

## Chapter 3: International Policy Issues

Interdependence in the world economy is not a new phenomenon—it has been growing in importance for decades, if not centuries. But it is perhaps not yet fully understood how far the process has now come, nor how much further it will go even in the next decade. The imbalance in world food demand and supply, and the rise in oil prices in recent years, have signaled some of the more dramatic aspects of interdependence. They have made more people aware of the importance of maintaining stable trading relationships in these vital commodities. But interdependence characterizes many more aspects of international relations.

With their expanding industrial capability, increasing numbers of developing countries are now involved in the massive rearrangement of international comparative advantage that started among the industrialized countries. This process of adjustment is very far from being completed. Large-scale international labor migration and the growth of tourism have helped to intensify the economic links between industrialized and developing countries.

There has been a dramatic expansion in the flow of capital on market terms to the developing countries. The international operations of the leading commercial banks—as suppliers of medium-term investment loans to developing countries—have expanded enormously. Some developing countries are technologically backward and have more capital than they can invest; other developing countries, despite their extensive modern industrial sectors, have large capital requirements and must borrow internationally to finance their investment and economic growth.

At present, with the slow recovery from the turbulence of recent years, there is widespread uncertainty as to how the international economy will evolve. This chapter discusses the policy issues and possible developments in various aspects of the international economy as they affect the developing countries. It examines the prospects for economic growth of the industrialized countries, the rise of protectionist pressures in those countries and the implications for developing countries' exports, the outlook for food and energy, and the prospects for flows of capital from industrialized to developing countries.

### The Growth of the Developed Economies Industrialized Countries

The industrialized countries purchased nearly two-thirds of all the merchandise exports of developing countries in 1975. Since the industrialized countries' demand for imports depends on their income, their economic growth is very important to the export and growth prospects of developing countries. The growth and external payments situations of the major industrialized countries have been very volatile in recent years and this gives cause for caution in projecting their prospects as a group. Most observers agree that their economic growth will be slower in the next decade than the 5 percent a year they maintained in the 1960s and early 1970s; this is because of their continued difficulty in managing aggregate demand and combating inflationary pressures. The problems of resuming a high rate of growth are aggravated by the rapidly changing imbalances in external payments. The lack of consistency among the balance of payments targets of different industrialized countries appears to have given their adjustment policies a deflationary bias; most of the deficit countries have applied deflationary policies, and even in the surplus countries expansionary policies have been far from vigorous.

#### 17. Industrialized Countries: Growth of Gross Domestic Product, 1960-85

(Average annual percentage growth rates, at 1975 prices)

	1960-70	1970-75	1975-85
North America	4.0	2.4	4.3
Japan and Oceania	9.4	5.0	5.6
Western and Northern Europe	4.7	2.5	3.5
All Industrialized Countries	4.9	2.8	4.2

Though observers differ in their estimates, it appears reasonable to assume that the industrialized economies will grow at 4.2 percent a year, on average, from 1975 to 1985. Allowing for the rather slow growth in recent years, this assumes that Japan's economy will grow at about 6 percent a year for the remainder of this period, offset by slower growth in Italy, the United Kingdom, and some other countries in Europe. The United States, Germany, and France are assumed to grow at about the average

rate for the group. The growth rates cannot be much lower than these projections without causing intolerably high unemployment and a divergence between the growth of labor productivity and wages, resulting in rising unit labor costs.

The interrelations between growth, inflation, wages, and external payments equilibrium are influenced by a wide range of policies, including monetary, incomes, and trade policies, a discussion of which is beyond the scope of this report. Of particular relevance to the growth of developing countries, however, is the increasing tendency to rely on protection against imports to cushion the impact of the prolonged recession on employment, thereby delaying some of the difficult structural adjustments that are necessary if there is to be a return to a higher growth path.

If there is a significant increase in protectionism, it is unlikely that the economic growth of the industrialized countries will reach the levels assumed here. Open trade policies, which characterized the 1960s, make an important contribution to the pace of growth in industrialized countries in several ways: by fostering a division of labor that accelerates the upgrading of skills and labor productivity in industry, encouraging technological progress; by providing an inflow of manufactured articles at lower prices, thus increasing real purchasing power and reducing the inflationary pressures that inhibit the pursuit of growth through expansionary monetary and fiscal policies; and by stimulating growth in the developing countries, causing a further expansion in the markets for the industrialized countries' exports.

#### **Centrally Planned Economies**

The growth of the centrally planned economies (CPEs) does not materially affect the developing countries. The CPEs accounted for only about 5 percent of developing countries' exports in 1975, and about 40 percent of those exports consisted of food and beverages. Trade between the two groups of countries has not grown as rapidly as that between the industrialized and developing countries, and most of it is between relatively few countries.<sup>1</sup> The net contribution of aid from the CPEs to the developing countries is small.

Nonetheless, there are several respects in which the performance of the CPEs may directly influence the prospects of developing countries.

First, if the CPEs increase their exports of manufactured goods to the industrialized countries at the same rates as in the past, protectionist sentiments in Western Europe may be intensified. The value of the CPEs' exports of manufactures to Western Europe rose from US\$2.3 billion in 1970 to US\$5.5 billion in 1975—more slowly than developing countries' manufactured goods exports, but in roughly the same sensitive product categories. Second, the CPEs have borrowed sizable amounts of commercial capital in the Eurocurrency market in recent years and they are expected to continue relying heavily on this market. They may, therefore, affect the supply of medium- and long-term external capital available to the developing countries. Third, there is considerable uncertainty about the growth of the CPEs' import demand for food and fuels, and its impact on availabilities and international prices.

### **Protectionism in the Industrialized Countries**

#### **Recent Developments**

There has been a marked increase in protectionism in the industrialized countries and pressures for further measures are strong. These pressures partly stem from the continued slow growth of the industrialized countries and their consequent high levels of unemployment, and are partly the result of the concentration of developing countries' export growth in relatively few categories of manufactured products. The protectionist measures have entailed the use of a wide variety of devices, for example "orderly marketing arrangements" and new import quotas; price floors on imports, as in the case of steel and agricultural products; new "voluntary" export restraints; "countervailing duties"; administrative obstacles to imports; and subsidies to domestic industries to sustain levels of production in excess of those justified by demand. There have been calls for the control of market shares on a regional or worldwide basis and for extending protection to a wider array of products. All these types of measures adversely affect developing country exporters: quantitative restrictions and market sharing agreements limit their sales in industrialized countries directly, while subsidies to weak industries do so indirectly.

Although developing countries' exports have continued to grow rapidly through 1977, recent policy developments affecting the trading environment have been noticeably adverse. They have taken two main forms with respect to developing countries: increasingly severe restraints on their exports, and the creation of an atmos-

<sup>1</sup>Only eight developing countries sent more than 15 percent of their exports to the CPEs in 1976: Afghanistan, Egypt, Ghana, Mali, Peru, Syria, the Yemen Arab Republic, and Yugoslavia.

phere in which more and more producers clamor for protection with an increased probability that they will get some relief. It is not possible to forecast how, when, or to what extent the present protectionist pressures will be accommodated, or will abate, but the present situation and the uncertainty it creates for future exports is of profound concern.

The restrictions on exports of clothing and textiles from developing countries are based on a system of bilateral quotas, involving a quota on each group of textile products from a particular exporting country to a particular importing country, governed by the internationally agreed rules and procedures of the Multi-Fibre Arrangement (MFA). The MFA was originally negotiated in 1973 and has recently been extended through 1981. The provisions of the MFA designed to protect exporters have been weakened, and in the past year more restrictive quotas have been imposed. The new quotas in the European Common Market, for instance, do not merely limit growth but actually reduce import levels. For three leading suppliers (the Republic of China, Hong Kong, and the Republic of Korea), quotas for 1978 are well below their actual 1976 trade levels in several major product categories. All the significant and potentially significant exporters have seen their scope for expanding exports severely restricted by quotas that grow only slowly from past trade levels, usually by between 0.5 percent and 4 percent a year, compared with the previous norm of 6 percent a year. The new agreements also establish low "trigger levels" for further quotas that limit the scope for diversification of exports into new products. Restrictive new quotas have been imposed by other importing countries such as Australia, Canada, Norway, and Sweden, while the United States, in its new bilateral agreements, has held the quotas of its largest suppliers at the same level in 1978 as in 1977. Although the growth of imports has been greater than the limits established in the past, and this divergence may also occur in future years, the recent measures are more restrictive than previous ones and will reduce the growth in textile and clothing exports. They will affect exports not only from the major exporters but also from the smaller, poorer, and less advanced developing countries where textile products usually make up a large share of manufactured exports.

Quotas have been introduced in other categories of products that are of interest to developing countries, and there is a danger that more will follow. In recent years, imports of footwear have been subject to new quantitative restric-

tions in such countries as Australia, Canada, France, Sweden, the United States, and the United Kingdom, while quantitative restrictions have continued in force, for example in Japan. Communitywide restrictions are being considered by the European Community. Special protective measures have been introduced in steel by the European Community and the United States, posing serious difficulties for developing countries now emerging as exporters. Imports of television sets from the Republic of China and the Republic of Korea have been restricted by quotas in the United Kingdom, and are threatened in the United States and elsewhere. In the shipbuilding industry, in which developing countries have become increasingly competitive, some industrialized countries are taking special measures to support their own firms. There is a growing demand from producers in industrialized countries for protection in a wide range of other products, from petrochemicals to bicycle tires and tubes. In agriculture and food products, the barriers that most seriously affect expansion of exports from developing countries appear to be those on beef, sugar, vegetables, tobacco, and grains, and on manufactured food products of various types.

Systematic reduction of these barriers remains one of the great unfinished tasks in multilateral trade negotiations and one in which developing countries have a large stake.

In addition to direct restrictions, a great variety of other measures can have a discriminatory impact on developing countries' exports, even where this is not the original intention. Examples include industrial standards, health regulations, packaging requirements, customs valuation practices, administrative entry procedures, government procurement regulations, and subsidies on domestic production. The complexity of the procedures affecting the entry of imports is itself a deterrent to developing countries, especially those that are not already major exporters or do not use transnational firms for marketing. The codification of rules, introduction of explicit criteria for their application, and provision of reasonable time for adjustment by foreign suppliers would be among the desirable features of a trading system that operated to the mutual benefit of industrialized and developing countries.

The growing restrictions compound the uncertainty about the future. In an atmosphere where demands for protection are likely to be accepted, even protests by producers in industrialized countries against the growth of imports

can deter investors in developing countries. Countries that rely on export growth will scale down their expansion plans in export industries and cut back on associated investments. Countries that are not yet major exporters will be more hesitant about making the long-term commitment to amending the framework of their policies and encouraging the growth of exports.

#### **Implications for Industrialized Countries**

By discouraging the growth of trade, protectionist policies will disrupt the increasing division of labor that has been a major source of growth for the industrialized countries over the past twenty-five years. By delaying structural change, protectionism delays the shift of labor out of traditional industries where labor productivity is low, such as textiles, clothing, and footwear, into industries where labor productivity is higher, such as machinery and chemicals. Labor costs in the latter group of industries in the industrialized countries will therefore rise more than they would if greater labor mobility were permitted, and economic growth will be slower.

Imports from suppliers whose production costs are low can have a very beneficial effect on prices, reducing inflationary pressures and facilitating the management of demand. For instance, in the two product categories in which the United States drew a substantial share of its imports from the developing countries, prices rose considerably more slowly than those of other goods. The wholesale prices of apparel rose by only 26 percent in the United States during 1970-76, while other wholesale prices rose by 66 percent. Over the same period, prices of consumer electronics fell by 2.5 percent. Restrictions on imports from developing countries will inevitably tend to push prices up in industrialized countries, adding to the already difficult problem of persistent inflation.

That reduced growth and more inflation are costs worth paying to avoid unemployment caused by the growth of imports from developing countries is a dubious proposition for a number of reasons. First, in the aggregate, the level of employment is affected far more by the growth of the economy at large than by imports from developing countries. Second, the employment that is preserved by protection against imports from developing countries is offset by the loss of employment in industries that export to these countries. The amount of employment lost in this way has often been underestimated, but it is large and growing. A detailed study in the

Federal Republic of Germany has shown that, with a balanced growth of exports and imports, the loss of employment in import-competing industries was fully offset by the gain in employment in the exporting industries.

Furthermore, if the developing countries' export earnings are reduced, the effects on their economic growth and demand for imports will be transmitted back to the industrialized countries, with adverse effects on employment. Manufactured exports to industrialized countries have been the fastest growing category among developing countries' exports (in real terms), and restrictions on their growth will affect the ability of developing countries to sustain their economic growth and to service their debt. There is no doubt that this would result in smaller exports from industrialized to developing economies.

The size of the developing countries' import market and its importance for the industrialized countries is not widely recognized. The total exports of the industrialized countries amounted to about US\$550 billion in 1975, and fully one-quarter was purchased by developing countries. Of their total manufactured goods exports, 30 percent went to the developing countries. The dependence on developing countries' markets is greater than this average for the United States (34 percent) and Japan (45 percent). Not only are developing countries' markets of great importance to the manufacturing industries in the industrialized countries; they have been among the most buoyant elements of demand in the current recessionary period. Developing countries have been able to maintain their import levels through increased borrowing; had they been unable to do so, the demand management problems of the developed economies would have been even more difficult.

Finally, the tremendous difference in the magnitude of the trade in manufactures in the two directions should be noted: exports from industrialized countries to developing countries were worth about US\$123 billion in 1975; the reverse flow was only US\$26 billion. Thus, limitations on imports from developing countries can be self-defeating because they put at risk much larger flows of exports in the reverse direction.

These aggregate considerations are important since they define the likely net costs and benefits to the economy as a whole. They cannot, of course, allay the concerns about specific sectors or regions where adjustment may be necessary. But even at the sectoral level, the effect on employment is small in comparison with that

of other influences, including technology and changes in demand, that are the driving forces for structural shifts and growth in the economy. A number of studies have shown that, within a given industry, the amount of employment lost through competition from imports is generally much smaller than that lost because of technological changes that increase the productivity of labor. Another German study has shown that, in manufacturing as a whole, during 1962-75 growth of productivity in Germany displaced forty-eight workers for every one displaced by imports from developing countries. Even in clothing, where imports from developing countries grew rapidly and production technology changed relatively little, this ratio was more than 3 to 1.

Except in very narrowly defined product groups, imports from developing countries represent only a very small proportion of supply in the importing countries. Even for clothing, the product group that has contributed most to developing countries' export growth and where the increase in market penetration has been most rapid, the developing countries still supplied only about 7 percent of the consumption of clothing in the United States in 1976—up from less than 3 percent in 1970. In textiles and clothing together, the proportion was 4 percent in the United States in 1974, compared with about 8 percent in Germany, 6 percent in the United Kingdom, 5 percent in Canada, 4 percent in Japan, and 2 percent in France. Thus these imports have only a modest impact on the industrial structure of the importing countries. Their effect on the occupational structure is even smaller because different industries share a common demand for some occupations.

For the economy as a whole, and at the sectoral level, higher imports have only a small net effect on employment. But they can pose serious problems at the level of the firm, in products that are very labor-intensive and have stable technologies—attributes that work to the advantage of developing countries with low labor costs and moderate development of skills. The difficulty of withstanding competition is most acute in firms employing unskilled labor, and where labor productivity does not rise rapidly. Because of the rigidity of wages, unit labor costs in these firms become too high for their products to compete effectively with imports, and indeed with those of other efficient firms in the industry. However, such cases call for special measures to smooth the process of adjustment rather than broad protective measures that prevent adjustment.

The present efforts in industrialized countries to facilitate structural adjustment are too limited. At present, measures are often designed to support the affected industries rather than to retrain workers and provide economic incentives for shifting labor and capital to other sectors. Moreover, very few countries have begun to look to the adjustments that will be required in future as the international economy continues to evolve and the capacity of the developing countries to export manufactured goods expands.

Only with adequate forward planning can the acute frictions accompanying the adjustment process be reduced, the benefits of trade for both importing and exporting countries realized, and some of the uncertainty removed from investment planning in developing countries. Since the continuing growth of international trade is of benefit to all countries, so is the progress that is made in adjusting to international shifts in comparative advantage. It would thus be desirable that actions by industrialized countries to safeguard their domestic industries be subject to adequate multilateral surveillance to ensure that they are sparingly used; that they allow for some reasonable growth in competing imports; and that they are accompanied by measures that facilitate the shift of labor and capital away from the affected industries so that the safeguards can be dismantled in due course.

#### **Implications for Developing Countries**

How strongly the protectionist measures in the industrialized countries will affect the growth of developing countries' manufactured exports will depend, in part, on how strictly the negotiated quantitative restrictions are applied. For example, although the Multi-Fibre Arrangement initially included provisions by which developing countries' exports of textile products would grow in volume at annual rates of 6 percent, the actual growth up to 1976 vastly exceeded that figure. For many reasons, this performance is unlikely to be repeated: protectionist sentiment is stronger, the bilateral agreements in force now cover more products and permit lower growth rates, and many of the possible gains from upgrading the quality (and price) of specified products have already been used up. How fast exports covered by the Arrangement can grow in the next decade will depend on how existing quotas are administered as well as what is done when they expire.

A factor with important implications for developing countries' exports is the extent to which protectionism in the United States and

Europe is really directed against imports from Japan. Some of the developing countries are following in Japan's path, expanding exports of labor-intensive manufactures as Japan moves out of them because of rising labor costs. Their opportunities for expanding exports will depend on further shifts by Japan into exports of more sophisticated products and on the extent to which protectionist pressures will be moderated by a more liberal import policy in Japan. If Japan faces severe resistance to expansion of its exports of automobiles, sophisticated electronics, and machinery, it is less likely to relinquish its remaining shares in the other types of products it currently exports. The same argument applies to shifts between developing countries at different stages of industrial sophistication. For example, the Republic of Korea and the Republic of China cannot phase down their exports of garments and footwear unless they can expand adequately in consumer electronics and metal products.

Thus it is incorrect to assume that protectionist curbs on the growth of textiles and clothing imports into industrialized countries only affect the countries that are currently the major exporters of these products. Indeed, the most painful effect might well be felt in countries that are just emerging as significant exporters of manufactured goods.

The direct and indirect effects can be better appreciated if one categorizes developing countries by the nature of their manufactured export activities as follows:

- *The three major East Asian exporters of clothing and textiles, the Republic of China, Hong Kong, and the Republic of Korea, which together account for over one-third of developing countries' manufactured exports and over three-fifths of their clothing exports to industrialized countries. Textile products are still a large share of their total exports: in 1976, this share was 44 percent in Hong Kong, 36 percent in the Republic of Korea, and 28 percent in the Republic of China. However, their manufactured exports are already quite diverse and include an increasing share of technically complex products. Severe restrictions on their exports of clothing and textiles will adversely affect their economic growth, but they are likely to redouble their efforts to develop their machinery sectors and diversify their exports. They are sufficiently advanced in their industrial and manpower development to succeed in the longer run, to a large*

extent offsetting the effects of the protection in textiles and clothing.

- *Other developing countries that are relatively advanced industrially, such as Argentina, Brazil, Greece, India, Israel, Mexico, Singapore, Spain, and Yugoslavia, which export a wide range of manufactures both to industrialized and to other developing countries. They are less dependent on exports of textiles and clothing to industrialized countries. Present policies in some of them do not allow their export potential to be fully exploited. Thus, apart from the direct effect it has on demand for their exports, the rise in protectionism among the industrialized countries might also discourage a shift in incentives toward the promotion of exports to improve their growth.*
- *Countries beginning to be successful exporters of manufactures, such as Colombia, Malaysia, Morocco, Pakistan, the Philippines, Thailand, and Turkey. Growth prospects in these countries are likely to suffer heavily from increases in protection in textiles and clothing. The complexity of the detailed quota system in these products means that even the full use of quotas requires a dynamism, flexibility, and adaptiveness not shown by many of these countries in the past, and made difficult by their frequently cumbersome and restrictive import regimes.*
- *Economies at a low level of industrial development, with only a small volume of manufactured exports, consisting largely of processed agricultural commodities. The growth of their manufactured exports is limited mainly by their low level of industrial development and shortage of skills. However, some of these countries, such as Bangladesh, Indonesia, and Sri Lanka, are already being affected by quotas in textile products. Many of the other countries in this category have preferential arrangements with the European Community and are less affected, but most face at least some threat of restrictions on textiles and clothing if the present pressures continue.*

This discussion has focused on the consequences of the growing protectionism in industrialized countries, but the reasons why protectionism is essentially self-defeating in the longer run are of general applicability. Protectionist measures are common in the developing countries as well. For many, particularly those still at the early stages of industrialization, protection can be justified. But for those that are

well advanced in the development process, the adverse effects of industrial protection on economic efficiency and growth become increasingly evident. These developing countries will also face adjustment problems in increasing their competitiveness and diversifying their exports. Moreover, they are precisely the countries that have the greatest stake in avoiding an increasingly restrictive trading system. To maintain the benefits of liberal trade will demand a cooperative approach. The strength of such an approach would be enhanced if the developing countries were to participate more actively than in the past in multilateral trade negotiations and in efforts to reduce barriers to increased trade.

### **Trade in Primary Commodities Other than Fuel**

Primary commodities occupy a very different place in developing countries' trade from manufactures. Developing countries supply about a third of the world's exports of primary commodities other than fuel, whereas they supply only a tenth of the world's manufactured exports. About half of the major non-fuel primary exports of developing countries consists of commodities that are not produced in industrialized countries. The developing countries' share of world trade in primary commodities (excluding fuels) has fallen, whereas in manufactures it has been rising. The share of primary commodities, excluding fuel, in total developing country exports of merchandise declined from 68 percent in 1960 to 34 percent in 1975, while the share of manufactures rose from 14 percent to 26 percent during the same period.

In primary commodities, the problem of market access too is different. In non-agricultural primary products, tariffs are low or non-existent and there generally are no non-tariff barriers. As noted in the previous section, protection against imports of agricultural commodities is of long standing. Relatively few countries have been committed to as free a trade regime in agricultural products as in manufactures, and very little has been done over the years to reduce these barriers. Since they are intimately connected with domestic price policies and farm support programs, they are likely to be the most difficult to deal with. The demand for primary products grows much less rapidly than for manufactures, and in some commodities there have been serious excesses in global production. In general, demand for imports of primary products in the industrialized countries grows at about the same rate as incomes, whereas that for manufactured imports grows twice as fast. The

slow growth of import demand, the strong protection against agricultural imports, and the fact that they supply a large share of world primary commodity exports, makes it exceedingly difficult for developing countries to increase their primary exports.

Aside from questions of market access, the main concern of primary exporters is the fluctuation of commodity prices and export revenues. Of these problems the more tractable, and probably the more important, is that of revenue instability. Large fluctuations in export revenues cannot be adequately handled by individual countries holding foreign exchange reserves, and are liable to upset investment and economic growth. This problem is addressed directly by the Compensatory Financing Facility of the International Monetary Fund and by the Stabex program under the Lomé Convention. Although more modest in scale, Stabex funds are highly concessional, on a grant basis to the poorest countries, and disburse rapidly. Various improvements have been made to these schemes in recent years and others are under active discussion. It would be desirable to extend the coverage of these schemes to more items, and to arrange for longer-term lending for structural adjustments necessitated by medium-term fluctuations in commodity prices.

Price instability is a general problem affecting primary commodities, and is inherent in a situation where both demand and supply are insensitive to changes in price in the short run. As shown in Table 18, commodities accounting for about a third of developing countries' primary exports (other than fuel) experienced price fluctuations of over 10 percent from one year to the next. Price instability affects both consumers and exporters. Especially in products for which synthetic substitutes are available, as for jute, sisal, cotton, and rubber, excessive price fluctuations may lead consumers to seek substitutes, resulting in a long-run decline in demand. If fluctuations in international prices are allowed to influence producer prices in the exporting country, they can lead to wasteful cycles in investment and supply. The consequences of instability are difficult to measure, but can be very harmful to countries that depend heavily on primary exports—countries that often have pressing import needs and inadequate access to credit.

But price fluctuations are difficult to moderate, as shown by the numerous attempts to reach and sustain agreements among exporters and importers. The problem has been closely studied,

## 18. Primary Commodities Classified by Degree of Price Instability

		Index of Instability <sup>a</sup>					
0-5		5-10		10-15		Over 15	
Tea	1.3	Coffee	6.5	Sugar	13.9	Copper	5.0
Bananas	1.2	Cotton	4.0	Rubber	3.5	Cocoa	2.6
		Iron Ore	3.6	Phosphate Rock	2.6	Zinc	0.7
		Maize	2.3	Rice	1.6	Fishmeal	0.5
		Logs	2.2	Palm Oil	1.4	Copra	0.4
		Tobacco	1.9	Beef	0.7	Sisal	0.2
		Tin	1.7	Wool	0.6		
		Oranges	1.4	Coconut Oil	0.5		
		Soybean Meal	0.8	Groundnut Oil	0.4		
		Bauxite	0.7	Lead	0.4		
		Manganese Ore	0.6	Lemons	0.2		
		Wheat	0.6				
		Grain Sorghum	0.5				
		Groundnuts	0.5				
		Jute	0.2				
<b>Total</b>	<b>2.5</b>		<b>27.5</b>		<b>25.8</b>		<b>9.4</b>

Note: The figure shown against each commodity indicates its percentage share in total developing country exports of all primary commodities, excluding fuel, in 1975.

<sup>a</sup>The index is based on a five-year moving average of prices for 1955-76. It measures the average percentage deviation of the annual price from the five-year moving average. It does not take account of short-term fluctuations in prices.

and specific proposals to reduce the amplitude of price fluctuations are now being discussed intensively in various international forums.

### The Energy Outlook

Since the increase in the price of oil in 1973, energy has accounted for a significant share of the imports of developing countries, and the price of oil will have an important influence on their balance of payments.

countries. Table 19 gives an overview of projected trends in production and consumption, based on the assumption that oil prices will remain unchanged in real terms.

One of the main features of these trends is a significant rise in self-sufficiency in Western Europe (mainly because of the increase in North Sea oil production), and increased reliance on nuclear power, which is likely to supply nearly 6 percent of the total primary energy consumed

## 19. Primary Energy Balances, 1965-85

	Million Barrels a Day of Oil Equivalent		Average Annual Growth Rates (percent)			
	1975		1965-75		1975-85	
	Pro-duction	Con-sumption	Pro-duction	Con-sumption	Pro-duction	Con-sumption
Developing Countries <sup>a</sup>	24.7	15.4	6.3	7.1	4.9	6.2
(Non-OPEC Developing Countries)	(9.1)	(13.3)	(6.1)	(6.9)	(8.6)	(5.9)
Industrialized Countries	45.8	65.8	2.4	3.6	3.2	3.5
Centrally Planned Economies	38.0	36.0	5.2	5.2	4.1	4.4
Capital Surplus Oil Exporters	13.6	0.5	7.9	10.8	5.4	8.8
<b>Total</b>	<b>122.1</b>	<b>117.7</b>				

Note: Primary energy here refers to coal and lignite, crude petroleum, natural gas and natural gas liquids, hydro and nuclear electricity, expressed in barrels a day of oil equivalent.

<sup>a</sup>Here, as throughout this report, the group of "developing countries" excludes only the capital surplus members of the Organization of Petroleum Exporting Countries. Thus the energy balances of other OPEC members—Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Nigeria and Venezuela—are included in those for developing countries.

Future energy prices will depend primarily on developments in supply, on active efforts to develop production potential in both industrialized and developing countries, and on stronger efforts to conserve energy in the industrialized

by the industrialized countries in 1985.

In the developing countries, rapid growth in energy consumption will be a necessary concomitant of industrialization. Energy production in developing countries other than OPEC mem-

bers is expected to grow faster than in recent years. Particularly noteworthy is the sizable oil production potential in countries that are not currently exporting oil.

The increase in oil prices has provided a great incentive for new exploration and development of indigenous fuel resources in developing countries. Assuming that the plans based on the results of these efforts will be implemented on schedule, the production of petroleum in non-OPEC developing countries is projected to more than double, from 3.7 million barrels a day in 1976 to 8.3 million barrels a day in 1985. Large increases in production are projected for Brazil, Egypt, India, and Mexico, with smaller but significant increases in many other countries, including Angola, Congo, Malaysia, Pakistan, and Zaïre.

Thirty to forty countries that do not now produce petroleum have the potential to do so economically, thereby reducing their dependence on fuel imports.<sup>2</sup> But most of these countries lack the necessary technical skills and financial resources to develop this potential, or the expertise required to obtain them from abroad on terms that are both attractive to external sources and commensurate with national interests and objectives. In some countries, the deposits might be too small to attract international companies even though their development would be of great domestic importance.

The potential for an increase in natural gas production is widespread and important, especially in Indonesia, Malaysia, Mexico, and South Asia, but to exploit it commercially will require large-scale investments in transport and processing facilities. How far countries can exploit the potential depends on the available technology for substitution and export in the next decade.

Present plans call for more rapid growth of developing countries' coal production, from 1.5 percent a year in the late 1960s and early 1970s to about 5.6 percent a year up to 1985. The known reserves of coal are concentrated in a few countries. Colombia, India, Mexico, Mozambique, and Viet Nam are expected to increase their coal production very substantially; some of the countries are likely to be able to export coking coal and steam coal.

Expansion plans for primary electricity have

also been accelerated, and generating capacity is now expected to grow by 10 percent a year, compared with 8 percent a year in the early 1970s. Countries with major new hydro power projects are Argentina, Brazil, Pakistan, and Turkey; there are other projects in Central America, India, and Yugoslavia. Nepal and many African countries have excellent hydro resources, which at present levels of domestic demand could only be exploited economically in a regional context. Little effort has been made in this direction. Nuclear generation capacity is projected to grow very rapidly from 1.1 billion watts of electricity in 1975 to 16.5 billion watts in 1985. Most of this expansion is expected to take place in countries that are approaching full development of their existing indigenous hydro and fossil fuel resources, such as Brazil, the Republic of China, and the Republic of Korea.

To realize the projected energy supplies in developing countries will require concerted action on several fronts: first, technical assistance to help build the institutional capability to plan and implement comprehensive energy development programs; second, a variety of measures, particularly by the developing countries, to establish a favorable investment climate for attracting domestic and foreign capital and know-how to this sector, ensuring that investments appear not only profitable but secure; and, third, a substantial increase in financial and technical assistance from international lending institutions which will help to mobilize the necessary capital from other public and private sources. The special characteristics of petroleum exploration and development call for very close cooperation between official and private organizations to bring this about.

Petroleum and natural gas will inevitably become more costly in the long run as production moves to more difficult sites. Although there is a wide variety of estimates of both demand and supply, the current consensus among experts is that rising costs and growing demand will exert pressure for an increase in real oil prices in the mid-1980s, unless investments to expand global energy supply are rapidly undertaken, as outlined above. To maintain a balance between supply and demand in the longer run calls for greater support for research and development activities in alternative sources of energy. The developing countries must be assured of regular access to this research, so that they can benefit from it and participate in adapting it to local conditions as early as possible. The international research effort should include work on such

<sup>2</sup>Production costs in most oil importing developing countries are estimated to range between US\$3 and US\$6 a barrel at 1975 prices. They compare favorably with the present price of imported oil, and with the costs of production in Alaska and the North Sea.

potentially low cost and abundant sources as solar energy, bio-gas and fuel from forestry and agricultural wastes, and such decentralized energy sources as small hydro units and windmills which may be of particular relevance to the developing countries, especially for rural areas.

### International Food Issues

Over the past two decades, the growth in production of food in developing countries has not kept pace with the growth in demand resulting from increases in population and incomes. At low levels of income, a large part of any increase in income is spent on food. Thus, while the developing countries as a group were virtually self-sufficient in food in the 1950s, they were already importing 15 million to 20 million tons of major staple foods by 1970, half of which was in the form of food aid. Although good harvests in the poorer countries in the last few years have averted a worldwide shortage, the problem of matching food demand and supply

ized countries, which will give rise to a number of significant problems.

The first consequence will be an increase in the relative price of foodgrains—in both industrialized and developing countries. Apart from a few developing countries the future exportable surpluses of foodgrains will come largely from Canada and the United States. While those countries have the supply potential, the increase in production required can only be realized at rising marginal costs, which will be reflected in prices.

The increase in the volume and price of food imports will strain the foreign exchange position of a number of developing countries. A few foodgrain deficit countries, such as Iran, the Republic of Korea, and Mexico, are not likely to have difficulty financing the imports they require. But in most other countries, particularly the Low Income countries, mounting demand for grains will cause significant pressures on the balance of payments. As this demand reflects

**20. Developing Countries: Balances in Major Staple Foods, 1975 and 1985**

	1975 Deficit (estimated)		1985 Deficit (projected)	
	Million Tons	As Percentage of Consumption	Million Tons	As Percentage of Consumption
Asia	9	4.5	20	7.2
North Africa and Middle East	10	15.9	15	19.8
Sub-Saharan Africa	2	3.7	14	16.8
Latin America	—	—	—4	—3.7
All Developing Countries	21	5.0	45	8.0

Note: Major staple foods are here defined as unmilled rice, wheat, maize, sorghum, millets, oats, barley, rye, mixed grains, root crops, pulses, and groundnuts.

— Negligible.

Source: Based on Research Report No. 3, p. 44 (Washington, International Food Policy Research Institute, 1977).

at the global level will undoubtedly become more acute in the coming decade.

Assuming that production of major staple foods continues to rise at about the same rate as population and that consumption per person will rise somewhat more slowly than before, it has been estimated that by 1985 the total production of the developing countries will fall short of their demand by about 45 million tons. Excluding Latin America, which is projected to have a slight surplus in the aggregate, the other developing regions would need to import about 11 percent of their consumption demand. The figures shown in Table 20 are rough estimates and subject to considerable error. Moreover, they do not take account of the possibility that foodgrain production can be increased more rapidly. The main point, however, is that developing countries will almost definitely have to purchase large amounts of foodgrains from the industrial-

urban deficits, it has a very pressing claim on foreign exchange, competing with debt service and imports of intermediate goods. Unless the domestic production of food is stepped up very rapidly, which implies radical changes in agricultural policies in most countries, their capacity to import capital goods will be affected adversely, reducing economic growth. Even with efforts to raise domestic production, the Low Income countries will require increased food aid, or other forms of concessional aid which will enable them to purchase food.

The concentration of exportable surpluses in a few countries makes international foodgrain prices more volatile, not only because aggregate supply is vulnerable to weather conditions and policies affecting production in those few countries, but also because concentration reduces the ability to increase or decrease world supply rapidly in response to changes in demand. The

latter problem is important because some of the larger countries, both developing and centrally planned, depend on imports to offset fluctuations in their domestic supply. The year-to-year changes in import demand can then be very large, even if they represent only a small proportion of annual consumption in the affected countries. If unrestrained, the volatility of prices is likely to destabilize supplies, resulting in market uncertainty and higher prices for what is an essential commodity.

The policy implications of this state of affairs have been extensively discussed in various international forums. There is a broad consensus on the need for a number of measures. First, developing countries ought to make additional efforts to increase food production, with international support in the form of financial resources and technical assistance. This is of primary importance in the Low Income countries, which are least able to purchase food commercially and where malnutrition is closely associated with the lack of purchasing power among the poor. Second, with the prospect of growing instability in international grain markets, developing countries ought to increase the size of national buffer stocks. In the many countries that have food subsidy programs, national buffer stocks are especially important to stabilize the costs of these programs.

Third, an international stock of foodgrains should be established to supplement supplies in an emergency. Although the principle of such an international food reserve has been accepted, opinions still differ widely as to its desirable size, composition, location, management, and financing. Fourth, an expanded capacity to deliver food to Low Income countries at concessional terms must be planned for, so as to enable these countries to meet their import require-

ments. When there are widespread crop failures, Low Income countries are the ones least able to allocate additional foreign exchange to purchase foodgrains commercially.

### The Supply of External Capital

The principal issues in regard to medium- and long-term capital flows to the developing countries are the uncertainty about the rate of growth of lending from private sources, mainly commercial banks; the rate of expansion of multilateral lending at market terms; and whether the necessary measures will be taken to raise the flow of concessional capital.

#### Capital at Market Terms

On the basis of assumptions that are discussed in the following chapter, it is estimated that the developing countries' requirements for net disbursements of external medium- and long-term capital at market terms will grow by nearly 5 percent a year in real terms during 1975-85, or by about 12 percent in nominal terms, assuming an annual rate of inflation of nearly 7 percent. During 1970-75, nearly 90 percent of the increase in net disbursements of such capital came from private sources. Even allowing for a balanced growth of public and private capital flows, net annual lending from private sources to developing countries would need to grow by about 12 percent a year in nominal terms during 1975-85. Though this rate of expansion could be accommodated by the growing capacity of developing countries to service debt, there is considerable uncertainty whether the supply of private lending will grow so rapidly.

A nominal growth rate of 12 percent would be substantially slower than that of recent years. From 1971 to 1976, net lending by commercial banks to developing countries grew very rapidly: it is estimated that net lending by private finan-

**21. Medium- and Long-term Capital at Market Terms, 1970-85**  
(Billion current US dollars)

	Net Disbursements			Debt Outstanding and Disbursed		
	1970	1975	1985	1970	1975	1985
Private	4.7	21.7	67.6	17.3	90.6	358.3
Official, including Multilateral	1.3	3.4	10.6	13.7	25.7	109.8
Total	6.0	25.1	78.2	31.0	116.3	468.1
Note:						
At 1975 prices	10.0	25.1	40.1	51.4	116.3	239.9

ments. The existence of an international stockpile would be of some help. It would also be important that, when world supplies are scarce, foodgrain exporters resist pressures to increase commercial sales at the expense of concessional

cial institutions to governments and to the private sector against government guarantees increased by about 50 percent a year. Following this explosive growth, there appears to have been some slowing down in 1977, but the rate of

increase in outstanding claims reported by banks is still high.

Such rapid growth has caused some problems. The first is that the bulk of the increased lending has gone to about a dozen developing countries, leading to sharp increases in their debt service obligations and making the lenders particularly sensitive to developments in these countries. Debt problems in any one of these countries could easily affect the willingness to lend to all developing countries. While a number of analyses have concluded that there is no general problem of developing countries being unable to service debt, individual countries may run into liquidity problems for reasons within or outside their control. Expansion in the resources of the International Monetary Fund would enhance the capacity to deal with such liquidity crises.

A second problem is the potential for instability created by the projected rapid growth in the gross disbursements from commercial banks. This is due largely to the relatively short maturity of private commercial lending, leading to high amortization requirements which must be financed by additional gross borrowing. Thus, during 1975-85, the projected increase in gross disbursements is nearly three times the increase in net disbursements. Improved access to the long-term bond markets, a better balance between the lending from private and official sources, and measures which would extend average maturities would be helpful in gradually reducing the instability of the lending structure.

Finally, how far the banks will increase their exposure in developing countries over the next several years depends on the adequacy of their capital base, and the maintenance of a regulatory environment conducive to continued active lending to the developing countries. Much of the increase in lending to the developing countries over the past few years has been handled by a relatively small number of banks. Well over half of all outstanding claims on developing countries are held by about 30 major banks. Even if concern about the adequacy of capital were to prompt a slowing of growth at some of these banks, other banks as well as non-bank private investors would welcome an opportunity to increase their share of developing country financing. Lending to developing countries has traditionally been dominated by the large money center banks in the United States. Banks in Europe (especially German banks) and Japan have been increasingly active in lending to developing countries in the recent past, and appear to have the potential for considerable further growth. A few developing countries

have increased their sales of international bonds.

Diversifying the sources of lending would improve the prospect of a stable flow of commercial capital to developing countries. Mandatory diversification among borrowers, however, poses a potentially serious threat to the projected flows of commercial bank lending. In this connection, changes in the regulatory environment could be critical. The danger is that regulatory measures designed to assure the stability of the banks in industrialized countries could inadvertently cause abrupt changes in the availability of finance to individual developing countries, thereby triggering the sort of debt crises that the regulatory measures are intended to prevent.

Uncertainty about the availability of capital from private sources and the insufficient maturities of these loans heighten the importance of the growth of capital flows from multilateral financing institutions and official export credit agencies. During 1970-75, their gross flows of non-concessional capital grew at 8.5 percent a year in real terms. The future rate of growth of these flows depends on increasing the capital base of these institutions. Proposals to do this are being considered, but as legislative action is necessary the outcome remains uncertain.

#### **Official Development Assistance**

For the Low Income countries and for the poorer Middle Income countries, the capacity to service debt remains limited and they must rely on Official Development Assistance (ODA) at highly concessional terms. As is shown in Table 22, net annual flows of ODA from the industrialized countries that make up the Development Assistance Committee (DAC) of the OECD are projected to increase from US\$13.6 billion in 1975 to US\$43.6 billion in 1985—an increase in real terms of 5 percent a year. As a percentage of the donors' GNP, the projected increase is slight, from 0.36 percent to 0.39 percent in the same period; but even this modest increase will mean an important reversal of recent trends. It will not be easy to achieve the necessary increases without an early and large increase in commitments by three major countries—the United States, Japan, and Germany. While official statements have been made in all three in support of an enlarged aid effort, they have yet to be translated into action.

In recent years, there has been a marked increase in the concessionality of ODA from DAC members and this has been a very desir-

able development. Several DAC members now provide grants, instead of loans, to the poorest countries. However, there are still a number of ways in which the usefulness of ODA could be

their GNP. A continued growth in their disbursements is projected, to US\$13.2 billion in 1985, compared with an estimated US\$5.5 billion in 1975, despite a projected decline in the

## 22. Net Flows of Official Development Assistance from Donors, 1965-85

	Billion Current US Dollars			Average Annual Real Growth Rate (percent)	
	1965	1975	1985	1965-75	1975-85
Members of Development Assistance Committee of OECD	6.8	13.6	43.6	3.3	5.1
Members of Organization of Petroleum Exporting Countries	—	5.5	13.2	..	2.1
Total	6.8	19.1	56.8	6.9	4.3
Note: DAC Flows as Percentage of Donors' GNP	0.34	0.36	0.39		

Note: ODA flows in this table include contributions to multilateral agencies, and the value of technical assistance.

— Negligible.

.. Not available.

Source: *World Development Indicators*, Table 12.

enhanced. The most significant would be to untie procurement: about half of the aid from DAC sources remains tied to procurement in the donor country.

With the increase in oil prices, some of the oil exporting countries have become significant sources of ODA, contributing over 2 percent of

balance of payments surplus of the capital surplus oil exporting countries during this period. In the past few years, the distribution of ODA flows from members of the Organization of Petroleum Exporting Countries has broadened, with increasing proportions going to non-Arab countries.