ECONOMIC PROSPECTS FOR THE THIRD WORLD

The 1989 Forecasts

Diverging Trends in Latin America, Asia and Africa

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1. Return to Development

World growth and trade appear to be returning to normal. For the last five years on average, and in 1988, the industrial and the developing countries have grown at 4% a year, with world trade growing at 6%. Although most forecasters see a general slowing this year, it is not a large change (and they were wrong when they forecast it for 1988). Some interest rates have fallen. Even the growing concern for the environment and sustainable development could be interpreted as emerging because concern over whether there is any growth or development is receding. It is clear that performance in aggregate is better than it has been since the 1970s.

But this is both a weak comparison and an incomplete one. As the historical series in the Appendix show, the decade from 1973-83 was itself one of poor performance, and for many developing countries of stagnant or falling income per capita. Those analysing the prospects for the developing countries must therefore look for signs that performance will improve further, and for appropriate policies to achieve this. The improvement so far has pushed back the pessimism of a few years ago about ever returning to 'normal': the UN assures us that 'The picture presented of an economy undergoing sustained growth is not meant as an unattainable ideal' (p. 153). But there are fundamental structural differences behind the similarities in the aggregates, including the appearance of large divergences among developing countries in different areas (although those among the industrial have decreased) and the changes in capital flows between industrial and developing countries, which includes the debt crisis and its aftermath. Some of the Reports discussed here[1] also argue that the relationship of performance in the developing countries to the industrial is less close, but this could be a different interpretation of the nature of their 'dependence'. The industrial countries' return to growth above 3.5 % has now removed what many in the early and middle 1980s saw as an absolute constraint on improved prospects for the developing. Even then, however, it could be seen that while this would encourage the Asian countries, and perhaps permit development in Latin America, it would not be sufficient on its own to develop the low income, African countries. Most of

[1]The publications used in the comparisons of forecasts are listed in the Appendix, with definitions of the groups and assumptions.

the Reports take up three themes: further improving aggregate performance, explaining and reducing the disadvantages of the poorest, and improving the external financial position.

2. Output and Inflation in the Industrial Countries

Although growth is expected to slow in 1989, to slightly over 3% (table 1), this will be, for the third consecutive year, higher than initial expectations. UNIDO is again the most optimistic. A further slowing is expected next year, and expectations for the medium term are mixed. The World Bank and UNCTAD are both quite low, about 2.5%, similar to the second half of the 1970s (the low number for the World Bank suggests that they are low for 1989-90 as well). The IMF and UNIDO suggest that 3% can continue. The pattern of slowing from 1987-8 is similar for most forecasters in aggregate, but there are important differences in expectations for the relative growth of Europe and the US. All expect Japan to grow faster than the others, but the difference appears small compared to 1960-73. Some forecasters expect US growth to be deliberately slowed by a continued high interest rate policy, assuming that the rates of the first part of the year would remain, or even rise further (table 2).

Most stress that the years since 1983 have been an unusually prolonged period of growth, and, as has been true for the last two years, they are looking for when and how the 'landing' will occur, not whether it will; the metaphor emphasises growth above trend, rather than the level rising towards capacity. The reason for the unexpectedly good performance in 1988 is generally seen as high investment, but although several use this to explain other parts of their forecasts, there is little analysis of the reasons for it: most (apparently) assume that it was a temporary event. If, however, it was a sign of the restructuring to meet the changes in patterns of trade which many commentators expect, towards exports in the US, away from them to the domestic market in Japan, and to meet the post-1992 opportunities in Europe, then it is not obvious why it should now end.

Table 1: Industrial Countries percentages

	IMF	UN	UNCTAD	UNIDO	OECD	Asian DB
1989						
World Output (GNP/GDP)	3.3	3.5	3.3	3.4		
Industrial Countries	3.3	2.8	3.1	3.3	3.3	3.4
United States	3.1	2.2	2.6	3.0	3.0	3.2
Japan	4.5	4.5		5.0	4.8	4.7
Germany	2.4	2.7		3.1	3.0	
European Countries	2.8	2.8	3.1	3.1	3.0	
Unemployment Rate	6.8	7.0			7.0	
Import Volume	5.9	6.5	6.9		6.8	
Export Volume	6.1	6.0	7.2		7.3	
World Trade (volume)	5.8	6.0	6.1		7.5	
Trade in Manufactures (volume)		>6.0			8.0	
1990						
World Output (GNP/GDP)	3.2	3.4	3.3	3.3		
Industrial Countries	2.9	2.6	2.8	2.9	2.8	3.0
United States	2.5	2.5	2.2	2.1	2.3	2.8
Japan	4.4	3.3		4.8	4.3	4.2
Germany	2.9	2.2		2.9	2.8	
European Countries	2.7	2.4	2.7	2.9	2.8	
Unemployment Rate	6.7	7.1			7.3	
Import Volume	5.9		6.0		6.3	
Export Volume	5.3		6.7		7.3	
World Trade (volume)	6.0	4.0	6.5		7.0	6.0
Trade in Manufactures (volume)		>4.0			7.5	

Medium Term

	IMF	UNCTAD		UNIDO	World Bank 1988-95	
	1991-94	1990-95	1995-2000	1990-2000	AWG	LOW
World Output (GNP/GDP)		2.9	3.1	3.5		
Industrial Countries	3.0	2.4	2.5	3.0	2.6	2.4
United States		2.2	2.5			
Japan						
Germany						
European countries		2.1	2.2			

After the slow growth with two recessions of 1973-83, it is clearly difficult to judge correctly when countries will reach capacity. The IMF, for example, recognises this doubt, but explicitly chooses to 'illustrate the risks inherent in the current situation' (p. 31), and preliminary indications of its October revision of the forecasts were that it was lowering its figure for the US. UNCTAD bases its forecast for the medium term purely on expected future changes in the labour force (calculated cautiously) and productivity, not any further catching up. The BIS argues that any slack had been taken up by the end of 1988 (p. 3), although it admits that the difficulty of explaining the 1988 growth makes it difficult to forecast how long it will last, noting that growth in the 1980s remained below that of the 1960s and showing (p. 31) that by 1989 only Germany had returned to the 1973 level of capacity-utilisation. (It is only in retrospect that 1973 is perceived as a limit, an additional uncertainty to add to those of the changes in capacity and in output since then.) The combination of the investment boom with the still high unemployment figures supports the estimates that it has been reached for capital but not labour, but also suggests that faster than trend growth could continue on the basis of higher investment, leading to increasing capacity. European business and other unofficial forecasts and recent estimates for the US and Germany suggest that growth is not slowing as much as expected when these forecasts, even the revised IMF, were made. Orders for machinery seem to remain strong. A different reason for expecting growth to remain strong is that given by the African Development Bank (p. 3) and the IFC: that the 1988 expansion was general to all industrial countries, not confined to the US like 1984.

There are two types of reason, however, for expecting growth to falter in the industrial countries. One is through the capacity constraints or alternatively completion of a cycle. The other is a policy response: approaching capacity limits leading to inflation or the fear of it, and then to policies of restraint. The BIS argues strongly for the need to restrain possible inflation, but UNCTAD and possibly some of the other forecasters are more concerned to avoid the possible risks to growth, and some, for example the IFC, see the investment boom as alleviating rather than adding to inflationary pressures.

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

	IMF	UN	UNCTAD	OECD	Asian DB
	1989				
GNP Deflator, Industrial Countries	3.8			4.5	
Change US$ Effective Rate	1.2			1.1	
Six Months LIBOR	9.9	10.2		10.3	9.9
Six Months LIBOR Deflated by US GNP	5.0	5.0		5.0	5.0
Prices US$					
World Exports	3.4	4.0		1.0	
Manufactured Exports	4.5	5.0	3.5		4.5
Oil	11.1	10.0	10.0	15.9	10.0
Oil, real	6.3	5.0	6.3	15.9	5.3
Primary Products	1.5	0.0	5.1	4.9	1.5
Food	0.3		6.6	3.3	
Tropical Beverages	1.3		0.4	0.2	
Agricultural Raw Materials	2.3		2.8	1.4	
Minerals, Ores, Metals	2.0		15.0	11.9	
	1990				
GNP Deflator, Industrial Countries	3.5			4.5	
Change US$ Effective Rate					
Six Months LIBOR	9.2	9.2	8.6	10.5	9.2
Six Months LIBOR Deflated by US GNP	4.5	5.0		5.0	4.5
Prices US$					
World Exports	3.8	3.0		3.0	
Manufactured Exports	3.8	4.0	2.9	2.8	3.8
Oil	3.8	4.0-5.0	3.9	3.1	3.8
Oil, real	0.0	0.0	1.0	0.3	0.0
Primary Products	-5.8	0.0	-3.1	3.3	-5.8
Food	-4.6		-6.5	1.5	
Tropical Beverages	2.9		-6.7	1.9	
Agricultural Raw Materials	2.1		0.7	4.3	
Minerals, Ores, Metals	-20.7		4.7	4.7	

Medium Term

	IMF 1991-94	World Bank 1988-95 AWG	LOW
GNP Deflator, Industrial Countries	3.2	4.2	4.1
Six Months LIBOR		8.6	9.5
Six Months LIBOR Deflated by US GNP	4.5	3.0	4.0
Prices US$			
World Exports			
Manufactured Exports	3.8		
Oil	3.8		
Oil, real	0.0		
Primary Products	3.8		

The forecasts for inflation in 1989 (table 2) in the developed countries do now show a rise from 1988 (not expected a year ago), although they expect the rate to fall back to under 4% next year (except the OECD) and in the medium term (except the World Bank). For most major countries, therefore, theacceleration amounts to a one point rise, reversed within a year, so that (as was reflected at the most recent economic summit) it is unlikely to be seen as a major threat. The IMF does stress the risks, from high capacity utilisation, higher commodity prices, or (third in its listing) higher liquidity (p. 12).

Oil and other commodity prices have fallen since the beginning of 1989. After the 20% fall in the oil price on average in 1988, which was much greater than forecast, the forecasts (most prepared before the fall this summer) still expect a year-on-year recovery in 1989, and from next year the international institutions forecast or assume little change in the real price. Looking towards 2000 in a substantial chapter on the changing structure of energy supplies and markets, including environmental considerations, the UN expects production of energy to be able to keep pace with growth rates of 2.5-3 % (p. 111), but expects a relative rise in demand for oil which could require further new investment. This would (as it points out) mean only a return to previous production capacities, and recent revisions of forecasts for non-OPEC production (e.g. the North Sea) suggest that these may offer greater supplies than previously expected.

Other commodity prices are expected at best to stabilise now (giving a small rise in 1989, after reaching a higher than expected level in 1988); several forecasters expect them to continue to fall this year, and to rise less than manufactures or oil thereafter (although the real fall expected is less than in last year's forecasts). This means that little change is expected in most areas' terms of trade, especially as more developing countries reduce the share of primary products in their exports, but a continuing deterioration for those who do depend on commodities. The faster output growth now expected for at least the current year is thus not reflected in higher forecasts for either commodity prices or internal inflation after 1989. The UN explains the 18% 1988 rise, which it points out occurred mainly in late 1987 and early 1988, as partly the result of rapid growth in the developing countries: they are taking an increasing share, particularly of minerals and metals, because their economies are becoming more intensive users of raw materials, in contrast to the industrial countries. UNCTAD is relatively high for 1989 because it expects low stocks to keep levels firm, contrary to what has been observed so far this year; it also has a relatively low forecast for manufactures prices, so relative prices rise. (Other forecasts, for example by the Economist Intelligence Unit and the National Institute of Economic and Social Research have higher forecasts for oil and other primary products with similar industrial country growth.) The official forecasts, therefore, may be higher than would be consistent with the most recent data for this year: the African Development Bank and the IFC, two of the most recent forecasts, expect commodity prices to fall even this year, and do not suggest serious cause for concern about inflation from the current pattern of output forecasts (even the more optimistic). The major area for concern is those developing countries still highly dependent on primary prices.

3. Exchange Rates and Policy Coordination

The rise in the dollar so far this year (to about 5% above the 1988 average) is contrary to forecasts made last year or this, and occurred in spite of the higher than expected inflation. Most of the international agencies persist in refusing to make an explicit forecast; the OECD strongly implies that the dollar will fall. The rise, however, probably tends to be beneficial for developing countries: to exporters of manufactures by improving their competitiveness; to debtors by raising the ratio of their dollar denominated exports to any non-dollar debt, and through the fall which it permits in real US interest rates (discussed below). Fluctuations among the three major exchange rates increased after mid-1988. Whether the rise will continue and more generally what will happen to the coordination of exchange rate intervention are thus important issues. The rise in the dollar in the second quarter followed (immediately) the April reiteration of the commitment of the G-7 to stability, and took the dollar out of the apparent limits.

The views of the international institutions on the virtues of policy coordination are becoming more mixed, as its weakening has been accompanied by a steadying, and perhaps a fall, in interest rates. The UN believes that coordination may still lead to rising interest rates, on average, as other countries resist the appreciation of the dollar. It points out that 'many countries feel excluded from the Group of Five co-ordination process and some of them perceive it to be contrary to their interest' (p. 2). (This theme of the need to ensure that developing countries are not marginalised even within the institutions of which they are members was also taken up by Witteveen, the ex-Director of the IMF.) It does, however, support a coordinated approach to energy and the oil price. UNCTAD, although it approves of the more active use of interest rates to manage domestic economies, suggests, as is described below, that developing countries have suffered more from the instability among the industrial countries. The African DB also supports coordination (p. 13). The BIS argues strongly that exchange rates need to be 'managed' (p. 173), because of the international effects from domestic policies, and does not discuss the problem of the exclusion of most countries from this process. 'Monetary policy, international capital flows, exchange rates and current-account imbalances are' (p. 7) intertwined, and have to be coordinated to avoid protection; there is, apparently, an assumption that government intervention in this area is either easier or less potentially dangerous than in trade. Like the OECD, however, it considers the dollar over-valued, and under these conditions considers the system precarious. The OECD takes the risks from the present system more seriously: it points out that the 'credibility of international co-operation' (p. 51) has led to capital flows to high-interest countries whose high inflation would otherwise encourage expectations of devaluation. Its suggestion that 'at some point' markets will reassess these currencies seems to imply a risk of quite sharp movements.

4. Trade

In spite of the rapid growth in world trade last year, over 9%: the highest single-year rate since the mid-1970s, giving the highest five-year average rate since before the 1973 oil shock, the forecasters remain reluctant to suggest future rates much above the more recent (but before-the-oil-price-fall) average of 5% (table 1). The most optimistic are at 6%, except for the OECD (or the UN in an alternative scenario with debt relief), although GATT implies a higher rate. The high rate in 1988 is attributed by many to the spurt in investment, discussed above, in industrial and developing countries. The slowing would come because this does not continue in the industrial countries. The BIS thinks that it had already passed its fastest after the beginning of 1988 (p. 45), although this was more true for the US and Europe than for Japan. This also explains why these forecasters expect industrial countries' exports now to grow faster than their imports: although the differences are small, and not present in all forecasts, there is at least agreement that there will be no impetus to developing countries from high net import demand. Although Japanese imports grew 16% (and by over 30% for manufactures in 1988), this is not expected to continue; the mid-1980s had seen a stimulus from the US, which is also unrepeatable: the 26% growth of US exports of manufactures in 1988 made it more a competitor than a stimulus. The OECD expect the exceptionally high import demand from the NICs to continue in 1989, and only slow slightly in 1990, but the IMF and the Asian DB have lower forecasts.

The type of demand which is accounting for the growth in trade, and the strong shift since the mid-1980s from the US to Japan as the principal source of growth, is important in explaining whose exports gain. UNCTAD (p. 67) shows that two fifths of the increase in the value of industrial countries' imports of manufactures from developing countries between 1985 and 1987 was in engineering products, and a further 20% in clothing. Overall, developing countries gained little in share in 1988, and are not expected to do so in the future. UNCTAD is most pessimistic for the developing countries, expecting their total exports (and each area's within it, except the Asian in 1990) to grow more slowly than industrial countries' exports. The NICs, however, benefit strongly from the increase in demand (table 3, p.29). The IMF stresses the gains of the NICs at the expense of all industrial countries (except Germany and the US, but including Japan since the revaluation of the yen). They, and Asian countries or exporters of manufactures, depending on the classification system used, continue to increase their shares in world trade, although even in 1988 their rate of increase slowed markedly; as the BIS points out, they were the only group of developing countries to see slower growth of exports in 1988 than in 1987. In future, the Asian DB expects them to be less competitive because of currency appreciation. Other areas, and exporters of primary goods do less well. Even in Asia, the Asian DB fears capacity constraints in China and Thailand. Most expect Latin American performance to recover, at least in the medium term, so that they rise faster than African. The UN points out that the rate of growth of total trade relative to output might be expected to be higher than in the past because manufactures, with their higher elasticity, are now 70 % of world trade.

The exception is the IMF forecast for 1989 which gives a high rise for primary exports in 1989-90, coming from low income economies in Africa (p. 17): the only 'explanation' is that it comes 'after two consecutive years of weak export growth'. The African DB, in contrast is concerned about the dependence on primary products. It suggests, however, that moves away from this would face both new protection and escalation of protection within the present structure of trade barriers (p. 20), and therefore that regional trade, on which it has a special section, is the only effective path. The Asian DB, in spite of being much more optimistic about its members' prospects, also fears growth in protection and in intra-regional trade in the EC and North America, and therefore favours Asian regional trade; this grew at 'an astounding 39 %' (p. 20) in 1988, after 29 % in 1987 (value terms). The IMF, in a recently published set of historical trade data[2], noted that except in the mid-1970s, when the rise in the oil price increased exports and imports by OPEC, the share of developing countries in industrial countries' trade has tended to fall, with 1987 the lowest year since 1955(see Appendix historical statistics). The fall in their share in exports has been mainly in the primary products, not manufactures.

Because of the negligible changes in terms of trade or trade share, or (more analytically) because of the continuing constraints on finance discussed in section 6, there are no important changes in areas' current balances.

5. Trade Policy

All the forecasters agree about the dangers of rising protection. The BIS in particular notes that it continues in spite of the improvement in trade growth. There are three causes for this concern highlighted in this year's forecasts: the systemic dangers of growing regionalism among the industrial countries; the increase in explicit protection and bilateralism in relations between the industrial countries and the developing; and the possible outcomes

[2]IMF, IFS Supplement on Trade Statistics, 1989.

of the various international trade negotiations, particularly the GATT Uruguay round. As far as it is possible to judge from the stated assumptions, the forecasts, even for the medium term, do not include any allowance for the first and third; insofar as they assume unchanged policies and trends in trade relationships they assume that the second will continue as in the past, in spite of the trade and output improvements.

The UN reviews the various free-trade arrangements, for industrial countries and developing, and notes the need to examine their impact on non-members and on the trading system. The principal area where all the forecasters express concern, and where research is now beginning, is on the external effects of the completion of the EC internal market. The fears for developing countries are first for explicit changes in trading policy (e.g. on quotas such as the MFA or special arrangements such as those for the ACP or exporters of bananas or sugar) and second for a permanent disadvantage: as the lowering of costs within the EC will raise the relative cost of importing from non-members. As this is the principal source of the expected income gains to EC members, only a small fraction of the income effect can be expected to leak out.[3] UNCTAD looks particularly at the potential changes in the administration of MFA quotas.

The UN's concern for the system is how an increasing number of special trading areas can be integrated into a multilateral trading network, without subjecting it to pressures from the special interests of both the groups and individual countries. UNCTAD does not believe that the North American and EC initiatives suggest that the world is dividing into regional trading blocs: it does not see a parallel movement in the Asian or Pacific potential bloc: the increase in trade there has been because of liberalisation of trade and because of the faster growth of both industrial and developing countries in that area. But the forecasts and fears of the African and Asian DBs, reported in the previous section, suggest that they see the risks more strongly. The Asian DB notes that the share of EC intra-trade in total EC trade has already increased from 52 to 61 % since 1980, and expects 1992 to 'pose serious adjustment problems for its non-European partners' (p. 20).

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[3]These questions are discussed more fully in a forthcoming ODI Briefing Paper on the external effects of 1992.

The UN quotes the doubling in the number of restraints recorded by GATT between September 1987 and September 1988 (p. 46), and the increase in the share of trade subject to non-tariff barriers. It criticises the US Omnibus Trade Act for its emphasis on reciprocity and provisions for retaliation (p. 47). (India and Brazil are the developing countries named under it for suspicion of unfair trading.) UNCTAD also describes the Act, and considers it potentially damaging to other trading partners of countries directly damaged, an additional risk to growth in trade and to the multilateral system. It notes what it calls the 'incoherence' (p. VIII) between the growth in protection by the industrial countries and in liberal trade by the developing. The World Bank mentions the concessionary trading arrangements (GSP, Lomé, and the US Caribbean Basin Initiative) before the growth of bilateral restrictions, although the benefits of these are increasingly being questioned on both sides.

The UN describes the progress so far in the Uruguay round, particularly on tropical markets, but this does not appear to have had an impact on its forecast. The World Bank looks to the industrial countries to ensure the success of the Round (p. 2, 6), in contrast to other forecasts and observers generally who stress the importance of the active participation of the developing countries themselves.

6. Financing

The forecasts assume little change in the supply of any of the conventional forms of external finance, and no new forms. In the medium term, the IMF expects official finance to grow 4.8 % p.a., in real terms, slightly less than developing countries' output, while private flows rise only 2.6 %, less than either the rate of growth in industrial countries or developing countries. The World Bank has similar, or possibly more pessimistic expectations (p. 22 suggests a fall in private flows). UNCTAD forecasts that between 1988 and 2000, the share of official debt will rise from 35% of total debt to 46%; it rises from 23% to 31% even for countries which have in the past been dependent on eurocurrency borrowing, but from 75% to 85% for the least developed. This explains its concern about the criteria which official lenders use as they are now a very important influence on international development policy. The OECD, however, has identified a sharp change in flows in 1987-88 (in figures it published at the beginning of September): there was a rise of $6 billion to $103 billion, i.e. roughly no change in real terms, in contrast to the falls in recent years. The shift from private to official flows which has been evident since 1982, continued: official disbursements were two thirds of total flows.

In 1988 there appears to have been a substantial recovery in direct foreign investment (from $13 billion in 1987 to $16 billion, after a rise from $10 billion in 1986, according to the IMF; from $10 to $20 billion according to UNCTAD; OECD agrees with the $20 billion)[4]; this includes debt-equity swaps. The forecasts start from the new base (IMF) or the old (UNCTAD), and rise at the slow rate seen in previous year's forecasts. The UNCTAD procedure is consistent with the treatment of the 1988 investment boom in the output forecasts. The increase appears to have gone principally to Latin America (because of the swaps, according to the IFC), but the IMF does not expect this to continue (pp. 172-5), and the IFC notes that there was already a fall to Mexico because of the suspension of its swaps. Chile, however, has apparently had a large increase in swaps in the first half of 1989, so this pessimism may be excessive (although some of the Chilean were probably brought forward to beat the elections). India had a large increase in 1988. The IFC comments on the trend to increasing Japanese investment in exporting industries in East Asia, but (p. 9) appears to expect this to rise more slowly in future, and is concerned that the perception of 'Fortress Europe' by US and Japanese corporations could reduce the flow to developing countries in the immediate future. The Asian DB believes that the rate of increase of Japanese investment had already fallen in 1988.

The World Bank does not mention the recent increase in direct investment, but it argues for such investment on the conventional grounds that it transfers the risk to the supplier of credit, while loans impose it on the borrower (p. 23). It discusses other possible new forms of risk-sharing, through commodity bonds, etc., but not the other traditional form of finance, fixed interest

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[4]For most countries, industrial as well as developing, the data must still be mainly estimated.

lending. Its own lending continues to be at the floating rates which it identifies as 'not the ideal form of financing for long-term development', and to be in the pooled currency mix in which it borrows, which has a bias towards 'hard', low interest, currencies, and which may not be the appropriate mix for all its borrowers' liabilities. The countries, which can still borrow from the banks, particularly in South East Asia, but also including India, are thus faced with the choice between obtaining the additional external finance which the banks offer, although it is in 'not ideal' form, and choosing to develop more slowly in order to reduce the potential risks.

UNCTAD also looks for unconventional financing methods particularly for trade finance, examining countertrade and regional clearing arrangements (pp. 56-7). It does not believe that either offers substantial further opportunities. It is concerned by the fall in export credits since 1980, to a position of net repayment by 1986-7 (p. 34). Although they appear to have recovered in 1988, many countries remain off-cover or subject to restrictive conditions (p. 50).

The IMF in a different document[5] also considers various new forms of hedging device to reduce the risks of use of foreign capital, but does not explicitly mention the possibility of using fixed interest instruments. These are, however, clearly a possibility in shifts from loans to bonds.

Net lending by commercial banks was negative in 1988, and although the IMF expected this to change in 1989, preliminary figures and the discussions of the Brady debt plan suggest that this may be optimistic.

Multilateral institutions' own new lending fell, in real terms in 1988 for the third successive year (a point stressed by the UN, p. 62). The fall has been principally in the non-concessionary component, affecting the middle-income countries, too rich for concessional aid, too poor for private flows. The IMF had negative net flows of capital (-$6 billion in 1987 and 1988) and the World Bank negative total flows if interest payments are included; the UN expects the latter to remain true even after the 1988 increase in its resources, although the World Bank's net lending is expected to rise. The IMF expects

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[5]IMF Occasional Paper 65, Managing Financial Risks in Indebted Developing Countries, June 1989, by D.J. Mathieson, D. Folkerts-Landau, T. Lane, I. Zaidi.

its net lending to return to positive numbers from this year. An increase in resources for the Inter-American Development Bank was approved in May. The African DB's resources have been increased by 200% (p. 26).

As well as the increase in the amount it has to lend, the African DB emphasises that it has 'increased the share of flexible and quick disbursing policy-based loans' (p. 26). The need for faster response was also a point in the Brady debt plan. It is important that lenders have recognised that one of the reasons that countries turned to bank finance in the 1970s is that official finance has been very slow to respond to new needs. One reason countries find themselves particularly vulnerable to external variations in the 1980s is that even temporary finance is no longer available. The lack of short-term liquidity, whether from own reserves or readily available credit, at a tolerable cost, is mentioned also by the BIS (p. 215) and remains a failure of the international financial system.[6]

Official bilateral aid is not expected to expand more rapidly than recent it has done recently, although there has been substantial growth in Japanese aid and commitments for further increases (approximately an extra $10 billion a year). There could be problems in increasing their commitments to the multilateral agencies because of the sensitivity to voting shares of the other major donors. The Andean Pact, p. 9 study mentions this for the IMF in particular, but it could also apply to the World Bank and the regional DBs.

In the absence of external credits for the medium term, the institutions all stress the need to mobilise domestic savings. The measures taken so far appear to be rather preliminary: the World Bank's long special review of financial systems (about 85 % of this year's Report); a series of seminars reported by the African DB. This perceived need to turn to domestic finance (African DB, pp. 27-8) at what is, by past standards, a very early stage of development is one indication of how the constraints imposed by the external

[6] In its discussion of domestic financial systems, the World Bank comments that 'often, loans from moneylenders are used to make a transaction at short notice, and funds from formal lenders are used to repay the moneylenders', and it criticises the delays by the formal lenders (p. 114).

situation are seen as a critical influence on development, even if there are doubts about a direct relationship to industrial country growth.

7. Debt

In their alternative scenarios, some forecasters (UN, World Bank) discuss the possible impact of different amounts of formal debt reduction, but the relatively unchanged levels forecast for financial flows suggest that all are assuming that while at least the present amount of non-repayment continues (there are no large net outflows to the commercial banks from debtor countries) there is no major reform. The IMF does assume some increase in servicing: 'scheduled debt service payments will be met to an increasing extent through cash payments' (p. 21). All except the IMF (published in April) and World Bank (June) are able to include at least preliminary assessment of the Brady proposals made in March and implemented by the World Bank and IMF since June.

Although the World Bank and the BIS consider the fact that the ratio of the stock of debt to exports fell in 1988, because of the rise in the prices and volume of exports, 'one sign of improvement', this is not reflected in its forecasts, and the other forecasters mention instead the increased cost of servicing the debt because of higher interest rates (discussed in the next section), e.g. UN (p. 1) and UNCTAD (p. III). The BIS also points out that after allowing for the part of the reduction that simply represented the appreciation of the dollar, most of the fall was accounted for by debt conversions, especially by Mexico and Brazil, not repayments. The IMF and UN expect further rises in interest payments relative to exports in 1989, although they could level off or fall after that (a consequence of the forecasts for limited new borrowing and flat or falling interest rates). The BIS also notes the increasing difficulty in financing the debt in 1988; this was partly because of the continued economic and political uncertainty, which created the perception that there was a need, with which it agrees, for a new strategy to replace the Baker initiative (p. 73).

The Baker plan accepted that any new lending by banks would require a perception of renewed credit-worthiness on the part of the debtors, and believed that additional credit, which it would supply, and gradually falling debt ratios, as occurred in 1988, would give this. Experience since 1985 has not supported the view that debtor countries could return to sufficient credit-worthiness, and suggests that even if they did most banks would not want to continue to lend. (And the World Bank's view of the unsuitability of such finance has become increasingly widespread so borrowers might also be reluctant.) Within the developing countries, the economic incentive to repay was the prospect of new finance; as this receded and the difficulties of repaying increased, the balance of arguments for and against paying tended to shift.[7]

The principal point which the forecasters identify as new in Brady is the official acceptance that the commercial bank debts will not be repaid in full. This was accepted for bilateral official loans in 1988, and write-offs of some of these have now begun (UNCTAD, p. IX). For unguaranteed loans to private borrowers and for investments it has of course always been understood that some might not be repaid. 'This leaves one major component of international finance for which neither debt reduction, rescheduling nor refinancing have been introduced, namely, the multilateral lending institutions. As these institutions are the principal creditors of certain developing countries and as arrears to these institutions continue to amount, the problem continues to warrant international attention.' (UN, p. 186). It points out that by April 1989, 11 countries were in arrears to the IMF (amounting to 10% of Fund credit according to BIS, p. 133), 8 to the World Bank, and 3 to the Inter-American DB (p. 63); there is no institutional means at present even to reschedule these payments so countries which cannot pay have no alternative to going into arrears.

UNCTAD argues for an extension of relief to multilateral debt given on concessional terms (p. X) and to low-income countries outside Sub-Saharan Africa, the only area for which relief was agreed in 1988 (p. 171). The

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[7]Perhaps even more than cost-benefit analysis of repayment by the debtors: such arguments have affected bankers' and other economists' views of credit-worthiness even if the legal arguments for repaying remained strong for many debtor governments, which are not composed entirely of economists. (The Economist's comment on the possible Brazilian failure to pay interest in September was that 'Forgoing $600 m to boost the reserves by $2.2 billion will strike some as a better deal', 26 August 1989).

Andean Pact suggests that rescheduling or provision for repayment in local currency could be appropriate.

The major multilateral lender (supplying 48% of multilateral lending on non-concessional terms and a further 14% on concessional) does not comment explicitly on the question. The World Bank does, however, have comments on debt repayment within countries in its section on finance. There, it argues (p. 3) that 'The practice of rolling over unpaid loans and making new loans to cover unpaid interest has undermined the adjustment process.' On traditional efficiency grounds, it argues that new lending should not be tied to old unprofitable ventures, but to new opportunities, even if this means allowing banks to go bankrupt.

The BIS argues that anticipation of the need for a new initiative was itself an obstacle to debt financing in 1988. This suggests that any plan to end the 'debt overhang' (the implications of this term are discussed in a note in the Appendix) must now be sufficiently ambitious to avoid further speculation about further plans to fill further gaps. None of the forecasters appears to believe that the Brady Plan meets such a criterion. The BIS considers it only a further step which 'cannot be expected to go all the way' (p. 214), but will help some countries. The BIS argument and the World Bank's highlighting of the costs of 'muddling through' for banks faced with heavy losses, p. 79, suggest that this step-by-step approach should be reconsidered. But the need for the US government to make a provision of $20 billion to support savings and loans banks and the still increasing provisioning by UK banks, both announced in August, are a reminder that the size and timing of the steps do not depend only on developing country needs and industrial countries' advances in understanding these.

The Brady Plan[8] proposed that the multilateral institutions support debt reduction (for example, through buying back commercial bank debt at a discount). He emphasised that while the IMF and Bank should set 'guidelines', 'the negotiation of transactions will remain in the market place - encouraged and supported but not managed by the international institutions'. With

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[8]Perhaps better referred to as the Brady Remarks. Source is: Brady Remarks to Third World Debt Conference, 10 March 1989, Treasury Official Text.

additional support from Japan, estimates suggest that funds of at most $30 billion over three years could be available (about equivalent to a change of 3 percentage points in interest rates for one year). The World Bank in its debt reduction scenario (p. 21) estimates the effects of a reduction of 'debt stocks' by 20% in three years, which is, probably, slightly more than Brady. The definition is not given, but as the resulting fall in interest is $5-6 billion over three years, say $3 billion in the third year, this suggests a debt reduction of $30-40 billion at current interest rates, which is about 20% of the fifteen most indebted countries' debts to financial institutions. This gives a third of a percentage point extra growth on average over the three years to these countries, although of course some countries benefit more. UNIDO estimates that the Brady plan could raise investment/GDP ratios by one point, but a rise of four points is needed.

Brady also made proposals to relax those debt agreements which limit banks' (and the IMF's) freedom to offer write-offs and new credits. Some are legal, some customary: among bank lenders, between banks and the IMF, and between the banks and their home-country regulators, which limit banks' (and the IMF's) freedom to offer write-offs and new credits. UNCTAD suggests (p. XI) that the restrictions on IMF and World Bank lending will limit take-up, and that this will affect the countries most in need: they cannot make structural adjustments without obtaining external finance to support policy reform and cannot obtain the finance without satisfying the IMF or the World Bank that they have made the adjustments (p. 47).

The objective now seems to be simply to extricate the countries and banks from the debt problem, not, at least in the short run, to bring a return of medium or long-term bank lending. (The BIS points out that banks which are dealing in a country's discounted debt would find it difficult to justify new lending to it, p. 135.) The UN questions the Brady plan (in terms reminiscent of the World Bank's comments on lending within developing countries). It argues that it gives too much weight to reducing debt when what is principally needed is immediate cash flow relief of debt servicing payments, and also argues that the debtor countries might do better to channel any new external resources, including those potentially available from increased lending by the IMF and World Bank, to more productive uses, 'domestic programmes supporting reforms, investment and economic growth' (p. 78) rather than to banks wishing to reduce their exposure. Under the regulations adopted in April and May, up to 25% of a country's borrowing from the IMF and its World Bank adjustment lending (under certain conditions) could be used to reduce principal, with additional provision for interest payments.[9] It also argues that such objectives would be more in the interest of the Bank and the IMF (the loans 'would have a better prospect of repayment'), implying some doubts about those institutions' present loan portfolio. The most important part of the Brady Plan, it suggests, could be the delinking of the IMF from the banks, especially if the IMF decided to permit arrears to the banks to be treated as 'an appropriate exchange restriction'. UNCTAD also welcomes the IMF's acceptance of this part of the Brady plan.

From this point of view, the principal innovation of the Brady plan is not the additional finance, or even the rather belated public recognition of the obvious: that there are bad debts. It is the shift of the industrial country governments and the international institutions away from full support for the banks' claims and back to what the BIS sees as the appropriate role for regulators, 'to safeguard the orthodoxy underlying their prudential regulations, while ensuring that they do not impair the banks' freedom of choice' (p. 215). It is not yet clear whether this and the Brady 'remark' on leaving debt to the market place are a partial retreat from the 1974 Basle Communiqué commitment for the Central Banks to act as if they were lenders of last resort.[10] As UNCTAD implies, this acceptance that they need not support commercial banks without reservation is not a 1989 perception: it reminds its readers of 'one of the greatest of all social principles, namely the fundamental distinction between the right of the individual to repudiate contract and the right of the State to control vested interest...Nothing can preserve the integrity of contract between individuals, except a discretionary authority in the State to revise what has become intolerable. The powers of uninterrupted usury are too great...These conclusions might be deemed obvious if experience did not show that many conservative bankers regard it as more consonant with their cloth, and also as economising thought, to shift public

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[9]The World Bank conditions are described in a press release of 1 June, and the IMF in a speech by Camdessus, both published in IMF Survey, 12 June 1989.

[10]Cited as one of the 'Dozen Notable Events 1974-88', AMEX Bank Review, 10 February 1989 (i.e. pre-Brady).

discussion of financial topics off the logical onto an alleged "moral" plane, which means a realm of thought where vested interest can be triumphant over the common good without further debate.' (p. 113, quoting J.M. Keynes, A Tract on Monetary Reform).

But one reason that the Brady plan is regarded as more realistic and likely to have some success than the Baker initiative is that it does not attempt to tackle Baker's objective: ultimately to lead to new external financing. (This contrast is made explicitly in the US Treasury elaboration of the Brady plan: 'instead of focusing on new money, which adds to debt burdens rather than diminishing them, it attempts to bring about an improvement in debt positions...', an extremely risk-averse approach to borrowing.) The only references in Brady to new finance are support for export credits and for 'more timely and flexible financial support'.

No current debt initiative is likely to have a direct impact on the prospects for the developing countries. All the forecasts assume that the countries do not pay more than the recent years' outcomes indicate that they can (or want to) afford, and debt plans do little more than legitimate these, and no longer suggest that they will lead to other finance. The only effect could come from whatever part of the $30 billion (or less) is additional financing, not substitution for bank financing. The post-Brady forecasts do not suggest that this is large. Debt-for-forest and other unconventional swaps are more likely to have long-term (and small) effects on natural resources or damaging effects on countries' freedom to set their own priorities (c.f. UNCTAD, p. 45) than significant effects on economic prospects in the short-or medium-term.

8. Interest Rates

The forecasters now all expect high real interest rates in the short and medium term (table 2). The forecasts of about 10% nominal (LIBOR) and 5% real are about 2% and 1% higher than made in last year's reports, and 1% higher than late-1988 expectations, but could now be over-pessimistic. That both nominal and real are higher in the face of higher inflation suggests that they do not simply reflect higher expectations for inflation in the capital markets than among forecasters. If the summer 1989 movement down does continue (or even if the present level is retained) this could affect the output forecasts, or could indicate that these forecasts are too optimistic if it reflects a more recessionary scenario. The problem is that the high level which is forecast is not really explained, except as a continuance of last spring's level. If it is a delayed response to the slowing of growth which is already allowed for in the forecast, it could permit faster growth by the debtors both directly, by reducing debt servicing, and indirectly by encouraging investment in general and by increasing the relative advantage of returns to investment in developing countries. The UN, which devotes a special chapter to analysing interest rates in the 1980s, suggests that the high real rates of the 1980s help to explain the slow growth (p. 133), and considers the high US deficit, crowding out other investment, the principal cause (p. 148). Under its forecast, this remains a problem. OECD appears to attribute the rise from mid-1988 to caution or inexperience: 'the first major test for monetary policy...in containing a widely-based acceleration of inflation in an environment of substantially deregulated financial systems' (p. 13). If inflation is now stabilising and likely to fall, and interest rates are also falling, such an argument could hold, and would suggest lower rates now that the 'test' has been successfully completed. The BIS (p. 208) would support both this explanation and the policy, preferring 'overkill' to any risk that inflation might return, although, like the UN, it also sees the US deficit as part of the explanation. As the African DB notes, however (p. 5), the costs of this 'overkill' or insurance against inflation are heavy for developing country borrowers.

The World Bank, which has increased its base forecast for the medium term this year from 2.6% to 4%, pointed out that this level of interest rates makes a lower level of external borrowing necessary (p. 8). The IMF (p. 32) now claims to be treating interest rates, along with fiscal policy, exchange rates, and oil prices as an assumption; this seriously limits analysis and projection of international adjustment. The BIS, in contrast to the other explanations, suggests that returns on investment have been high (p. 35): if this is the explanation, and lower rates reflect the effects of the slower growth (actual or anticipated) in the industrial countries, this would help to explain the shift of investment towards industrial countries in the early 1980s and would be an additional reason for expecting a shift now of investment to the developing.

Some of the forecasters discuss interest rate differentials as well as the level of a single marker rate. The IMF (p. 21) notes that short-term rates have been high relative to long; this may have put borrowers with flexible rates tied to short-term rates at a disadvantage relative to those with more long-term forms of finance. UNCTAD (p. 29) gives projections of the interest payments by the different areas (see table 5 in section 10 on regional differences). Its average interest rates appear rather lower than those assumed in the Bank of England (7.2% in 1988), and probably fall more in 1990 (the Bank suggests over 8% this year, then 'falling slightly'). The Bank has a much more pronounced rise for Latin America.

The variability of interest rates is also considered a damaging influence on borrowers (and, as is normal, is not explicitly projected into the future). It also discourages external borrowing by increasing the risk from any level of borrowing. These arguments, increasingly used by all forecasters, suggest that reduced demand for bank finance would be expected to constrain external borrowing even if the supply were to be increased, at least with interest rates at early 1989 levels and variability. If policy-makers like the authors of these Reports, form expectations based on the 1980s, this could continue to be a constraint in the 1990s even if supply, cost, and variability were all more favourable. But if borrowers and creditors adjusted their expectations and borrowing, this could mean a major change in the prospects for credit-worthy borrowers. It would also mean, insofar as high interest rates make or should make developing countries (and businesses within them) turn more to equity than to debt finance, that lower rates could justify a shift in preference away from equity. The serious effects which high interest rates have had may be a sufficient reason to continue to prefer equity.

9. Development and Adjustment

The prospects for a large number of developing countries remain poor in the face of the removal of some of the obvious, immediate obstacles to their development: growth in the industrial countries and world trade have recovered; commodity prices have stopped falling; and progress has been made on regularising the debt position. This has led some of the forecasters, notably the UN, UNCTAD and the regional forecasters, to look again at the policies followed for 'structural adjustment' in recent years and at those required for development. The UN presents the problem starkly: 'so far, virtually none of the countries with serious debt-servicing problems in 1982-1983 have managed to restore a workable balance of payments position, let alone their creditworthiness. They have not regained their capacity to increase investment on the basis of their own resources' (p. 3-4). It suggests that it is too early to judge the success of structural change, and it questions simple comparisons. Exogenous factors such as the 1988 improvements in the weather, particularly in Africa (p. 29), and in international commodity markets help to explain some apparent successes. It also notes that those countries that have followed approved structural adjustment programmes have received much more generous flows of external resources (p. 31), a point which was highlighted in the debate earlier this year between the World Bank and other observers[11] over whether the performance of some countries which have undertaken approved structural adjustment programmes proves the merits of such programmes. Like UNCTAD, it sees external finance as in some cases a pre-requisite for adjustment and for the investment required for sustained development, not as an appropriate reward for those who achieve these (p. 153). This has been argued often before against World Bank and IMF policy-based, rather than need-based lending.

The UN reviews five countries which have followed 'adjustment' programmes. Some have achieved what might be called static adjustment, that it to 'establish macro-economic balance and resurrect what the economy was basically doing before the need for adjustment arose' (p. 185). The UN, however, does not consider this a sufficient aim, and it repeats that such success may have come in part from the financial flows that come with following approved policies, rather than as a result of the policies themselves. It, and other forecasters, now feel able to revive the more ambitious 'old message' of sustained economic growth.[12] It identifies two (also traditional) problems: over-specialisation, especially in primary production, and vulnerability to

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[11] World Bank, with UNDP, Africa's Adjustment ant Growth in the 1980s, March, 1989; UN Economic Commission for Africa, Preliminary Observations on the World Bank Report: Africa's Adjustment and Growth in the 1980s, April 1989.

[12]It is even prepared to mention (in a footnote in small print) the 'blasphemous...infant-industry argument for protection' (p. 186).

a volatile international economy. One element in this is the need to provide a cushion of finance (as argued in section 6); the other is the Asian and African DBs' support for a shift to industrialisation.

UNIDO takes up this point, arguing the need for a restructuring of industry. It asks that the 'techno-structural' imbalance be taken as seriously as the financial. One element in this is a need to transfer technology as well as finance. But another is to 'redress the past practice of making the manufacturing sector the primary victim under an austerity programme' and it assesses the effects on individual industries. The African DB also takes a negative view of structural adjustment programmes, considering that 'at least in the short run, their effects are contractionary' (p. 37).

The UN finds two positive approaches to the problem of development: that the successful countries have 'put heavy emphasis on the development of their human resources' and a 'vibrant international development constituency' in the form of a non-governmental network. The Asian DB, which identifies the success of its region with industrialisation (p. 12), and with a liberal approach to international trade as one possible instrument in this, devotes its special section to human resources. UNIDO, which agrees with the Asian DB's emphasis on international competitiveness, also stresses the need to improve the supply of skills, especially in Africa. UNCTAD argues that the contrast between poor economic performance in Africa and Latin America and the much more buoyant international economy casts doubt on earlier stress on the resumption of international growth as the solution. The African DB attributes the poor performance in 1988 principally to external factors, low finance, high interest rates, and low demand for primary commodities (p. 5). Its solution is therefore effectively also international, although for regional rather than world trade. Industry in Africa is still too small in share to give an impulse to growth (p. 41).

The Asian DB discussion of why its region has succeeded indicates what can happen once the domestic conditions are met, and the economy is opened: the Asian countries still depend crucially on 'trade, exchange rates, and domestic macroeconomic policies of industrial countries' (p. 1), but this now to encourage rather than simply permit growth. Achievement of this condition was the result of 'policy choice' so 'policy serves as the backbone of any explanation of the success of Asian developing countries' (p. 11).

UNCTAD looks particularly at the problems caused by external and internal instability. It stresses that external vulnerability has affected not only the obviously external variables, like the volumes and prices of exports and imports and external payments of interest, but also the fiscal balance, through trade tax revenues, interest payments, and later all tax revenues when deflationary action was taken to deal with the first round effects (p. v), and all interest payments when domestic monetary policy was tightened, greatly intensifying the difficulty of finding a starting point for successful adjustment. In a study of export performance and economic growth it finds, like the Asian DB, the association among exports, growth and industrialisation much more complex than a simple export-oriented model: 'where investment and output have risen briskly, larger exports of manufactures have been part and parcel of the broader process of growth' (p. VIII). But in some countries which have promoted exports without a suitable industrial base, the exports have been at the expense of investment and the domestic market (p. 130), rather than providing a support for industrialisation. UNIDO points out that by reducing domestic supply, exports may also have 'provided an added cause of inflation' in Latin America. UNCTAD finds no association between trade liberalisation and export growth, but does stress the effect of selective direct incentives for exports, thus indicating a role for government policy. But it accepts that there are obstacles to policies from countries' past histories and institutions.

The UN is also prepared to look again at the need for government intervention: to set overall policy, to 'provide services that the private sector cannot supply', and 'to ensure that the environment is defended' (p. 153). (This, and its section on energy are among the few mentions of the environment in this year's Reports.)

An over-simplifying generalisation about the resolution of the 1980s debate over whether the external situation or domestic policy is the fundamental determinant of development seems to be that both are necessary, but they are not sufficient. The UN and UNCTAD stress the difficulties caused by lack of external financial resources (and UNIDO other resources). The World Bank accepts that adjustment 'is neither simple nor purely economic' (p. 14), and that international support is necessary, although its emphasis is different: on taking action in spite of vested interests, rather than adapting to them or using external finance. It assigns a more important role to exports as explaining 'rapid modernization of production' and 'efficient domestic industry' (p. 9) in East Asia than does the Asia DB. In South Asia, however, success has come from policy (p. 11). The Asian DB and UNIDO look at exports more as a sign of successful policy. UNCTAD stresses the links: for policy to be successful, domestic consensus is necessary; to keep the cost of adjustment to a level where this is attainable, external resources may be necessary.

But the principal difference between the World Bank and the UN approach seems to be the contrast between the Bank emphasis on a finite adjustment programme taking place in exceptional circumstances, needed because countries 'are in dire financial straits', and apparently completely defined within itself. 'Adjustment' is now used without any indication of what the adjustment is to, and can be characterised as 'strong' (p. 19). Similarly 'developing' is apparently simply a permanent status, not a way by which countries change, or become 'developed'. This is shown in its sharp contrast between the roles of industrial and developing countries in the GATT round, or even its casual comment that 'before World War II, developing country governments had a poor record on financial development' (p. 49). Here it apparently refers to countries which come now into its list of developing countries, not all countries that were then at the level of the present 'developing countries'[13]. The UN, in contrast, looks for a sustainable, and presumably continuously adjusting, path of development. This both allows and requires its emphasis on more long-term considerations, such as human resources, and the ability to reject both external circumstances and domestic policies as complete explanations. The World Bank approach effectively requires it to believe that some specific solution, whether external or domestic, must exist for an identifiable need to adjust. UNCTAD appears to take an intermediate view: that 'adjustment programmes ... implemented to restore economic growth as well as to move the external account into balance'

[13] A more precise and analytic usage might encourage it to ask why some governments had a better record and examine the causal links between this and development.

(p. 168) could exist to make definable changes, but that those which have been followed have failed because they have 'concentrated on short-term payments equilibrium' instead of long-run development (p. 175). In spite of the fact that this discussion occurs in its section on the least developed, it begs the question of what adjustment means in countries which were not growing satisfactorily before their situation became desperate, and in those for which 'external balance' is not yet appropriate.

10. Output and trade of developing countries: diverging patterns

With favourable external conditions now viewed more as permitting than causing successful growth and development, and changes in domestic policy no longer treated as readily definable and applicable formulas, the short- and medium-term forecasts now effectively take any present performance differentials as given and, without being prepared to make a long-term case for changes, carry them forward. Throughout the Reports, including their analyses of the causes of successful development, the forecasters are classifying the countries into three groups. They use a variety of different analytical categories (the IMF has the largest number of methods of subdividing), but, as can be seen in the country groupings in the Appendix, these systems all are reducible to: successful, exporters of manufactures, not debt-burdened, creditworthy, with access to official and private finance, often referred to as Asia; semi-industrialised, with the structural basis for growth and trade, but debt-burdened, and unable to succeed without external assistance, or Latin America; debt-burdened, with economies too dependent on primary production to grow rapidly even if the external situation and domestic policy do improve, with insufficient official finance even before the debt crisis, known as Sub-Saharan Africa. Only a few countries (except for the smallest) fall into the 'wrong' continent or have other mismatches. The countries that have been able to grow rapidly have also been able to service credits at high real interest rates, and through their high investment have industrialised and diversified, thus reducing their vulnerability and need for such capital. Those that have grown more slowly need but cannot qualify for such capital. Of these, the more advanced could break out of the circle with enough capital to increase investment (UN, p. 155), but current emphasis on conditions for such capital prevents them from obtaining it. Debt-relief

Table 3: Export Volume by Developing Countries percentages

	IMF	UN	UNCTAD	OECD	Asian DB
	1989				
All Developing Countries	5.5	6.5	4.2	9.0	5.5
Oil Exporting	0.2				
Non-Oil Exporting	7.0				
Exporters of Manufactures	7.5				
Exporters of Primary	7.9				
Market Borrowers	6.7				
Official Borrowers	5.3				
Four Asian NICs	10.8			11.0	9.4
Fifteen Heavily Indebted Countries	1.7				
Small Low Income Economies	5.8				
Asia	9.8		5.4		9.6
Western Hemisphere	0.8		3.2		
Africa	3.8		-0.8		
Sub-Saharan Africa	4.4				
	1990				
All Developing Countries	7.2		6.2	9.0	6.7
Oil Exporting	5.1				
Non-Oil Exporting	7.7				
Exporters of Manufactures	8.3				
Exporters of Primary	6.1				
Market Borrowers	8.2				
Official Borrowers	6.5				
Four Asian NICs	9.7			11.0	8.8
Fifteen Heavily Indebted Countries	5.2				
Small Low Income Economies	7.1				
Asia	9.7		6.4		10.3
Western Hemisphere	5.3		5.6		
Africa	3.2		5.8		
Sub-Saharan Africa	5.4				

Medium Term

	IMF 1991-94	World Bank 1988-95 AWG	World Bank 1988-95 LOW
All Developing Countries	6.7	5.1	4.1
Manufactures Exporters		7.4	5.7
Primary Exporters		2.8	2.7
Fifteen Heavily Indebted Countries	4.8		
Asia	8.6		
Western Hemisphere	4.6		
Africa	3.0		

has been available (at least for bilateral loans) for the poorest, but for them it is not a sufficient condition for growth.

The forecasts embody this analysis, but only cautiously. In the last four years, most of the forecasters have tended to be reasonably accurate (usually, with the exception of UNIDO, slightly low) for developing countries on average, but to have seriously underestimated how far Asia would out-perform that average and how far Africa and (particularly in 1987-8) Latin America, fall below.

Tables 3 and 4 show the current forecasts.[14] In 1988, exports of developing countries in aggregate responded to the growth in world trade, but grew only slightly faster (10-11%); although both manufactures and oil grew strongly, primary exports rose only 3%, giving a substantially slower growth for Africa than for Asia or Latin America. In spite of the IMF's more optimistic expectations for primary products, all expect this pattern to continue (although the Latin American average will be held down this year by low growth in oil trade). Most expect a sharp reduction in the rate of growth of Asian, especially NIC, exports in 1989. In 1988, NIC exports were the only Asian exports not to rise faster than in 1987: except for Singapore, all of these suffered from lower export demand, explained by the Asia DB as the result of appreciating currencies (p. 8). The same problems as in 1988 will hold down 1989, but UNCTAD (p. 4) also points out that the East Asian countries have now been removed from the US GSP scheme. The BIS (p. 39) had already noted the growing competition from the other Asian countries in 1988. UNIDO is less pessimistic: it accepts all these obstacles, but believes intra-regional (including Japan) trade and investment will be strong enough to offset them. African exports, however, are expected to remain constrained by poor commodity markets.

The output forecasts show the divergence even more starkly. In 1988, the Asian NICs grew more than 10% and all Asia by 9%, helped by continued good performance in India and China. Most of the NICs actually grew less than in 1987 as the structures of their economies adapted a shift of demand from

[14]Forecasts for individual countries are given in UNIDO and Asian DB.

Table 4: Output in Developing Countries percentages

	IMF	UN	UNCTAD	UNIDO	Asian DB
1989					
All Developing Countries	3.3	3.5	3.1	3.6	3.5
Oil Exporting	2.3	2.5		2.5	
Non-Oil Exporting	3.7	4.5			
Exporters of Manufactures	4.0				
Exporters of Primary	2.3				
Market Borrowers	2.6				
Official Borrowers	4.0				
Four Asian NICs	8.2			6.8	6.9
Fifteen Heavily Indebted Countries	1.0	1.5			
Small Low Income Economies	4.1				
Asia	6.4		5.1		6.7
South				4.9	5.1
East				6.5	6.4
China		10.0		5.0	8.0
Western Hemisphere	0.8	0.5	0.6	2.0	
Africa	2.3	2.5	2.8	2.7[a]	
1990					
All Developing Countries	4.2	4.5	4.0	4.1	4.5
Oil Exporting	2.9	3.5		3.6	
Non-Oil Exporting	4.7	5.0			
Exporters of Manufactures	5.1				
Exporters of Primary	3.4				
Market Borrowers	3.8				
Official Borrowers	4.4				
Four Asian NICs	6.2			7.1	6.3
Fifteen Heavily Indebted Countries	3.2	3.5			
Small Low Income Economies	4.7				
Asia	6.2		5.4		6.8
South				4.3	5.2
East				6.6	5.9
China		9.0		6.0	9.0
Western Hemisphere	3.2	3.5	2.8	3.0	
Africa	3.3	3.0	2.5	3.2[a]	

Medium Term

	IMF	UNCTAD		UNIDO	World Bank 1988-95	
	1991-94	1990-95	1995-2000	1990-2000	AWG	LOW
All Developing Countries	5.1	3.4	3.7	4.5	4.6	3.7
Oil Exporting				4.5		
Fifteen Heavily Indebted Countries	4.2				3.2[b]	2.3[b]
Asia	6.6	4.6	4.5		6.0	4.9
South				4.4		
East				5.5		
China				5.0		
Western Hemisphere	4.3	2.3	3.1	4.0	3.1	2.3
Africa	3.6	1.4	1.7	3.5[a]	3.2[a]	3.1[a]

a Sub-Saharan Africa b 17 Highly Indebted Countries external to more domestic sources. The other continents (or categories) were very different. Africa (or primary exporters) was at around 2%. As the African DB points out, this was higher than 1986 or 1987, and if sub-Saharan Africa is taken on its own, it was an increase from -0.5 to 3.3, with rates of 3.5% in West Africa and 4.9% in Eastern and Southern Africa (p. 34). This illustrates the danger of using regional averages, although the problems of the oil-exporters are as much a problem of primary exports as those of Sub-Saharan countries. The improvement, however, is attributed to the weather, and therefore cannot be projected into the future. Latin American growth was under 1%, in spite of its export success. If, therefore, the BIS explanation (high inflation, p. 41) is correct, this was operating through domestic disruption, not through international competitiveness. UNCTAD comments on the 'inability to translate a vigorous expansion in external demand into satisfactory domestic expansion' (p. 6), but also fails to explain it. The external constraint was much more serious than is obvious from the export performance because of the high cost of debt servicing (UNCTAD estimates the net transfer from Latin America as one third of exports of goods and services), and domestic demand may have been constrained by fiscal restraints and also by the diversion of resources into exports from investment (as argued by UNCTAD and UNIDO).

In 1989, the Asian growth rates are forecast to be less spectacular, partly because of poorer performance in China and South Asia, as both China and India introduced restraining policies after the 1988 growth, but the NIC figure is also lower. Little change is expected for Africa or Latin America. Other, country-based, forecasts for Asia tend to be rather higher for the NICs and the ASEAN countries, although forecasts are now being revised down for China because of the immediate and possible longer-term results of the disruption there. UNIDO is more optimistic for the NICs because it expects restructuring within the region to bring new opportunities, supplemented, perhaps, in the long run by new trading opportunities with the Asian centrally planned economies.

By 1990 and in the medium term, normal forecasters' caution is bringing the areas nearer together, and Latin America is assumed to have moved out of serious crisis into the intermediate position. The effect of debt servicing, low investment, and public sector restraints as constraints even in a year of exceptionally rapid world trade growth suggests that growth will continue to be held down until they are changed. It is not clear what is forecast to change them so that Latin America can attain the medium-term rates given in these Reports.

The UN emphasises debt-servicing as a constraint on African investment and growth as well on Latin American (p. 30). For Africa, UNCTAD does not see any improvement in the medium term because conditions will not change. The BIS (p. 40) cites the same problems of commodity-dependence, debt-servicing, and ('not independently of the influences mentioned above') low investment. It also mentions (as does the World Bank) the problem of rapid population growth[15]. Other areas (notably some Latin American countries since the 1960s) have seen falls in population growth when income levels rose. It is the combination of rapid population growth with income growth that produces the discouraging forecasts.

On these forecasts, African per capita income at best rises slightly throughout the period, with Latin America only recovering after 1990. But 1% per capita growth, as the World Bank points out, 'is probably insufficient for the economic revitalization that is necessary for Latin America to keep pace with other parts of the world' (p. 21). The historical table in the Appendix, shows how exceptional this pattern is. The divergences were not as stark in the past, and, except for Asian non-NICs, all areas grew significantly faster in the past, even in the 1970s when industrial country growth was comparable with what is expected for the medium term. The past growth rates were not associated with substantially faster export growth.

The Reports do all discuss these divergences. In looking for regional explanations as well as the general determinants of development success discussed in the previous section, some seem to fail to recognise how closely

[15]The Bank's comment that 'Africa's population is growing faster than has that of any other region of the world in this century' (p. 15), may be strictly true, but individual countries, the more relevant comparison, and sub-continental regions have had equally fast rates, and continue do so as shown in the Bank's statistical appendix.

the regional and economic classifications correspond. The World Bank places its major emphasis on the policy strategies discussed in section 9, but does not appear to recognise fully how closely its areas correspond to economic classifications referring to growth rates in African nations and in the heavily indebted countries (p. 2) as if they were separate groups. Similarly the Bank of England can say that higher interest payments are 'significant only in the Latin American group...and in the African group' (p. 336), i.e. they only affect major debtors. The IMF variety of classifications, however, tends towards the problem of showing the obvious, that debt ratios are higher for the heavily indebted.

What is more interesting are the indications of differences among areas, or similarities within them that might not be immediately obvious. Both the Bank of England and UNCTAD (p. 29) give data that can be used to show the considerable divergence in the interest rates paid by different areas (table 5). As can be seen from the UNCTAD data (which is supported by evidence from past interest payments by middle income countries[16]) this is only partly for the reason which the Bank gives, the higher share of variable-rate borrowing in Latin America; as well as borrowing in the highest cost forms, Latin American countries have paid higher rates on all types of loans. In its section on the least developed UNCTAD points out structural characteristics which they share and which are different from other developing countries: the high share of agriculture and their inherent isolation from normal trade patterns: out of 42, 15 are land-locked (5 other developing countries) and 9 are small island economies.[17] It also makes a different association, those 'persistently in the grip of depression' are often in 'disorder as well' (p. I). This aspect of the sustainability of adjustment programmes contributes to the UN and UNCTAD scepticism about their success. UNCTAD also notes the greater strength of institutions embodying vested economic interests in some countries (including some which have most difficulty in 'adjusting' (pp. 83-4). The 'disorder' may also arise from other sources, internal or external and UNCTAD emphasises how instability can result. In countries faced with

[16]Table 14.6 in S. Page, Trade, Finance and Developing Countries, 1989.

[17] The other characteristics which UNCTAD uses are closely associated with low income itself.

Table 5: Interest Rates For Debt Repayments

	1988	1990	1995	2000
All Developing Countries	6.5	6.7	6.4	6.0
Asia	5.9	5.6	4.8	4.7
Eurocurrency Borrowers	7.4	7.1	5.6	5.4
Least Developed Countries	2.1	2.4	2.3	2.0
Others	5.0	4.9	5.0	4.9
Western Hemisphere	7.8	8.2	8.3	8.4
Eurocurrency Borrowers	8.1	8.6	8.8	8.5
Others	6.1	6.4	6.5	5.9
Africa	4.8	5.4	5.6	5.3
Eurocurrency Borrowers	6.3	7.2	7.4	7.3
Least Developed Countries	3.1	3.2	2.6	1.5
Others	4.7	5.4	5.7	5.7

Source: calculated from UNCTAD, p.29

crises (since these Reports were prepared: China and Colombia), it is not only that adjustment may be more difficult in practical terms: it is not the government's priority.

The UN emphasises from the beginning (p. 7) the increasingly regional pattern; and in particular the growing divergence among countries and the exceptional nature of the growth of a small group of Asian countries (pp. 26-7). The IFC also cautions that the success of exports of labour-intensive manufactures has been confined to 'a relatively small number of developing countries: around 90% of all labour-intensive exports came from just twenty countries in 1986 (eleven in Asia, four in Latin America, three in Europe-Middle East, and two in Africa).' (p. 7). It warns of a 'two-track' (p. 10) process, and that the gap between the tracks will widen 'without restoration of investment activity in the highly indebted, low-growth countries'. As was pointed out earlier, the World Bank and UN scenarios indicate that simple changes in the external position cannot narrow the gap and UNIDO suggests greater attention to technology. All the reports now accept at least implicitly that industrialisation and reducing dependence on primary exports are essential components of development.[18]

Regional trade (as discussed in section 4) has been a self-reinforcing stimulus within Asia, emphasised by the Asian DB. The World Bank also looks at the market opportunities for the Asian countries to Japan and to each other. Japan's performance, however, was more divergent from that of other industrial countries in the past than it is now; it is now increasing its imports of manufactures, but this was also true pre-1973, although the relative exchange rate movements and changes in its general openness may make this more important to Asian countries now. UNCTAD shows (pp. 7-8) the advantage offered by expanding markets to Asian exporters, especially of manufactures, using constant market shares analysis: the difference in the area composition of their exports could account for about 2% of the Asian countries' difference from the average in 1988; it is in fact particularly important for non-NIC Asian countries (3.6%). It would account for shortfalls for Latin America (2.1%) and Africa (1.6%). But it is the

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[18] In a press briefing, International Economic Commentary, the World Bank distinguished 'between the creditworthy manufacturing economies and the rest' (February 1989).

commodity composition of trade which is normally the more important difference in the demand faced by the different areas: adding 2.6% for East Asia and costing Africa 1.9%. The World Bank (e.g. in its comments on African failures on p.10) makes little allowance for the different commodity composition of the areas' exports. The UNCTAD discussion which mentions the shift from US to Japanese markets also suggests the obvious point that successful exporters do not simply respond to markets: they look for them. The African DB suggests this in noting the need for Africa to shift more of its trade away from North America and Europe towards Asia (p. 9).

11. Issues Raised by the Forecasts and the Reports

The direct impact of small differences in the growth rate of the industrial countries is small on total output and trade for developing countries: the different IMF scenarios in the medium term, which are typical, show that 1% lower industrial country growth reduces developing countries by 0.5%. The effects on particular variables and groups are significant: the middle income, manufactures-exporting, Asian countries are most vulnerable (0.8%); for Latin America and Africa it is 0.2%. The effects of a fall concentrated on investment may be most severe. The effects on inflation concern exporters of primary commodities in particular and the direct and policy-induced effects on both nominal and real interest rates will have an impact on past and potential borrowers. For these reasons, the uncertainty that has surrounded these forecasts in the last few years, and which, given the lack of an agreed interpretation for the past, must still be assumed, is clearly unsatisfactory. The whole pattern of the forecast, and therefore its implications for the external situation and the internal policies of the developing countries is uncertain. For output, investment, interest rates and financial flows, the forecasters have tended to take the cautious side in making their projections or assumptions. This is valuable in discouraging strategies as risky as those followed in the 1970s proved to be, provided that it does not discourage all forms of risk-taking required for development.

One risk for developing countries in the area of exchange rates and policy coordination comes from the potential for disruptive realignment or, alternatively, higher than necessary interest rates to postpone this. The more basic danger comes from their exclusion from an increasingly institutionalised inner circle in the international organisations. Curiously, this has received much less attention except from the UN, than their risks from trade policies imposed by sub-groups of the industrial countries (the EC or US-Canada, for example) or from failure to participate fully in the GATT negotiations.

One important question for the developing countries is whether the forecasters are right to fear that the various 'special factors' stimulating trade in 1988 were all short-term and unrepeatable, in particular the industrial countries' investment boom, Japan's move into high imports of manufactures, and the high growth by the NICs. There are arguments for being less cautious; some were mentioned in sections 2 and 10 on output. In addition, the elasticity of trade relative to output, particularly if the output continues to be stimulated by investment, could well be higher than most forecasters assume here: 1.8-1.9 would not be exceptionally high, and with continued growth at over 3% makes 6% easily attainable even in the absence of special factors. The adjustment to the revaluation of the yen may not be complete, and the growth projected for trade by the NICs seems low relative to output growth, especially if there is any liberalisation by Taiwan and South Korea.

The progress of the GATT (and other) trade negotiations does not seem to have affected the forecasts. It is possible that the forecasters consider that the appearance of a serious risk of breakdown, and increased restrictiveness of trade, after the December, Montreal, meeting has been exactly offset by the April completion of the mid-term review, leaving prospects for developing (and other) country trade unchanged from a year ago. It is arguable, and it would be interesting to know the institutions' views, that on agriculture and textiles, at least, and possibly the probability of a substantially more liberal trading system, there has been progress that could affect medium term prospects or trading strategies.

The forecasts for financing raise two doubts: are the forecasters right to remain fundamentally pessimistic: that there is no increased (or more accurately, a return to old) external financing, in spite of the encouraging signs of 1988? Are they right, especially those which are suppliers of funds themselves, to reject or ignore, the possibility of finding more appropriate forms of finance, especially as official finance is now such a large proportion of the total? It is encouraging that the problem of flexible financing, and of fast response, is receiving more attention in this year's reports, but there are no firm proposals.

A difference that becomes obvious on reading the reports is relevant to the Reports' suggestion that non-economic factors have a role: the Asian DB's Report starts: 'During the 1980s, developing Asia emerged as the most dynamic region in the world'. The presence of the few successful countries of recent years has affected the performance of the rest of the region not only openly, through the trade flows discussed above, and through such phenomena as the tendency of foreign investors and banks (commercial and official) to look at countries' neighbours and areas, but through example and confidence. It is convenient in Reports (such as those reviewed here and this one) to treat areas as units: they do share characteristics and (almost more important) aggregate forecasts and data for the past are available. But this should not imply that the distinctions become institutionalised, as, for example, in confining some debt initiatives to 'Sub-Saharan Africa' rather than 'all low income borrowers from official sources'. Generalisations about good or bad policies followed in the past[19] must reinforce traders' and investors' stereotypes. Both the UN and UNCTAD express concern about neglect of the problems of low-income countries outside Africa.

Although the Reports this year show a tendency to draw back from fixed or ideological positions on official intervention within national economies, on several issues there now appear to be inconsistent approaches to intervention in international markets. The euphemism 'management', first introduced to avoid calling non-tariff barriers instruments of protection, is spreading: Brady does not want the IMF and World Bank to manage the use of the funds which they will allocate to debtors; the BIS, while strongly opposing managed trade, and hoping that the central banks will draw back from managing the debt crisis, insists on the necessity of managing the exchange rate, and probably some capital flows. The UN, also opposed to trade protection, wants energy prices to be managed. For exchange rates, 'management' has apparently

[19]'Throughout the nineteenth century, Latin American countries relied too much on foreign capital.' World Bank, p48.

remained sufficiently pejorative that those who support it now use 'coordination'. But in all these the two fundamental problems of 'managed' trade remain: first that the sector is not being 'managed' on behalf of all of its participants, but by a sub-group of them: one importer, not the exporter or alternative importers; the G-5, not all IMF members. (This would also apply to the World Bank's support for concessionary, importer-governed trade schemes like GSP or Lomé.) Second, that what is at issue is not finding a technical solution to implementing defined and agreed objectives but reconciling inconsistent, perhaps directly opposed, interests. In a world where the developing countries are taking a more active part in international negotiations and where sub-categories of developing countries are joining with sub-groups of the industrial countries according to interest rather than level of per capita income such proposals are clearly unacceptable. Alternative mechanisms must be considered in a realistic assessment of future prospects for the developing countries, whether using the market or a more universal forum to resolve them by negotiation and intervention. This question seems a particularly appropriate one for the international institutions to address. It is unfortunate that they are so silent on these systemic issues as well as on their own as role as creditors and as past policy-makers for some developing countries now in distress.

APPENDIX

Debt and the Incentives to Invest

J.T.Winpenny

Debt, unwisely incurred, is bad for development. Its servicing absorbs resources which could be applied to investment, and imposes deflation on countries struggling to generate the necessary foreign exchange. It can be observed that investment is depressed in heavily-indebted countries. This note will examine some of the reasons for this and will argue that the obvious explanations are more convincing than others based on so-called 'debt overhang'.

There is strong evidence that investment in the most heavily indebted ldcs has been lower since 1982 than it was before, and lower than in other ldcs at a similar level of development (IMF). This is the empirical basis of the growing belief that heavy debt servicing is depressing investment and growth.

This intuitively appealing result cannot go without some explanation. If borrowing were undertaken to finance investment by the public or private sectors, then increased indebtedness should be associated with a higher investment/GNP ratio. If, on the other hand, debt had been incurred to finance consumption the investment rate would be depressed.

The evidence is consistent with the view that borrowing before 1982 by countries currently with a serious debt problem was undertaken to maintain previous levels of public and private consumption, which were under pressure from declining terms of trade and weakening rates of growth.

The reasons why heavy debt servicing might depress investment are not far to seek. Countries in debt difficulties need to undergo demand deflation through stabilisation or adjustment measures in order to reduce local absorption and divert resources for export. Devaluation is often part of this process, and itself increases the local currency cost of debt servicing and the price of imported capital goods.

Public investment will be squeezed twofold: overall budgets will come under strain as part of the general deflation, and more room will have to be found for debt service payments at the expense of public investment and consumption. There will be a strong temptation for Finance Ministers to trim postponable investment outlays rather than spending programmes with an immediate popular 'bite'.

Private investment will likewise react against deflation in the domestic market, the tighter fiscal stance of Government, the higher cost of borrowing or raising capital, and other dampeners on business confidence. The main offsetting factors would be better investment prospects in export or import-replacing sectors. If there were no faith in the success of current policies, pessimism about the time they would need to succeed, and/or uncertainty about the stance of creditors, these would be further reasons to expect reduced investment.

A more tenuous effect would be through the link between the growth of manufactured exports and low domestic investment noted for several indebted industrialising ldcs (UNCTAD). On this view, exports to service the debt 'crowd out' production for the domestic market. However, the precise causal relation between a growth in manufactured exports and a decline in domestic investment is not robustly specified. It is conceivable that the domestic market might be unable to absorb the exportable surplus anyway, in which case the underlying factor would be the deflationary effects discussed above.

A more subtle link between debt and investment appears in the concept of 'debt overhang' (IMF, Portes). The argument is that, if future debt servicing becomes dependent on economic performance (exports, trade surplus, GNP growth, etc.), either formally or de facto, this reduces investment incentives. We might term this "performance related debt servicing" (PRDS). Debt servicing becomes a '... heavy tax on investment' (Portes). The analogy might be with the 'poverty' trap in the context of social security payments, in which poor people have a disincentive to better themselves because of the forfeit of benefits entailed. In judging how far PRDS acts as an extra disincentive to investment, analysis of the alternative debt scenarios is necessary, and of how exactly PRDS impinges on the behaviour of public and private investors.

Obviously full debt cancellation would improve investment incentives by reducing the need to deflate and removing some uncertainty about future economic policy. But, if PRDS is compared to formal rescheduling or a constant level of debt service, it is not immediately apparent why it should be worse in its effect on investment incentives.

Consider the public sector. Would a Finance or Planning Minister be less inclined to proceed with public investment projects because of the likelihood that, for the duration of PRDS, better performance would require that part of the increment of export receipts or public revenue would disappear in increased debt servicing? Would a Government deliberately refrain from public investment, in a variety of sectors and for a mixture of motives, because of the PRDS 'tax' on good performance?. This posits an odd outlook by policy-makers.

Or consider private investors. It is usual to view private investment as being influenced mainly by market prospects; financial constraints and opportunities (liquidity, ability to raise capital or borrow); the availability and cost of capital goods; and expectations about future economic policy. In the case of foreign investors, these are joined by the terms on which new investment can be made, and profits and other fees remitted.

Are these basic factors likely to be worse under a regime of PRDS than under other debt scenarios (excepting outright cancellation)? Unless they expected PRDS to lead to different macroeconomic prospects or a tighter foreign exchange position than other debt scenarios, private investment need not be affected.

The exception could be foreign private businesses contemplating new investment, who would be strongly influenced by the prospects of remitting profits. The amount of foreign exchange available to the government after debt servicing would affect their ability to allow such remittances. Although it leaves this amount more uncertain, PRDS improves the chances of such funds being made available, compared to more inflexible debt servicing arrangements. The reality is that ldcs undergoing tough stabilisation programmes, with serious uncertainty about their economic performance, are not the most tempting targets for new private foreign investment.

A complication might arise if the private sector were a significant debtor to foreigners, and if it were not able fully to service those debts because of the national debt problem, rather than its own local currency liquidity. (This might arise if foreign supplier credits were in arrears because the Central Bank was not releasing enough foreign currency to local banks to make the payments on behalf of their customers.) But on the assumption that the private sector was able and willing to pay the local currency for servicing its foreign debts, PRDS could even be advantageous, compared to other debt scenarios, if it enabled private customers to restore their creditworthiness more quickly.

Conventional explanations based on macroeconomic deflation, devaluation, budgetary restrictions, lack of confidence in the efficacy of the public policy stance, and associated private responses are more convincing reasons than those based on 'debt overhang', and the risks from relating debt servicing to economic performance.

<u>Reference:</u>

(Portes) 'Universal benefits in debt reduction' by Richard Portes, <u>The Independent</u>, 19 August, 1989.

Historical Data 1960-88, percentages

	1960-68	1968-73	1973-80	1980-83	1983-88
INDUSTRIAL COUNTRIES					
GNP/GDP	5.0	4.5	2.4	1.3	3.7
United States	4.5	3.0	2.2	1.0	4.1
Japan	11.9	8.8	3.7	3.3	4.5
European countries	4.6	4.8	2.2	1.0	2.8
GNP Deflator	3.1	6.2	9.4	7.0	3.5
Import Volume	8.9	9.7	3.1	0.7	8.3
Six Months LIBOR	4.8	8.1	9.5	13.4	8.4
Six Months LIBOR Deflated by US GNP	2.3	2.3	1.2	6.4	5.0
World Trade (volume)	7.6	8.5	4.2	0.0	6.3
Trade in Manufactures (volume)	9.0	9.3	5.4	1.3	6.0
Oil Price, US$	-1.8	15.9	38.1	-2.4	-13.9
Oil Price, real	-2.9	7.4	25.3	0.5	-19.1
Price of Manufactured Exports	1.1	7.9	10.2	-2.9	6.4
Prices of Primary Commodities	0.0	13.0	8.8	-5.9	1.8
DEVELOPING COUNTRIES					
Output	5.2	6.3	5.1	2.1	3.9
Export Volume	5.9	8.9	0.6	-3.4	7.7
Import Volume	4.7	8.4	8.3	0.5	2.7
Export Prices	0.6	10.6	24.0	-2.7	-2.0
Import Prices	0.7	7.8	13.7	-2.4	2.7
Terms of Trade	-0.4	2.5	9.0	-0.3	-4.6
Output by Group					
Oil Producers	5.9	9.1	5.2	0.4	0.8
Non-Fuel Exporters	5.1	5.9	5.1	2.9	5.3
Exporters of Manufactures		8.3	5.4	3.7	6.5
Primary Product Exporters				-0.8	2.7
Without Debt Servicing Difficulties				5.4	6.5
With Debt Servicing Difficulties				-0.5	2.8
Official Borrowers				1.5	3.9
Four Asian NICs	8.2	13.0	9.2	6.8	8.1
Asia	3.9	5.2	6.4	6.4	7.8
Western Hemisphere	5.7	6.5	5.4	-1.1	3.0
Africa	4.1	6.0	3.5	1.2	1.8
Exports (volume) by Group					
Oil Exporters	6.6	10.2	-2.8	-11.5	4.1
Non-Fuel Exporters	5.4	8.1	5.3	4.5	9.7
Manufactures Exporters	7.1	12.8	7.7	7.2	11.5
Four Asian NICs				8.8	15.5
Fifteen Heavily Indebted Countries	3.2	6.4	1.4	-0.2	4.9
Asia	5.5	11.7	7.9	5.9	15.0
Western Hemisphere	2.7	2.6	0.6	4.4	4.5
Africa	8.8	7.2	0.1	-6.7	4.0
Imports (volume) by Group					
Oil Exporters	3.4	12.3	16.7	2.3	-9.8
Non-Fuel Exporters		7.6	6.2	-0.2	6.8
Manufactures Exporters	6.5	10.0	6.3	1.4	9.6
Primary Exporters				-8.9	2.2
Four Asian NICs				5.2	13.4
Fifteen Heavily Indebted Countries	3.8	7.5	9.3	-12.1	2.1
Asia	4.7	7.7	8.5	5.9	9.5
Western Hemisphere	3.7	7.1	6.9	-13.6	4.0
Africa	2.8	6.8	8.1	-2.9	-4.4

Sources: IMF, International Financial Statistics, IMF, Asian DB, OECD, UN, Monthly Bulletin

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NIESR, National Institute Economic Review

OECD, Financing and External Debt of Developing Countries

Note on the Reports

The forecast documents were written at different times and for different purposes. The earliest of the international institutions are the IMF and the World Bank, completed by the spring. The BIS covers events to the end of March; the IFC and OECD reports, to June. The UN, UNCTAD, and UNIDO were all finished during the summer (taking in events in early June), as were the Asian and African DB. Only preliminary documents were available from UNIDO in September. The World Bank is (increasingly) written less for a professional economic audience, although the recommendations are directed at policy-makers, in industrial and developing countries. The World Development Report does not reflect the full range of research and forecasts for developing countries within the Bank. Its report on financial systems, which takes up most of the volume, attempts 'to capture the essentials of the complex field of finance' (p. 132, the last page of the report), i.e. to cover all aspects of the use of money and the institutions and criteria involved in monetary policy, with a detailed history of the problems of developing country financial management in the last few years. As it admits, in the limited space this leads to a large number of generalisations and to neglect of 'the human and political dimensions of the subject'.

The forecasters are much more careful than this review of them has been to distinguish some (or all) of their numbers as assumptions or scenarios. The IMF now considers its short-term figures to be forecasts, but its medium-term 'projections' to 'have no predictive or normative value' (and expresses frankly the strong wish, for oil prices, interest rates and exchange rates, to avoid publication of projections for 'sensitive' variables to avoid triggering 'undesirable market reactions' (suggesting it lacks confidence in the efficiency of markets). Although stating their positions less clearly, the other organisations would probably share these caveats, except on interest rates.

The UN looks at the forecasting problem in the context of the discussion of 'international indicators' and tries to identify criteria for useful 'early warnings'. It discusses the information available within the UN system, and suggests that sectoral level work may be most appropriate (p. 209). It also includes analysis of the centrally planned economies which is not discussed here.

The Reports by the Asian DB and the African DB are the first to be published by those banks. In addition to the forecasts, the Asian has a special section on human resources and the African on economic integration. The Inter-American DB Report had not been published at the time this review was written. The UNCTAD special section, as mentioned earlier, is on the least developed countries.[1]

The IFC report is a short document (44 pages), but offers a much more business and investor-orientated approach than the World Bank, with special reports this year on horticulture and the car industry. (Its general section, at about 30 pages, is in fact longer than the 19 pages that the World Bank now gives to 'Adjustment and growth in the 1980s and 1990s'.)

UNIDO reviews the performance of major industries in the larger developing countries and has a special chapter on South-South industrial cooperation.

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[1]Some of the country reports were prepared by members of the ODI staff.

Definitions and Country Groups

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

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

World Bank scenarios:
Adjustment with growth (AWG): assumes policies that reduce US budget deficit, so interest rates and dollar fall, and structural adjustment in developing countries.
Low: no policies; imblances are financed so interest rates remain high; protectionism increases.

Developing countries (and area sub-totals): as defined by IMF but excluding South Africa, with minor differences for some reports (see pages 50-52).

Manufactures Exporters

Asia	W. Hemisphere	Africa	Others
China	Brazil	Tunisia	Greece
Hong Kong*			Hungary
India			Poland
Israel			Portugal
Korea*			Romania
Singapore*			Turkey
Taiwan*			Yugoslavia
Thailand			

* Four Asian NICs

Market Borrowers

Asia	W. Hemisphere	Africa	Others
Hong Kong	Antigua and Barbuda	Algeria	Greece
Korea	Argentina	South Africa	Hungary
Malaysia	Barbados		Portugal
Papua New Guinea	Bahamas		
Philippines	Brazil		
Singapore	Chile		
	Ecuador		
	Mexico		
	Suriname		
	Trinidad and Tobago		
	Uruguay		
	Venezuela		

15 (17) Heavily Indebted Countries

Asia	W. Hemisphere	Africa	Others
Philippines	Argentina	Côte d'Ivoire	Yugoslavi
	Bolivia	Morocco	
	Brazil	Nigeria	
	Chile		
	Colombia		
	(Costa Rica)		
	Ecuador		
	(Jamaica)		
	Mexico		
	Peru		
	Uruguay		
	Venezuela		

Countries With Recent Debt-Servicing Difficulties

Asia	W. Hemisphere	Africa	Others
Afghanistan	Antigua and Barbuda	Benin	Poland
Burma	Argentina	Burkina Faso	Romania
Iraq	Belize	Cape Verde	Yugoslavia
Philippines	Bolivia	Central African Republic	
Viet Nam	Brazil	Chad	
Western Samoa	Chile	Comoros	
	Colombia	Congo	
	Costa Rica	Côte d'Ivoire	
	Dominican Rep.	Egypt	
	Ecuador	Equatorial Guinea	
	El Salvador	Gabon	
	Grenada	Gambia, The	
	Guatemala	Ghana	
	Guyana	Guinea	
	Haiti	Guinea-Bissau	
	Honduras	Liberia	
	Jamaica	Libya	
	Mexico	Madagascar	
	Nicaragua	Malawi	
	Panama	Mali	
	Paraguay	Mauritania	
	Peru	Morocco	
	St. Lucia	Mozambique	
	Suriname	Niger	
	Uruguay	Nigeria	
	Venezuela	Sao Tome and Principe	
		Senegal	
		Sierra Leone	
		Somalia	
		South Africa	
		Sudan	
		Syria	
		Tanzania	
		Togo	
		Uganda	
		Zaire	
		Zambia	

Low Income Economies (excl. China and India)

Asia	W. Hemisphere	Africa
Afghanistan	Guyana	Benin
Bangladesh	Haiti	Burkina Faso
Bhutan		Burundi
Burma		Central African Republic
Kampuchea		Chad
Lao		Comoros
Maldives		Equatorial Guinea
Nepal		Ethiopia
Pakistan		Gambia, The
Sri Lanka		Ghana
Vanuatu		Guinea
Viet Nam		Guinea-Bissau
		Kenya
		Lesotho
		Madagascar
		Malawi
		Mali
		Mauritania
		Mozambique
		Niger
		Rwanda
		Sao Tome and Principe
		Senegal
		Sierra Leone
		Somalia
		Sudan
		Tanzania
		Togo
		Uganda
		Zaire
		Zambia

Primary Products Exporters

Asia	W. Hemisphere	Africa
Afghanistan	Argentina	Botswana
Bhutan	Bolivia	Burundi
Burma	Chile	Central African Republic
Lao	Colombia	Chad
Papua New Guinea	Costa Rica	Comoros
Solomon Islands	Dominica	Cote d'Ivoire
Sri Lanka	El Salvador	Djibouti
Viet Nam	Guatemala	Equatorial Guinea
	Guyana	Gambia, The
	Honduras	Ghana
	Nicaragua	Guinea
	Paraguay	Guinea-Bissau
	Peru	Kenya
	St..Vincent	Liberia
	Suriname	Madagascar
	Uruguay	Malawi
		Mali
		Mauritania
		Mauritius
		Niger
		Rwanda
		Sao Tome and Principe
		Somalia
		Sudan
		Swaziland
		Togo
		Uganda
		Zaire
		Zambia

Official Borrowers

Asia	W. Hemisphere	Africa		Others
Afghanistan	Belize	Botswana	Madagascar	Malta
Bangladesh	Bolivia	Burkina Faso	Malawi	Poland
Bhutan	Dominica	Burundi	Mali	
Burma	El Salvador	Cape Verde	Mauritania	
Kampuchea	Grenada	Central African Republic	Mauritius	
Lao	Haiti	Chad	Morocco	
Kiribati	Honduras	Comoros	Mozambique	
Maldives	Jamaica	Djibouti	Niger	
Nepal	Netherlands Antilles	Egypt	Rwanda	
Pakistan	St. Kitts-Nevis	Equatorial Guinea	Senegal	
Sri Lanka	St. Lucia	Ethiopia	Sierra Leone	
Tonga	St. Vincent	Gambia, The	Somalia	
Vanuatu		Ghana	Sudan	
Viet Nam		Guinea	Swaziland	
Western Samoa		Guinea-Bissau	Tanzania	
Yemen Arab Rep.		Kenya	Togo	
Yemen, P.D. Rep.		Lesotho	Uganda	
		Liberia	Zaire	
			Zambia	