistic interpretation of current data than the other forecasts. For Latin America, it looks at evidence that exports of manufactures were rising rapidly. For the medium term, it expects India's strong improvements in performance in the 1980s to be maintained, and the new NICs to use their greater competitiveness and the increase in Japanese direct investment to become 'growth leaders in the region'. More generally, it regards an increase in foreign investment as an important vehicle both for improving trade prospects (through 'circumventing protectionism') and to bring in technology and capital. This would make its forecast particularly vulnerable to any diversion of foreign investment because of the effects discussed below in section 3. It regards the decline in the old NICs, however, as short term, not a change in trend, although the explanation in terms of 'the world wide cyclical phase' seems surprising given the rather good world performance last year. The growth in Africa is not explained.

UNCTAD is pessimistic, effectively for parallel reasons: the squeeze on investment of the last decade is expected to continue, and to constrain growth. For the medium term it presents 8 scenarios, although these are better regarded as simulations because the policy or behavioural changes which could justify them are not fully worked out (pp. 62-6) (for example, the high savings scenario produces high investment, in spite of being modelled by reducing consumption). The results for higher industrial country growth are in line with those of other organisations' less than 1 for 1 transmission of growth, with most gain for Asia, while, unsurprisingly, the more indebted countries benefit most from debt write-offs and the poorest from higher aid. Some odd results, however, (no effects on GDP for changes in interest or debt for Latin America, for example) raise questions. UNCTAD concludes that general policies bring 'limited benefits to the African region in general and to certain particular countries of the region' (p. 66), and that these therefore require specially targeted measures. It includes commodity agreements (which do not appear to meet this criterion) as well as greater debt relief and development assistance.

The Asian DB is certain that the reduction in Asian growth in 1989 was a change to a new path (p. 13), although a small recovery is expected in 1990-1 for South Korea; Korean forecasters share this limited optimism. In South Asia both agricultural and industrial output contribute to a recovery in growth. The new trend is partly because of domestic restraint and partly lower exports (mainly in the NICs). The domestic restraint in the NICs is partly to curb inflation and partly because of political and labour difficulties. It also cites environmental opposition to new projects. The NICs thus seem to be passing out of the period in which economic development could be pursued single-mindedly, without regard to other interests.

The analogy is obviously with the slowing of Japanese growth in the 1960s, and then the early 1970s: it retains the fastest growth among the industrial countries, but the rate is no longer of a different order of magnitude. If the NICs can make that transition without creating further social and political pressures, and while meeting those that already exist, they will have 'graduated' to developed status in a more fundamental way than is normally understood by that term.[4] If they do not, of course, they risk finding themselves in the blocked development, facing vested interests and a semi-developed industrial structure, that has obstructed some Latin American countries.[5]

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[4]The World Bank in its 12 July News noted another graduation: the final loan repayment by Japan to the World Bank, on a loan made in 1965.

[5]See Angus Maddison, The World Economy in the 20th Century, Paris: OECD, 1989, for a long-term comparison of development in different areas.

In Southeast Asia, in contrast, the Asian DB suggests that policies 'have been shifting...towards a more competitive and less restrictive stance' (p. 19). It discusses the specific industrial and structural needs in detail (pp. 22-3). In China, it places more emphasis on 'the restoration of macroeconomic stability and...a wider range of economic management instruments' (p. 24). (The instruments in the other countries are discussed in detail in the forecast chapter and there is a special section on informal finance.) It puts particular emphasis on the determination and mobilisation of domestic saving. As rapid population growth is one negative factor for saving, it notes the vicious circle possible in a region with low income, low saving, and high population growth.

Capital flows

As always, it is difficult given the delays in data to know even what has happened to financing in the last year. In 1989, the IMF estimated that the $3 billion rise in direct foreign investment from $10 to 13 billion between 1986 and 1987 had been repeated in 1988, but it now appears that it rose only modestly, to $14 billion. As the estimated rise was explained as the result of debt-equity swaps, it is not clear whether the fall now estimated for 1989 (to $10 billion), which is attributed to the contraction in swaps, rests on firmer evidence. For 1990 and 1991, the IMF takes an optimistic view, of investment recovering this year, and rising a further $4 billion next year, reaching nearly the pre-debt crisis level ($20 billion in 1982). The increase appears to be expected to go mainly to Asia, with a smaller rise to Latin America.

In general, however, the IMF is not optimistic about financial flows to the developing countries. Its forecast in the short term for official aid is for little change, and it sees little hope of a resumption of commercial bank lending. It does expect its own net lending to resume (after 5 years of net repayments), although the World Bank expects the IMF to continue to receive net repayments, with only a small positive lending by 1991.

The BIS also estimates that foreign investment into developing countries slowed in 1989, and notes the large increases in flows to the EC in anticipation of the Single European Market. The World Bank's scheme to promote foreign investment, the Guarantee Agency MIGA, finally signed its first three contracts. But two were in mining projects (Indonesia and Chile) and the manufacturing project was in Hungary, so it remains some distance from its goal of encouraging new types of investment in otherwise risky developing countries. (A recent official description emphasised its technical assistance role, with its original guarantee function relegated to a final sentence, World Bank News, 22 February 1990.)

The UN and the Asian DB, like UNIDO, stress the inflow of investment into the Asian new NICs, from Japan and from the NICs. UNIDO cites the 'milestone' in 1988 when NIC investment overtook Japanese. The Asian DB notes that this means a change in the character of foreign investment, towards more manufacturing and also involving more small and medium-sized firms. This could give a different future character to the new NICs' economies, compared to the NICs. The World Bank points out that the NICs are now net exporters of foreign investment, but unlike other forecasters does not expect this to continue because their current surplus will diminish. (Higher cost oil imports could bring such a fall forward.) Any fall could have a significant effect now on the other Asian economies, but the outflow from South Korea continued to rise in the early part of 1990, and Japan is also increasing its flows of investment significantly to that region. (And the NICs and new NICs are benefiting from some diversion of Japanese investment from China to the rest of the region.)

For other countries, especially the debtors, the UN considers official finance the only feasible source in the near future 'to restore order and consolidate debts in a manner that makes it possible to resume growth and regain creditworthiness' (p. 11). It does, however expect some increase in foreign investment into Latin America. It 'assumes' that official financing to Africa will increase moderately (p. 48), although it notes the low forecast for OECD country aid (of 2% growth), and the poor prospects for aid from the USSR and Eastern Europe. It does, however, expect more aid from OPEC. It is multilateral assistance which it apparently expects to increase most strongly, because of the replenishment of the resources of the IDA arm of the World Bank, the IMF, and IFAD. The World Bank also assumes increased aid for Africa (and automatic rescheduling of all its bilateral official debt), and in its final chapter describes, without quantifying, what could be achieved by much higher resource transfers. Like the UN, it expects any increase to come from official flows, thus further increasing the proportion of finance from this source. The UN does sketch the results of an alternative scenario, under which an additional transfer of $6 billion in 1991, rising to $30 billion by 1994 would raise growth rates in debtor countries by 1% a year (with their own savings and investment also rising in response). (This seems a much larger response than UNCTAD obtains in its higher aid scenario.) The largest benefit would go to Latin America, but Africa would at least achieve output growth greater than population growth. It points out that this net transfer would be less than they were receiving in 1981 before the debt crisis (pp. 77-8, 82).

This good performance by direct investment to Asia and modest, but universally expected, increases in official flows to Africa will help to sustain their expected growth rates. Latin America faces less favourable financing forecasts, so it remains unclear what supports the expected rebound in its growth.

There has been no progress on the need stressed a year ago (and explicitly identified in the Brady initiative) for more flexible and faster responding forms of official finance. These are needed to prevent the heavy temporary costs of a temporary financial crisis (or indeed a natural disaster) from leading to a permanent debt burden; and the prospect of higher oil prices makes solving the problem more urgent. The World Bank cites a need for 'insurance against shocks' (p. 20), by which it probably means quick access to existing financing.

There were large increases in interest arrears in 1989, to private creditors, as rescheduling slowed (perhaps, according to the BIS, because both sides were waiting to see the impact of new debt initiatives), and to multilateral lenders. A change was made to IMF regulations to permit borrowing from related, but not officially IMF, funds by those in arrears, and to permit suspension rather than expulsion of persistent offenders, but the general problem of debt to the multilaterals has not been tackled. The African DB encourages the multilateral lenders to find a solution to preserve their own credit-standing, perhaps by only offering concessional resources in future (p.28).

The last year has seen the first three debt settlements under the last initiative, the Brady plan (Mexico, the Philippines and Costa Rica; Venezuela is under negotiation). All the forecasters are at best sceptical about their success or the prospects that they offer for bank-debtor relations in the future. The IMF describes the slow progress as 'disappointing' (p. 2 and p. 62). It does not offer further suggestions, and notes that there is now little further gain from official debt reductions by bilateral negotiations. The BIS is particularly critical of the Brady programme. It suggests that while creating 'exaggerated expectations' of new money, the use of secondary market prices and facing banks with losses on existing loans made the climate for new lending 'bleaker than..for some time' (pp. 157-158). The structure of incentives actually encouraged banks to choose to offer reductions in debts and debt services (which gave them debts with preferred status), rather than new money. (Past, unilateral, Latin American debt initiatives, such as the Peruvian in 1985-6, explicitly tried to do the reverse.) the BIS also notes that the Mexican settlement reduced the number of banks exposed to new calls, and therefore may have made it difficult for Mexico to raise finance in the future. The UN and UNCTAD also are concerned that most of Mexico's and the Philippines' creditors chose the exit, rather than new money options, and Costa Rica raised no new money. The official funds used to help finance the Brady settlement are not subject to renegotiation, increasing the future rigidity of Mexico's position, and were in part diverted from what would otherwise have been new World Bank funding.

The World Bank claims that 'the Brady initiative so far suggests that it is possible to strengthen adjustment programs and mobilize private investment through partial debt reduction' (p. 20), but as it was only signed for Mexico in January, there can be no evidence to support this. It merely describes the favourable confidence affects for which it hopes. The President of the World Bank has been reported to be more sceptical, with concern about the reduced flexibility it implies (<u>Financial Times</u>, 9 May 1990). But he did support continued and increased funding for debt schemes. The UN asks 'whether these moneys would have produced greater benefits for Mexico had they supported the investments for which they were originally approved' (p. 91). Its conclusion is strongly stated:

> A larger commitment of official resources to finance debt reduction would not be a prudent or efficient use of those resources. Although helping banks to accept losses through the various swaps and buy-back schemes is not what is usually meant by 'bailing out the banks', these arrangements do serve to transfer at least some risk from private creditors to public agencies that were established by Governments for very different purposes. What they do best is allocate investable resources to finance balance-of-payments adjustment and long-term development programmes and projects. (pp. 93-4)

The continued preoccupation of some creditors with past debts, rather than future needs, thus remains a serious obstacle to development, and according to the UN and BIS analysis, one that is actually reducing new financing available for middle income countries. As commercial banks have criticised even the Brady plan as being too generous and for allowing IMF and World bank funds to go to countries not deemed credit-worthy by the banks, it is likely that, as the UN suggests, any initiative to leave the 'debt management' cycle must come from official agencies.

The BIS also expresses a more general worry about 'the fragility of financial markets' (p. 231) because of the proliferation of new instruments, imperfectly understood, and in some cases, not yet legally tested. It feared that in 'a harsher climate' the 'underestimation of risk' which some imply could create difficulties. It thought (even writing before July) that any slowing down in economic growth in 1990 could create such a climate. The real and financial effects of the Gulf crisis could increase such pressures.

3. The Effect of the Transformation of the International System

Most of the reports have sections discussing changes in the geographical structure of trade, especially looking for trends towards regionalisation and at the policies that are affecting this, notably the Single European Market, the Canada-US agreement, and the factors behind the growth of intra-Asian trade. Most also look at trade policy more generally, in the context of the Uruguay round and of bilateral trade policies. All also mention the developments in Eastern Europe, not only for their direct effect on those countries, but for their impact on developing countries in the traditional sense of the term. There have also been changes, which some of the reports mention or reflect, in broader aspects of foreign policy or official concern which impinge on economic variables, most notably the increased attention to non-economic criteria in international economic policy (notably aid and trade concessions). Democracy and/or 'good government' (or more fashionably, governance) have joined the environment, labour conditions, and gender issues as potential conditions or criteria for assistance. All of these (and the potential interactions among them) clearly are current issues in north-south relations, and some of the institutions are particularly well qualified to discuss each of them, but in the context of looking forward for the developing countries, it is unfortunate that in most cases they are treated as special subjects (as, therefore, they must be here), rather than as integral factors affecting (and perhaps also being influenced by) the forecasts. The advantage of the forecasting framework of these reports over the plethora of special reports available on each of these topics should be to encourage measuring these influences and discussing them in context.

Trade and trade policy

Two questions are raised on the geography of trade, whether trade is becoming increasingly intra-regional and whether it is becoming increasingly intra-industrial-country, with developing countries being 'marginalised'. The evidence from recent trading patterns does not support either of these. If, therefore, forecasters expect risks (or opportunities) from either of these processes, they must explain why current trends will change through economic or policy variables. 'Regionalisation' arguments depend on policy. Some reports look at the identifiable changes in trade policy, and measure what their effects ought to be (not yet, what they have been, although arguably any 'Europe 1992' effects at least must already be appearing both through anticipation and through the current investment boom, which anticipates 1993). Although there is extensive discussion of the various regional agreements in some of the reports (notably the UN and UNCTAD), fears for the extent and damage of effects seem to have decreased in the last year. More calculations have now been done (notably for Europe 1992), and the inherent limitations of an extended breakdown of the multilateral system are perhaps appearing: a major country which has entered a regional pact with one minor country, or group, will face opposition from that partner if it then tries to acquire new ones: US overtures to Mexico have not pleased Canada; the EC is having difficulty balancing existing commitments to EFTA, the ACP countries, the Mediterranean, Latin America, GSP beneficiaries..., among each other and for all these against Eastern Europe.

For individual developing countries, diversification of markets, not concentration on one 'industrial area' is closely associated with development, and it is increasing for the most successful. The Latin American countries have increased their dependence on US markets, but the rapid growth of US imports in the 1980s provides a potential explanation to be explored before considering 'regionalisation'. It probably will be difficult for Latin America now to shift to the faster-growing European markets, for the policy reasons discussed below, although their over-weighting towards primary products in this trade may prove an advantage in the short run. UNCTAD (pp. 93-5) tries to go beyond simple observation of the increase in Asian NICs' and new NICs' exports to Japan in the second half of the 1980s by relating the growth of intra-Asian trade to Japanese intra-multinational firm trade: although most of the growth can in fact be explained by composition and competitiveness effects, it does find some evidence that this contributes to the high shares. This, however, except insofar as the Japanese investment may be for geographical, rather than more economic reasons (such as the Asian countries' natural and human resources and rapid domestic growth) is not a regional effect.

UNIDO explicitly rejects the 'regionalisation' expectations: it 'believes the globalisation of production will continue to be a major economic force in the 1990s', and that 'regional integration movements have ...reinforced the globalization trend'.

The UN reports on the EC 1992 process and EC negotiations with EFTA, the ACP countries, and potential new members; on the US-Canada agreement, and also the US relations with the Caribbean and Mexico; and on developing country groupings such as the Asian Pacific Economic Cooperation Forum, the Arab Maghreb Union, and the Arab Cooperation Council. It mentions the 'great variety of petty producer interests' which influence these and contrasts them with 'dynamic industries...oriented towards the conquest of world markets'(p. 70), but does not quantify the effects or apply them to the forecasts. It quotes the UNCTAD measure of non-tariff barriers, but again without using it to modify its trade forecasts.

The World Bank (in one of its chapters on poverty, not in its section on prospects, p. 123) quotes the gains which some countries could expect on their exports 'if trade were completely liberalized' (this concept is not defined; it is not even clear whether it is all trade or trade by the industrial countries, although the emphasis on gains to developing country exports suggests the latter). The major gains under this heading go to middle income countries, but the timing and the probability of the gains are not assessed. The trade section of the forecast (pp. 22-3) cites the importance of the Uruguay round, and quotes EC estimates for trade creation (mainly on primary products) and diversion (probably giving a negative net effect for manufactures), but does not say how this has affected the quantitative forecasts.

UNCTAD (p. 80)[6] takes the view on 1992 that the 'net impact...could be small' but that commodities, especially fuel, would gain and manufactures would lose; again it is not clear how these results have been used in the forecast. It describes the issues still to be settled and the past history of EC trade policy towards different groups of developing countries.

The African DB (p. 39) expects '1992' to improve prospects for primary product prices, but fears relative loss of preference as a result of Uruguay round concessions. It does not quantify these. Its 'special topic' this year is an analysis of 'International trade and African economic development'.

Since, as discussed above, developing countries have been increasing their share of trade, the marginalisation argument, which is usually derived from assumptions about the change in developing countries' absolute advantages through shifts of demand or technology away from labour-intensive products towards more 'high-tech' or on requirements for 'just-in-time' production, should also be justified in terms of differences in the future. It is applied to current trends, but only by eliminating those countries to which it does not apply (the successful exporters of manufactures) from consideration, an invalid, though effective approach to analysis.[7] This can be considered an updated version of the fears for the ldcs as 'periphery' in the 1950s, with products using low-cost labour following those based on large supplies of physical raw materials into a declining share in output and demand. These changes are certainly a reason for expecting successful development to follow different routes in different periods, and for different countries to find that they have the greatest advantages (not all developing countries, especially in Africa, have Asian concentrations of labour), but past trading patterns and speculation about the future suggest that other types of exports have been and will be successful in the 1990s.

The area which does have a large number of countries that have not shifted to new industrial country markets and whose shares of trade have fallen (thus

[6]Based partly on an ODI study for UNCTAD.

[7]To quote (only because it is the most recent) the speech by the Secretary General of the OECD to the UN Least Developed Countries conference, 6 September 1990: 'except for some remarkable exceptions.., the developing world's economic performance has not been so satisfactory' in the 1980s. The 'exceptions' have of course been sufficient to make the developing countries' growth higher than the industrial in the 1980s, as it was in the 1970s.

offering evidence of both adverse regionalisation and marginalisation) is Africa, but even here some are successful, reinforcing the indications that the problems are more likely to be found in country-specific (or low-income-specific) characteristics which prevent countries from taking part in 'normal' trade stimuli, than in the international trading system. The African Development Bank (p. 23) cites the large weight of commodities in African exports, and discusses the interaction of international forces and domestic policy extensively in its special section. It suggests that in the short term export growth depends on 'the rehabilitation of existing (mainly primary product) exports. In the somewhat longer term, diversification in terms of products and markets are critical for fostering export earnings growth.' (p. 93). Although current prospects (e.g. 1992) offer temporary opportunities for increasing the volume and prices of commodities, in the longer term, it emphasises the role of light manufactured products, especially the traditional first manufactured exports for developing countries: textiles, clothing and footwear. It does not, therefore, appear to share the more pessimistic 'marginalisation' views that the international system makes it now impossible for developing countries to achieve the same results following roughly the same strategies as countries have in the past (provided, as it emphasises, that the reasons for the association between exports and growth are correctly analysed).

There are non-trade arrangements, in some of which there is better support for 'marginalisation', which are insufficiently explored. These could affect medium-term trade and output performance, as well as exchange rates and interest rates. They could also have more fundamental effects on developing countries' approach to external strategies.

The changes in the nature of international economic policy making: bilateral (or cartelised) against multilateral decisions.

An increase in the share of 'large' units (the EC, most obviously) relative to middle-sized in negotiations.

Increasingly rule-based international systems (if GATT succeeds in establishing regulatory frameworks for the new areas, and continues to change its role to a more interventionist stance as it has in the last two years).

More complex forms of 'nation' in international organisations: the EC, again, but also North America and the regional groupings for trade or payment transfers or exchange rate purposes among developing countries.

More complex hierarchies among countries which are not simply 'developed' or 'developing', but normally contain a range of more or less developed sectors.

The general increase in the role of trade, international capital, and other external factors within national economies, changing the nature of the relationship to the 'rest of the world' of governments, business, and consumers.

The reports continue to discuss the question of external 'openness' without considering the changes in what countries are 'opening' to.

The forecasts do not appear to use the insights from these special sections on trade. Developing country trade is forecast basically on the basis of present composition and market shares and competitiveness. Only the change which is already becoming apparent, the growing success of the new NICs in Asia relative to the old appears to be reflected (and this disappears within 'Asian exports' in most forecasts). This lack of effect on the forecasts could be justified as many of the effects found tend to be small, at least net, but there are some indications from the regional analyses that different types of producers will be favoured or damaged, and that effects will be different in the immediate and in the medium term. These do not appear to be reflected, for example in a forecast of a temporary improvement in demand for primary commodities, or in the terms of trade of primary against manufactured products, or used to modify trends derived from the past relative performance of different areas in different markets. As noted in section 2, if the forecasts embody an increase in the efficiency, and therefore the productive potential and demand for developing country exports, of the trade-bloc-forming countries, the duration of the effect does not fit the analysis. The 'marginalisation' arguments are not quantified. If they are included in any forecast, their effect must be offset by some other new influence: the forecasts uniformly expect developing countries' performance relative to industrial to be better in the medium term than in the recent past.

Eastern Europe

The reports now give more attention than in the past to Eastern Europe as a part of the world in its own right (so that it is possible to include them here in table 1). Most also look explicitly at how events there have changed the prospects for developing countries.[8] The possible effects considered are trade, including trade policy, the supply of public and private finance, and its cost. The effect of the rejection of the previous regimes on the nature of the international system, and on how the developed countries now view policy in the developing countries, and the lessons developing countries may themselves draw for economic or political policy are also considered, but will be discussed in the next section. As with trade policy, it is not clear how the extensive descriptions have actually been used in the forecasts.

Except for UNIDO (with a very small rise this year), the forecasts are for a small fall in their output this year, a small rise in 1991, and slow growth in the medium term. The discussion, however, in the reports and in other sources, suggests much more severe disruption to output this year, followed by prolonged difficulties or by a rapid rise in output as the economies are transformed, or possibly first one then the other. The cautious quantified forecasts are presumably equivalent to the cautious hypotheses forecasters use for other difficult (and in this case, unfamiliar) variables which could more strongly in either direction: they must be interpreted as a very unlikely, but central path. But only if they actually prove to be small is it unnecessary to make explicit allowance for the sensitivity of the rest of the forecast to them. Uncertainties over their current levels of trade and output (when valued at world prices) and therefore over appropriate weighting. are valid reasons for caution in computing their impact on macro-variables.

The most extensive discussion of their economies is in UNECE (which has always had full coverage of both parts of Europe). It offers a comprehensive and quantified programme for what international and domestic measures are needed.

The UN has a section discussing and advising on the process of economic restructuring (Chapter VI). The IMF (pp. 70-1) accepts that 'there is no theory of the transition from a centrally planned to a market economy', but

[8]In traditional terms of level of income per capita or structure of output the Eastern European countries are poor developed countries, not developing.

nevertheless feels able to present a list of recommendations for what needs to be done, and in what sequence. Although it mentions Latin America as 'particularly' relevant, it argues for optimism for the medium term based on the post-war recovery of Western Europe and Japan and the growth of the NICs, although the immediate outlook is poorer than was expected before the political changes (p. 5). It gives a background note on each country. OECD discusses their external ties to the rest of the world, and their potential need and receipts of funds.

In general, their incomes (and their consumption patterns) are expected to move more rapidly than would have been previously expected towards Western European patterns, implying a step improvement in demand for developing countries' commodity products (notably beverages and tropical fruit), as well as for more industrial consumer products. As the African DB points out, this would not imply a permanent change in the rate of growth of demand for these. As competitors in export markets, their impact is more uncertain. Initially the trade creation effects are likely to be most important, but in basic manufactures or heavy engineering products, where their location near markets would be an advantage, they may divert demand from new NICs, if not from those old NICs which are already more advanced. All these effects could be strengthened by the reduction in trade discrimination against them: removal of special restrictions on imports and the reform of COCOM restrictions on exports, and even more by granting of special concessions to them, on GSP and tariffs. The UNECE (p. 218) calculates the effects of these on the Eastern European countries, but not on developing who may lose markets. At a macroeconomic, rather than sectoral, analytical level, their faster growth and higher incomes will raise average levels and rates of growth of world output and demand, benefiting the developing areas in the 'usual' proportions (NICs most; primary producers least).

If they grow rapidly, and particularly if they prove an effective platform for exporting to western Europe, they will attract foreign investment, and most are willing or anxious to use this. This is unlikely to be a rapid process, first because of the uncertainties and the risk of a period of slow growth (at best), but also because the legal regimes for a modern industrial sector or for the participation of foreign capital are still being put in place. The UN (p. 99) does not expect large investments soon, except in eastern Germany. Some immediate effect, however, cannot be ruled out if there is an immediate portfolio adjustment effect, under which companies or financial investors put in a 'marginal' (the UN's p. 99 expectation) amount. Given the previously negligible flows to Eastern Europe, and the small new flows to most developing countries, such 'small' diversions could be relatively important. In the long-term, higher foreign and domestic investment will encourage the growth discussed above, but if new investment rises faster than rises in income permit their saving to rise, this could increase the expected rates of return, and thus the cost of capital. Their growth would also increase other areas' potential returns, including developing countries. The net effect would be different in different areas and countries, but countries with good long-term growth prospects and high domestic savings generation would seem a priori more likely to gain (probably NICs or new NICs, more than the poorest or debtors).

UNIDO finds good opportunities for (and responses from) private investors in Hungary, Poland, and to a lesser extent Czechoslovakia, and even the USSR. although it points out that the levels are still low. It discusses the institutional infrastructure needs, banking and financial instruments, accounting, 'reasonable labour mobility', distribution, and information, and the use of joint ventures.

These real economy effects are one reason for expecting higher real interest rates as an 'Eastern Europe' effect. A more immediate one is if transfers to them permit exports to them to rise more rapidly, and if this strains productive capacity in the industrial countries (or threatens to do so) so that monetary policy is tightened, It is unclear whether the rise in the last year in interest rates should be regarded as sufficient, or whether further increases are expected (the risk effects may be fully discounted, but are the new growth prospects? Will future changes in these be offsetting?) This is potentially a very serious effect on developing country debtors (or indeed on the Eastern European debtors themselves).

Although OECD assumes that the impact on OECD countries, at least, will be small, because their trade with Eastern Europe is small (it excepts the impact of German reunification), it does note both the rise in risks and the increase in opportunities from Eastern Europe as explanations behind the rise in interest rates in the past year (p. 5).

The quantity of public sector funds, and the terms under which they will be offered, are clearly crucial to estimating Eastern Europe's ability to increase investment and to restructure rapidly. The UN (p. 99) gives preliminary estimates of commitments, and the UNECE goes furthest in estimating what quantities would be needed to match those available to Western Europe in its restructuring in the 1940s (pp. 5-26). The assumption in the forecasts appears to be that these are at non-concessional terms, and not diverted from aid programmes for developing countries. UNECE notes that US and Canadian aid officials have stated that aid will be at the expense of developing countries (p. 33), although European governments have promised that it will not. The IMF (p. 73) warns of risks of diversion of private and public capital, and also of debt relief from the developing countries. UNECE favours technical assistance over funds: Eastern Europe's debts are already high, and changes in structure are the most necessary immediate reform, not higher investment.[9] Technical assistance, also, could be provided by diversion from developing countries (and anecdotal evidence so far suggests that this has been the source). The implication of the cautious forecasts for Eastern European growth is that whatever funds are provided are not sufficient to produce rapid growth, but do prevent collapse.

The restructuring of the East German economy and the effect of this on its and on West German economic relations with the rest of the world may provide an accelerated indication of how the rest of Eastern Europe will move. Some of the reports do treat German reunification separately, or at least discuss the impact on future data and definitions.[10]

The IMF explicitly states that it has not allowed for German reunification (its report is the earliest, published in May), but notes that this would raise its expectation of growth in Germany (quoting a German estimate of the increment as 1-1.5%) and in other European countries. Initially demand in eastern Germany would rise, from government and private investment, while

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[9]It is not, however, clear why (p. 15) it concludes that 'economists, political theorists, anti-trust lawyers and some central bankers' are the experts needed. Its assertion that a 'businessman is no more an expert on the rules of a market economy than is a chauffeur on the physics of the internal combustion engine' is true, but it is an engineer or a mechanic, not a physicist, whom most people would ask to design or repair an engine. Its analogy would provide better support for technical than theoretical advisers.

[10]Separate balance of payments data have already been discontinued, for example, but, apparently, 'Germany' in most of the forecast tables is West Germany: this has the advantage for forecasters that this year's forecasts will be uncheckable.

supply would fall. In the longer run, higher labour productivity would raise potential there, and more efficient allocation of resources would also raise it in western Germany, Initially, favourable output effects on demand for output in the rest of the world would be approximately balanced by 'the restraining effects of higher real interest rates' (p. 75), but with net favourable effects in the longer run. German forecasts for eastern Germany are for a fall in output in this year, but thereafter very rapid, growth. They accept continued high German interest rates. If the growth is as high as the most optimistic expect (catchup in 5 years), this will permit Germany to keep on a high interest rate, high growth path. But this need not imply that the other European countries can sustain a parallel increase in interest rates without a fast-growing new territory. Continued high real interest rates (presumably not yet incorporated in the main international forecasts) clearly imperil developing country growth. If eastern German growth is closer to the pessimistic forecasts (catchup in 15 years was suggested by the OECD after the publication of their Outlook), with perhaps more than a year before it begins, and if even this has led to the present interest rates, it may be difficult for Germany itself to reconcile interest rates and growth without higher saving, through a spontaneous increase or through taxation. If this means lower western German growth, the German average, and therefore the impact on the rest of the world, would be less favourable.

Democracy

Official funds for Eastern Europe will be partly channelled through the new European Bank for Reconstruction and Development (although it will not be in place until 1991) with different criteria as well as different resources from the banks funding developing countries.[11] Unlike the other development banks, it includes an explicit commitment to political criteria for lending, not merely to 'market economics', but to 'the principles of multiparty democracy'. Since March, both the international institutions and some bilateral donors have emphasised such criteria in aid for developing countries as well. This is not yet reflected in the reports (although it was in the World Bank's presentation to this Conference last year), but it is a potential change in the conditions governing developing countries' prospects for funds. Although the simultaneous economic and political restructuring of the Eastern European countries invites observers to assume that they must go together, the history of the relationship between economic policy and political regimes is

[11] The EBRD is described in a new ODI Briefing Paper.

too complicated to permit the easy conclusions which are now being drawn that democracy is either a necessary or a sufficient condition for economic reform.

If such criteria do come to influence World Bank lending policy, there appear to be two possible interpretations, with differing effects. The first would mean a diversion of funds away from Africa. Most of the World Bank (and IFC) enunciation of the new doctrines has focused on the lack of democracy there: the cynical view would be that such arguments have appeared now because it is necessary to find a 'developmental' reason for redirecting aid from the poorest countries to middle income countries (or, for bilateral donors, a substitute for 'national security' as a way of overriding developmental aid allocation criteria). If it is a more genuine change of perceptions about the nature and needs of developing countries, the diversion of funds will be much more diffuse, and the lending decisions and procedures of the international institutions (and some bilateral donors: so far, principally the US; not the EC,) will need a new set of criteria. The nature of the judgements required means that (unlike previous additions to lending criteria like the environment or gender) it cannot be relegated to small departments to review lending decisions as a last step. The obvious difficulties (and inconsistency with all previous efforts to distance international institutions from 'politics') unfortunately tend to support the more cynical diagnosis, but if the EBRD can apply such criteria, this could influence procedures.

Developing countries themselves have been influenced by the implications of the new choices being made in Eastern Europe, and the implied judgements about which systems are successful. If they respond by changing their own policies, liberalising domestic and external markets, or by altering the structure of production, they also may want additional resources to meet the short-term costs of output foregone. This would put additional new pressures on the international system. Their performance and their relationship to the international system would also change.

The forecasts of basically unchanged trends within developing countries and of their trade and of capital flows to them implicitly assume that even in the medium term none of this has an effect.

4. Oil

All the international institutions' forecasts were made before Iraq's occupation of Kuwait, and indeed before the OPEC July settlement. For this reason, only preliminary reports are now available of how they would revise their forecasts, and the price and supply of oil are still too uncertain for them or other forecasters to present more than indications and 'scenarios'. Some conclusions, however, are beginning to emerge.

Since the very large fluctuations of the price at the beginning of the crisis, both the price and forecasters' expectations have settled down. Even the worst imaginable case seems to be taken to be around $65 to $70 a barrel, and most 'base' forecasts are for the highest price to be under $30 and in the second half of this year; with a fall to low or mid 20s in 1991, and a price in that range (remaining firm or falling further depending on whether the conflict drags on or is resolved) for the medium term. This assumes that most of the loss of Iraqi and Kuwaiti exports is made up (although not quite immediately). None of the forecasters appears to expect an actual use of present stocks, although their existence helps to contain the price. Given this type of scenario, the effect on the industrial countries (according to the World Bank, National Institute, and EIU) is at most half a percent off GDP, with about 1% extra on prices. The 'more serious' scenario which is usually explored (e.g. NIER or EIU) is a temporary rise to up to $40 a barrel. This gives losses of around 1% to output and increases of up to 2% on prices. It is notable that some of the largest effects come through onto the interest rate, as monetary policy is assumed to be tightened in response to the inflationary threat, and it is indeed its effects which appear to be most important on output, not the direct economic effects of the oil price. (This is consistent with the more serious impact, with a smaller initial shock, of the second oil price shock than the first; monetary policy was less accommodating after the second.)

For industrial countries, therefore, a moderate scenario reinforces the tension between growth and real interest rates, but does not appear to have significant effects. There is one important caution that must be applied to such results: that the invasion happened and that the oil price has risen are events which must already have destroyed the confidence among some investors in a low-energy-price, shock-free future. If such views were helping to sustain the late 1980s investment boom, this could have an additional, difficult-to-model, effect on investment intentions and therefore on medium-term growth. Alternatively, if a settlement and a return to low oil prices is achieved fairly rapidly and smoothly, this could even increase confidence in the future. The least likely outcome is that only the direct effects of changes in the oil price will affect the forecasts, and that existing behavioural responses will be unchanged.

Clearly if one of the more catastrophic scenarios materialises (the $65-$70 range effectively assumes loss of Saudi Arabian production as well), more than the price of oil will change in the international economy.

For the developing countries, only the World Bank has (at time of writing) indicated some changes, and without full quantification. Its analysis is most useful for emphasising the range of paths through which the effects are transmitted, in addition to more expensive imports of oil. For those most sensitive to output growth in the developed countries, the fall in this will be important (this was the source of the principal effects on developing countries in previous oil price crises). But oil exporters' imports will expand and offset at least some of this. As they are less developed than the OECD countries and still heavily dependent on primary commodity imports, including food, it seems possible that there will be a relatively favourable effect on primary producers. The highly indebted, especially the middle income, countries will suffer from the interest rates, and presumably they will also tend to be more affected by loss of industrial country (and NIC) export markets than the lowest income (primary producing) countries. The Bank points out that imports of oil are now a higher share of most developing countries' imports and output because they are more developed than they were in the 1970s. Countries dependent on remittances from those workers now forced to leave Iraq and Kuwait will clearly suffer further current balance and income losses. While the USSR will be a major gainer from the rise in oil prices, Eastern European countries, which already faced the transition to world prices as the USSR 'liberalised' its market prices, will be even more severely hit by the higher market price. There is a risk that the extra costs of supporting them as well as the emergency aid to those affected by the conflict will come from resources that would otherwise be allocated to development assistance. (Even if the western industrial countries do not divert resources to these new needs, aid from Eastern Europe, already likely to fall, will be further reduced.)

The result for oil importing developing countries on average of the type of oil price scenario that costs industrial countries 0.5% of GDP is a loss of 1%, with the most indebted losing about 2% (or more for the low income). The less indebted are apparently assumed to be able to mitigate some of their loss by borrowing, but it is not certain that they will want to at present interest rates: the second round effects of policy responses must be considered for them as well. A further policy-induced response could come if multilateral and bilateral donors advise oil importers to adjust in full, rather than seeking temporary assistance, to what (on most forecasters' scenarios) is likely to be a temporary rise in the oil price, while warning oil exporters not to expect the rise to be permanent.

It is the identification, by private forecasters as well as the World Bank, of interest rates (and behind them, monetary policy in the industrial countries) as the principal transmission mechanism of oil price effects to the developing countries that is the most interesting result of using a general rather than partial calculation of the oil price effects. For Latin American countries, using only oil price changes would give a much more favourable outcome as even some which do not export oil are close to self-sufficient in energy. This result should focus attention on the problems now caused to developing countries in both 'normal' and 'crisis' conditions by the cost of finance.

The other issue raised is how to avoid a severe loss of confidence by investors and increase in risk-averse behaviour by governments, industrial and developing, oil exporting and oil importing, which could affect the 1990s in the way the response to the Iran-Iraq war contributed to the depression of the early 1980s.

5 Poverty

Most of the World Development Report this year, effectively all of the UNDP's new report on Human Development, and unusually large parts of the other reports are devoted to poverty or welfare issues rather than the more usual development questions. There are also a number of efforts to define development and poverty. Coming in 1990, these studies have been helpful to place the Eastern European countries in their appropriate position (essentially middle-income). As subjects for development analysis, they do not fit easily into traditional categories or modes of thought. But the main studies were planned before the major changes there, and may have been inspired more by concerns that some countries appear to be making little progress, or, more generally, that the problem of poverty is still as serious as ever.

A worrying corollary of this concern is what UNIDO calls 'impatience' with developing countries. It points out that 'economic development is a long-term process which has never been achieved in one generation....It is, however, important not to lose the proper perspective, since historically at least, what developing countries have managed to accomplish since the early 1960s seems impressive enough, and at times they are more than comparable to similar achievements of the industrialized countries during the last century.' The turn to new requirements like democracy may also reflect this impatience, as does the tendency to belittle developing countries through generalisations about their 'failure' (which has occurred in criticisms of Africa's democracy and was noted for economic policy in last year's report) and about the failures of aid.

The plethora of special sections has given us some rather different 'definitions of development' by the different organisations.[12] UNIDO calls it 'only a means to achieve a higher living standard for common men and women', although it immediately modifies this to point out that 'with industrialization comes the easy availability of a wide range of goods and services which are inputs leading to achieving' some of the elements of higher living standards (and these go beyond just income).

The UNDP report, by calling itself Human Development Report and its combined index of income, literacy, and health a 'development indicator' effectively implies the same type of definition. Although it starts by declaring that the 'purpose of development is to offer people more options' (p. iii), it promptly (p. 10) delimits the 'essential' choices as a 'long and healthy life, to acquire knowledge and to have access to resources needed for a decent standard of living'. Its intention is to show how growth permits, but does not ensure these. Its index (which is intended to measure the gap between a country's achievements and 'good' performance on each of these indicators) is an important addition to the analysis of a country's own performance, over time, and relative to other countries (table 5 reproduces the elements used to

[12] A defence can be made of looking primarily at the purely income measures, without the modifications suggested in these reports: 'The advantage of economic growth is not that wealth increases happiness, but that it increases the range of human choice....The case for economic growth is that it gives man greater control over his environment, and thereby increases his freedom.' W. Arthur Lewis, Theory of Economic Growth, London: Allen & Unwin, 1955), pp. 420-1.

calculate it, the ranked results, and the full definition). In principle it could measure success of different policies or need for assistance. It uses the indicator to analyse how and why countries' performances differ, in particular the role of different policies towards providing health, education, and poverty relief services. One of the clear results at national level is the need for intervention to supplement simple growth to ensure that all parts of the population have a satisfactory standard of living. Although it raises many questions, its emphasis on quantification (not only of the index, but of the cost of achieving specific attainments) provides a useful additional tool as well as a new meaning to modelling countries' prospects.

In contrast, the World Bank survey of poverty is more descriptive, and gives an account of individual countries' experiences and possible policies. In concentrating its analysis and definition of poverty on income (although it also looks at social indicators), its estimates of the cost of bringing people to given standards are simply of income transfers. For it, 'reducing poverty is the fundamental objective of economic development'.

UNCTAD (p. III) mentions the problem of worsening income distribution as an 'inevitable' part of any national income fall ('upper income groups cannot be made to share to any great degree in those losses' because both the highly trained and capital are internationally mobile). The diverse experiences analysed by UNDP suggest that this 'inevitability' is overstated.

The Asian DB discusses the relationship of development to the 'quality of life' (pp. 20-1), and the existence of serious deficiencies in its members, particularly on education, but does not draw policy recommendations for individual countries firmly in the way the UNDP Report does. Like the UNDP, it extends its definition of development explicitly to education: 'If the purpose of development is to enhance the quality of life and the dignity of individuals, it follows that the spread of literacy must be seen as a goal in its own right' (p. 20).

6. Assessing the Prospects for Developing Countries

The range of changes in and strains on the international economy which the reports discuss, and the further changes since they were published, make drawing conclusions for developing countries, in general or for any country a daunting task. But the way in which these reports are now approaching it does not take full advantage of the potential benefits from the analytic structure and constraints of the forecasting framework.

Within the quantified forecasts that are presented, there appear to be too many potential internal contradictions (particularly when carried into the medium to long term) The most notable is between the cost and scarcity of capital and the level of investment and willingness to take risks, casting doubt on the long-term growth rates (in both industrial and developing countries). As the World Bank points out, and UNCTAD explicitly assumes, real long-term interest rates are now expected to exceed growth rates in some industrial countries, and much of Africa and Latin America, not just temporarily (which could reflect mistaken or inconsistent price expectations or temporary costs of adjustment), but over a 'medium term' long enough for any such expectations to adapt. But the forecasts do not assume that there will be a significant reduction in investment in response, or diversion to other areas. For the heavily indebted, although most support more or better relief mechanisms, the forecasts assume that present arrangements continue, regardless of the effects on long-term growth. It is not useful for long-term forecasts to present continuation of present relationships and trends while pointing out that they are not feasible. The structural changes which the Asian DB and UNIDO examine could well affect medium term trade and output, and they are cited in their forecasts, but these organisations do not do medium-term forecasts.

The other important lack is that all the new and interesting changes are treated as 'special topics', to be analysed outside the forecasting framework. This is a useful first step (or for non-forecasters, even a sufficient step). But failing to integrate them explicitly, however imperfectly, with the forecasts carries two risks, both of which appear to have affected this year's forecasts. The first is that potentially significant changes in trend: for example, the possible benefits to primary exporters that have been identified from 1992 trade diversion and terms of trade effects, Eastern Europe effects, and oil price effects; the greater risks for exporters of manufactures; the upward pressures on real interest rates which also could follow from each of these; or possible reallocations of public sector assistance funds, are not integrated into the main forecast. Some of these could, if they are large enough, suggest an interesting shift to better prospects for primary producers in the next few years, and worse thereafter. That some of the variables which the special studies analyse are considered too political to forecast (the oil price for the IMF) is not a tenable position; the 'note' makes the IMF forecasters' view clear. If the answer is that they were quantified, but found to be too small to matter, and therefore not mentioned, this is an example of the second risk: that the attraction of the new because it is new, even though not very important, distorts the weighting of the analysis. It is, of course, necessary for researchers to examine the new influences to learn whether they are significant, but in an economic outlook or development report, the emphasis in the end should be on those elements which do matter, even if they are old and familiar.

The forecasts in the reports, even modified by initial estimates of oil price effects, are for reasonable growth for the industrial countries, but with the risk that this will prove unsustainable. For the developing countries which have been able to benefit from industrial country growth in the past, if present trade relationships continue, prospects are also still good. Trend or shock dangers from trade or new trade arrangements now seem less likely. In terms of the international economic system, as well, the 'marginalisation' of developing countries from decision-making and therefore their exposure to risks now seem more serious on interest rate and exchange rate management than on trade policy. In GATT, they have been increasingly active (and increasingly seen by the other participants as a force to be met or obstructed). The current GATT round may bring both specific opportunities from reduced protection and a general improvement from a return towards a rule-based system. Once the temporary risks from the various new regional trade agreements and from the reintegration of the Eastern European countries have been passed, these processes should improve trade prospects. On trade, the problem is to identify and quantify the changes in the composition of trade with more structural analysis than is present in most of these reports.

The problem which remains is therefore how to reduce the vulnerability of the countries which still need to change their structure to the continuing pressures of unfavourable capital supply and cost and to the shocks which also seem likely to come from these. They must find the long-term financial resources to exploit the changed opportunities, and the short-term finance to meet temporary difficulties: like the transition to 1992; shocks: like the current oil price rise; and the risks that some of their long-term choices will be wrong; and also to meet the costs of their past debts (or these must be lifted from them). Although the UNCTAD report emphasises the problems of finance, its remedy of greater 'collective control and guidance over international finance' concentrates on the distribution, not the supply or cost. It does identify three important institutional problems: the development of new instruments which do not give helpful signals about risk, especially long-term; the dependence on monetary policy in the industrial countries, without appropriate institutional changes to reduce the strains this imposed on the interest rate tool; and the absence of 'effective multilateral constraints and obligations on policy making in the major countries' (p. 106). These do tend to make the general problems of international finance affect the developing countries disproportionately. It also brings out the long-term effects of lack of saving on investment, output, and technological progress(p. 73).

What are most needed in all the reports, however, are suggestions and analysis of how to secure the quantities and forms of finance which they show are necessary: to reverse the fall of concessional flows relative to output in the industrial countries; to supplement the now inadequate amounts of short-term, quick-disbursing forms of balance-of-payments finance which the IMF was intended to supply; and, to meet new long-term needs (e.g. debt commitments) and new demands (e.g. Eastern Europe). Can and should this be done by increasing present forms (if so, how?) or are new types needed, to offer lower long-term risks or faster response and disbursement? If funds are expected to be lower relative to needs or if the new needs are seen as different from traditional development, what should be the criteria for allocating them? What changes are needed in the role of the international institutions?

1 Human development index

		Life expectancy at birth (years) 1987	Adult literacy rate (%) 1985	Real GDP per capita (PPP $) Actual 1987	Real GDP per capita (PPP $) Log 1987	Deprivation: Life expectancy	Deprivation: Literacy	Deprivation: North minimum purchasing power	Deprivation: Average of the three	Human development index	GNP per capita rank 1987	HDI rank minus GNP rank
Low human development												
1	Niger	45	14	452	2.66	0.90	0.98	0.77	0.884	0.116	20	-19
2	Mali	45	17	543	2.73	0.92	0.94	0.71	0.857	0.143	15	-13
3	Burkina Faso	48	14	*500*	*2.70*	0.83	0.99	0.73	0.850	0.150	13	-10
4	Sierra Leone	42	30	480	2.68	1.00	0.80	0.75	0.850	0.150	27	-23
5	Chad	46	26	*400*	*2.60*	0.88	0.85	0.81	0.843	0.157	4	1
6	Guinea	43	29	*500*	*2.70*	0.97	0.81	0.73	0.838	0.162	31	-25
7	Somalia	46	12	*1,000*	*3.00*	0.89	1.00	0.51	0.800	0.200	23	-16
8	Mauritania	47	17	840	2.92	0.86	0.95	0.57	0.792	0.208	40	-32
9	Afghanistan	42	24	*1,000*	*3.00*	0.99	0.87	0.51	0.788	0.212	17	-8
10	Benin	47	27	665	2.82	0.85	0.84	0.64	0.776	0.224	28	-18
11	Burundi	50	35	450	2.65	0.78	0.74	0.77	0.765	0.235	18	-7
12	Bhutan	49	*25*	*700*	*2.85*	0.81	0.86	0.63	0.764	0.236	3	9
13	Mozambique	47	39	*500*	*2.70*	0.85	0.70	0.73	0.761	0.239	10	3
14	Malawi	48	42	476	2.68	0.84	0.66	0.75	0.750	0.250	7	7
15	Sudan	51	23	750	2.88	0.76	0.87	0.60	0.745	0.255	32	-17
16	Central African Rep.	46	41	591	2.77	0.88	0.67	0.68	0.742	0.258	29	-13
17	Nepal	52	26	722	2.86	0.72	0.84	0.62	0.727	0.273	8	9
18	Senegal	47	28	1,068	3.03	0.87	0.82	0.49	0.726	0.274	43	-25
19	Ethiopia	42	66	454	2.66	1.00	0.39	0.77	0.718	0.282	1	18
20	Zaire	53	62	220	2.34	0.69	0.43	1.00	0.706	0.294	5	15
21	Rwanda	49	47	571	2.76	0.80	0.60	0.69	0.696	0.304	26	-5
22	Angola	45	41	*1,000*	*3.00*	0.90	0.67	0.51	0.696	0.304	58	-36
23	Bangladesh	52	33	883	2.95	0.73	0.76	0.55	0.682	0.318	6	17
24	Nigeria	51	43	668	2.82	0.74	0.65	0.64	0.678	0.322	36	-12
25	Yemen Arab Rep.	52	25	*1,250*	*3.10*	0.72	0.86	0.44	0.672	0.328	47	-22
26	Liberia	55	35	696	2.84	0.63	0.74	0.63	0.667	0.333	42	-16
27	Togo	54	41	670	2.83	0.67	0.68	0.64	0.663	0.337	24	3
28	Uganda	52	58	511	2.71	0.73	0.48	0.73	0.646	0.354	21	7
29	Haiti	55	38	775	2.89	0.63	0.71	0.59	0.644	0.356	34	-5
30	Ghana	55	54	481	2.68	0.64	0.53	0.75	0.640	0.360	37	-7
31	Yemen, PDR	52	42	*1,000*	*3.00*	0.73	0.66	0.51	0.631	0.369	39	-8
32	Côte d'Ivoire	53	42	1,123	3.05	0.69	0.66	0.47	0.607	0.393	52	-20
33	Congo	49	63	756	2.88	0.80	0.42	0.60	0.605	0.395	59	-26
34	Namibia	56	*30*	*1,500*	*3.18*	0.61	0.80	0.38	0.596	0.404	60	-26
35	Tanzania, United Rep.	54	*75*	405	2.61	0.67	0.29	0.80	0.587	0.413	12	23
36	Pakistan	58	30	1,585	3.20	0.57	0.80	0.36	0.577	0.423	33	3
37	India	59	43	1,053	3.02	0.53	0.66	0.49	0.561	0.439	25	12
38	Madagascar	54	68	634	2.80	0.66	0.36	0.66	0.560	0.440	14	24
39	Papua New Guinea	55	45	1,843	3.27	0.64	0.63	0.31	0.529	0.471	50	-11
40	Kampuchea, Dem.	49	75	*1,000*	*3.00*	0.79	0.28	0.51	0.529	0.471	2	38
41	Cameroon	52	*61*	1,381	3.14	0.73	0.44	0.41	0.526	0.474	64	-23
42	Kenya	59	60	794	2.90	0.52	0.46	0.58	0.519	0.481	30	12
43	Zambia	54	76	717	2.86	0.66	0.28	0.62	0.519	0.481	19	24
44	Morocco	62	34	1,761	3.25	0.46	0.75	0.33	0.511	0.489	48	-4
Medium human development												
45	Egypt	62	45	1,357	3.13	0.46	0.63	0.41	0.499	0.501	49	-4
46	Lao PDR	49	84	*1,000*	*3.00*	0.79	0.18	0.51	0.494	0.506	9	37
47	Gabon	52	62	2,068	3.32	0.71	0.44	0.27	0.475	0.525	93	-46
48	Oman	57	30	*7,750*	*3.89*	0.60	0.80	0.00	0.465	0.535	104	-56
49	Bolivia	54	75	1,380	3.14	0.66	0.29	0.41	0.452	0.548	44	5
50	Myanmar	61	*79*	752	2.88	0.48	0.24	0.60	0.439	0.561	11	39
51	Honduras	65	59	1,119	3.05	0.37	0.46	0.47	0.437	0.563	53	-2
52	Zimbabwe	59	74	1,184	3.07	0.52	0.30	0.45	0.424	0.576	45	7
53	Lesotho	57	73	1,585	3.20	0.59	0.31	0.36	0.420	0.580	35	18
54	Indonesia	57	74	1,660	3.22	0.59	0.30	0.35	0.409	0.591	41	13
55	Guatemala	63	55	1,957	3.29	0.42	0.51	0.29	0.408	0.592	63	-8
56	Viet Nam	62	*80*	*1,000*	*3.00*	0.44	0.23	0.51	0.392	0.608	16	40
57	Algeria	63	50	2,633	3.42	0.41	0.57	0.20	0.391	0.609	91	-34
58	Botswana	59	71	2,496	3.40	0.52	0.33	0.21	0.354	0.646	69	-11
59	El Salvador	64	72	1,733	3.24	0.40	0.32	0.33	0.349	0.651	56	3
60	Tunisia	66	55	2,741	3.44	0.33	0.51	0.18	0.343	0.657	70	-10
61	Iran, Islamic Rep.	66	51	*3,300*	*3.52*	0.34	0.56	0.12	0.340	0.660	97	-36
62	Syrian Arab Rep.	66	60	*3,250*	*3.51*	0.34	0.46	0.13	0.309	0.691	79	-17
63	Dominican Rep.	67	78	*1,750*	*3.24*	0.32	0.25	0.33	0.301	0.699	51	12
64	Saudi Arabia	64	*55*	8,320	3.92	0.38	0.51	0.00	0.298	0.702	107	-43
65	Philippines	64	86	1,878	3.27	0.39	0.16	0.31	0.286	0.714	46	19
66	China	70	69	2,124	3.33	0.23	0.36	0.27	0.284	0.716	22	44

		Life expectancy at birth (years) 1987	Adult literacy rate (%) 1985	Real GDP per capita (PPP $) Actual 1987	Log 1987	Deprivation: Life expectancy	Literacy	North minimum purchasing power	Average of the three	Human development index	GNP per capita rank 1987	HDI rank minus GNP rank
67	Libyan Arab Jamahiriya	62	66	*7,250*	*3.86*	0.46	0.39	0.00	0.281	0.719	103	-36
68	South Africa	61	*70*	4,981	3.70	0.46	0.34	0.00	0.269	0.731	82	-14
69	Lebanon	68	78	*2,250*	*3.35*	0.30	0.25	0.25	0.265	0.735	78	-9
70	Mongolia	64	*90*	*2,000*	*3.30*	0.39	0.11	0.29	0.263	0.737	57	13
71	Nicaragua	64	88	2,209	3.34	0.38	0.14	0.25	0.257	0.743	54	17
72	Turkey	65	74	3,781	3.58	0.37	0.30	0.08	0.249	0.751	71	1
73	Jordan	67	75	3,161	3.50	0.32	0.29	0.14	0.248	0.752	76	-3
74	Peru	63	85	3,129	3.50	0.43	0.17	0.14	0.247	0.753	74	0
75	Ecuador	66	83	2,687	3.43	0.34	0.19	0.19	0.242	0.758	68	7
76	Iraq	65	89	*2,400*	*3.38*	0.37	0.13	0.23	0.241	0.759	96	-20
77	United Arab Emirates	71	*60*	12,191	4.09	0.20	0.46	0.00	0.218	0.782	127	-50
78	Thailand	66	91	2,576	3.41	0.34	0.10	0.20	0.217	0.783	55	23
79	Paraguay	67	88	2,603	3.42	0.31	0.14	0.20	0.216	0.784	65	14
80	Brazil	65	78	4,307	3.63	0.35	0.26	0.04	0.216	0.784	85	-5
81	Mauritius	69	83	2,617	3.42	0.24	0.19	0.20	0.212	0.788	75	6
82	Korea, Dem. Rep.	70	*90*	*2,000*	*3.30*	0.23	0.11	0.29	0.211	0.789	67	15
83	Sri Lanka	71	87	2,053	3.31	0.21	0.15	0.28	0.211	0.789	38	45
84	Albania	72	*85*	*2,000*	*3.30*	0.17	0.17	0.29	0.210	0.790	61	23
	High human development											
85	Malaysia	70	74	3,849	3.59	0.23	0.30	0.07	0.200	0.800	80	5
86	Colombia	65	*88*	3,524	3.55	0.36	0.14	0.10	0.199	0.801	72	14
87	Jamaica	74	*82*	2,506	3.40	0.11	0.21	0.21	0.176	0.824	62	25
88	Kuwait	73	70	13,843	4.14	0.14	0.34	0.00	0.161	0.839	122	-34
89	Venezuela	70	87	4,306	3.63	0.23	0.15	0.04	0.139	0.861	95	-6
90	Romania	71	*96*	*3,000*	*3.48*	0.21	0.05	0.15	0.137	0.863	84	6
91	Mexico	69	90	4,624	3.67	0.24	0.11	0.01	0.124	0.876	81	10
92	Cuba	74	96	*2,500*	*3.40*	0.11	0.05	0.21	0.123	0.877	66	26
93	Panama	72	89	4,009	3.60	0.17	0.13	0.06	0.117	0.883	88	5
94	Trinidad and Tobago	71	96	3,664	3.56	0.21	0.05	0.09	0.115	0.885	100	-6
95	Portugal	74	85	5,597	3.75	0.13	0.17	0.00	0.101	0.899	94	1
96	Singapore	73	86	12,790	4.11	0.14	0.16	0.00	0.101	0.899	110	-14
97	Korea, Rep.	70	*95*	4,832	3.68	0.23	0.06	0.00	0.097	0.903	92	5
98	Poland	72	*98*	*4,000*	*3.60*	0.19	0.02	0.06	0.090	0.910	83	15
99	Argentina	71	96	4,647	3.67	0.21	0.05	0.01	0.090	0.910	89	10
100	Yugoslavia	72	92	*5,000*	*3.70*	0.16	0.10	0.00	0.087	0.913	90	10
101	Hungary	71	*98*	*4,500*	*3.65*	0.21	0.02	0.02	0.085	0.915	87	14
102	Uruguay	71	95	5,063	3.70	0.20	0.06	0.00	0.084	0.916	86	16
103	Costa Rica	75	93	3,760	3.58	0.10	0.07	0.08	0.084	0.916	77	26
104	Bulgaria	72	*93*	*4,750*	*3.68*	0.16	0.08	0.01	0.082	0.918	99	5
105	USSR	70	*99*	*6,000*	*3.78*	0.23	0.01	0.00	0.080	0.920	101	4
106	Czechoslovakia	72	*98*	*7,750*	*3.89*	0.19	0.02	0.00	0.069	0.931	102	4
107	Chile	72	98	4,862	3.69	0.18	0.02	0.00	0.069	0.931	73	34
108	Hong Kong	76	88	13,906	4.14	0.05	0.14	0.00	0.064	0.936	111	-3
109	Greece	76	93	*5,500*	*3.74*	0.07	0.08	0.00	0.051	0.949	98	11
110	German Dem. Rep.	74	*99*	*8,000*	*3.90*	0.13	0.01	0.00	0.047	0.953	115	-5
111	Israel	76	95	9,182	3.96	0.07	0.06	0.00	0.043	0.957	108	3
112	USA	76	96	17,615	4.25	0.07	0.05	0.00	0.039	0.961	129	-17
113	Austria	74	*99*	12,386	4.09	0.11	0.01	0.00	0.039	0.961	118	-5
114	Ireland	74	*99*	8,566	3.93	0.11	0.01	0.00	0.039	0.961	106	8
115	Spain	77	95	8,989	3.95	0.04	0.06	0.00	0.035	0.965	105	10
116	Belgium	75	*99*	13,140	4.12	0.09	0.01	0.00	0.034	0.966	116	0
117	Italy	76	97	10,682	4.03	0.07	0.03	0.00	0.034	0.966	112	5
118	New Zealand	75	*99*	10,541	4.02	0.09	0.01	0.00	0.034	0.966	109	9
119	Germany, Fed. Rep.	75	*99*	14,730	4.17	0.09	0.01	0.00	0.033	0.967	120	-1
120	Finland	75	*99*	12,795	4.11	0.09	0.01	0.00	0.033	0.967	121	-1
121	United Kingdom	76	*99*	12,270	4.09	0.08	0.01	0.00	0.030	0.970	113	8
122	Denmark	76	*99*	15,119	4.18	0.07	0.01	0.00	0.029	0.971	123	-1
123	France	76	*99*	13,961	4.14	0.07	0.01	0.00	0.026	0.974	119	4
124	Australia	76	*99*	11,782	4.07	0.06	0.01	0.00	0.022	0.978	114	10
125	Norway	77	*99*	15,940	4.20	0.04	0.01	0.00	0.017	0.983	128	-3
126	Canada	77	*99*	16,375	4.21	0.04	0.01	0.00	0.017	0.983	124	2
127	Netherlands	77	*99*	12,661	4.10	0.04	0.01	0.00	0.016	0.984	117	10
128	Switzerland	77	*99*	15,403	4.19	0.03	0.01	0.00	0.014	0.986	130	-2
129	Sweden	77	*99*	13,780	4.14	0.03	0.01	0.00	0.013	0.987	125	4
130	Japan	78	*99*	13,135	4.12	0.00	0.01	0.00	0.004	0.996	126	4

BOX 1.4

Constructing a human development index

Human deprivation and development have many facets, so any index of human progress should incorporate a range of indicators to capture this complexity. But having too many indicators in the index would blur its focus and make it difficult to interpret and use. Hence the need for compromise — to balance the virtues of broad scope with those of retaining sensitivity to critical aspects of deprivation.

This Report has chosen three types of deprivation as the focus of attention: people's deprivation in life expectancy, literacy and income for a decent living standard. Each measure could have been further refined (especially by making distributional adjustments) if there had been adequate comparable data. But in the absence of such data, the focus here represents a move in the right direction — away from the narrow and misleading attention to only one dimension of human life, whether economic or social.

The first two indicators — life expectancy and adult literacy — are commonly used concepts. But the third — the purchasing power to buy commodities for satisfying basic needs — is not as well understood. The GNP figures typically used for international comparisons do not adequately account for national differences in purchasing power or the distorting effect of official exchange rates. To overcome these inadequacies, we use here the purchasing-power-adjusted GDP estimates developed in the International Price Comparison Project, a collaborative effort of the UN Statistical Office, the World Bank, EUROSTAT, OECD, ECE and ESCAP, now being expanded by USAID. And since there are diminishing returns in the conversion of income into the fulfilment of human needs, the adjusted GDP per capita figures have been transformed into their logarithms.

To construct a composite index, a *minimum* value (the maximum deprivation set equal to one) and a *desirable* or *adequate* value (no deprivation set equal to zero) had to be specified for each of the three indicators.

The minimum values were chosen by taking the lowest 1987 national value for each indicator. For life expectancy at birth, the minimum value was 42 years, in Afghanistan, Ethiopia and Sierra Leone. For adult literacy, it was 12%, in Somalia. For the purchasing-power-adjusted GDP per capita, the value was $220 (log value 2.34), in Zaire.

The values of desirable or adequate achievement were Japan's 1987 life expectancy at birth of 78 years, an adult literacy rate of 100%, and the average official "poverty line" income in nine industrial countries, adjusted by purchasing power parities, of $4,861. The nine countries are Australia, Canada, the Federal Republic of Germany, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom and the United States.

The minimum and desirable or adequate values are the end-points of a scale indexed from one to zero for each measure of deprivation. Placing a country at the appropriate point on each scale and averaging the three scales gives its average human deprivation index, which when subtracted from 1 gives the human development index (HDI). A mathematical formulation of the HDI is given in technical note 3.

Appendix:
Reports Discussed

Forecasts by international institutions

African Development Bank, African Development Report.

Asian Development Bank, Asian Development Outlook.

International Monetary Fund, World Economic Outlook.

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

UN, World Economic Survey.

UNCTAD, Trade and Development Report.

UN, Economic Commission for Europe, Economic Survey of Europe.

UNIDO, Industry and Development Global Report.

World Bank, World Development Report; working papers; Long-Term Outlook for the World Economy.

Other reports used

Andean Pact, Economia Andina.

Bank for International Settlements, Annual Report.

Economist Intelligence Unit, The Gulf Crisis: Its Global Impact.

Institute for Economic, Market Research and Informatics, Hungary, Economic Trends in Eastern Europe and the World Economy.

GATT, International Trade.

Japan Center for Economic Research, JCER Report.

Korea Development Institute, Quarterly Economic Outlook.

NIESR, National Institute Economic Review; The Effects of Higher Oil Prices.

OECD, Financing and External Debt of Developing Countries.

UN Development Programme, Human Development Report.

Definitions and Country Groups

For full definitions see individual reports; the forecast tables have used the nearest available category.

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(Some Resources)

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Economist Intelligence Unit, Global Outlook, The Global Economy.

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