3 International problems and policies

The analysis in Chapter 2 has emphasized that the international economic outlook poses particularly difficult choices for policymakers in the 1980s. A sustained recovery of the world economy from the slowdown expected in the next few years will depend largely on the policies pursued in the three areas of international concern discussed in this chapter—energy, trade and capital flows. Particular attention is paid to policies aimed at ensuring that current account deficits are financed—and over time reduced—with minimal loss in the growth of developing countries. Where projections are given, they are consistent with the High case described in Chapter 2, but the specific policy issues discussed here are not related to any particular set of projections.

Energy

Recent increases in petroleum prices (Figure 3.1) have ensured that the economic impact of energy will remain a central concern of policymakers everywhere. Their past concern, however, has achieved only limited success in producing coordinated energy policies—in part because of the emphasis given to managing immediate balance-of-payments difficulties. While this issue is again important, all economies will also have to adapt to higher energy prices. The long-term outlook is uncertain, but prudent energy policy should assume that real energy prices will rise for the foreseeable future. Temporary fluctuations aside, what happens to prices will be determined by trends in energy conservation and production; this section considers each in turn, paying particular attention to the position of developing countries.

Conservation

• Industrialized countries. The greatest scope for conservation lies with the industrialized countries; they account for more than half of world energy consumption (and more than a third of production).1 On average the industrialized countries use about eight times as much commercial energy per person as the middle-income developing countries and more than 40 times as much as the low-income countries. This is partly because they are more industrialized; but their agriculture and households are also more energy-intensive. They have been reducing the ratio of energy use to GNP: between 1973 and 1977 this ratio fell 16 percent in Japan, 13 percent in France, 12 percent in the Federal Republic of Germany, 10 percent in both the United States and Italy, 9 percent in Canada and 7 percent in the United Kingdom. Moreover, Japan and Western Europe have held their absolute volume of petroleum use constant since 1973, and the United States has done so since 1978.

This represents considerable progress, but it is still inadequate. The evidence of the past six years shows that pricing policies (including taxes) have a major role to play in curbing energy demand (and, no less important, in encouraging domestic production). But political difficulties have often inhibited governments from passing higher energy prices through to final consumers. These difficulties have been most acute in the United States and Canada, less so in Europe and Japan.

Solutions need to be found that convey the right price signals to users—and here taxation can help (see box)—and provide incentives to producers. If higher prices mean that existing producers reap large

Figure 3.1 Petroleum prices, annual averages, 1972–80
(dollars per barrel)

1. The word "energy" means commercial energy unless otherwise specified.
windfalls, some of their extra profits can be appropriated directly—for example, by a “windfall profits tax” (the US solution) or by a “petroleum revenue tax” (as in the United Kingdom).

- Developing countries. Excluding the capital-surplus oil exporters, they account for only about 13 percent of the world’s use of commercial energy (and about 15 percent of production). About half of all the energy produced by low-income oil-importing countries is noncommercial—from wood and dung, for example. As their economies develop, much of this will have to be replaced by commercial energy. Even with appropriate pricing and other conservation measures, the consumption of commercial energy in developing countries is projected to rise more than 80 percent in the 1980s, compared with GNP growth of about 70 percent. (By contrast, energy consumption in the industrialized countries is projected to rise by just over 30 percent and GNP by about 40 percent.) By 1990 the developing countries’ commercial energy requirements are likely to rise to around 17 percent of world use (See Table SA.2 in the statistical appendix to Part I).

In curbing demand growth, developing countries have experienced many of the same difficulties as industrialized countries—and usually more acutely. Domestic prices—particularly of domestically produced energy—often have not been raised in line with world prices. Until recently, domestic petroleum prices in Indonesia, for example, were less than 40 percent of the world price; Egypt, Ecuador and Venezuela have also underpriced their oil. This is a major reason why energy use in relation to GNP has tended to grow much faster since 1973 in energy exporters than in energy importers like Brazil and South Korea. Some countries (Brazil, India and Pakistan, for example) have tended to pass on higher prices to domestic users relatively quickly; and others are now moving in the same direction. The alternative subsidizes energy use—thus draining budgets and discouraging conservation.

While there is a natural reluctance to inflict hardship on lower- and middle-income groups by raising energy prices, energy subsidies (if essential) should be reserved for products consumed primarily by poorer people. Even then, care is needed to prevent those products from being diverted to other uses. On grounds of equity or efficiency, there is little justification for subsidizing gasoline and domestic electricity (which in most developing countries are consumed primarily by richer groups), industrial fuels and the energy used by public sector agencies.

**Production**

- The oil exporters. For most major oil exporters, oil is the one reliable source of finance for their development over the medium term (at least 10–20 years). Accordingly, how much oil they produce depends on a variety of factors—such as how much investment their economies can absorb productively and without social disruption; the actual and prospective price of oil; and the (expected) yields on the foreign assets that can be bought with oil revenues. For the capital-surplus oil exporters, current revenues far exceed immediate investment needs; their oil exports are not expected to expand rapidly. The other oil-exporting developing countries are therefore projected to increase their share of energy trade (see Table 15).
3.1). This will require increased investment in exploration and exploitation; yet spending on exploration and the ratio of proven reserves to production are declining in some countries, while the domestic consumption of oil is rising in all.

Both oil exporters and importers share a common interest in ensuring that oil price rises and supplies do not change sharply or unpredictably. Steady changes would help investment planning and financial management in the importing countries; and all countries stand to gain from a stronger, more stable world economy.

- New supplies of energy. In 1974 producers and governments may have doubted that real oil prices would be maintained, so there was less pressure to commit the funds needed to develop alternative energy supplies. Today such doubts have disappeared. But considerable uncertainty remains about the returns from developing some potential alternatives to oil; and energy projects take many years to come on stream, and require large capital outlays. The projections in Figure 3.2 (and Table SA.3) take a positive view of what can be achieved. With strong efforts to develop these alternatives, the share of petroleum in the world supply of primary commercial energy could fall from 46 percent in 1980 to 38 percent in 1990; by contrast, its share fell by only two percentage points between 1970 and 1980.

In addition to raising the profitability of developing domestic petroleum and other conventional sources of energy, higher oil prices stimulate research into new ways of producing, converting and using energy of all kinds. Many alternative sources are still in their technical and economic infancy, while others—notably nuclear power—face opposition on environmental grounds. This is an important source of uncertainty about production prospects, particularly over the long-term; but in the next 5-10 years production will be determined mainly by projects now in the pipeline. For technological and financial reasons, the development of supplies of new energy to the stage of commercial production is mainly a task for the industrialized countries. How it is achieved will also influence the prospects for energy production in developing countries, considered in the rest of this section.

- Developing countries' energy production. Since 1973 several countries (including Cameroon, Ghana, Guatemala, Ivory Coast and the Philippines) have started producing petroleum; existing producers (such as India, Malaysia and—strikingly so—Mexico) have expanded capacity. Although exploration generally has been inadequate, discoveries of exploitable oil and gas deposits have been made (for example, in Chad, Pakistan, Tanzania and Thailand). Several developing countries (including India, Turkey, South Korea and the Philippines) have expanded coal and lignite production; others (among them Argentina, Brazil, Cameroon, Ivory Coast, Uruguay and Sri Lanka) have taken measures to increase hydroelectricity output; a few (most notably Indonesia and the Philippines) are tapping significant geothermal sources; and Brazil leads the world in producing alcohol fuel for automobiles.

In the 1980s progress should accelerate—but will require large increases in investment. The main gains are likely to be in petroleum and natural gas, coal, and primary (other than thermal) electricity generation—mainly hydro and nuclear. But much also needs to
be done to increase the supplies of the kinds of energy that are particularly important for poor people.

- Petroleum and natural gas. While the oil-importing developing countries have only about 2 percent of the world's proven oil reserves, their share of ultimately recoverable oil reserves may be 15 percent. One study (undertaken for the World Bank) estimated that 23 of 70 countries surveyed each might have ultimately recoverable reserves of at least 750 million barrels. (For comparison, imports of oil for energy use by developing countries will amount to about 110 million barrels in 1980.) To realize their full potential, most countries must step up exploration activities; the same study judged that exploration was inadequate in 51 of 58 countries that were not producers.

Gas is widely spread; many countries can significantly expand production—both for domestic energy use and for petrochemicals—during the decade. A lot of gas associated with oil production is now wasted by venting or flaring; much of it could be recovered.

- Coal. For most developing countries, coal is still a minor fuel used mainly in electricity generation and—in larger coal producers (such as India, Turkey, South Korea and Yugoslavia)—in industrial applications. Coal can substitute for oil in electricity generation, but the potential for increased use is limited largely to new capacity—since converting existing plants is often uneconomic.

- Primary electricity. Two-thirds of the electricity generated in developing countries is used in industry (compared with 40 percent in the industrialized countries). Hydro-power, currently accounting for 44 percent of electricity output, can be greatly expanded in many developing countries—particularly in Latin America. Despite considerable geothermal potential in up to 30 developing countries—among them Kenya, Mexico, El Salvador, Nicaragua and the Philippines—geothermal capacity will produce relatively little electricity in the 1980s. But nuclear power could produce 11 percent of the total by 1990 (2 percent in 1980)—mainly in the major existing producers (Argentina, Brazil, India, South Korea and Pakistan), but in other countries as well (for example, Romania, Thailand, Yugoslavia and the Philippines).

- Other sources. Any significant increase in the production of oil from tar sands in developing countries depends on a major technological breakthrough. Solar and windpower are also unlikely to make much of a contribution over the next 10 years; shale oil and methanol have rather more potential. Alcohol produced from biomass (cereals, sugarcane, beets and so on) is now used as a partial substitute for gasoline. The technology for producing it is well established. A key question is the extent to which agricultural land should be diverted from food to fuel production (see box). Energy for the poor. The poor, especially those in rural areas, rely on noncommercial energy for cooking and heating; these forms of energy provide more than 85 percent of rural requirements in many countries. Yet their supplies are dwindling, thus inflicting several sorts of hardship. Much time is spent just in gathering fuel (for

### Fuel from food

Alcohol produced from sugarcane or grains is becoming competitive with gasoline as real petroleum prices rise. Conventional automobiles and trucks can run on "gasohol," a mixture of alcohol and (at least 80 percent) gasoline. With engine modifications, they could run on pure alcohol; such engines are already being produced in Brazil. By 1977 the estimated national ratio of alcohol to gasoline used in Brazil was 4.3 percent; in 1979 it had risen to 19 percent, and will rise further as more cars run on pure alcohol.

Brazil's alcohol is still derived almost exclusively from sugarcane, but alcohol can be produced from a variety of crops. Ethanol, the cheapest alternative to gasoline in the 1980s, comes from fermenting sugar crops, principally sugarcane; root crops, mainly cassava; and cereals, especially corn and potentially sorghum. The United States also has ambitious plans for producing alcohol fuel, primarily from corn. The US target of 2 billion gallons of ethanol by 1985 would require 20 million tons of corn or its equivalent, one fifth of the current US exportable grain surplus. And other food exporters (including Argentina, Australia, New Zealand, the Philippines and South Africa) either have already launched or have the potential for large "gasohol" programs.

This development could indirectly affect the availability and price of food for developing countries that either import grain on commercial terms or depend on international food aid to meet their deficits. Current plans in Brazil and the United States envisage that the area of cultivated land would be expanded to grow fuel crops, so that food production (and therefore price) is not significantly affected. In practice these goals may not be fully achievable.

Whether ethanol proves economic in other countries will depend on land availability, markets and prices for food exports, and the development of such alternative sources as wood, sorghum and agricultural waste. In the next five years or so, the quantity of agricultural production diverted into alcohol is likely to be small (with the exception of Brazil and the United States). But as more countries consider ways of reducing petroleum import costs, the "food or fuel" issue may become more serious. A satisfactory solution will require a major effort to develop alternative biomass sources of energy, including crops that can be grown economically on marginal land.
example, 5 to 19 work days a month for each family in upland Nepal); often the gatherers are children who might otherwise be in school. In many countries (including the entire Sahelian belt from Senegal to Somalia) forest land is being turned into desert. This pernicious process would be (at least partially) arrested if affordable energy were made available. As well as this, burning dung and vegetation carries health risks, and every year deprives the soil of enough fertilizer to produce 20 million tons of grain—enough to feed 100 million people.

Although there are no easy solutions to these energy problems, the essential policy initiatives remain as described in last year's World Development Report. Existing forests must be husbanded, new ones planted. Roughly 50 million hectares (125 million acres) of fuelwood planting may be required by the year 2000 to meet domestic needs for cooking and heating in developing countries. Their present rate of afforestation is less than a tenth of what is needed to ensure self-sufficiency in fuelwood by then. More efficient ways of burning wood (for example, improved stoves) can help; but new technologies need to be devised to use the sun, the wind and other renewable energy sources. And better use should be made of other traditional fuels (for example, through biogas generation, which does not destroy the fertilizer value of animal wastes).

The need for energy strategies

In the developing countries, national and regional planning is urgently needed to evaluate fuel minerals and other energy sources, to examine conventional and new technologies, and to assess the likely trends in demand for commercial and non-commercial energy.

But many countries do not have formal energy strategies and adequate sector plans. Planning continues to be hampered by lack of essential data on fuel deposits, on consumption patterns and on how energy demand and supply are likely to respond to income and price changes. Geological and geophysical surveys and detailed market studies are still required before effective planning can take place. Many countries also lack some of the technical and managerial skills required to undertake the preliminary studies, draw up an energy plan and oversee the exploitation of domestic energy resources.

Countries facing these constraints can benefit from external capital and technical assistance. Although some assistance has been provided already (for example, by the UNDP and the World Bank), there is scope for considerable expansion of these activities.

International trade

International trade has been emphasized in previous World Development Reports for two reasons: first, trade is a principal means of promoting economic efficiency and growth; second, a strong trade base tends to be a prerequisite for attracting foreign capital. Given the world economic outlook, these benefits acquire added significance; but two policy questions stand out.

- What developments in world trade (and the resulting effects on the distribution of payments deficits) will contribute most to rapid growth?

- With a less buoyant outlook for world trade, do developing countries face a changed tradeoff between producing for the foreign or for the domestic market?

The first question turns mainly on the policies of the industrial and oil-exporting countries: they are discussed first. The second question is largely a matter for developing countries: their policies are considered in the second part of this section.

Trade policy for industrialized countries

Most industrialized countries will run current account deficits in 1980. How they respond to these deficits will largely determine the climate for world trade. If they all simultaneously attempt to restrain imports while boosting exports, shrinking markets for each others’ exports will defeat their purpose, and world trade and output will suffer—as happened in acute form in the 1930s.

After the 1973–74 oil price rises, some of the major trading nations (especially Japan and the Federal Republic of Germany) acted quickly to reverse the deterioration in their trade accounts. They were able to do so because some industrialized countries (notably the United States) and most developing countries financed much larger current account deficits, and because surpluses of the major oil-exporting countries were quickly reduced. Avoiding an excessive slowdown in world trade and output in the early 1980s requires that industrialized countries, as a group, run larger deficits—and for longer.

The countries best placed to run large deficits and thereby support growth are those with the capacity to borrow heavily (or run down reserves)—and those with the lowest inflation, since deflationary policies aimed at curbing inflation will tend to moderate demand for imports. Industrialized countries that restrain domestic growth to control inflation should minimize the effect on world trade by maintaining their demand for imports and avoiding beggar-thy-neighbor support for exports. They can do this by refraining from deliberate
exchange-rate depreciation, by avoiding subsidies to exporters and by opening their markets to imports.

Each of these policies will also serve to dampen inflation. Without them, the industrialized countries will find that the developing world cannot maintain its growth—or its demand for their exports.

- The outlook for exports. The sluggish demand from the industrialized countries expected in the early 1980s will harm developing countries' exports—particularly of primary commodities—as it did during 1973–77. The growth of developing countries' exports decelerated sharply in that period; their exports of primary commodities fell after growing at around 4 percent a year in 1963–73 (see Figure 3.3). Even excluding fuels, primary commodities account for about 55 percent of the merchandise exports of developing countries and they have grown roughly in line with the industrialized countries' GNP.

There is no reason to expect this relation to change, especially as exports of some agricultural products remain constrained by heavy protection in Japan and Western Europe. Even if demand were to grow rapidly, the developing countries may not be able to expand the volume of their agricultural exports very much (because of supply constraints), though they would benefit considerably from higher prices. In the short-term, most primary producers would be assisted by improved schemes to stabilize revenues or prices (see box overleaf). If the industrialized economies begin to pick up, there would be a recovery in demand for primary products.

The outlook for manufactured exports is much brighter; as in 1973–77, their growth is likely to be comparatively robust. At present, they account for only about 10 percent of the imports (and less than 2 percent of the consumption) of manufactured goods in the industrialized countries. But they are concentrated heavily in some products, and therefore have attracted protectionist attention. The developing countries most directly affected by protection have been the more successful exporters (particularly the major East Asian exporters of manufactures and Brazil); but they have continued to expand their exports rapidly by diversifying into new product lines. Current restrictions on items other than textiles and clothing are not (with some minor exceptions) an insuperable barrier to rapid export growth.

Harder to assess (but clearly important) is the longer-term disincentive—from both current restrictions and risks of their expansion—to countries at earlier stages of export development. Generally, they do not have the manufacturing and marketing skills required either to export a wide range of manufactures or to adapt quickly to changes in market conditions.

While no new major restrictions were imposed in the past year, some measures were consolidated. In some sectors (particularly textiles and clothing) elaborate mechanisms to control imports have become more entrenched, reducing the chances of their early removal. In some industrialized countries, imports of footwear and some consumer electronic goods are still subject to fairly stringent quotas. In shipbuilding, although substantial subsidies remain, there has been progress recently in cutting capacity in uncompetitive countries. France and the United Kingdom, in particular, have taken steps to reduce general subsidies to industry.

- The Tokyo round. The latest (Tokyo) round of multilateral trade negotiations (MTN) was largely completed in April 1979; it made valuable progress in some areas (see box on page 21); in some others, the results were a disappointment for the developing countries. Nonetheless, the MTN agreements have considerable potential to liberalize trade.

The extent to which this potential is realized, especially by developing countries, will depend on how the agreements are implemented and on the outcome of continuing negotiations—the most important of which pertain to the safeguard clause. This attempts to limit the emergency protection that can be adopted on the grounds of serious injury to domestic industry. Safeguard measures have been invoked frequently against imports from developing countries (often outside the legal framework of the General Agreement on Tariffs and Trade—GATT). The main dispute holding up agreement is
whether safeguard measures can be invoked selectively against specific countries—an approach favored by some industrialized countries but opposed by developing countries.

If developing countries sign (and actively participate in) the Tokyo agreements, they are likely to add significantly to the benefits they obtain from it. Under its terms, only signatories can participate in the implementation and surveillance of the governing codes of conduct. But most developing countries so far have refused to sign—partly because of dissatisfaction with the progress made and partly because they maintain that they should benefit from the codes without being bound by their provisions.

The reciprocal obligations of developing countries are a sensitive issue that will be increasingly important in future negotiations. In particular, the status of those developing countries that are major exporters of manufactures and are reaching a more advanced stage of development ("the graduates") is unresolved. If their eligibility for special treatment were reduced, there would be more scope for the lower-income countries to benefit.

The extent of the gains from the MTN nevertheless depends mainly on the industrialized countries. Stagnation or slow growth of their economies reduces alternative employment opportunities for displaced workers, and aggravates protectionist sentiment. (There is in fact no evidence that competition from developing countries is a major cause of unemployment. Several studies have shown that a balanced increase in trade with developing countries has insignificant effects on employment in industrialized countries, especially as compared with the job losses due to technological change; other studies show employment gains for some countries.)

In turn, protection impedes economic recovery by slowing the movement of resources from low- to high-productivity sectors, thus exacerbating inflation. And imports can reduce inflation directly, restraining the price rises that domestic producers seek and increasing the pressure on them to improve efficiency. A 1978 survey in the United States of all consumer goods (except food and automobiles) found that imports from
Asia and Latin America were on average 16 percent cheaper than domestic products of similar quality.

Pressures for protection can be offset by policies to improve productivity within particular industries and to ease the movement of resources between industries. Policies to improve mobility were discussed at length in last year's World Development Report. These include quick and adequate compensation for affected individuals, retraining schemes and the creation of new industries, and removing obstacles to labor mobility, such as nontransferable pension rights. These measures complement efforts to raise employment and growth and to reduce inflation. But if adjustment policies are not properly designed and implemented, they can delay rather than assist restructuring.

Trade issues for capital-surplus oil exporters

After the 1973–74 oil price increases the oil-exporting countries rapidly expanded their imports—thereby moderating the world economic slowdown. The imports of the capital-surplus countries are unlikely to grow in the 1980s at the extraordinary rate (more than 20 percent a year) of the 1970s; but they are expected to grow almost twice as fast as the imports of the industrialized countries (9 percent a year compared with 5 percent). This will offer buoyant opportunities for exporters in developing countries—but within limits, since the oil-exporters' market is still relatively small (see Table 3.2).

### Multilateral trade negotiations: the Tokyo round

Several novel features are contained in the MTN agreements, including the incorporation of preferential treatment for developing countries into the legal framework governing trade and codes on nontariff barriers. But they largely exclude existing quantitative restrictions on textiles, clothing and agriculture.

**Tariffs.** Industrialized countries are to reduce tariffs 38 percent (simple average) over eight years, affecting trade worth about $125 billion (1976 values). The simple-average tariff cut on developing countries' traditional exports would amount to 25 percent for industrial and 7 percent for agricultural products. The tariff reductions are less than average on products eligible for the generalized system of preferences; they are larger on finished manufactures than on semi-manufactures.

**Nontariff barriers.** The aims are as follows:

- To prevent increases in protection arising from use of arbitrarily determined customs values as a base for tariffs.
- To reduce discrimination against foreign suppliers for government contracts valued at SDR150,000 (about $200,000) or more.
- To regulate export subsidies and, for countervailing duties, to require proof that subsidized imports caused material injury to the domestic industry in question.
- To ensure that technical regulations adopted for such reasons as health or environmental protection do not create unnecessary obstacles to trade.
- To prevent procedures for import licensing from constituting barriers to trade.

**Framework for conduct of trade.** This reforms several aspects of the GATT system. Its main features are: providing a legal basis within GATT for preferential treatment of developing countries, and special treatment of the least-developed countries; increasing the regulation of trade measures adopted for balance-of-payments purposes; recognizing the developing countries' need to take safeguard action not only for new industries

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**Table 3.2 World merchandise trade, by country group, 1970 and 1977 (percent)**

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<td>Oil-importing developing countries</td>
<td>17.4</td>
<td>20.5</td>
<td>3.5</td>
<td>8.4</td>
<td>1.5</td>
<td>3.1</td>
<td>69.0</td>
<td>61.8</td>
<td>100.0</td>
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<tr>
<td>Oil-exporting developing countries</td>
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<td>21.5</td>
<td>3.9</td>
<td>2.2</td>
<td>0.5</td>
<td>0.8</td>
<td>66.6</td>
<td>72.6</td>
<td>100.0</td>
</tr>
<tr>
<td>Capital-surplus oil exporters</td>
<td>20.2</td>
<td>20.6</td>
<td>1.7</td>
<td>4.3</td>
<td>0.8</td>
<td>1.2</td>
<td>74.4</td>
<td>69.6</td>
<td>100.0</td>
</tr>
<tr>
<td>Industrialized countries</td>
<td>18.2</td>
<td>16.4</td>
<td>4.7</td>
<td>6.7</td>
<td>1.5</td>
<td>5.6</td>
<td>71.0</td>
<td>65.7</td>
<td>100.0</td>
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<tr>
<td>Worlda</td>
<td>18.0</td>
<td>16.9</td>
<td>4.1</td>
<td>6.1</td>
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<td>4.3</td>
<td>65.4</td>
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<td>100.0</td>
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a. Includes centrally planned economies and unallocated trade (usually about 1 percent).
Migration and money

Emigration once played a crucial role in reducing poverty in Western Europe: about 50 million people are estimated to have left for the "new world" in the second half of the 19th century. Whole families moved then, for good. Today many of the migrants are male workers who go abroad for a period and send much of their earnings home. Many of them are illegal; some of their remittances go unrecorded or enter official balance-of-payments accounts in ways that make it hard to disentangle them from other flows.

While estimates are imprecise, the broad picture is clear. There were roughly 20 million migrant workers in the world in the late 1970s, of whom 12 million were from developing countries. Some 6 million were in the United States (mostly Mexicans); 5 million in Western Europe; and 3 million in the Middle East (other main destinations include the West African coast and the mines of South Africa). The number in Western Europe increased from 2 million in the early 1960s to 6 million in the early 1970s and then declined, but this was more than offset by an upsurge in migration to the oil-rich countries of the Middle East. More than 2 million of the migrant workers in Europe are from developing countries (mainly Algeria, Morocco, Tunisia, Turkey and Yugoslavia); in the Middle East about 2 million come from other countries of the region, most of the other 1 million from South Asia.

Remittances to developing countries have grown rapidly, from about $3 billion in 1970 to an estimated $17.5 billion in 1980, with more than $3 billion going to South Asia, about $5 billion to the Middle East and North Africa and close to $7 billion to Southern Europe. Remittances are about a fifth as large as merchandise exports in South Asia, and in the Middle East and North Africa (excluding the capital-surplus countries). The proportion is especially high in Pakistan, Bangladesh, Jordan, Egypt, Morocco and the two Yemens. Other countries where remittances are particularly important include India, Turkey, Greece and Yugoslavia.

There has been controversy over the net benefits to developing countries when skilled people emigrate. The "brain drain" represents a serious loss of manpower for some countries, and there are social costs as well. But governments can often take steps to encourage vocational education and training to meet a demand for skills—in order to increase remittances while retaining enough trained people within their countries. In any event, most of the objections apply less strongly to the unskilled or semiskilled, the majority of migrant workers; for them, migration offers a chance of dramatic improvement in their often meager incomes.

The share of the oil-importing developing countries' exports going to both the capital-surplus and other oil-exporting developing countries increased sharply between 1970 and 1977 (Table 3.2)—exports to each group grew at annual rates exceeding 20 percent. Some developing countries (including South Korea and India) have won major contracts for "turnkey" plants and for construction and consultancy services; these areas offer many export opportunities.

Remittances from migrant workers in the oil-rich states have boosted the foreign exchange earnings of some developing countries considerably (see box above). Labor shortages remain a significant constraint on growth for several oil-exporting countries. But migration raises sensitive social and political issues for countries of origin and destination; if investment programs in the capital-surplus oil exporters are more conservative and slow growth persists in the industrialized countries, migration is likely to grow less rapidly in the 1980s.

Trade policy for developing countries

Slower growth in world trade does not change the principles that should govern the trade policies of developing countries. Generally, the policies that maximize benefits from trade in good times will also maximize them in bad. But the likely slowdown in trade poses markedly different policy problems for oil-exporting and oil-importing developing countries. As discussed in World Development Report, 1979, the main trade issue for oil exporters is to prevent their sharply increased foreign earnings from discouraging growth of other exports and import substitutes.

For oil-importing developing countries, the likelihood of a difficult external environment—rising oil prices and slower growth in world trade and capital flows—increases the urgency of taking steps to earn and save foreign exchange through export promotion and import substitution. The unfavorable environment makes it harder for the developing countries to achieve rapid export growth but makes it more important to do so. Also of great importance are efforts to reduce the import requirements of their overall growth strategies—by some combination of curbing nonessential imports, shifting production toward less import-intensive items and replacing more imports by domestic production.

Balance between export promotion and import substitution. Several factors indicate caution in emphasizing import substitution.

- Most developing countries now have trade policies that are heavily biased toward import substitution.
- These biases commonly result from excessive reliance on quotas and administrative controls, and indiscriminate use of tariffs. Frequently such policies have been introduced in response to temporary balance-of-payments crises but then maintained for long periods. They result in misallocated resources and create a constituency for retaining protection. Reducing the general bias toward import substitution should therefore continue to be of high priority.
Inward-looking policies may prevent developing countries from taking advantage of the considerable export opportunities that will exist in the industrialized countries even if their growth slows, and may also retard the growth of developing countries' trade with each other.

World trade could recover strongly by the mid-1980s—and experience (particularly in the 1950s) illustrates the costs of excessive export pessimism, both in terms of lower import capacity and inefficiency in highly protected industries.

Pricing and other policies that encourage efficient export growth encourage efficient import substitution as well.

Emphasis on selective import substitution can, however, help growth. Many countries have unexploited opportunities for import substitution through the production of energy (see pages 16–17) and food (see box). And in most countries—including South Korea, for example—it played an important role in initiating industrialization. But South Korea, unlike many countries, eliminated

Food, farming and foreign exchange

Before 1939 only Western Europe among the world’s regions was a net importer of grains. Today only North America and Oceania are not. Trade in grains has risen from 25 million tons in the late 1930s to 181 million tons in 1979—from 4 percent of global production to 14 percent. North America now accounts for 20 percent of world grain production and 80 percent of world grain trade.

The largest rise in net imports since the early 1960s has been in the middle-income developing countries—from 13 percent to 23 percent of their consumption (see table). Of the low-income countries, there has also been a sharp rise in Sub-Saharan Africa. In 1980 food and beverage imports are estimated to be $7.7 billion in low-income countries (17 percent of their merchandise imports) and more than $36 billion in middle-income countries (9 percent). Historically, a 10 percent increase in average incomes has led to a 7 percent increase in grain imports in developing countries.

The growth of imports has placed severe pressure on the grain handling and distribution systems of developing countries (when domestic production is included, their marketing and distribution capacity is today handling roughly four times the tonnage of only 20 years ago). In times of food shortfalls, distributional bottlenecks are often a more important constraint than the ability to procure imports. Both these constraints argue for a measure of self-sufficiency in food but within limits: the earnings forgone as a result of diversion of resources from other agricultural (or nonagricultural) investment can be substantial. Increased food production should be part of a broad-based effort to stimulate agriculture.

From 1955 to 1975 more than 150 million hectares of new farmland were brought into production in developing countries (more than the acreage devoted to cereals in the United States, Canada, the EEC and Japan combined). But this expansion has slowed since the mid-1960s, and it can be expected to account for no more than a quarter of incremental food production in the 1980s.

Hence the importance of increasing yields. Typical constraints include: undue emphasis on large-scale irrigation at the expense of smaller projects; wasteful use of water; inadequate support for research and extension; and pricing policies that discriminate against agriculture.

Several countries went a long way to removing these constraints during the 1970s. India is a good example. In the early 1970s prices to farmers were raised, and there was increased emphasis on small-scale irrigation and agricultural extension. Helped by good weather, these policies contributed to record grain crops in 1977–78 and 1978–79; in 1979–80, when the country experienced one of its worst droughts, output fell 8 to 9 percent—but the crop was still the third largest ever (some 20 percent bigger than in 1973–74, when there was a comparable drought).

Water may become a critical constraint in agriculture in the next 25 years. Over the past 50 years the area under irrigation has trebled. Costs of irrigation have risen far more rapidly than water charges generally; the result is inefficient use and a lack of funds for maintaining and operating irrigation systems. Water wastage is immense: in many parts of the world only 25 percent of water released from dams is used to grow crops. Improved management of water systems would result in major increases in grain production. But for large parts of the world and many of the world’s poorest people, the key to greater food production lies in a breakthrough in dryland farming (see Chapter 4, page 37).

Grain consumption and trade

(millions of tonnes)

<table>
<thead>
<tr>
<th>Country or country group</th>
<th>Average annual consumption*</th>
<th>Average annual net trade balance*</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>139.8</td>
<td>32.7</td>
</tr>
<tr>
<td>Canada</td>
<td>15.1</td>
<td>10.2</td>
</tr>
<tr>
<td>EEC</td>
<td>92.0</td>
<td>-21.5</td>
</tr>
<tr>
<td>Other</td>
<td>50.3</td>
<td>-3.0</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>64.3</td>
<td>-6.4</td>
</tr>
<tr>
<td>USSR</td>
<td>119.0</td>
<td>7.3</td>
</tr>
<tr>
<td>China</td>
<td>112.3</td>
<td>-4.0</td>
</tr>
<tr>
<td>Developing countries†</td>
<td>254.1</td>
<td>-11.1</td>
</tr>
<tr>
<td>Low-income</td>
<td>139.3</td>
<td>-5.6</td>
</tr>
<tr>
<td>India</td>
<td>73.1</td>
<td>-4.1</td>
</tr>
<tr>
<td>Middle-income</td>
<td>101.3</td>
<td>-12.7</td>
</tr>
<tr>
<td>Major exporters†</td>
<td>13.5</td>
<td>7.2</td>
</tr>
</tbody>
</table>

a. Excludes Albania, Cuba, Mongolia and Southern Africa (South Africa, Lesotho and Zimbabwe).
b. Includes capital-surplus oil exporters and excludes Southern Europe (Greece, Portugal, Yugoslavia, Romania and Israel).
c. Thailand and Argentina.
the bias in favor of producing for the domestic market at an early stage of industrialization. That resulted both in a surge of export-led growth and in rapid and efficient growth in production for the domestic market—illustrating the strong underlying complementarities between the two.

**Some Possibilities for Expanding Exports.** The industrialized countries’ market for finished manufactures offers developing countries the biggest scope for expanding exports. But they have opportunities for raising exports in other areas as well.

- Processed primary products. Primary producers face more serious export constraints than countries exporting manufactures. For many of them, processing their primary products offers a way of increasing the value of export earnings. For some primary products, the potential gains from increased processing can be exaggerated: some stages of processing certain commodities (for example, nickel and bauxite) are highly capital- or energy-intensive; others (for example, some edible oils) can cost less to transport in their unprocessed form. This does not necessarily mean that such processing activities are unsuitable for a developing country, but in these cases a more careful evaluation of the costs and benefits is required.

The decision to do more processing, however, is seldom in the hands of developing countries alone. The tariff structures of industrialized countries typically impose low (or no) duties for unprocessed primary products; but in many cases these rise progressively with the degree of processing (often to high levels). Unfortunately, this protects advanced stages of processing in the importing countries and inhibits exports of processed products from developing countries. Another brake on processing is that transport charges for processed products, where set by “conferences” of shipping firms, may not reflect genuine differences in the costs of carrying processed rather than raw materials. The location of processing activities is also influenced by the policies of transnational corporations.

- Trade between developing countries. Recent growth in “south-south” trade has been robust, and the outlook is promising. Developing countries’ exports of both manufactures and nonfuel primary products to each other have been growing faster than they have to industrialized countries (see Figure 3.4). UN data (in which developing countries include capital-surplus oil exporters but exclude the semi-industrialized nations of Southern Europe) show that trade between developing countries accounted for barely more than a quarter of the increase in their manufactured exports during 1963-73, but almost half in 1973-77.

Most of such trade in manufactures is from more- to less-industrialized developing countries, or between adjacent countries that are not otherwise major exporters of manufactures. In the composition and characteristics of the products, south-south trade differs significantly from developing countries’ manufactured exports to industrialized countries; in particular, it is more skill- and capital-intensive, with a higher proportion made up of engineering and chemical items (see Table 3.3). Trade in capital goods, including turnkey plants, is expanding very rapidly; but its value is still small.

**Regional Integration Schemes** offer a means for expanding south-south trade, but experience has been mixed. They often lead to

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**Table 3.3 Product composition of developing countries’ merchandise exports to industrialized countries and other developing countries, 1977**

<table>
<thead>
<tr>
<th>Product group</th>
<th>Share of product going to</th>
<th>To industrialized countries</th>
<th>To developing countries</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share of product group</td>
<td>To industrialized countries</td>
<td>To developing countries</td>
</tr>
<tr>
<td><strong>Machinery and transport equipment</strong></td>
<td>19.9</td>
<td>30.2</td>
<td>53.5%</td>
</tr>
<tr>
<td><strong>Textiles</strong></td>
<td>10.2</td>
<td>16.3</td>
<td>48.4</td>
</tr>
<tr>
<td><strong>Clothing</strong></td>
<td>23.1</td>
<td>6.2</td>
<td>85.3</td>
</tr>
<tr>
<td><strong>Chemicals</strong></td>
<td>7.4</td>
<td>11.6</td>
<td>50.3</td>
</tr>
<tr>
<td><strong>Iron and steel</strong></td>
<td>3.0</td>
<td>5.1</td>
<td>49.6</td>
</tr>
<tr>
<td><strong>Other manufactures</strong></td>
<td>36.4</td>
<td>30.6</td>
<td>67.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0</td>
<td>100.0</td>
<td>62.4</td>
</tr>
</tbody>
</table>

a. UN classification (South Africa and most of Southern Europe are included in industrialized countries).
b. Includes capital-surplus oil exporters.
c. About 80 percent for electronics and electrical machinery; much lower shares for other products.
inward-looking policies, with high protection and low overall trade growth. But they could play a bigger role if properly designed and implemented. One promising avenue for improving the benefits from regional cooperation is to coordinate large-scale investments to avoid excess capacity (as members of ASEAN—the Association of South-East Asian Nations—have begun to do). But the main vehicle for expanding south-south trade is more likely to be those general policies that liberalize developing countries’ import regimes and strengthen their export capabilities (for example, by expanding export credit and insurance facilities).

**Capital flows**

The links between the growth projected for developing countries and the capital flows required to sustain it received close attention in Chapter 2. The projected capital inflow to developing countries reflects judgments both about the availability of finance and the amounts the countries will want to borrow. But the flows that in fact materialize will be determined by savings and investment behavior in the industrialized countries and the capital-surplus oil exporters—and specifically on how much of their saving they choose to invest in the developing world.

This choice cannot be forecast with precision. The High case described in Chapter 2 requires aid and commercial capital from industrialized countries totaling about 0.5 percent of their GNP in 1990. By historical standards, this is not a large amount: it was 0.8 percent of their GNP in 1970 and still about 0.5 percent in 1975.

It implies, however, a substantial turnaround from 1980, when the industrialized countries themselves are likely to have a net inflow of capital (before official transfers) of about 0.5 percent of GNP—the counterpart of their current account deficit. Moreover, by 1990 much of the projected net capital inflow to developing countries would be needed to meet interest payments on loans. The share of gross lending that is available for buying imports and adding to reserves would fall sharply during the 1980s (see Figure 3.5).

Clearly, the uncertainties in these projections are high. Considerably more resources could be available to developing countries over the decade, and the result could be more growth. But it looks as though their capital inflow will be relatively modest in the 1980s, because of constraints both on their capacity to borrow and on the supply of funds.

**Factors affecting borrowing decisions**

In general, the oil exporters face few financial constraints on their growth. Their major challenge (especially if the real price of oil continues to rise throughout the 1980s) is to use their oil revenues efficiently and not to exceed their capacity for absorbing investment. If they succeed, they will not need much foreign capital over the next five years or so. For major borrowers (such as Algeria or Mexico) this means that debt-service ratios will tend to decline despite strong economic growth.

Later in the decade, however, their position will change. The initial surge of revenues from the oil price rises of 1979–80 will have been digested; their ability to absorb more foreign investment productively will have risen. With oil providing them with a strong credit standing, the oil exporters could choose to finance further rapid growth by more foreign borrowing.

The position of the oil-importing developing countries is altogether different. In 1978 net oil imports (for energy uses) cost them $30 billion; in 1980 the same amount of imports would cost them about $65 billion. Their potential financing gap is widened further by slow growth in the industrialized countries, as a result of which their exports in 1980 could be about $6 billion lower than they might otherwise have been. In the short-term this means they will run higher current account deficits than in earlier years for any given rate of growth.

In these circumstances the policy options of the low-income oil importers are limited. They cannot borrow much capital on commercial terms, nor would it be prudent to do so. Their growth rates depend essentially on three factors: their own efforts to raise investment and saving; the availability of concessional finance; and how efficiently they use domestic and foreign resources. Without much more aid (beyond the increases currently projected), GNP per person in these countries is unlikely to grow faster than 1.7 percent a year in the first half of the 1980s.

The hardest decisions lie with the middle-income oil importers, for whom prudence will have to remain the watchword. In the short-term (perhaps until the end

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**Figure 3.5 Developing countries**

**use of borrowed funds, 1970–90**

**High case**

(percentage shares)

<table>
<thead>
<tr>
<th>Year</th>
<th>Amortization</th>
<th>Interest</th>
<th>Available for imports and reserves</th>
<th>Gross medium- and long-term loans (S billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>14.3</td>
<td>40.1</td>
<td>46.7</td>
<td>25.1</td>
</tr>
<tr>
<td>1975</td>
<td>16.5</td>
<td>14.2</td>
<td>70.3</td>
<td>75.0</td>
</tr>
<tr>
<td>1980</td>
<td>21.5</td>
<td>12.5</td>
<td>65.9</td>
<td>100</td>
</tr>
<tr>
<td>1985</td>
<td>25.2</td>
<td>20.8</td>
<td>53.9</td>
<td>100</td>
</tr>
<tr>
<td>1990</td>
<td>28.1</td>
<td>23.7</td>
<td>48.2</td>
<td>100</td>
</tr>
</tbody>
</table>

---
of 1981), they can resort to the temporary expedients of compressing imports and running down inventories—and in some cases using foreign exchange reserves (which were boosted by heavy borrowing in 1977–78). These measures will not prevent external deficits from rising, so more finance will be needed to maintain growth, even at the comparatively low rates of 1977–80.

But these countries may find their options increasingly restricted by a key constraint—their creditworthiness for larger and larger amounts of borrowing on commercial terms. This means not only creditworthiness as perceived by lenders, who may be willing to continue to lend to countries that have demonstrated an ability to manage their debt. Developing countries themselves must determine how much they will benefit from continued heavy commercial borrowing—allowing for their existing levels of debt and debt-servicing obligations, their uncertain export prospects and the likely return on additional investment. Some countries have already run into debt-servicing difficulties. In the absence of more official finance, the wise policy for some oil importers may be to borrow less and accept slower growth in the near term, while current account deficits are reduced and debt-servicing capacity and creditworthiness are strengthened.

Countries that can finance higher deficits and more rapid growth will also have to take steps to restructure their domestic economies and their external payments. They, too, will be faced with the need to raise exports rapidly, to use imports efficiently, to control domestic expenditure and inflation and to invest productively so that their debt-servicing ability and creditworthiness will not be impaired. A lesson that has been learned from the 1970s is that foreign capital—especially on commercial terms—cannot substitute for structural adjustment but can ease it.

**The outlook for capital availability**

To meet their needs in the 1980s, developing countries will seek finance from private sources (mainly commercial banks, but also bonds and direct investment) and from official sources, both on concessional and on market terms.

**Outlook for capital from commercial banks.** Despite the increased liquidity of the international banking system, arising from the surpluses of the capital-surplus oil exporters, developing countries will find it harder to maintain rapid growth in borrowing in the 1980s than they did in the 1970s. Apart from the considerations of creditworthiness already discussed, they can expect greater competition for funds and direct constraints on bank lending. These factors are likely to affect borrowing more in the next few years than over the whole of the decade.

- Increased competition. Developments in the 1970s have highlighted the need for heavy investment in the industrial economies, to overcome structural weaknesses. The increased cost of energy provides a strong incentive for governments to stimulate both public and private investment in energy programs. Investment is thus unlikely to be compressed much further, even in the short term when demand will be depressed. Unless savings rates rise sharply, the industrialized countries are not likely to eliminate their current account deficits as rapidly as they did in 1974–78—especially as the real price of oil is expected to rise further in the 1980s.

Borrowing by industrialized nations is therefore likely to take a larger share of the surpluses of the capital surplus oil exporters than in previous years. In addition, the European centrally planned economies are likely to increase their demands on the capital market. They have been substantial borrowers in the past and (apart from the USSR) are net importers of energy with large debts to service. Finally, China seems poised to enter the market to finance ambitious modernization; over the decade China could become a sizable borrower.

While developing countries will therefore face more competition for loans in the 1980s, this does not mean that net lending to them will not increase. But the pace will be slower than in the past, and they will probably pay higher spreads (the margin over interbank deposit rates) than they have done in recent years. Interest rates themselves are likely to be higher as well—because of competing demands for funds, and because of restrictive monetary policies (in the next few years, at least) in industrialized countries.

From 1976 to 1978 the relative ease of monetary policy (especially in the United States) helped to boost international liquidity and thus facilitate the rapid expansion of commercial lending. The current stance of monetary authorities suggests that the 1980s will see tighter monetary policy to combat domestic inflation. But the dramatic fluctuations in interest rates over the past year underline the potential for error in this kind of prediction.

- Constraints on banks. The two previous *World Development Reports* have noted the potential constraints on commercial bank lending to developing countries that arise from portfolio concentration, higher debt-equity ratios and the associated concern of bank regulators. The danger to developing countries is not that banks will stop lending to them; rather that lending growth will slow be-
cause individual banks or banking groups may have to restrain their lending—and it will take time for new lenders to expand their activities.

The main factors behind these constraints still exist and may have become more acute. The rapid growth in lending by the main money center banks in the United States, the Federal Republic of Germany and Japan has meant that their capital base (shareholders’ equity plus retained earnings) has failed to keep pace with lending. For the major US banks at least, how much they can lend in the future will be affected by how fast they can expand their capital. But this is difficult in a world of low spreads, high inflation (which increases loans and deposits relative to capital) and low prices for bank stocks. Second-tier banks that are comparatively underlent relative to their capital will probably expand their international lending. But because these banks are smaller, less experienced and probably more risk-averse than the large international lenders, developing countries are likely to pay more for their services.

In addition, some banks may wish to limit their exposure in some countries, since lending has been very concentrated (see Table 3.4). Regulatory agencies reinforce this caution: they have become increasingly concerned that foreign lending should not pose a threat to domestic banking systems. The effect of regulatory constraints on lending is not certain; it depends on the attitudes of regulators. In the past, banks have been free to interpret quite liberally the guidelines within which they operate. There have been moves to tighten control of international lending (for example, banks are increasingly having to report foreign and domestic operations on a consolidated basis); but the monetary authorities of many countries as well as the Bank for International Settlements are concerned to avoid undue constraints.

While these factors may cause lending to developing countries to grow more slowly, banks could be encouraged to lend more if spreads (between deposit and lending rates) widen. These spreads have a major influence on the profitability of lending; they have narrowed considerably since 1976 (see Table 3.5), but this trend seems to have been arrested in 1980. Since 1977 spreads have not been a major element in the cost of borrowing; at current levels of both spreads and interest rates, the latter should have more effect on the developing countries’ willingness to borrow.

OUTLOOK FOR OTHER FORMS OF PRIVATE FINANCE. Both bonds and private direct investment offer some alternative to bank lending, though their main impact will be felt in the longer term.

- The bond market. Developing countries made few international bond issues before the end of 1975, when outstanding external bonds of 96 developing

Table 3.4 Commercial bank claims on developing countries, 1976–79

<table>
<thead>
<tr>
<th>Country* or group</th>
<th>1976</th>
<th>1977</th>
<th>1978</th>
<th>June 1979</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>16.7</td>
<td>16.6</td>
<td>16.2</td>
<td>16.1</td>
</tr>
<tr>
<td>Mexico</td>
<td>16.2</td>
<td>13.4</td>
<td>11.4</td>
<td>11.7</td>
</tr>
<tr>
<td>Venezuela</td>
<td>6.2</td>
<td>6.0</td>
<td>6.9</td>
<td>7.5</td>
</tr>
<tr>
<td>Spain</td>
<td>6.6</td>
<td>7.6</td>
<td>6.5</td>
<td>6.5</td>
</tr>
<tr>
<td>Argentina</td>
<td>3.0</td>
<td>3.2</td>
<td>3.4</td>
<td>4.8</td>
</tr>
<tr>
<td>Subtotal, 5 largest borrowers</td>
<td>48.7</td>
<td>46.8</td>
<td>44.4</td>
<td>46.6</td>
</tr>
<tr>
<td>Next 5 borrowers</td>
<td>17.4</td>
<td>18.7</td>
<td>18.8</td>
<td>18.0</td>
</tr>
<tr>
<td>Next 10 borrowers</td>
<td>20.4</td>
<td>19.6</td>
<td>19.9</td>
<td>19.2</td>
</tr>
<tr>
<td>All others</td>
<td>13.5</td>
<td>14.9</td>
<td>16.9</td>
<td>16.2</td>
</tr>
<tr>
<td>All developing countries</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Amount (billions of dollars)</td>
<td>110.5</td>
<td>151.1</td>
<td>203.9</td>
<td>221.5</td>
</tr>
</tbody>
</table>

Source: Bank for International Settlements and US Federal Reserve Board.

Table 3.5 Average spreads over LIBOR for external borrowing, 1974–79

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>All developing countries</td>
<td>1.13</td>
<td>1.68</td>
<td>1.72</td>
<td>1.55</td>
<td>1.20</td>
<td>0.87</td>
</tr>
<tr>
<td>Typical industrialized country (France)*</td>
<td>0.58</td>
<td>1.42</td>
<td>1.09</td>
<td>0.92</td>
<td>0.63</td>
<td>0.36</td>
</tr>
<tr>
<td>Difference</td>
<td>0.55</td>
<td>0.26</td>
<td>0.63</td>
<td>0.63</td>
<td>0.57</td>
<td>0.51</td>
</tr>
<tr>
<td>Memo item</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LIBOR rate*</td>
<td>11.32</td>
<td>7.74</td>
<td>6.26</td>
<td>6.54</td>
<td>9.48</td>
<td>12.12</td>
</tr>
</tbody>
</table>

a. LIBOR is the London interbank offered rate, the rate charged by banks in London for dealings with each other.
b. Spreads reflect the credit standing of the borrower as well as market costs. This explains the very low difference in 1975.
c. Calculated as an annual average from monthly averages for the Eurodollar bid (deposit) rate plus one-eighth of a percent.
countries totaled an estimated $5.5 billion. (By comparison, the World Bank alone then had outstanding bond issues of $12 billion.) And only a handful of (mainly higher-income) developing countries had tapped the bond market: Israel accounted for 40 percent of outstanding bonds, while Argentina, Mexico and Spain together contributed a further 35 percent.

Issues by developing countries increased rapidly after 1975 (see Figure 3.6). They totaled $6.0 billion in 1978, of which $5.9 billion was the debt of middle-income countries. But their share of a slow-growing (if turbulent) market for international issues turned down sharply in 1979, to $3.9 billion (compared with issues by the international organizations of $8.3 billion).

Over time, bond issues should become more important as a source of funds for developing countries. But the bond market is a conservative one in which investor acceptance is acquired only slowly; borrowers must approach the market cautiously until they establish sound reputations. This suggests that in the foreseeable future bonds will not substitute to any great extent for commercial bank lending.

This conclusion is reinforced by the regulations imposed on bond transactions in many countries. These regulations do not discriminate among borrowers; they are intended to protect national investors and currencies. But their effect is to favor established borrowers and to make markets inaccessible for inexperienced borrowers. For example, the Securities and Exchange Commission imposes strict disclosure requirements on public offerings in the US bond market that new borrowers often find difficult to satisfy. The United States and most European countries restrict the foreign bond portfolios of some types of institutional investor. And in practice a foreign borrower must make a successful public offering in another foreign bond market before it can enter the Japanese market. Governments and regulatory agencies could help developing countries by improving their access to bond markets, but quick results cannot be expected.

• Direct foreign investment. Direct investment could provide more capital to developing countries, with the capital-surplus oil exporters playing an increasingly important role. But in the short-term its potential is limited—partly because many projects take so long to come on stream, but also because developing countries are often concerned about foreign ownership and influence in their economies. Because the risks are high, the foreign investor typically requires high returns on capital (and in some cases substantial control of the enterprise). Any major increase in direct investment is likely to need greater agreement between governments about the role of transnational corporations. Barring that, direct investment over the next 5 to 10 years would probably grow at only about 3 percent a year in real terms.

OUTLOOK FOR OFFICIAL CAPITAL. Given this relatively uncertain outlook for private capital flows, official agencies will have to help secure the financing needs of the developing countries (especially the low-income oil importers), as they did in 1974. Finance from the centrally planned economies is modest and probably will remain so. Official capital from the industrialized countries and the capital-surplus oil exporters—together with the international financial institutions they support—will effectively determine the capital inflow to low-income countries and will supplement the middle-income countries’ private borrowing.

• Prospects for concessional assistance. The aid projections that underlie the High case are shown in Table 3.6. They show aid from DAC donors reaching no more than 0.36 percent of projected GNP in 1985 and 1990. Measured against the target (0.7 percent of GNP) established by the United Nations for the Second Development Decade, the performance of DAC donors has been most disappointing. Real growth from 1965 to 1979 averaged only 1.5 percent a year. Excluding countries that have already reached the UN target (Denmark, Netherlands, Norway and Sweden), the aid performance of most of the remaining 13 DAC members deteriorated from 1975 to 1979. There is little assurance of significant progress in response to the Brandt Commission’s call for rapid growth in aid, and the evident needs of developing countries.

Recent actions give cause for concern. The aid cuts announced by the British Government could cause their aid to fall to 0.38 percent of GNP by 1985, from the 0.48 percent average for 1977–79. Aid bills continue to face difficulties in the US Congress, suggesting that support from the biggest donor is likely to remain the lowest, relative
to GNP, of all large industrial nations. Some countries, such as Japan and the Federal Republic of Germany, have indicated their intent to continue their recent improvements in aid flows. Nevertheless, achievement of the projected overall increase (a tripling of aid in nominal terms, or 4 percent real growth throughout the decade) is far from certain; it depends on strong growth in industrialized countries as well as on maintenance of their aid shares.

Economic difficulties in the industrialized countries are an important—but not a sufficient—reason to explain their lack of support for aid. Most governments simply have not found it expedient to expand foreign assistance while restricting domestic spending. The failure even to maintain the share of aid in GNP will have serious long-term economic and political consequences for the developing countries—particularly for the poorest among them. The inadequate provision for development aid contrasts starkly with the sums devoted by all countries to military expenditures (see box).

Close examination suggests, however, that political factors will inhibit a rapid redistribution of concessional aid. France and the United States, in particular, maintain strong political ties with some higher-income aid recipients. Nonetheless, there is an extremely strong case for donors to provide at least 50 percent of their aid to low-income countries; this redistribution is built into the capital-flow projections underlying the High case in Chapter 2. If it fails to take place, total aid flows from DAC members will have to be very much higher ($85-90 billion in 1990 rather than the projected $69 billion) to achieve the projected bilateral flow to the low-income nations.

- Official capital on market terms. The other major source of funds for developing countries is official capital on nonconcessional terms (that is, with a grant element of less than 25 percent); this is provided principally through official export credits, government-to-government lending, the World Bank and the regional banks and the International Monetary Fund. While it offers limited support for the low-income countries, for middle-income countries it has been and could remain a very important supplement to private capital.

Prospective aid from OPEC members is also uncertain. The Arab countries that are the major donors have been generous in their support of developing countries in the past. In the peak year, 1975, the oil producers together gave 2.7 percent of their GNP as aid, while the major Arab donors—Saudi Arabia, Kuwait, Qatar and the United Arab Emirates—gave proportionately much more (a range of 5 to 15 percent of their GNP). By 1978, however, aid in real terms was only about 60 percent of what it had been in 1975; estimates for 1979 indicate a further real decline.

The increase in oil revenues should permit a substantial increase in the oil producers' aid in 1980 and beyond. OPEC donors have not yet agreed to boost substantially their aid through multilateral channels; much therefore depends on the expansion of the national programs of the major bilateral donors—the four mentioned above, plus Iraq and Libya. Iraq has become the third largest OPEC donor in absolute terms, partly because of its interest-free

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<tr>
<td>DAC&lt;sup&gt;a&lt;/sup&gt; (As percentage of GNP)</td>
<td>13.8</td>
<td>20.0</td>
<td>22.3</td>
<td>25</td>
<td>44</td>
<td>69</td>
</tr>
<tr>
<td>OPEC&lt;sup&gt;b&lt;/sup&gt; (As percentage of GNP)</td>
<td>5.5</td>
<td>4.3</td>
<td>4.7</td>
<td>5</td>
<td>10</td>
<td>15</td>
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<tr>
<td>Centrally planned economies and other&lt;sup&gt;c&lt;/sup&gt;</td>
<td>2.71</td>
<td>1.35</td>
<td>1.28</td>
<td>(n.a.)</td>
<td>(n.a.)</td>
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<tr>
<td>Total</td>
<td>19.9</td>
<td>25.4</td>
<td>28.0</td>
<td>31</td>
<td>56</td>
<td>86</td>
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<sup>a</sup> Preliminary figures.
<sup>b</sup> Reporting by DAC members has changed to a uniform system (see the technical notes for Table 16 of the World Development Indicators). Under the old system of reporting, the 1975 figure was $13.6 billion, the 1978 figure $18.3 billion.
<sup>c</sup> Includes OECD countries that are not members of DAC.
loans to poorer countries to compensate them for higher oil prices.

- Improving aid to benefit the poorest. To maintain energy imports at their 1978 levels, the poorest oil-importing countries need extra aid of about $2.2 billion in 1980 (for 36 low-income countries). This could be provided by increasing aid from DAC and OPEC donors by only 8 percent. Yet even this additional aid will not be made available without strong efforts; and it would not compensate for the losses in trade and aid from the slowdown in world growth.

Besides expanding aid, donors should redistribute it toward the poorest nations. Some donors send a comparatively high proportion of their aid to the middle-income countries. In 1978 DAC donors distributed 38 percent of their bilateral aid to low-income countries (see Table 3.7) and 52 percent to middle-income countries (data on the country distribution of the remaining 10 percent are unavailable). Although only seven DAC donors currently give less than 55 percent of their bilateral aid to low-income countries, this group includes the four largest donors—France, the Federal Republic of Germany, Japan and the United States. Bilateral aid to the low-income countries from OPEC donors has fallen since 1976 and there is scope for redistribution. Flows from multilateral institutions, by contrast, are concentrated more on the poorest countries.

Official export credits are difficult to separate statistically from associated officially supported private flows. Together, however, they have grown rapidly over the past two decades; in 1978 net disbursements from DAC members to developing countries were more than $13 billion (exceeding net bilateral aid from the DAC countries for the first time, and considerably above private direct investment of $11 billion). Continuing growth is likely, but the limitations on what is financed by official export credits (usually, only specified capital goods) restrict their ability to compensate for slow growth of other capital.

Government-to-government lending affords a more direct means of assisting developing countries. The greatest potential seems to lie with OPEC governments, which provided $2.5 billion a year in 1975-76 (mainly on market terms to low-income countries) compared with their aid of $5.5 billion a year. Current and projected surpluses of the capital-surplus oil exporters could support a much larger volume of such lending.

- The role of multilateral institutions. While the machinery exists to assist developing countries in the difficult times ahead, the international agencies are hampered by a shortage of resources, especially to finance longer-term adjustment. Most of their proposed major capital increases and replenishments have run into authorization or appropriation delays.

The Inter-American Development Bank’s capital increase (agreed to in 1979) was to sustain nominal lending growth of about 14 percent a year, but legislative ratification has been delayed. The Asian Development Bank’s current replenishment period extends to 1982, during which time both concessional and nonconcessional lending in nominal terms are expected to grow 12 percent a year. The African Development Bank, despite the expansion of resources resulting from the admission of nonregional members in 1980, will be similarly constrained. The aid program of the European Community under the Second Lomé Convention, and the United Nations Development Program will increase at a somewhat slower rate.

Higher inflation will erode the real value of capital increases and replenishments. The capital increase for the World Bank was intended to support 5–6 years of lending growing at a nominal rate of 12 percent a year with an implied inflation of 7 percent a year (at present, that inflation rate looks a distinct underestimate). The sixth replenishment of IDA (a proposed $12 billion) was planned to provide for an annual real increase in loan commitments of 5 percent for fiscal years 1981-83 (July-June). Again, however, the real resource flow will be eroded by inflation.

Against this backdrop, the Board of the World Bank has accepted a proposal that will provide loans to support developing countries’ structural adjustment programs. But agreement has not yet been reached that these loans will be in addition to the previously planned lending programs. Over the decade, unless the international agencies get more funds, they will only be able to reallocate funds already earmarked (and allowed for in the High-case projections

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Table 3.7 Distribution of DAC donors’ bilateral official development assistance, 1970-78

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<tr>
<td>Low-income countries</td>
<td>47</td>
<td>44</td>
<td>38</td>
<td>35</td>
<td>38</td>
</tr>
<tr>
<td>Middle-income countries</td>
<td>44</td>
<td>46</td>
<td>51</td>
<td>56</td>
<td>52</td>
</tr>
<tr>
<td>Unallocated by country</td>
<td>9</td>
<td>10</td>
<td>11</td>
<td>9</td>
<td>10</td>
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<tr>
<td>Total</td>
<td>100</td>
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in Chapter 2). Ways of increasing their lending capacity should be considered, within the constraints of the capital available to them from the industrialized countries.

- The IMF. The seventh quota increase is expected to become effective in 1980, raising the quotas of the oil-importing developing countries to around $16 billion. And in response to members’ needs for financial assistance to ease their current adjustment problems, the Fund is studying initiatives designed to raise the amount of finance it offers; to extend credit for longer periods; and to emphasize its role as a supplier of finance. The maturity of loans under an extended arrangement has already been lengthened from 8 to 10 years to encourage a smooth transition to lower deficits. For countries that have severe deficits the IMF has been willing, in some instances, to provide financial support amounting to six times their quotas.

More multilateral finance is needed
From 1970 to 1978 multilateral flows on nonconcessional terms grew 11 percent a year in real terms (concessional flows grew 12 percent). On present plans, they are likely to grow at less than half these rates between now and 1990. But there remains a clear need for additional resources to allow the developing countries to adjust to changed external conditions and at the same time maintain acceptable growth. Without such resources, the chances of successful adjustment in 1980–85 will be much reduced; consequently, the recovery projected for 1985-90 would be weakened and longer-term development goals jeopardized.