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ECONOMIC PROSPECTS FOR THE THIRD WORLD

Will the oil price fall be the road to recovery?

The 1986 Forecasts

Sheila Page

Overseas Development Institute

CENTRE FOR EUROPEAN POLICY STUDIES

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1. HOW THE OUTLOOK HAS CHANGED

The central conclusion from last year's forecasts[1] was that the developing countries were facing an unsustainable situation. Since then, almost all the most important external elements facing them have altered: the price of oil, the real (and nominal) rate of interest, the dollar exchange rate, non-oil commodity prices, inflation in the developed countries. This is true even in areas where it does not show up in a comparison of forecasts: actual expectations for industrial country growth had fallen well below forecasts by autumn 1985. A fundamental question that the forecasters will need to answer is how far the changes are the result of the economic forces and imbalances identified at the end of 1985: unsustainable disequilibria should be expected to lead to changes, and if the forecasters did not expect policy-makers to alter demand, or other policies, could they have identified which supply variables, including prices, would alter to move the world economy to a sustainable path? For developing countries, the more immediate question is how the changes will affect them, although a better understanding of their causes would contribute to judging how durable they are and what further changes can be expected through economic forces.

Almost all the forecasters agree that their prospects have changed since last year. Only UNCTAD finds that what has occurred does not alter its expectations for the developing countries. There are four types of change. Those observed in different variables: comparing mid-1986 with the average for 1985, the oil price had fallen in dollars by over 50%, other commodity prices were unchanged in dollars, but the dollar's effective rate had fallen by 20%, and prices of traded manufactures had risen by a sixth. Inflation within the industrial countries, however, was down to around 3% (from 4.5%) and real interest rates had fallen by about a point. For these movements there are questions about whether they are complete (much of the change in industrial country inflation, for example, preceded any possible feed through from oil prices), whether they will persist, and how their direct and indirect effects will ultimately be felt in the deve-

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

loping countries. Some of these effects will offset each other, for example in determining the net terms of trade change or interest costs relative to export prices. These are discussed in the next three sections, with particular emphasis on the changes in oil and other commodity prices.

The second type of change is in the economic relationships used, as the large movements have tested forecasters' models. The magnitude and timing of the impact of changes in price levels, rates of inflation and relative prices on demand and supply are much more important in shaping this year's forecasts than under the unchanging trends of previous years. The forecasts, which are discussed in sections 5 and 6, suggest there has been a reappraisal of trade elasticities, which retain great importance in setting the prospects for the developing countries: many of the forecasters expect the direct effects of the price changes to be greatest on the industrial countries; the developing countries therefore depend on growth there, as they remain constrained by foreign exchange. The UN and OECD discuss elasticities, seeing little change in industrial countries for manufactures, although as discussed below, the UN does find changes for primary commodities.

A third change is in the climate of expectations. Among forecasters, there was a consensus of hopelessness by early autumn 1985. UNCTAD led in pointing out the desperateness of the choices available to the developing countries, but the failure of growth and trade to be sustained after the promising performance of 1984 led to a general reappraisal of judgements that the depression and the debt crisis could be treated as temporary problems. In the context of hopes early in the year, 1985 was not simply 'somewhat disappointing' as the IMF (p.1) suggests. In the 1986 Reports, all the forecasters except UNCTAD think the prospects much better, at least than last year, with the BIS arguing that the 'world economy now looks healthier ... than it has done at any time during the last five or six years'(p.3). But what matters for the outcome is whether economic decision-makers, consumers, investors and governments, share this change in expectations, and also whether to be better than during the worst recession in 50 years is sufficient to alter behaviour. More specifically, their expectations about the future of such variables as the oil price and general inflation matter to determining how economies will respond.

The final change which occurred at the end of 1985 was the series of moves towards greater international coordination of exchange rates and management of the debt crisis, of which the Baker initiative is the symbol. Section 7 on the debt problem discusses the practical effects in increasing official and private finance so far, while some forecasters cite a more general improvement in international cooperation. This has not been evident in trade policy, the other major issue in current international negotiations discussed in Section 8.

Two issues affect the approach to these negotiations and many of the other questions raised in this paper. First, what the costs and benefits are of, on the one hand, greater international intervention to mitigate shocks from economic changes, with fixed or managed prices, which may display smaller short term fluctuations, but larger step movements, and which may be less susceptible to economic judgement or market means of reducing the risks of changes, and on the other, greater freedom for markets, to give the advantages of lower costs and more appropriate prices for planning of future production, but with greater short-term fluctuations. Second, how far a country should consider itself obliged to operate what it regards as its domestic policy to avoid damaging others (or whether the line between domestic and internationally-accountable policy needs redrawing).

Oil, other commodity prices, exchange rates and capital flows have raised the first, and there are suggestions for 'managing' one or more of these in all the reports. But all still warn against protection, which raises both issues. Limits on national policy affect the discussion of US budgetary policy and the appropriate policies of the German and Japanese governments. The IMF, responding to specific demands from both developed and developing members, includes a chapter on policy interactions. It suggests that there is a role for Fund surveillance in 'ensuring that the interests of the international community are fully taken into account by the authorities' (p.100). The UN (p.99) sees the system of floating exchange rates as having increased countries' ability to pass on domestic shocks to the rest of the world. It could be argued that international obligations in some other area should be strengthened to compensate. UNCTAD, which sees the weakening of commodity prices as the result of the attack on inflation in the developed countries (p.59) suggests that it is wrong that the benefits of such policies have not been shared.

The forecasts published in 1986 continue last year's move towards offering much more breakdown of 'developing countries' into different groupings, not only by area, but by type of export, type of borrowing, income, etc. As these do not, normally, provide specific information about individual countries, it is not clear that showing, for example, how much oil exporters are hit by falls in the oil price, is as valuable as more analysis of how countries react to extreme changes would be. The forecasters also avoid even more than usual any suggestion that they are forecasting. The World Bank is particularly defensive in stating that its scenarios show 'what is achievable, rather than what is likely to be achieved' (p.43), and the IMF states that its scenario 'represents an assessment of the consequences of certain assumptions about exogenous economic conditions, given other assumptions about the behavioral relations that link these conditions to actual developments' (p.8). It then gives seven medium term scenarios for different price, lending, and interest rate assumptions. The World Bank as usual gives a High and Low, and the UN two paths. For those interested in the properties of the organisations' economic models (whether formal or more judgemental), the quantification of the effects of each exogenous variable on each sub-group is useful, but it is arguable that they belong in a users' guide to the model, rather than in a forecast and policy document. Choosing plausible assumptions and identifying reasonable behavioural relations seem the essence of producing a 'world economic outlook'.

It is noteworthy that five of the forecasters now give details on changes in per capita GDP (IMF, World Bank, UN, UNCTAD, IDB), and note the falls. The UN report is particularly useful this year in its special sections on current problems, including oil and commodity prices, the trading system, the effect of exchange rate volatility (like others, it is moving towards a belief that this damages trade growth), international reserves, and patterns of investment. The BIS, while not presenting a forecast, has greatly increased its general economic coverage, assessments and policy recommendations. The World

Bank's special report this year is on agricultural policy. Its economic growth section concentrates more on arguing for specific policies than on forecasting, or on demonstrating which domestic policies have been most successful for developing countries in the past, although it describes what policies have been followed. It shows that countries integrated into the international economy (as it argues the NICs are) and countries like India and China have both been relatively successful (p.48). It does attempt to quantify the effect of different domestic policies for given external conditions (p.26), but not the reverse. UNCTAD, having seen its 1985 pessimism and its view that any solution to the debt problem would require more official funds adopted by the other forecasters, concentrates this year on looking back, at what the depression has done to living standards and investment, including interesting comparisons of different groups, and how it came about. Although it is the only forecaster not to accept that the fall in oil prices will have some positive effect on industrial country demand, it shows this only as a result, without quantifying why the various effects cancel out.

2. OIL

Price movements

In 1985 the price of oil was not expected to fall in spite of forecasts of weak demand; and, once again the forecasts for 1986 and 1987 recorded in table 2 assume no change in the dollar price, the differences reflecting the date the forecasts were made. For the medium term, the IMF assumes no change in the price relative to manufactures, which rises at 4.5% a year, while the World Bank has a smaller nominal change, suggesting a very small real fall (3% a year), but this is from a 1986 base of $22 a barrel. The others start at $15 to $18. The UN 1986 base forecast is $18, with a low of $10 and a high of $25, with no nominal change from either. The UN explores in detail (pp. 57-61) the costs of production of different producers to derive the lower limit. It argues that, considering marginal costs, there is a high share of oil production available at a price of $10 or under. The higher bound is postulated as the result of differences among OPEC producers in preferences for production now and in the future. For the short-term, the UN (and IMF) stress the importance of the high present level of stocks. The $10 lower limit was supported in country forecasts before the summer, and corresponds to the lowest point reached. It is harder to set the upper limit, but as $25 is less than the price of around $28 of the last three years, it may be reasonable. UNCTAD considers the same arguments for, and constraints on, cooperation, but without reaching precise conclusions. It is notable that none of the forecasters now considers the level of prices they all forecast for the medium term in 1985 within the bounds even of their alternative scenarios.

Table 1 attempts to put the recent sharp movements in prices into perspective. In 1973 dollars, the oil price is now about $6.50, higher than before the rise, lower than after. The fall relative to manufactures began in 1982, although it only became precipitate in the last year: although the revision of forecasters' expectations is recent, and may therefore be regarded as insecure, it is not based only on 1986 figures.

Explanations for the oil price

The sharp fall in demand for oil in industrial countries took place between 1979 and 1982. This was too early to be explained by the rise in the price of oil which began in the second half of 1979, and there had been no general rise in prices in the years since 1974, so it is normally attributed to a lagged response to the 1974 rise. It corresponds to the type of delay necessary to bring on non-oil sources of energy as well as to accept the 1974 rise as 'permanent'.

In all countries, the slow growth of total demand acted on demand for oil and its price as it did on other primary commodities. The energy content of output fell in industrial countries because of government measures to encourage lower use as well as its cost. Within the total, the use of oil, and of imported oil within this, fell much more because of the encouragement of indigenous sources of energy, particularly oil and gas in North America and northern Europe, some coal, and nuclear energy (the UN gives a summary on pp. 157-158, IMF, p.149). In non-OPEC developing countries, there were some large increases in production of oil (notably in Mexico) and other fuels, but energy intensity has continued to rise. This is partly because of the continuing transition to marketed fuels, and the lower level of

TABLE 1

Oil and Commodity Prices since 1970

1970 = 100

	$ indices			DM indices				Yen indices				Price ratios			
Year	Oil price	Non-oil commod. price	Manuf. price	US CPI	Oil price	Non- oil price	Manuf. price	Germ. CPI	Oil price	Non-oil price	Manuf. price	Japan CPI	Oil/ manuf.	Non-oil/ manuf.	Non-oil/ Oil
1970	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
1971	122	97	105	104	116	93	100	105	118	94	102	106	116	93	80
1972	137	110	113	108	120	95	98	111	116	92	95	111	121	97	80
1973	182	162	133	114	133	119	97	119	137	122	100	124	137	122	89
1974	643	216	162	127	455	153	115	127	522	175	131	154	397	134	34
1975	640	192	182	138	431	129	122	134	528	158	150	172	352	105	30
1976	688	210	183	146	482	144	126	140	567	173	151	188	376	115	30
1977	711	257	200	156	451	163	127	145	530	192	149	203	355	129	36
1978	727	245	229	168	399	134	126	149	542	143	134	210	318	107	34
1979	1056	282	261	187	529	141	131	156	643	172	159	218	405	108	27
1980	1771	320	290	212	880	159	144	164	1131	204	185	236	611	110	18
1981	1993	271	272	234	1232	167	168	174	1221	166	167	247	732	99	14
1982	1910	230	267	248	1268	152	177	183	1322	159	184	254	716	86	23
1983	1660	242	255	256	1159	169	178	190	1096	159	168	259	651	95	14
1984	1589	245	246	267	1237	190	191	194	1049	161	162	265	645	99	15
1985	1555	218	249	276	1250	175	200	198	1032	145	165	270	624	88	14
1986 I	1303	241	290	280	833	156	185	199	680	127	151	271	449	84	19
" II	712	227	e290	279	439	140	e174	198	338	108	e134	e272	245	e 78	32
18 Aug	833	e218	e290	e280	e470	e123	e164	e197	357	e93	e124	-	e287	e 75	26

Source: IMF, International Financial Statistics use at which they started in 1973, but also the result of growing industrialisation, in contrast to the shift towards less energy-intensive services in the industrial countries. Differences in the composition of industry were probably also important, as some heavy industry moved from the industrial to the newly industrialising countries. Within energy, oil and gas remained most important. The result of the saving and substitution of other fuels was that total consumption of oil was approximately the same in 1985 as in 1973, while substitution of non-OPEC oil meant that OPEC exports had fallen from 29.6 million barrels per day to 13.6.

The pricing of oil was affected by changes in the structure, as well as weakening in the level, of demand. OPEC's share of total production has fallen from over a half in 1973, and still 48% (BP,-1986) as late as 1979, to under a third in 1985, although it is still the major exporting area. This should weaken its influence on the price, and more important, it has lowered the share of oil production coming from oil-dependent countries which have an unambiguous interest in a high price. The non-OPEC developing countries have accounted for most of the increase in production outside OPEC, and also now account for a larger share of total world demand for oil. They may be more price-sensitive (on both output and demand) than the industrial countries, and they increase the number of participants in the oil market. The role of the OPEC governments had reduced the concentration of oil markets in the mid-1970s, and offered the opportunity for the spot market to increase in importance. The UN (p. 160) argues that this may be reversing, in the last two years, but its share is still well above pre-1973 levels (at a third compared to 5-10%), and the prices set there are now used as indicators in other contracts.

The initial response of OPEC to the post-1979 fall in demand may have been muted by the simultaneous cut in supplies and increase in prices (following the Iran-Iraq war). The value of exports did not fall back to the 1979 level and below until 1983, under the combination of continued substitution and recession. The first export quotas, replacing voluntary restraint, were introduced then and the dollar price was openly reduced. Saudi Arabia took on more formally its traditional <u>de facto</u> role as marginal producer. Growth (and perhaps expectations of growth) in the oil consumers in 1984 and the

Table 2

Prices, Interest rates, and Exchange rates

percentages

	IMF Base-line	UNCTAD	UN	World Bank High	World Bank Low	OECD	NIER Aug.
			1986				
GNP deflator indus.	3.4		3.3			4	est.3.2
Change US$ effective rate	-11.2		-20			-16	
6 month LIBOR defl.US gnp	4.2		3.9			4.7	
Price US$							
Manufactured exports	14					16.5	16.7
Oil price	-40		-35	-29	-29	-32.5	-42
Primary products	12					8.3	7
Food						10.4	13
Tropical beverages						14.5	
Vegetable oils							
Agric. Raw Mats.						6.45	0
Minerals,ores,metals						0	-4
			1987				
GNP deflator indus.	3					3	est.3.5
Change US$ effective rate	0		-5			-1	
6 month LIBOR defl.US gnp	4.5		3			3	
Price US$							
Manufactured exports	4.5					1	5.4
Oil price	-6.3		0			-11	-25
Primary products	1					0	0
Food						2.4	-2
Tropical beverages						-7.1	
Vegetable oils							
Agric. Raw Mats.						8.1	3
Minerals,ores,metals						0	3
	1988-91	1985-90	1988-90	1985-95	1985-95		
GNP deflator indus.	3.7			4.8	7		
Change US$ effective rate	-2.1		-2.5				
6 month LIBOR defl.US gnp	4.2	3		2.6	4.5		
Price US$							
Manufactured exports	4.5						
Oil price	4.5						
Primary products	4.2						

peaking of non-OPEC oil production helped to hold the price through that year (although discounting continued) but in 1985 the move back into recession and the effect of low revenue on Saudi Arabia in particular made the pressure on the cartel too great. As UNCTAD notes, the quotas were too low to give them acceptable short-term revenue, and the price too high to preserve their long-term market position (p. 52). The IMF describes this history (pp. 150-153), emphasising that the 1986 fall came out of the events of 1983-5. It expects that the result will be a 'market-oriented' price, although within a 'structured oil market system' to avoid large price swings. It is not clear what price this implies, or why attempts to obtain a managed market should be any more successful than in the past: as it is only since 1979 that OPEC has had to face falling world consumption and falling export demand, and only since 1983 that it has attempted to operate formally as a cartel, there is little evidence that it can be successful. The IMF's reference to 'restoring' output restraint (p.148) may underestimate the difficulty.

The IMF argues that price fluctuations may be large because pricing by non-OPEC producers is more flexible because of their high capital costs (p.156). Some, however, also have high marginal costs, a more traditional determinant of prices. Among industrial country producers, the constraints on cartels in some countries and greater reliance on market rather than government decisions may be more important explanations. Among the other developing country producers, their need for foreign exchange (which may suggest a premium, or high shadow price, on export revenues) may make them particularly willing to cut prices, especially if they see themselves as purely price-takers, not significant exporters. The change in the structure of the market, however, means that such a perception may not be true.

<u>Effects of the oil price movements</u>

The impact must depend on the size of the change for different groups. For primary producers, the price compared to non-oil commodities has only fallen to the level before the second, 1979-80 price rise, and the fall only began this year (table 1). But for industrial countries other than the United States, the fall in the dollar has made the recent fall much greater, and for Japan even the nominal price is now below its yen price in 1974.

The most obvious effect from a price change is not discussed in detail in the forecasts. OECD does argue that demand for oil should rise, but its forecast for world trade in oil is only 4.5% this year and 5.5% next, 1-1.5% more than for total trade, although within this there is some shift back to the OPEC countries. The IMF expects even lower rises in the short-term, with no apparent rise in the medium term rate of growth: exports by non-oil developing countries are expected to rise faster than those of oil exporters. It notes that the saving in energy per unit of output continued even when the price was falling in 1984-85, and suggests that this will continue. It expects the legally required conservation measures to continue to have an effect, and assumes that users will continue to switch to other fuels because these are expected to be more abundant and cheaper in the long run (p.160), although it believes that the major fall in consumption has come to an end. This cautious forecast of consumption is in spite of the fact that, as it notes, the rise in the dollar up to 1985 meant that consumption rose in the United States while still falling in Europe and Japan, and, as it recognises, the fall in the dollar is too recent for any opposite effects to have come through in 1985. It does, however, expect some increase in the rate of growth of demand in the developing countries, although their continued low growth and balance of payments constraints will limit this. The UN explicitly forecasts no change in industrial country consumption at least in 1986. UNCTAD does suggest that demand will rise (p. 55), but does not quantify this.

There appears to be some inconsistency between the observed transformation of forecasters' own price expectations, which are all now lower in the short and medium term than they were a year ago, and the assumption that energy consumers and investors will make only marginal changes (or postponements) to their plans. Because of the move to greater flexibility of sourcing by some consumers, and the presence of the old oil-using equipment, for example in electricity suppliers (UNCTAD p. 49 notes that this was one of the main areas of fuel switching), it would seem possible that lags in short-term substitution should be shorter than in substitution out of oil in the mid-1970s. For the medium term, forecasters' expectations may not be a perfect indication of decision-makers', but they may be some evidence. The growth of alternative fuels had slowed even before 1986. IMF (p.155) shows that the share of oil consumption in the total fell from 49% to 45.5% between 1980 and 1982 (the period when the greatest post-1974 effect would be expected), and then only to 44.5% in 1984 and 43.5% in 1985. If any similar step-change were expected five years after 1979-80, it would be happening now, not in the next 5-10 years. Since the forecasts were made, events may have made the supply of alternative fuels, especially nuclear energy, less certain. The forecast of oil consumption and trade is extremely important to the medium term view first because of its effect on the oil price itself: if demand and supply trends remain as they have been, it is not clear why the price should now be expected to rise after falling for five years. It is important to the effects on non-oil sectors: if the increase in real income is entirely directed to these, their growth, and investment in them, will be greater. The UN notes (p. 60) that at low prices, there is a strong shift from industrial country production (especially in North America) to OPEC, so that there would be less of a transfer of income (and therefore consumption) from OPEC to the industrial countries than at first appears. This could reduce the negative transitional effects of the change in oil price.

The questions of the size of transitional effects and of the duration of the transition have received increasing attention during the summer. These depend on the influence of uncertainty, variability and lags. They are particularly difficult for economics to answer because they involve the timing of shifts in production, speed of reaction by consumers and investors, and government reactions. They should not be allowed to distract attention from assessing the ultimate effects, especially when we look beyond 1986. The BIS is in no doubt: 'for the developed countries the decline in oil prices stands out as a favourable development: it brought down energy prices in general, further reduced inflation rates quite substantially and will tend to boost economic growth' (p.182). This summarises the effects most of the forecasters expect. Except for UNCTAD, they expect the fall in oil prices to add between a half and one per cent to industrial country growth rates, for between two and four years (according to whether they are assuming an oil price of \$18-\$20 or \$10-\$15. The principal mechanism is the reduction in price acting on real incomes, consumption, and finally investment. Monetary policy is explicitly (IMF, OECD) or implicitly assumed to be accommodating. Some note that some of the gain is being appropriated by governments through higher energy prices, but the rest of their forecasts do not suggest that they think the European governments will or should deflate so this may not be a permanent change in fiscal stance.

UNCTAD, (p.III) argues that some OECD consumers may choose to save rather than spend the increase and that governments may choose to deflate (p.102). It therefore assumes that there will be no effect on output in the industrial countries (p. 120) because it believes the direction and size to be indeterminate and dependent on policy choices. Investment in new energy will fall. But it is not clear why the fall in price of one good should so alter decision-makers' preferences between consumption and saving that existing models and assumptions have nothing to offer. The increase in real incomes or companies' expected profits is small enough for oil consumers relative to present levels for normal relationships to hold (with the earlier caveat about lags), and certainly for an assumption of no effect to need justification, not imposition as an exogenous variable. Because the size of the effect on the energy sector is larger and more focussed, it is probably the case that it is easier to find reports about cuts in energy-related investment than increases in non-energy (the parallel with those helped and hurt by protection is obvious), but again there is no reason to believe that if investment can respond to demand, it will not behave normally in response to the oil price fall. More structural, supply-oriented views of why output has been low and slow to grow in developed countries could justify lack of response: some German forecasters, taking the extreme view that structural rigidities are entirely responsible, would argue that the oil price is irrelevant to these, and its effect therefore nil. The international organisations do not share this view, and some of the 'rigidities' may be result of the need to adapt industrial structure and methods to high energy prices in the 1970s. The oil price fall may therefore relax such constraints and, in the medium term, such structural effects could reinforce the demand effects. The forecasts do not discuss this. Alternatively, if growth must come from new industries or new technologies, a real income change would not have a strong multiplier effect.

The forecasters generally agree that the effects on the developing countries come mainly from the effects on the industrial countries, not from the decline in their own oil costs, partly because oil tends to be a less important part of total demand, but also for the technical reason that they are net exporters, as a group and in most of the conventional divisions (by continent, income, or debt) used in the projections. The traditional 'non-oil' category is roughly in balance. Such effects are discussed in section 6 on their output and trade. The World Bank (pp. 50-51) gives a detailed discussion of the different direct and indirect effects on developing countries, although it only shows the effects on external variables, not growth. For oil importing countries the size of the reduction in the cost of oil is significant, and the IMF in particular argues that because the constraints on their foreign exchange are binding, changes will be reflected in output, not current balances or savings (p.10).

One effect which UNCTAD in particular notes is that the fall in the oil price 'has introduced an element of uncertainty into the investment and planning' (p.55) of the energy industries. It also suggests that the fluctuations in the price are damaging to economies as a whole. It is not clear that the uncertainty, except in the very short-term, is greater than it has been since the rises of 1973-4, and particularly, those of 1979-80. But both it and the IMF, as indicated above, argue that price fluctuations are damaging. The IMF is apparently in favour of market-related, but managed oil prices (p.153) (a commodity agreement on the model of managed floating or the EMS?) and UNCTAD more strongly in favour of management, but this is clearly an area in which more information about the costs of fluctuations and the costs of divergence from market prices is needed.

A second set of costs to set against any long-term benefits is in transition and adjustment. The first is the loss of output between the demand effect of the loss of income on the oil producers and the effect of the gain on consumers. This results from lags, first in the transmission of the price change from exporter to importer to final consumer, then in overcoming uncertainty over whether the change is durable, in a short-term horizon, to alter consumption levels and patterns, then in a longer one, for investors. The adjustment costs of the rise in oil price were high because of the need to change from a cheap energy industrial structure and because they were accompanied (for the industrial countries) by its depressing effects on demand, and adjustment is normally regarded as more difficult in recession. The adjustment to low oil prices should be less costly, as both these factors are reversed, but not negligible. For the oil producers, the costs will be greater in proportion to their economies than those suffered by oil-consumers in 1974, and the UN worries that 'a free fall of oil prices would have a devastating effect on the socio-economic conditions of oil-exporting developing countries' (p.20). The possible shift of demand for oil to them could soften, but not remove this effect. The level from which the faster growth begins may therefore be lower than they expect because of lower growth in 1986. On the other hand, there may be a greater long-term gain to growth than the calculated income effects if the return of oil prices to pre-1974 levels increases confidence, of investors and governments, that oil prices in particular, and therefore other costs, are not immune to market forces and that the inflation-constraint on growth is lifted. OECD asks whether there will be 'a critical boost to business confidence' (p. 1).

It must be remembered that in both industrial and non-OPEC developing countries the rise in oil (and other domestic fuel) output was not only a market response. The insecurity of supply and price of imported fuel made a profound impression on governments in 1974, and led to a determination to increase self-sufficiency that may endure even under lower world prices (possibly through trade controls). One reason the present imbalance between supply and demand developed was that many importing countries import-substituted while there was still a world surplus. In other basic sectors (agriculture, for example) countries have shown a willingness to encourage or preserve domestic production even at the cost of not taking full advantage of lower world prices. It is possible that the world market for oil and energy generally could produce a continuing contrast of low prices for the major exporters and over-production. (The UK proposed a common energy policy for the EC to protect its high cost production from the risk of a fall in the OPEC price more than a decade ago.)

3. OTHER COMMODITY PRICES

By the middle of 1985, it was obvious that the prices of other primary commodities were falling sharply, in contrast to earlier forecasts of little change, to give an average fall of over 10% (table 1). As manufactures prices in dollars rose (for the first time since 1980) this had a severe effect on the developing countries' terms of trade. More worryingly, except for a small rise in the first quarter of 1986 (largely coffee), they remain depressed: in dollar terms, at the mid-1970s level, but relative to manufactures (which have risen sharply this year) lower than they have been throughout the 1970s. But it is important not to exaggerate the extent or the peculiarities of the fall. In the 1970s, commodity prices were on average higher relative to manufactures than they had been in the 1960s (IMF, Commodities 1986, p. 2), because of their peaks in 1973-4 and the late 1970s.

Forecasts earlier this year were for a recovery, but the recent forecasts are lower (table 2),in line with the outcome in the first half. Even the early forecasts did not expect the rise to make up for the 1985 fall or to continue into 1987 and the medium term. The IMF forecast excluding coffee was 4% in 1986, and 7% in 1987, with high supply and slow output growth constraining any recovery. The World Bank does implicitly suggest an improvement in the terms of trade, but the IMF expected prices to rise marginally less than for manufactures or oil in 1988-1991 (as coffee prices fall back). The IMF looks at the implications of a lower (not a higher) path: at 3% instead of 4.2% dollar rise a year, GDP growth on average is reduced by half a point a year, but for Sub-Saharan Africa by a point (p. 98). The UN (and implicitly UNCTAD) agree on slow growth.

This is surprising when output is accelerating in the industrial countries, and reflects the view of the forecasters that, as in the oil markets, there have been fundamental shifts in supply and demand, affecting all primary commodities. It should be noted that although the fall in the last two years has taken prices to lower levels than for oil, the falls have been smaller and began later (during 1984). The IMF (and by implication other forecasters) suggest that fluctuations in exchange rates may have postponed recognition of price weaknesses. Long-term changes may therefore be more important and recent changes in supply (quantities and sources)less so.

The forecasters agree that low demand (commodity prices traditionally respond with large fluctuations to industrial demand changes, (IMF Commodities, 1986), and may fall more in periods of prolonged weak demand, (UN p. 53), high stocks, and the high cost of holding stocks because of high interest rates are important present explanations. The growth that has occured in demand has been principally in the US which has less effect on exports of commodities. The pressures on the balance of payments of the debtor countries may have also (as with the smaller oil exporters) prompted 'distress selling' (BIS, p. 15, IMF, p. 143) to obtain foreign exchange. These, however, are all factors that should decline in the medium term (or rather longer, for debt), not create a permanent shift down in levels and growth rates of prices. Even more than for oil prices, there are reasons for demand to rise as the effects of the combination of lower commodity prices in dollars and dollar devaluation only began to come through to European and Japanese markets in 1985. Until then, they were rising to new peaks (table 1), and therefore presumably strongly discouraging consumption (UN p. 53): the magnitude of the changes since then is impressive: a DM price only 20% above the 1970 level and a yen price below it give radical changes in relative prices (table 1).

In a longer perspective, on the demand side, there are the structural changes away from industry and within industry that are cited to explain lower oil use (IMF p. 142). New technologies substituting lighter materials for metals and improving recovery of scrap have had an effect. The effect of the oil price fall is uncertain: it permits greater substitution by some synthetics, but it could retard if not reverse, the move towards light industry to the extent that has resulted from efforts to save energy. The demand for primary commodities, especially food, has long been expected to rise more slowly than income (as the World Bank notes, p.4). The Bank of England suggests that the increased number of producers may also reduce the chance of large rises in commodity prices, because of local shortages, which would suggest a lower average performance in the future than in the 1970s. This could be reinforced if the reduced vulnerability of prices to shocks made the commodity markets less attractive to speculators.

In 1984-85, the IMF also finds an unusual build up of supply particularly of agricultural commodities (p. 142, IMF Commodities 1986, p.8: 7% in 1984), which it traces to high prices in 1980-1 (earlier for beverages), although also to the weather, while UNCTAD notes the influence of the high dollar on prices received. The UN also believes that the price in dollars was important. It suggests, without explanation, that commodity producers each increased output without expecting others to do the same. The explanation some forecasters offered last year, that many producers diversified, without reducing their principal exports, has some plausibility, although UNCTAD (p. 47) now notes that diversification has been constrained by lack of foreign exchange for the necessary investment and difficulty in obtaining market access. The countries that have succeeded, however, have been relatively large, and therefore may have had an effect. The general but mistaken optimism in the early 1980s about economic prospects must also have had an effect in inducing over production.[2] But the IMF also notes the importance of policy, in particular, price support in producing countries, and it seems possible that policy on supply, with most countries now actively trying either to export or to reduce imports, may have affected non-oil prices as well as oil. Another similarity to oil can be noted: the UN argues that 'the exposure to volatile international commodity prices and supply disruptions in the 1970s also led countries to deliberately attempt to reduce import dependence. As a result, in recent years commodity trade has declined faster than commodity use' (p. 52).

The performance of commodity prices raises several issues where the interests of developing and industrial countries diverge. The industrial countries have encouraged their producers and discouraged imports of foods, while the international agencies have encouraged greater food production in the developing countries, with particular success in Asia. The World Bank, with special emphasis in this year's

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[2]This was noted for cotton production, <u>Le Journal de l'economie africaine</u>, July 1986, which contrasts World Bank forecasts of the cotton price: its end-84 forecast for 1986 was almost twice the January 1986 level.

report on agriculture, criticises the industrial country policy and the UN points out that it gives a bias towards over-production which is transferred onto international markets (p. 55). The World Bank, however, suggests that the change in trading patterns owes more to policies in the developing countries (p. 11). The UN and UNCTAD both emphasise that the industrial countries have gained reduced inflation from low commodity prices.

Some of the forecasters, notably the UN and UNCTAD, stress differences in the price movements for different types of commodities (notably between food and others). Although all agricultural commodities have not moved very differently from the average, food has declined most sharply. This is the commodity where national policies might have been most common. UNCTAD contrasts the move of some metal production from developed to lower cost developing country producers (p. 44) with the protection for industrial country agriculture. But even it notes that it is mainly the policy responses, not the price changes that are different, and the IMF stresses that all prices have moved, although for different reasons.

The weakness of prices, especially of developing country foods, leads UNCTAD to contrast prices determined by markets (primary products) with those that it considers are managed (oil and manufactures, pp. VI, 39). It argues that primary producers (presumably excluding industrial country agricultural producers) are more vulnerable to world demand changes, and its forecast expects these to be unfavourable. It examines the collapse of the International Tin Council, emphasising the effects on the banking system and other lending to governments as well as on producers. Although it therefore still supports commodity agreements, as it does for oil, it does not indicate how it thinks they could work in a period of declining demand and prices. Further, the share of developing countries in total output has fallen for all major groups of commodities (IMF, Commodities 1986, p.70). This change, combined with the diversification of sources of supply and the growth of import-substituting production in industrial and developing countries must weaken prospects for agreements as similar trends have done in oil. The UN suggests that action has to be mainly at the domestic level (p. 8), although hoping for international co-operation in adjustment. It cites 'disenchantment' with agreements since the early 1980s, with only coffee and rubber successful (p. 55), because both producers and consumers undermined them as prices fell. The fluctuations in the dollar may have added technical difficulties to the economic ones. In 1986, coffee has been sustained by the cut in Brazilian production, the Cocoa Agreement has been renegotiated, but without a strong effect on prices, and rubber remains vulnerable to high production and high buffer stock levels.

The long-term tendency for primary product prices to weaken is not a recent discovery; what is more surprising is the continuing emphasis on expanding primary, particularly agricultural, production, in developing countries in the 1970s and 1980s in the face of such trends. With, in addition, mistaken expectations about growth in the early 1980s, it is not difficult to understand in general terms why there should be a severe short-term excess of production over demand. The important questions for the medium term are how much of the present slump in prices is the result of the additional short term problems of slow growth, recent exchange rate changes, high interest rates, etc., and whether the part that is due to a more permanent disequilibrium between supply and demand will persist because policies remain autarkic.

Some further pressure on prices will probably appear at least in 1986 because of the strong policy pressures to increase US agricultural exports. But the major shift down in desired stocks is unlikely to be repeated, unless interest rates rise. If world output does eventually respond to the fall in the oil price (and the falls in commodity prices, and any changes in inflation expectations) it is not clear that commodity prices must remain as depressed as they are at present throughout the medium term. With the long-term trend down, however, the need for primary producers to move to other sectors in order to grow even as fast as the industrial countries supports the UN's advocacy of diversification of the economies.[3] In contrast, the Bank (and others) still encourage the developing countries to shift

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[3]The UN compares the first half of the 1980s to the 1960s to show a decline in agricultural trade from a growth of 4% to 2%, while manufactures declined from 11% to 5% (p. 39). The World Bank takes the period 1971-84 to show that agricultural exports grew at 4.64% and manufactures at 4.78% (p. 9).

prices in favour of agriculture, and the ECAFE 1986 report notes that policy was continuing to shift in Africa towards encouraging agriculture 'in conformity with the programme of' the OAU (pp.7-8).

4. EXCHANGE RATES AND INTEREST RATES

The fall in the dollar so far this year suggests that the average change on 1985 could come to -20%, in line with the most recent forecast in table 2. The change from its peak was about 30% with much larger changes against individual currencies. This is a change of the same magnitude as the oil price, and, as has been seen, reinforces the effect of that and the commodity price changes for other industrial countries which gain, and for developing countries, whose terms of trade with industrial countries are further damaged. The international forecasters by convention don't forecast the exchange rate, but this is clearly one way in which the large imbalances they saw last year may adjust, although again there is considerable uncertainty over the length of the lags. The developing countries whose exports are mainly priced in dollars (oil and other primary commodity exporters) have not gained from the devaluation of the currency in which their debts are denominated. There could be some gain for the exporters of manufactures, but even these depend closely on the US market, where invoicing is more likely to be in dollars than their home currency. Although there are still no forecasts, it is probable that dollar rates are back to levels forecasters consider more realistic and smaller changes are now implicitly expected than last year so that the published forecasts may be a better guide to forecasters' views and reasoning on associated variables. The IMF assumes a further fall in the medium term, but starting from a level higher than has now been reached so there is probably little fall from now. The adjustments to world manufactures prices are assumed to be mainly coming through this year, and as has been seen no reaction is assumed on primary products' prices. For non-oil, this is in symmetry with their rise with the dollar in the early 1980s.

The fall in interest rates in 1986 has already been much greater, in real and nominal terms, than the cautious forecasts made last year. Little change is expected for 1987, but the IMF forecast already looks high in comparison to present rates. OECD and the UN do expect a further fall. Medium term forecasts are substantially lower than last year for UNCTAD and the World Bank, but the IMF does not expect a further fall (although it presents a variant with a lower rate). Deflating by developing countries' export prices instead of by US inflation, however, suggests that interest rates are even higher for them than previously expected, and will continue to be high. The UN notes the serious rise they suffered in 1985.

As with the change in oil prices and the exchange rate of the dollar, the return of real interest rates towards more conventional levels in 1986 may affect expectations about the future more than extrapolating from behaviour in recent years would suggest if, and when, decision-makers reach the conclusion that they are durable. The effects on investment may therefore be important.

5. THE FORECASTS FOR THE INDUSTRIAL COUNTRIES

Inflation

The falls in oil and other commodity prices have brought significantly lower domestic inflation forecasts for 1986 and 1987. The figures of around 4% last year were considered satisfyingly low then, but forecasts are now for 3% this year, and perhaps lower next. OECD is higher because it does not yet allow in full for the fall in the oil price and dollar exchange rate (table 2). In individual countries, the rates are approaching 0. The IMF expects inflation to be slightly higher in the medium term, while the World Bank has substantially higher numbers. (It also now expects inflation to be higher with lower growth, while in last year's forecasts the reverse was true.) They expect the favourable external effects to come to an end, and not be replaced by lower internally generated inflation in the industrial countries.

Output

Output grew last year about 2.8%, less than had been expected early in the year, but in line with expectations by last October. The fall from the 1984 rate was almost entirely accounted for by the US. Forecasts for 1986 have again come down during the year from just over 3 to just under. The pattern, however, is different from 1985 with lower growth in Japan (4.5% last year; now 3-3.5% with Japanese official sources at 2.8%) and higher in Europe, particularly in the early

Table 3

Industrial countries

percentages

	IMF Baseline	UNCTAD	UN	World Bank High	World Bank Low	OECD	NIER Aug.
			1986				
Output							
Average	3	2.8	3.1			3	2.6
United States	2.9	3.2	3.3			3	2.3
Japan	3	3.5	3			3.25	3.2
Europe	2.9	2.4	2.8			2.75	2.5
Unemployment rates							
Average	8.1		8.1			8.25	
United States	7		6.5			7	
Japan	3		2.6			2.75	
Europe	11.1		11.4			11	
Import volume	5	4.8	6			5	5.4
US import volume	4.1					4.25	5.5
Export volume	2.7	3.5	4			3.5	3.5
World trade	3.3	3.7	4			3.5	3.5
			1987				
Output							
Average	3.2	2.9	3.3			3.25	3.2
United States	3.6	3.5	3.6			3.75	3.5
Japan	3.2	3.5	3.7			3	4
Europe	2.5	2.5	2.7			2.5	2.7
Unemployment rates							
Average	7.9					8.25	
United States	6.7		6.8			6.75	
Japan	3.1		2.6			3	
Europe	11		11.5			11	
Import volume	4.3	5.1				5.25	5.5
US import volume	3.2					6.25	3
Export volume	3.4	3.3				3.5	4.8
World trade	3.8	3.1	4.5			4	4.5
	1988-91	1985-90	1988-90	1985-95	1985-95		
Output							
Average	3	2.8	>3	4.3	2.5		
United States	2.9						
Japan	4.1						
Europe	2.7						
Unemployment rates							
Average	7.5						
United States	6.4						
World trade	5						

forecasts for Germany which were at 3.5-4% (latest official: 3.5%) and the US. Forecasts were generally most optimistic in early summer when the full effects of the oil price were being calculated, but before the length of lags was appreciated. Although recent official forecasts for some countries are lower than earlier in the year, they are not in general lower than in the international forecasts, but the tendency is to reduce forecasts. In 1987, growth is expected by all forecasters except UNCTAD to be greater than this year; those who have revised this year down expect the oil effects to start to come through then. Europe, however, does not share this improvement because of slower growth in Germany. In the medium term, growth is put at about 3%, as was expected last year, although the World Bank has raised its 'high' forecast. This appears inconsistent with the forecasters' views on the effect of the oil price (although the IMF and World Bank may have been too early to include full oil price effects) but may be explained by the great increase in pessimism at the end of last year: compared to the revised expectations, it is higher. But it is possible that the forecasts made in both years display forecasters' caution in forecasting large changes: given the discussion in last year's reports, the numbers seemed optimistic. On the basis of this year's comments they appear low. The IMF includes a lower growth scenario, but not a higher.

Several of the forecasters consider the cyclical argument that output growth should be slowing in the industrial countries because it has lasted too long, and reject it. OECD argues that the present upswing is unusual and sustainable because it has not been stimulated by fiscal policy and because inflation has dropped during it, not acted as a constraint as it reached a peak. It also notes that the trend for the average inflation rate to rise in each upswing which had caused increasing concern was being reversed (pp. 20-1). The BIS agrees that the success in avoiding an increase in inflation can permit sustained growth. The IMF (pp. 28, 45) suggests a variety of reasons, including low inflation, spare capacity, divergences among countries, and, oddly, the less favourable external environment. Like most forecasters, they all probably simply do not believe in automatic cycles.

Trade

World trade slowed in 1985 to a growth of about 3%, but not simply because of the reduction in industrial country growth; there was still a net stimulus from industrial countries' imports rising faster than exports, contrary to expectations, although there may have been some destocking after the rapid growth in 1984. In particular, US imports continued to increase more than three times as fast as output. It was imports by OPEC which fell sharply (perhaps 10%) with other developing countries rising at most 3% (estimates are still uncertain). All areas' exports were therefore tightly constrained.

In 1986, a similar pattern is expected, with total trade growth only slightly higher (3.5%) and again the fastest growth in demand in the industrial countries and large falls for OPEC. US imports were expected to grow only half as fast as in 1985 although demand is forecast to rise more rapidly. As OECD argued that import prices were not fully reflecting exchange rate changes in the first part of the year, and it would be unusual for the dollar's fall to affect volume as quickly as these forecasts apparently assume, they may be low. In 1987, there is a small rise in the rate of growth of world trade, in spite of little change (or a fall) in the growth of industrial country imports, because of a recovery in developing country imports (in particular a smaller fall for OPEC). Developing country imports recover fully in the medium term, according to the World Bank and IMF, and the rise in the forecast for world trade seems consistent with this being the only change. There is thus no shift to external demand by the industrial countries caused by the lower commodity prices, and the implied elasticity for world trade against output remains at or below the 1970s level. The IMF medium term rate is slightly below the 1985 forecast although industrial country output is marginally higher; trade by developing countries is slightly lower. Exports of manufactures continue their traditional lead over other goods.

These forecasts thus take a cautious view of the direct and indirect effects of the oil price, and also of trade elasticities as they have done in the recent past. There are, however, some structural changes. OECD point out that by 1987, on the falls forecast here, OPEC's share of imports of manufactures will be down to 7%, approaching its pre-1974 level. Industrial countries increase their share relative to other developing countries, at least through 1986 and 1987, so that there is in total a large shift towards the industrial countries as the source of demand. Although they are not expected, as in earlier years' forecasts to reduce imports relative to exports, they are still expected to depress world demand by low elasticities relative to income and apparently prices. If the pessimistic view of relationships in these forecasts is correct, previous forecasts must have taken the optimistic end of all uncertainties.

6. THE FORECASTS FOR THE DEVELOPING COUNTRIES

Output

Although the figures are still uncertain, output in the developing countries probably rose by less than 4% for all areas (except perhaps Asia, helped by high growth in China), although the IMF remains higher than this. Africa grew particularly slowly on all estimates (perhaps 2%), and both it and Latin America (about 3.5%) probably by less than expected (although Brazil had rapid growth). Slower growth is expected in 1986 (except in Africa although it is still expected to do least well) (table 4). The forecasts are lower than a year ago, particularly of course for the oil exporters, but for other primary producers as well, although exporters of manufactures are expected to do better, and preliminary figures for some of the Asian countries are confirming this. Latin America is expected to grow most slowly. ECAFE agrees that Africa will grow more rapidly in 1986, but these forecasts were of course made before disruption to trade in Southern Africa became a serious threat. In 1987, output in Latin America could recover, and there is also expected to be some improvement in the oil exporters.

The poorer performance expected in these forecasts for Latin America reflects some deceleration in Brazil (from 8% in 1985) and the importance of the oil producing countries, notably Mexico. In general, the slow growth of demand for exports is expected to constrain all countries (reinforced by the poor terms of trade and the financing difficulties discussed later). In the medium term, average growth recovers to at most 5%, with Asia still fastest and Africa slowest. In effect, recent trends and constraints are assumed to continue, with the only growth coming when temporary phenomena (such as the actual

Table 4
Output in developing countries

percentages

	IMF							UNCTAD	UN	World Bank	
	Base-line	More lending	Low Ind. growth	Low int. rate	High oil	Low dollar	Low non-oil			High	Low
								1986			
Developing countries	3							2.6	3		
Oil exporting	-.1								1		
Non-oil developing	4								3		
Net oil exporters	-.4								1		
Net oil importers	4.7								4.5		
Output by area											
Western hemisphere	1.6							2.1	2		
Africa	2.8								2.5		
North								2.3			
Other								.2			
Sub-Saharan Africa	4.7										
Asia	5.5								4.5		
South								4.8			
East								3.6			
								1987			
Developing countries	3.4							2.7	3.5		
Oil exporting	-.3								2		
Non-oil developing	4.6								3.5		
Net oil exporters	2.5								2		
Net oil importers	5								4.5		
Output by area											
Western hemisphere	3.5							3.1			
Africa	2.8										
North								2.1			
Other								-.6			
Sub-Saharan Africa	3.5										
Asia	5.5										
South								4.9			
East								3.6			
	1988-91	1986-91	1987-91	1987-91	1987-91	1987-91	1987-91	1985-90		1985-95	1985-95
Developing countries								3.5		5.9	4
Non-oil developing	4.8	5	3.6	4.9	4.8	4.8	4.5			5.9	4
Net oil exporters	4.2	4.6	3.5	4.4	5.2	4.1	4			4.8	3.4
Net oil importers	5	5.2	3.7	5.1	4.9	5	4.7				
Major exp. of manu.										6.4	4
Output by area											
Western hemisphere	4.3	5	2.8	4.6	5	4.3	3.7	3.4			
Africa	3.7	4.1	2.8	3.8	4.3	3.7	3.2	2.7		4	3.2
Sub-Saharan Africa	3.3	4	2.6	3.4	3.3	3.3	2.5				
Asia	5.8	5.8	4.4	5.8	5.8	5.8	5.5	4.3		6.4	4.4
Indebted developing	4.7	5	3.4	4.9	5	4.7	4.3				
Market borrowers	4.4	4.6	2.8	4.5	4.6	4.4	4				
Major borrowers											
With debt-serv.prob.	4.1	4.7	2.8	4.3	4.5	4.1	3.6				
Without debt.serv	5.4	5.4	4	5.4	5.4	5.3	5.1				
Official borrowers	3.6	4.1	3.1	3.6	3.6	3.5	3.2				

fall in the oil price or the drought in Africa) cease to have their impact. The prospect, on these numbers, for the developing countries even in the medium term remains as depressing as before. The changes from last year seem small relative to the events described in the forecasts and the first part of this paper. The IMF in particular presents its forecasts as showing a sharp improvement because of the fall in the cost of oil (pp. 51-2), stressing the rise in growth to around 4% for the average non-oil commodity-exporting developing country. Per capita GDP does rise for most areas, but by very small amounts, after a period from 1980-85 (IMF p. 54) when it stagnated for all developing countries and fell for Africa, Latin America, and the Middle East. The countries with debt servicing problems and the poorest groups continue to do worst so that there are no changes in the distribution of problems. There is an improvement in outlook for the exporters of manufactures but 6% is not high by their past standards.

The IMF does a series of sensitivity analyses, to higher lending, 1% lower growth in the industrial countries, 1% lower interest rates, $20 (instead of $15) a barrel for oil, 5% lower dollar, and 1% lower rise per year in non-oil commodity prices. The most important effect on output (more than 1 for 1) is from output in the industrial countries, confirming the view that the most important effects from oil prices will come from this route, although $5 on the oil price is worth a third of a point on output, suggesting that the effect of the actual fall of close to $15 may have had a similar effect. Lower commodity prices are also, however, a significant influence, again a third of a point for the simulation chosen, surprisingly with a fall in the volume of exports. The commodity and oil price simulations do come close to explaining why after the changes in both prices since last year the forecasts remain little changed, especially given the apparently weak response of industrial country demand to these prices.

Trade

Exports did rise more than imports as expected in 1985 for most areas, although for all non-oil countries and most groups by only 3%. The main surprise was the rapid rise in imports by China which meant a very high import growth for Asia, and sharp deterioration in its balance. Latin American exports may have fallen, by about the same amount as its imports, and African imports also fell. In 1986, oil exports are expected to rise slowly, and primary commodities even more slowly, but exporters of manufactures are expected to increase their share of world trade: although the OECD has found that developing countries are continuing to lose share in their markets, it still expects this to reverse in the forecast period, with small rises relative to markets in 1986 and 1987 (table 5). The growth rates are not high even by recent standards. The IMF expects exports of manufactures to grow most rapidly but although it argues that their prices have made them competitive and help explain the past apparent high elasticity of industrial country demand for them, it has lowered its forecast to only 'half their "normal" rate' (p. 64). The export growth rates for different types of commodities forecast by the World Bank do suggest some effect from lower prices. Although manufactures rise most rapidly at almost 10%, suggesting a strong increase in their market share with industrial country growth at 4.3%, primary products do keep up with this output rate (although in the low case they fall short, at 1.5% compared to 2.5) (p. 44). This equalling of output growth and the rate itself are unprecedented (on the World Bank's own figures), but on the arguments suggested in section 3 could be justified. The World Bank, however, offers no explanation for them in the Report.

For all developing countries, and each area, the poor performance on terms of trade (next section) leads to the elimination of their trade surplus, although oil exporters are worst hit. This helps to explain the continued slow growth of imports into 1987, although by then volumes of exports are rising more rapidly on the IMF forecast. In the medium term, the IMF and World Bank both see little change in the volume balances, little change in terms of trade, and thus little change in the need for finance. The implied import elasticities in the medium term in total and for individual areas are quite low for the World Bank and the IMF. Although the IMF suggests that there will be some recovery from the cutbacks in 1982-3 (p. 94), it is extremely limited, on these figures.

The distribution of import demand suggests a large rise in the share of developing country exports going to industrial countries. This is an unusually abrupt change, especially for Asia. Latin-America did have a small rise (from 65% to 71% of the total) between 1980 and 1984; for Asia, the rise to the US, which it shared with Latin America, was offset by falls to Europe and Japan. Unlike Latin America, it has continued its growth of intra-area trade. Such a large shift in demand could meet structural problems because of the different composition of trade.

The IMF discusses the problem of forecasting how rapidly oil exporters will cut their imports (other developing countries are assumed to be finance-constrained and therefore to respond immediately to falls in commodity prices). It suggests (p. 50) that their reserves allow them some latitude. While the cuts have been large in the past, this itself makes further cuts more difficult. Clearly the forecast that they will cut by half their loss in purchasing power must be uncertain, but the discussion seems reasonable: unless OPEC took the view that the oil price would remain permanently high, it must have intended some of its reserves for use in precisely the present circumstances. The non-OPEC oil producers do not have this cushion of reserves.

Terms of trade

The consequence of the price movements in trade and within industrial countries discussed above was a severe fall in developing countries' terms of trade in 1985, for both oil and non-oil exporters. In 1986, early forecasters, expecting a recovery in commodity prices, forecast some improvement for non-oil exporters, but the fall since then has probably made that unlikely. As many exporters of manufactures also followed dollar pricing, the loss is again likely to be general, although worst for those with oil exports. All these influences continue into 1987 (because even with unchanged prices and exchange rates from mid-1986, the average for 1987 will be lower), giving a third year of decline. In the medium term, little change is forecast.

Financing

In 1984, there was an improvement in developing countries' trade balance which even permitted some accumulation of reserves; the reduc-

Table 5

Trade by Developing Countries

percentages

	IMF Base-line	UNCTAD	UN	World Bank High	World Bank Low	OECD
			1986			
Developing countries						
Terms of trade	-11.7	-19	-18			non-oil-3
Export volume	3.8	4.1	4			
Import volume	-.6	-4.7	-1.9			
Oil exporters						
Export volume	2.4	4.7	4			5
Import volume	-16.5	-18				-12.5
Non-oil developing						
Export volume	4.2	3.5				4
Net oil exporter	6.1		4			
Net oil importer	3.9		4.5			
Exp.Manufs.						4.75
Import volume	4.1	4	-1.9			3
			1987			
Developing countries						
Terms of trade	-1.4	-1.4				non-oil-1
Export volume	5.5	3.6				
Import volume	2.1	-.4				
Oil exporters						
Export volume	4.8	3				5
Import volume	-10.4	-5.4				-15.25
Non-oil developing						
Export volume	5.5	4				5
Net oil exporter	3.3					4
Net oil importer	5.9					
Exp.Manufs.						6.25
Import volume	5.2	2				4
	1988-91			1985-95	1985-95	
Developing countries						
Terms of trade	-.1					
Export volume	5.1			7.1	3.2	
Import volume	5.3			7.7	3.4	
Non-oil developing						
Export volume	5.1			7.8	3.8	
Net oil exporter	4.2			5.1	1.5	
Net oil importer	5.2					
Exp.Manufs.				8.1	3.9	
Import volume	5.3			7.7	3.4	

tion in the trade surplus in 1985 made this impossible. Interest payments did not rise, because the fall in nominal rates was offset by the continued rise in debt. As was expected, for some countries interest payments are now higher than new receipts from borrowing: the UN (p. 74) estimates that this was true for one third (about 30) of the capital-importing developing countries in 1984, and probably more in 1985. They include the well-known major Latin American borrowers, but also some poorer African countries (Zaire and Zambia) and some East Asian (Malaysia and Philippines)[4]. The UN discusses the contribution of 'capital flight' to the low net inflows to these countries (p. 75), criticising simplified calculations which include all omissions in balance of payments statistics: on its own admittedly 'shaky' estimates, it finds that flight is falling and that even if it is subtracted, there is still a negative net transfer. It questions why, therefore, it has become an issue recently. It notes that more deposits in industrial countries must be expected from greater integration of capital markets (and removal of capital controls), both for commercial reasons and because investors can now choose where to invest. It points out that more favourable opportunities in the developing countries are the ultimate solution, and implicitly criticises the current 'clamour'. The IMF also notes that the flight is falling, and expects it to stabilise, because of greater controls and better domestic prospects (p. 67). The World Bank, in contrast, believes that it is still 'endemic' and is waiting for it to reverse (p. 41).

In spite of the fall last year, official flows (even if involuntary bank lending is not included in these) are now the principal source of balance of payments financing for the developing countries. There has been a return to the position in the 1960s, after the 1970s when export credits and private flows provided more than half the financing (OECD Finance, 1986). Multilateral official lending, in particular, has increased since 1980, except in 1985, and the banking sector's share has fallen back to its pre-1974 position. Borrowing actually fell in 1985, because of a decline in official lending.

[4]The IDB gives a figure of $100 billion for servicing net of receipts in the last four years, but as this was written before ODI received its forecast it is not clear whether this is on comparable definitions.

There was also a very sharp reduction in export credits. New IMF lending, net, ceased. There was a small rise in official transfers, and there is estimated to have been little change in foreign investment which remains important but static. In 1986, official lending, although not from the IMF, was expected to recover to meet the further increase in current deficits, with little further change in 1987. The new IMF trust fund, proposed by the US last year, was established in March (the Structural Adjustment Facility) and lending began in August, but this will only partly offset the repayments to the IMF. The recovery in official lending assumes that the multilateral institutions will be able to overcome the 1985 problems, which appear to have affected all the regional banks as well as the World Bank, of finding creditworthy projects when local finance from governments is restricted by fiscal and balance of payments constraints and the projects to be financed are being reassessed in the light of slower growth (UN, p. 79). The Baker initiative of October 1985 put particular stress on increasing this lending, including relaxing the constraints on the types and amount of financing the official banks can provide. The US has not, however, supported, increased resources for the World Bank. The World Bank's lending projections do now expect a substantial increase. The other part of the Baker plan, increased lending by commercial banks, has not yet produced concrete results, and the IMF has therefore not included it in its projections (IMF, p. 69). It expresses particular concern about the fuel exporters, fearing that they could suffer net outflows of private finance. OECD assumes that international efforts will preserve a constant level of financing.

This will not permit further rebuilding of reserves, although the UN argues that present levels are low, even in terms of historical ratios to imports, and that the desirable level may now be higher because of the reduced access to other forms of short-term finance (bank lending in particular) (pp. 83-4).[5] It views this as one reason for greater official creation of liquidity. It points out that the reduction of IMF lending, and the need of some countries to repay

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[5]Reserve levels are discussed in an IMF contribution to Michael Posner, ed., Problems of International Money, 1972-85, IMF/ODI, 1986.

their borrowing, is putting an additional strain on the international financing system.

An interesting development in 1985 and 1986 has been the increasing use of bonds, so far almost exclusively by Asian countries, to replace part of the fall in bank lending. Bank lending, in contrast, had been predominantly to Latin America. In 1985, issues rose from the average early 1980s figure of $3 billion a year to $7 billion. Official lending by the IMF in the early 1980s was principally to Latin America, while the World Bank lent more to Asia, although Latin America was also important, sharing most of the increase so that there has been little recent change in World Bank lending to Africa. The new IMF Structural Adjustment Facility is intended for poorer countries, and the first loan went to Africa. Most bilateral aid goes to Africa and Asia. Overall, therefore, there has been a shift in financing towards Asia, and away from Latin America, with little change for Africa.

The World Bank expects that its High case would improve credit worthiness sufficiently to reverse the trend in private finance, giving a growth rate to 1995 of 7%, while official lending and transfers each grow at only about 3%. As it believes that private direct investment could rise at 5.7% (p. 56), this would be a change back from the current dominance of public investment. Total flows would grow at 4.5%. In contrast, the IMF expects official financing to grow at 9% while private grows at 3%. (Private investment should grow in line with industrial country demand, and it expects no change in official transfers.) Because of the different uses to which official and private finance can be put and the different areas to which they tend to go this divergence is a major one between the two forecasts. The World Bank's Low case is completely different: total flows fall by 2% a year, and within this private bank lending falls most. Official lending also falls, but there is continued slow growth in direct investment and official transfers. There is thus increasing pressure from financing difficulties on countries' imports and particularly on those relying on private finance. The UN also believes that official financing must take the principal role, and quotes the World Bank in support.[6] It notes that the World Bank's new insurance scheme (MIGA) for foreign investment has now been established, but also argues that an increased role for private investment makes it more important to secure agreement on a code of practice (as proposed by the UN Centre for Transnational Corporations).

Area prospects

The uncertainties identified in the first part of this paper affect the Latin American and African countries more than most Asian. If the oil price remains low and the industrial countries are stimulated into rapid growth, this will stimulate all trade volume, but the difference between slow and rapid growth is likely to be greater for primary producers, including oil exporters, than for manufactures exporters (although their exports grow fastest under any scenario). To the extent that the stimulus comes from low inflation in the industrial countries, this on its own should improve the terms of trade of primary products relative to manufactures, and there could be a further effect on commodity prices. Although Asia always faces the most favourable prospects as an exporter of manufactures (with a high share of trade to Japan, which should gain most from a low oil price, and high regional growth feeding back on intra-trade), Africa benefits most from higher primary product volume or prices, although its dependence on these puts it last on any scenario. Higher growth with larger flows of private finance, and lower interest rates, would improve Latin America's access to finance most (Asia appears less restricted even on a lower forecast). Africa gains from the slightly higher flows of official finance (in line with higher growth in the aid donors), but remains least well placed.

7. DEBT

The burden of past debt has been increased by some of the same changes that seem favourable looking toward the future. The fall in

[6] 'Adequate financing will not come spontaneously from private lenders. The official sector must assist through a combination of strong leadership and greater lending of its own.' World Bank, World Debt Tables 1985-86, quoted UN p. 78.

real interest rates is an unambiguous benefit, but lower inflation in all the debtors' export prices means that the cost relative to expected export revenues falls more slowly, if at all (IMF, p. 10) and only for Asia (on the IMF medium term forecasts) does export volume rise more rapidly than the real rate of interest. On the World Bank High case, most groups achieve this, but not in the Low. The World Bank, however, is expecting higher inflation than the other forecasters in both Low and High case, and also an improvement in terms of trade. The poor trade balances last year, and slower growth of exports for at least the current year, have increased the volume of debt on which interest must be paid compared to last year's forecasts. The fall in the dollar will benefit the countries which export to Europe and Japan to the extent that they can raise their export prices to these areas (UN p. 20).

The signs which the IMF (p. 67) identifies as encouraging in 1985 seem mainly to be the result of the improvements in 1984 (rebuilding of reserves, adjustment to lower borrowing, rescheduling) and it points out that the financing situation of most countries 'remained as tight in 1985 as...in 1984' (and the forecasts indicate that it remains so in the future). The UN thinks that 'despite rescheduling, debtor countries are no closer to a permanent resolution of their debt problems' (p. 80) and cites the continued rise in the ratio of debts to exports in 1985 and, on its forecast, 1986, reversing the 1984 improvement; it notes that exports are unlikely to grow faster than interest rates. The World Bank (pp. 52-53) points out the particular difficulties of Sub-Saharan debt: because it is largely official, it is not (by international agency rules) rescheduable, and this in turn restricts the area's access to other finance. It concludes that domestic policies are not sufficient, and more official assistance is necessary. It also sees a change for the worse for middle-income countries in 1985: 'It became widely accepted that the debt-servicing problems of some developing countries would last longer than had earlier been thought and that their solution depends critically on the restoration of sustained growth' (p. 54). It notes the compression of imports and investment that has already occurred and concludes, as for the African countries, that growth and domestic policies are not enough without additional finance. UNCTAD makes the same point (p. XIII). Some events external to the indebted developing countries have threatened to make the problem more difficult to solve, including the uncertainty over government liabilities to banks following the collapse of the International Tin Council (cited by UNCTAD, p.72), the additional pressures on banks, particularly in the US, from low energy and agriculture prices, and concern over South African payments.

This discouragement at the performance in 1985 led to the Baker initiative, although this was to provide continuing financing (discussed in the last section) not deal with the overhang of existing debt. The BIS, however, bluntly points out the connection: 'it was necessary to give the debtor countries hope that it was worth their while to continue their efforts towards re-establishing their creditworthiness. Failing this, the consequences for the creditors of a massive default...could again have constituted a threat to the financial system' (p. 187). It also, however, notes that the quantities involved were only a fraction of the interest payments required. It suggests that the initiative is incomplete without growth and trade liberalisation in the industrial countries. It is thus arguing for the acceptance by the industrial countries of international obligations in economic policy. In spite of the Baker plan, it considers the debt problem fundamentally unchanged for the debtors, although it believes that the banks have been able to strengthen their position, reducing the impact of default. All the forecasts have accepted Baker's tying of debt repayment to growth in the developing countries.

All agree that the case-by-case approach is necessary, but the UN and UNCTAD both argue for an international framework and recognition of the global implications of each country settlement. The UNCTAD report also points out that the international mechanisms for dealing with country debt are less developed than national systems for dealing with company debt, for example US provisions for bankruptcy. While accepting that national systems could not be transferred directly to countries, it argues that lack of some equivalent is a serious gap in international mechanisms. It discusses some of the other proposals that have been made to introduce flexibility or to adjust debt to countries' ability to pay. It concludes that private creditors would be unlikely to accept the increased risks. It does, however, take a more optimistic view of the proposal by US Senator Bradley for regular reductions of the interest rates and capital value by small amounts.

(This appears to be opposed by the US government: the chairman of the Federal Reserve has opposed writing down debt.)

Events since the forecasts were published provide conflicting evidence about approaches to debt. Mexico's latest agreement with the IMF embodies Mexican targets for growth, on which the IMF's conditions will depend, an innovation in flexibility. But Peru, the first debtor to set a share-of-exports limit on the payment of interest has (at last) been cut off from IMF financing, although it is still receiving bilateral aid and disbursements from committed World Bank loans. Brazil, in a strong position following its exceptional growth performance in 1985, is talking about a limit relative to GDP. Clearly, the emphasis on growth and on the World Bank in the US initiative of 1985 have encouraged debtors to take stronger positions against deflationary adjustment (and against the IMF, now a minor source of finance). The basic element in the post-1982 negotiations, that an internationally agreed, managed, solution is preferable to individual action by a debtor or a bank, remains unquestioned (except perhaps in UNCTAD's comments on bankruptcy) although it has so far failed to lead to any real improvement in the debt situation.

8. TRADE NEGOTIATIONS

These have become linked with the debt problem because debtor countries have argued that the increase in non-tariff protection by the industrial countries and their efforts to promote their own agricultural exports have damaged the trade prospects and therefore the ability to repay of the major debtors. If the industrial countries are concerned about debt repayment, this could give the developing countries additional negotiating strength by identifying a sector within industrial countries, the banks, which can be seen to be damaged by protection as easily as the industries involved can be seen to be helped. As in all recent years, the forecasters argue for reduced protection in the industrial countries, to benefit their own growth and structural adjustment as much as for the sake of developing country exports. But, except in the World Bank's High case, the growth forecast even into the medium term is not sufficient to reduce the high unemployment figures which are one of the explanations of protection, and they start from higher levels than previously expected because of the slow 1985-86 growth rates.

The Multi-Fibre Arrangement was extended for five years from the end of July, with an extension in the fibres covered, but some concessions to the poorest countries. It may preempt even more protectionist action by individual countries, but the negotiations did not suggest that concessions to the developing countries would be easily obtainable in the GATT round, and the types of concession offered in the latest settlement do not offer a promising point of departure: proposals to give concessions to developing countries that had liberal regimes themselves for textile imports failed, weakening reciprocity as a way forward.

The GATT round should start following the latest preliminary meeting in September in Punta del Este. Most of the principal issues are in areas where GATT rules have not operated in the past, because of evasion (non-tariff barriers), because some sectors have been effectively excluded (agriculture and textiles), or because they were not included in its responsibilities from the start (services). The disputes procedure itself is another issue. The more traditional negotiations about tariffs will apply to a few sectors, but could only become important if developing countries are pressed to give up their special rights to reduced tariffs (on a limited range of goods) under GSP in the industrial countries or their greater freedom to use them against imports. The importance of new issues means that questions will need to be raised about the appropriate boundaries between trade rules and domestic policy, not only economic policy but the social and political policies embodied in regulation of some sectors, notably in services. The broader question of rules or discretionary action will also be central. The UN emphasises the recent 'erosion' of the trading system and the need to establish rules for any system to work. It reviews the history of the exclusion of agriculture and textiles and recent protection (pp. 90-91).

Agricultural trade has become an increasingly controversial issue as both the US and the EEC have subsidised and expanded their exports, threatening other exporters in third country markets, as well as excluding them from their own. Other industrial countries and a range of developing countries have argued that agriculture should be discussed in the Round, but the EEC has not agreed to any mention of subsidies. GATT has put forward two types of approach: to regulate markets further, with market-sharing restraints superimposed on the national schemes, or to attempt to reduce the present level of domestic intervention, leaving freer markets.

The system that has evolved in this sector in which belief in a national interest in self-sufficiency has the longest history offers a warning of the costs of protecting domestic output: it has put pressure downward on the volume of exports by countries that cannot match the most subsidised and on the price on world markets, while imposing costs directly in higher prices and indirectly through subsidies on national consumers. The first two raise the issue of the acceptable international effects of national policy. World trade in agriculture (like oil) has risen more slowly than output suggesting an inefficient diversion to home production from the most appropriate suppliers. The last effect is principally a matter of national policy choice, between efficiency and other objectives and of distribution among sectors.

Textiles is a purely industrial against developing country issue, not only the protecting importers but other industrial countries that have replaced developing country suppliers have an interest in preserving the Multi-Fibre Arrangement against absorption into normal GATT procedures.

Trade in services and legislation on intellectual property have provoked disputes between industrial countries and developing, but there are also differences in policy within both groups, so that the main difference will be between the countries that look mainly at the direct economic benefits and costs of increasing trade in these and those that see other national interests, either in furthering a particular pattern of economic development (some developing countries look at the Japanese trading companies or US banks as either threats or models) or in non-economic areas: a much higher proportion of services is closely regulated within countries than of goods, and it is unlikely that countries will offer more freedom to foreign suppliers. GATT has been compiling information on countries' services as this an area where international data are seriously lacking, another obstacle to negotiation.

GATT has been trying to re-establish some regulation of the variety of non-tariff barriers (NTBs) that have proliferated since 1974. Its existing safeguard provisions are intended to permit temporary restrictions on imports from any source, but they do not permit the type of protection against specific suppliers which interest groups in the industrial countries have wanted. Relaxing the provisions could be considered desirable to regulate what cannot be prevented or a gesture of approval toward measures that ought not to be taken. The working group set up after the last round to deal with this shows little progress towards agreement. GATT has, however, started to move towards recording them and, therefore, establishing some definitions of what are barriers. This is an issue in which conventional product-by-product negotiation will be difficult to start because the developing countries take the position that the barriers were imposed unilaterally and without compensation and therefore they should not offer any concessions in return for their removal. But their objectives of 'standstill' and 'rollback' could require discussion, if not negotiation, of what measures are NTBs and where they exist.

One of the particular issues mentioned by the UN is of 'graduation', how to determine when a country should no longer be included in 'developing countries' to which GATT special treatment applies. This will raise issues of two types: who should decide, i.e., which trading arrangements are basically concessions by the industrial countries, where they make the rules, and which are negotiated agreements; and secondly, how far developing countries gain from special treatment, and conversely lose from the argument that if they are claiming special treatment they must accept some discrimination. Extension of MFN to the new sectors could be an issue.

9. PROBLEMS

Present prospects

The forecasters (except UNCTAD) agree that the outlook for developing countries has improved relative to the recent past, but that it is still unsatisfactory, and that policy changes as well as economic responses are called for. The World Bank puts it strongly, arguing that 'policy reforms...are essential to take full advantage of this stimulus' (p. 1). OECD argues that though there is little change from previous years in the numbers, there has been a reduction of the risk of a lower outcome. The UN goes further, suggesting that the projections now may be too low if confidence is self-reinforcing (p. 34). The BIS, however, emphasises that there are still risks, which may be serious precisely because the adjustments to the large recent changes are not complete. The IMF takes a more pessimistic view, because of the actual deterioration in balances and debt ratios in the last year, the 'scope for achieving such a [satisfactory] result has narrowed' (p.11). Its latest forecasts are apparently lower for 1987 as well as 1986, suggesting growing pessimism about the extent of stimulus from the oil prices, not merely a longer lag. UNCTAD's verdict is 'much the same' (p. XII).

Last year, 3.5% was the optimistic medium-term output forecast for the industrial countries for the IMF and World Bank, and the minimum necessary for a continuing improvement in the developing countries for the UN and UNCTAD, and all treated it as an extreme hope, not a forecast. This year, forecasts are still generally below it (although the mid-point of the World Bank's medium terms is 3.4%), but it is approached in some years, in some forecasts, and cannot now be regarded as beyond reasonable uncertainties. The prospects have, at the least, returned to being sustainable, given identifiable policy changes or some optimism; last year even the forecasters appeared not to believe in their own outcomes.

Policy recommendations

Last year saw a strong change to emphasising the need to change policies in the industrial countries: this remains true, but some still argue that reforms in the developing countries are important and necessary, and there is perhaps greater emphasis than in the recent past on what should be done internationally. In spite of the further reduction in inflation, current and expected, the forecasters all remain apparently pessimistic about the possibility of reflationary policy in the industrial countries, and still fail to explain this lack of policy response: if last year's inflationary prospects were sufficiently low that deflation was not expected, why is reflation still unlikely with lower inflation?

The World Bank continues to argue for structural changes to reduce price distortions and make markets more flexible in the industrial countries (p.3), but the OECD appears undecided on whether reforms have gone far enough (pp. xiv or xvi). (It also thinks macroeconomic policy can remain steady, and its general view on policy is cautious.) The UN (p.9) and UNCTAD (p.XIII) call for coordinated reflation, UNCTAD stressing that in the absence of greater growth, no policy measures by the developing would be sufficient. It also considers such growth a precondition for the roll-back of protection which it supports. The IMF supports reflation, in Japan and, if necessary to keep output growth up, in Germany (p. 12), and also argues for lower interest rates and a general easing of monetary conditions. It gives a 'special mention' (p. 18) to avoiding protectionism.

The World Bank still puts its main emphasis on developing country policy, although its High and Low scenarios are based on different industrial country policies. Its central recommendation is policy which allows developing countries to adapt to an unstable or unfavourable world economy (p.40), including increasing domestic savings, increasing the efficiency of investment, and stimulating exports. UNCTAD argues in detail that savings cannot be increased significantly because of the reduction of incomes and output needed in recent adjustment policies (p. XII, pp. 123-5), and that the growth of exports necessary for satisfactory growth implies an unrealistic penetration of industrial country markets. The IMF's recommendations are in the same direction as the World Bank's, with more specific structural suggestions (pp. 15-16), but it does not expect them to be able to raise exports to past growth rates, given its forecasts for the industrial countries. The UN also emphasises the need for structural changes within developing countries, but suggests that they should coordinate their trade objectives within GATT and UNCTAD.

The UN calls international policies that could improve the developing countries' prospects one of its 'main themes' (p. 7), mentioning the GATT negotiations, new international monetary arrangements, and international coordination of developing country diversification out of single-commodity dependence. It also lists the types of expanded multilateral agency lending necessary because it does not expect private lending; it includes the IMF (both structural and for commodity compensation), as well as advocating increased liquidity through a new issue of SDRs. The BIS is cautious about an international monetary policy, which it fears could accommodate inflation. But it deliberately goes beyond its mandate to identify the poorest countries as 'the darkest spot' and most in need of international help; it finds an institutional gap between the international agencies and private charitable organisations; neither can direct sufficient funds and advice, without breaching national sovereignty (p.-188). The need for increased flows of capital from the multilateral agencies also comes out clearly in the World Bank, UNCTAD and IMF analyses. The general support this year for more funds for both the major debtor countries and the poorest was not put as strongly in all of last year's forecasts, which generally took the supply of loans and concessionary finance as given. The reason for the change in approach may be partly the further deterioration in balances and debt, but could also be greater optimism that funds can be increased following the Baker initiative. This confidence may be an additional favourable indicator.

General issues

One issue identified was the extent of external constraints on a country's behaviour, and of international obligations, and what responses are available or appropriate when these are breached. In the trade negotiations, this includes extending them to new areas but the argument by some debtor countries that protectionist and discriminatory trade barriers by their creditors, by making it more difficult to earn income to repay their debts, justify poor performance on repayment shows how far it can go. On debt it has a direct financial logic, but if it becomes generally accepted that 'bad' behaviour on the part of any country justifies breaking international conventions by others, then the risks of a breakdown of international rules increase seriously, and it is possible that the developing countries, as most are economically weaker than most industrial countries, have most to lose. This goes beyond trade and international payments. The argument, put strongly by UNCTAD, that the collapse in commodity prices is the result of deflationary action in the industrial countries, and more generally, the agreement by all forecasters that growth there is the principal determinant of growth in the developing, and therefore that the recession in the former is responsible for much of the loss of income and the continuing burden of debt, could imply that compensation is due to the developing countries, whether directly, in the form of debt writeoffs, etc., or more generally in capital inflows or special trade treatment. More inflation would be helpful to some developing countries, if it permitted faster write-down of debt or higher commodity prices. Put this way, the argument seems extreme, but it is difficult to know where to draw the line between this and some arguments being put forward by the international agencies and governments of the industrial countries: that the United States should not be conducting a fiscal policy that absorbs a large proportion of world saving, or that European countries or Japan should alter their policies to reduce the pressure on the United States. Conflicts of interest exist, and the BIS notes the perennial difficulty in establishing a basis for cooperation, that a large country can act without taking account of international repercussions, while a small one may believe it can act without attracting retaliation-(p.185)

The other issue is the choice between 'efficient' and 'managed' markets. Completely unrestrained markets, with modern facilities for instant information and reaction (and inexperienced participants), may produce fluctuations of a size and frequency that have serious costs for those who need to make long-term plans, with clear signals in advance and small variance at the time they may come to the market. Attempting to manage markets, whether of trade or capital flows, prices, exchange or interest rates, with the intention of reducing the costs of unnecessary short-term adjustment or permitting slower-medium-term adjustment, has severe risks of wrong decisions, through simple failure to recognise when a fluctuation is a change in trend and more fundamentally through the creation of vested interests in a particular level. Unilateral attempts to reduce the impact of international shocks have serious costs to the country (or group) undertaking them and to the rest of the world: low prices and surplus production in agriculture and oil and the impact of import controls on the developing countries offer examples. International agreement to regulate managed markets may restrict problems from new controls, but reinforce those that exist. Any solution will have costs, in short or long-term efficiency, or in excessive adjustment, or restricting some of the advantages of rapid adjustment, or direct costs of insurance. In the absence of international agreement, there seem now to be risks of autarkical policies spreading. Just as it will be important to ensure that the economic costs from the depression, the loss of investment and capacity, the debt burden, and the personal and social consequences of unemployment and depressed incomes do not become obstacles to growth as prospects begin to improve, it is necessary to avoid creating institutional protection against change that could retard response to favourable conditions.

APPENDIX: DOCUMENTS DISCUSSED AND DEFINITIONS

Forecasts and other reports used

Bank of England, Quarterly Bulletin (June, 1986).

Bank for International Settlements, Annual Report.

British Petroleum, Statistical Review of World Energy, 1986.

Commonwealth Secretariat, Variable Exchange Rates and Trading on Commodity Markets, 1986.

Economic Commission for Africa and African Development Bank, Economic Report on Africa.

GATT, International Trade.

Inter-American Development Bank, Economic and Social Progress in Latin America, Commodity Export Prospects of Latin America.

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

National Institute of Economic and Social Research, National Institute Economic Review (August 1986).

Organisation for Economic Co-operation and Development, OECD Economic Outlook, (June issue), Financing and External Debt of Developing Countries (1985 Survey).

UN, World Economic Survey.

UNCTAD, Trade and Development.

World Bank, World Development Report.

Definitions

For full definitions see individual reports.

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

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

Price of manufactured exports: UN index for developed countries.

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

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

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

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

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

Market borrowers: countries that obtained at least two thirds of their external borrowing from 1978-82 from commercial creditors.

Major borrowers: Argentina, Brazil, Indonesia, Mexico, Philippines, South Korea, Venezuela.

Official borrowers: countries that obtained at least two thirds of their external borrowing from 1978-82 from official creditors, except China and India.

Notes

The IDB and GATT reports were published too lated to be included.

The IMF has seven medium term projections

Baseline: 'most likely' policies: US deficit falls from 5.5% to 2.5% of GNP by 1991.

Additional lending: Private lending grows 1.75-2% faster and official, 3%.

Lower growth in industrial countries: 1% lower 1987-91.

Lower interest rates: LIBOR 1% lower 1987-91.

Higher oil prices: $5 a barrel higher (than $15) in 1986, then 0 real rise.

US $ depreciation: by 5% at end 1986.

Lower prices of non-oil commodities: rise of 3% p.a. instead of 4.2%.

The World Bank has two medium term scenarios.

Low: 'unchecked budget deficits' in industrial countries.

High: Reduced government deficits in industrial economies.