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IMMEDIATE ATTENTION

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October 2, 1987

To: Members of the Committee of the Whole for the Development Committee

From: The Secretary

Subject: Draft Minutes of Meeting 87/2

Attached are the draft minutes of the meeting of the Committee of the Whole for the Development Committee held on March 11, 1987. If no further revisions are proposed by the close of business on Friday, October 9, 1987, the draft minutes will be deemed approved on that date.

Att: (1)

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CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Committee of the Whole for the Development Committee

Meeting 87/2

10:00 a.m., March 11, 1987

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	
	Song G., Temporary
	M. K. Bush
	G. Seyler, Temporary
	R. Morales, Temporary
	A. H. Mustafa, Temporary
G. Grosche	
J. E. Ismael	J. Reddy
	J. R. N. Almeida, Temporary
	M. Foot
	I. Puro, Temporary
	D. McCormack
	C. V. Santos
Y. A. Nimatallah	I. Al-Assaf
	L. Filardo
H. Ploix	
	J. de Beaufort Wijnholds
	I. Sliper, Temporary
G. Salehkhou	
	A. Vasudevan, Temporary
K. Yamazaki	
S. Zecchini	

L. Van Houtven, Secretary
J. K. Bungay, Assistant

Also Present

F. Fischer, Executive Secretary, Development Committee.
IBRD: E. R. Grilli, Economics and Research Staff; I. Ul Haque, International Relations Department. Exchange and Trade Relations Department: M. Guitián, Deputy Director; S. J. Anjaria, H. Hino. External Relations Department: A. Mountford. IMF Institute: O. B. Makalou. Middle Eastern Department: J. G. Borpujari. Research Department: N. M. Kaibni, E. C. Meldau-Womack, B. E. Rourke, M. A. Wattleworth. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Advisors to Executive Directors: A. Bertuch-Samuels, L. P. Ebrill, G. D. Hodgson, Khong K. N., J.-C. Obame, A. Ouanes, P. Péterfalvy, G. Pineau. Assistants to Executive Directors: H. Alaoui-Abdallaoui, M. Arif, A. R. Ismael, V. K. Malhotra, T. Morita, J. A. K. Munthali, S. Rebecchini, G. Schurr, B. Tamami.

1. NON-FUEL PRIMARY COMMODITY MARKETS IN THE 1980s

The Executive Directors, meeting as the Committee of the Whole for the Development Committee, considered staff papers on non-fuel primary commodity markets in the 1980s, and a paper prepared by the staff of the World Bank on the long-term commodities problems and its implications for developing countries (EB/CW/DC/87/2, 2/25/87; and Sup. 1, 3/2/87), which were to be submitted to the Development Committee for its meeting on April 10, 1987. Mr. Fritz Fischer, Executive Secretary, Development Committee, and Mr. D. R. Clarke, Mr. Enzo Grilli, and Mr. Irfan Ul Haque, World Bank, were also present.

The staff representative from the Research Department reported that the Executive Directors of the World Bank had met the preceding day as a Committee of the Whole to consider the draft of the President's report to the Development Committee (EB/CW/DC/87/1, Sup. 1, 2/12/87), which covered several items on the agenda for the Development Committee meeting. On one of those items concerning market prospects for raw materials, several Directors had referred to the background papers but their remarks on the topic had been brief. The views of the Executive Directors would be reflected in the President's report, which was expected to be circulated to the members of the Development Committee within the next few days. The two background papers on non-fuel primary commodity markets would be transmitted to the Development Committee as one document.

Mr. Ismael made the following statement:

> The two papers on market prospects for raw materials are important landmarks in focusing on the real issues confronting the production of primary commodities. Of particular significance is the unequivocal message that the so-called commodity problem is a problem of the entire world community, not just that of the developing countries. How this problem is to be resolved will determine critically the evolution of the world debt problem; the stability of the international monetary system; growth in the developing countries and the industrial countries themselves, given the increasing interdependence of countries; and ultimately, the level of global welfare and prosperity.
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> With one exception, I can agree with the thrust of the analysis in the papers. On the whole, I find the outlook presented in the papers too pessimistic. I am not too optimistic about market prospects in the near future, nor would I exclude scenarios that are worse in the short run than what is projected. My purpose is to inject a greater note of caution about long-term projections that are subject to great uncertainties, as pointed out in the papers themselves. The elasticity of supply of many primary commodities is higher than many think is possible. For rubber and palm oil, for example, proper application--or lack thereof--of fertilizers and growth stimulants, as well as the intensity of

maintenance and harvesting, can lead to a deviation of 5-10 percent in production from the trend, depending on the price range in question. My own assessment is that the recent low prices will lead to a more rapid adjustment of the current commodity surplus than assumed, with a consequently faster recovery in prices until the effects of the next cycle of more investment and increased production set in. In other words, economic factors and market forces work more efficiently than many economists expect. After all, many "conventional wisdoms" about commodities--for example, the poor prospects for natural rubber in the 1960s because of competition from the synthetic product, the "commodity shortages" of the early 1970s, and the "US$100 per barrel of oil by 1990" of the early 1980s--have not lasted long. It is hoped that the current "surplus syndrome" and "wisdom" of declining commodity prices will likewise not last too long.

Nevertheless, I would not want to detract from the emphasis in the two papers on accelerated world economic growth and development to promote a recovery of commodity prices to more reasonable levels. Indeed, I feel strongly that the interdependent international community should cooperate in a concerted manner to raise the growth rate of world demand for commodities and to reduce the dependence of developing countries on them.

The responsibilities of the major groups of countries are clear. The developing countries have to face the harsh realities of the market with appropriate domestic policy responses to diversify their economies, achieve efficiency in commodity production and other areas, let market forces work, and adjust their external payments positions to the prospects of a less favorable environment. This is what the Fund and the World Bank have actively promoted in recent years with some degree of success.

However, it is the policies of the industrial countries that should be our main focus of concern now. At the macroeconomic level, even the projected modest recovery in commodity prices would require a sustained economic growth of 3 percent a year in the industrial countries, along with moderate interest rates and low rates of inflation. Even if these targets are achieved, I note that both oil and non-fuel commodity prices would in 2000 still be lower in real terms than the depressed prices of 1985. This problem must be addressed effectively by the world community in its own self-interest.

I agree with the World Bank paper (EB/CW/DC/87/2, Sup. 1, 3/2/87) that the rationalization of agricultural policies in the industrial countries, together with a rollback of protectionism, would contribute significantly to improve the prospects of developing countries. This is one area where the Fund should do more in its annual surveillance of the policies of individual industrial countries. It is ironic that developing countries are often given all kinds of advice to improve efficiency in their economies--from labor market laws and agricultural policies, to macroeconomic management--yet agricultural policies in the industrial countries have been relatively sacrosanct. It is even more ironic, given that the policies of the European Economic Community (EEC), the largest agricultural protectionist bloc in the world, have wasted so many national and world resources.

Even as we discuss this subject, the EEC is now considering the imposition of an exorbitant levy on imported vegetable oils and fats that will set back the development and agricultural diversification efforts of many developing countries. The countries of my constituency, as the largest producers of palm oil, will be particularly hard hit. The move will lead to further inefficiencies in the use of global resources, since the purpose is to maintain, in the EEC, oilseed prices at levels two to three times the world price--in order to increase the receipts of farmers who already have incomes that are many multiples of the per capita income of developing countries. The interest subsidy--proposed at EBM/87/37 (3/3/87) by Mrs. Ploix for drawings under the compensatory financing facility--pales in comparison with the potential loss that this EEC policy means for exports of developing countries.

Coming back to the role of the Fund, I find that the two papers before us reinforce this chair's arguments for a more effective compensatory financing facility. Viewed in retrospect, a more liberal facility could have alleviated the difficulties of developing countries in managing their budgetary, debt-servicing, and balance of payments problems caused by the severe decline in commodity prices in 1985-86 as they grappled with economic reforms to adjust. As for the World Bank, I support its present role in addressing the basic causes of the difficulties faced by developing countries with volatile exports. In particular, this chair would agree that the Bank should not refrain from financing low-cost projects in developing countries just because they compete with higher-cost production in the industrial countries.

Mr. Vasudevan made the following statement:

Of the two papers before us today, the Fund paper (EB/CW/DC/87/2, 2/25/87) is less ambitious in its scope, while the Bank paper (EB/CW/DC/87/2, Sup. 1, 3/2/87) discusses many issues that have wide policy implications. We all know that the prices of non-fuel primary commodities have shown a declining trend in the 1980s and have declined very sharply in 1986. The major causes mentioned in both papers as contributing to the declining trend have been the overall slowdown in the growth rate of industrial countries, the reduction in the intensity of the use of commodities, and the abundant supply of commodities; the Bank paper also cites the market disruptions caused by agricultural policies. Focusing on this aspect in good measure, the Bank paper shows clearly that agricultural protection in industrial countries has a substantial impact on developing countries in terms of loss of export revenues and real incomes. This type of protection also affects those developing countries that are food importers and have to pay higher import prices. Agricultural protection also imposes costs on industrial countries themselves, mainly in terms of costs to consumers and to taxpayers. The paper therefore suggests that in their own interests, industrial countries need to undertake a reform of agricultural policies. It argues that the most efficient way is to move toward freer trade and better distribution of world agricultural production, even if it means satisfying the political need to provide direct income subsidies to farm families. One may or may not necessarily agree with this suggestion, but the main point to be appreciated is the paper's advocacy of freer trade. The arguments in Section 3--Industrial Country Agricultural Policies--are convincing, since they are supported by data and estimates of the costs of agricultural protection. The paper even suggests that while the Uruguay Round of Multilateral Trade Negotiations would provide an opportunity for the parties to make concessions, it will take several years for the results to be seen. In the meantime, it is necessary to halt the worsening of the domestic and international disequilibria caused by agricultural policies pursued by industrial countries. We fully support this stand.

Both the papers expect a bottoming out of the prices of primary goods in 1987, and some recovery thereafter. The Fund paper limits its projections for the period up to 1989; the Bank paper, however, provides long-term projections to 2000. These projections are based on assumptions, the certainty of which is suspect, given the trends thus far in the 1980s. For instance, the growth rate of non-fuel primary commodity exports is projected at 4.8 percent a year from 1986 to 1995, which is far above the average rates of 2.6 percent in 1980-84 and 1.6 percent in 1984-86. If the rate does not occur as projected, the implications for growth will be grim. Even if the projections materialize, prices of non-fuel commodities in 2000 will be 4 percent below their 1985 levels.

The Bank paper argues that the recovery in prices in the next ten years could be promoted by a greater commitment to domestic policy reforms in some developing countries, including a more rapid deployment of resources toward manufacturing exports; the improvement of economic management in the major industrial countries; and a general dedication to an open trading environment. I have already referred to the industrial countries' agricultural policies. The paper emphasizes the need for developing countries to reduce protection or subsidization of agriculture by adopting measures such as a flexible exchange rate policy, price and import liberalization, and removal of export taxes. These are familiar arguments. True, the promotion of economic efficiency--not just in the production of primary commodities but throughout the economy--would in the long run reconcile the interests of individual producers with the collective interests of developing countries. However, given their low per capita incomes, these countries cannot afford to wait too long for the results to appear, which gives rise to the crucial issue of the timeliness of policy reforms and the urgency of obtaining results. The adjustment process in developing countries cannot stand on its own policies; it needs to be supported by the external trading environment, as well as by sufficient foreign financing.

Unfortunately, the Bank paper has not considered this as an important issue of relevance to the theme under consideration. It treats the need for stabilizing export earnings of developing countries by describing the two Fund mechanisms that deal with the effects of export fluctuations--the compensatory financing facility and the buffer stock financing facility--and the STABEX scheme of the EEC. It does not suggest whether these mechanisms are adequate to take care of the problem of the lower export earnings caused by the declines in commodity prices. It would have been interesting had the paper worked out the financing needed to stabilize export earnings in 1987 and in the remaining years of the 1980s, in the light of the projections of commodity prices.

The Bank paper frankly states that the Bank's actions to foster stability in export earnings are only indirect--through the promotion of economic growth and structural change--by financing investments for the development of infrastructure, agriculture, fertilizers, chemicals, oil, gas and coal, as well as by providing policy advice. Of policy advice, developing countries receive more than necessary; it is in respect of financing requirements, however, that the actions of multilateral institutions do not add up to much, partly because of lending policies and partly because of limited resources. The Bank's own lending capacity is constrained by the size of its general capital base. For many developing countries, lending by the Bank and the Fund needs to be concessional as well. The way to tackle the problem of the declining trend in commodity prices does not consist merely of undertaking policy reforms in developing countries and removing the protectionist tendencies from the agricultural policies in industrial countries, but also of providing financial support for economic development and diversification.

Mr. Sliper said that in the discussion by the World Bank Board of the background papers, his chair had made extensive comments, and thus he intended to restrict his remarks to what he hoped could be incorporated in a letter of transmittal from Fund Directors to the Development Committee.

He considered that the point or linkage that should be stressed was the importance to the growth and stability of developing countries of reducing agricultural subsidies and protection in industrialized countries, Mr. Sliper stated. In the view of his authorities, the current level of subsidies and protection being given to agricultural products in the EEC, the United States, and Japan had produced and was producing a massive distortion in world trade. The extent of subsidies and support measures had not allowed prices to fulfill their proper allocative function and thus allow production to shift to areas and countries where comparative advantages existed in the development of primary products.

He believed that there was a fundamental contradiction between first the agricultural policies currently being pursued in the EEC, Japan, and the United States that denied market access for agricultural exports of important debtor countries, and second the Baker formula for overcoming debt problems through structural adjustment with growth, Mr. Sliper concluded. His chair considered that the key message to get across, namely, that the halting and rolling back of agricultural protection was fundamental to the structural adjustment efforts of the vast majority of Fund members.

Mr. Grosche made the following statement:

> The two papers before us today provide indeed a comprehensive and well-balanced analysis of the movements in commodity prices and of the factors causing them. For me, the most disquieting aspect of the weakness in commodity prices experienced after the 1970s is that it has coincided with the emergence of the international debt problem, and has greatly complicated our efforts to find appropriate solutions. As we are only too aware, many of the adjustment programs looked promising at the time they were launched, but the rapid decline in commodity prices soon invalidated the authorities' and the staff's projections with regard to the attainability of balance of payments viability. The Fund and the local authorities found themselves increasingly confronted with the need to make substantial adaptations to ongoing adjustment programs.
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> Where should we go from here? A number of actions need to be taken or reinforced both in developing and industrial countries, notably diversifying the economy, improving the allocation of resources, rolling back protectionist barriers, maintaining growth, and eliminating disruptive agricultural policies.
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> As to the papers before us, I found it most noteworthy that the experience of commodity-exporting LDCs has by no means been uniform. As the Bank's outlook shows, the future prospects look rather promising for a number of developing countries, because they have already made substantial progress in diversifying their production structure and reducing their dependency on primary commodity exports, which has also helped them in dealing with their debt problems. This clearly confirms the appropriateness

of our present approach, namely, that the Fund should continue supporting sound macroeconomic policies and that the Bank should support medium- to long-term solutions to structural deficiencies. This is not to say that countries that have a comparative advantage and can produce commodities efficiently should not continue or even expand production. But it is obvious that rapid development cannot be expected when a country has too narrow a supply base. Countries need to diversify if they are to take advantage of the dynamic forces for growth generated in the export sector.

I am convinced that these papers speak for themselves. However, I would suggest that they be combined, because that might eliminate one problem that I found. In paragraph 4 of the Executive Summary, the World Bank paper states that both oil and nonfuel commodity prices in 2000 would still be lower in real terms than the extremely low prices of 1985. This seems to contrast with the Fund paper's more cautious assessment, that over the medium term there should be some recovery in commodity prices as the imbalances resulting from sluggish growth and excess demand are corrected. I would appreciate some further clarification of this apparent contradiction. I realize that the Bank paper projects an increase in real commodity prices after 1988--but one that will not be sufficient to offset the decline in 1986 and 1987. I wonder, like Mr. Ismael, how realistic such a pessimistic assumption is, given the length of the projection period.

Mrs. Ploix made the following statement:

The staffs of the Fund and the Bank have prepared useful and complementary papers that present an in-depth analysis of the causes and consequences of the decline in commodity prices. Even though the matter is both complex and controversial, we regret that the reports, which provide an excellent basis for reflection and proposals, lack recommendations.

It is clear from the reports that the decline in non-oil commodity prices has affected mainly sub-Saharan African countries and, to a lesser extent, highly indebted countries; it is also clear that the weakness in these commodity prices is likely to continue in the years to come--even if the Fund staff expects, albeit with great caution, that the trend will bottom out in 1987. One must also acknowledge the understatement in the remark that "fluctuations in the prices of primary commodities are believed to cause serious disruptions to economic development."

I regret that the reports do not assess the present means of action or intervention of international institutions vis-à-vis disrupted markets. It is our hope that it will soon be possible to arrive at a major consensus on operational recommendations in the following areas: development strategy guidelines for producer countries; types of interventions in the commodities that appear to be the key to the development of the poorest countries; and, as I proposed at EBM/87/37 (3/3/87), a new means by which the Fund can provide concessional compensation for export shortfalls for single-product, low-income countries.

It would be appropriate to present more explicit assumptions about commodity prices in the reports devoted to those developing countries that are heavily dependent on the evolution in the prices of one or two commodities. I am thinking in particular of the requests for stand-by arrangements as well as the policy framework papers. Indeed, Fund-supported adjustment programs or medium-term development frameworks are based on assumptions the realization of which is of the utmost importance for the success of the adjustment effort. It is thus logical to emphasize the major uncertainties and to indicate the possible consequences of adverse developments.

Finally, I would like to make one point on the paragraph devoted to the agricultural policies of the industrial countries: I regret that no mention is made of the profound recent and ongoing modifications of European agricultural policy. I think that the scope and nature of these modifications are still underestimated.

Mr. Nimatallah made the following statement:

The facts show that countries, developed and developing alike, are much more interdependent today than ever before. In the past, industrial countries could afford to pay little attention in the formulation of their policies to the economic performance of the developing world. However, as was made clear by the debt crisis and, more recently, the developments in the oil markets, both sides depend on each other's performance and policies. For example, the sharp decline in oil prices last year has led not only to a decline in income and imports in oil exporting countries, but also has had a significant ripple effect throughout the world economy. With that in mind, therefore, I will start from the premise that it would be in the best interest of the industrial countries to make sure that efforts of adjustment and growth in the developing countries are not interrupted or protracted. Otherwise, exports of the industrial countries will suffer and, therefore, growth and employment will suffer too.

Export revenues of the LDCs have been volatile, and developing countries as a group have been adjusting for a long time to the instability of their export earnings and to the secular downward trend in international commodity prices. Yet, they are facing still further deterioration in their terms of trade, and continue to be vulnerable to the volatility of commodity prices. The World Bank and Fund projections are quite striking in this respect--even by 2000, non-fuel commodity prices will, in real terms, still be 4 percent below their 1985 level, and as much as 25 percent below their 1980 level. Both institutions seem to be in agreement that the outlook for commodity prices is not encouraging. No rebound from the present, depressed level is expected in 1987, and only a marginal recovery is in store for the medium term.

What causes fluctuations and long-term deteriorations? The Bank and Fund papers confirm that three out of four major reasons lie on the doorsteps of the industrial countries. Demand by industrial countries for these commodities is affected, in the short run, by the business cycle impact on the pace of economic growth; in the long run, by technological changes to substitute for these commodities; and in certain industrial countries, by deliberate agricultural and industrial production policies that tend to discourage the flow of imports from certain developing countries. If these are the facts, what can be done about helping the developing countries to persevere and to continue their efforts to adjust, develop, and grow? The answer obviously is that both partners--the developed and developing countries--must work together to minimize these interruptions in adjustment and growth efforts both by reducing volatility in primary commodity prices and by decreasing the dependence of developing countries on commodity exports of a single commodity.

The industrial countries should bolster demand to the extent possible by sustaining their own growth and by resisting the adoption of production policies, particularly agricultural policies, that are intended to compete unfairly with agricultural commodity imports from developing countries. Of course, sustaining growth in industrial countries is a difficult task, but in general, the present policies in the industrial countries are on the right track, and therefore should be continued. And, to sustain these policies, the large industrial countries should enhance their efforts to coordinate their economic policies. In addition, it is certainly important to be aware that the agricultural policies in the industrial countries, which entail heavy subsidies to domestic producers, can have a potentially damaging impact on agricultural and manufacturing sectors and incomes in the developing countries. To subsidize heavily ailing industries or sectors--just to make jobs in the industrial countries--is not only detrimental to the economic prospects of trading partners in the developing world, but it can also be detrimental to the welfare of all consumers in the world community, and especially in the industrial countries themselves.

At the same time, developing countries must adopt and implement policies that will help them diversify their export bases. Countries that have a comparative advantage in expanding and diversifying their exports should pursue the right medium-term policies and make efforts to realize the objective of reducing their dependence on one major commodity export. However, good policies and sincere efforts to diversify exports, although necessary, are not sufficient, unless demand for these exports is sustained in the markets of their industrial trading partners. If these efforts from both sides are sustained--without interruption--I am confident that the discouraging picture painted by the Fund and Bank papers about the medium-term prospects for commodity markets will improve; and, I am hopeful that the efforts to adjust, develop, and grow in the developing countries will, in turn, be sustained.

The Fund and the Bank can help in many ways. One important way is to continue to support growth-oriented adjustment programs. The Fund and the Bank can enhance their collaboration in promoting policies of structural reform. In addition, the Bank can emphasize financing projects that help promote export diversification. The Fund can also enhance its efforts to help industrial countries coordinate policies. Finally, the Fund can continue its compensatory financing policy to prevent interruptions in adjustment and growth efforts.

Mr. Wijnholds made the following statement:

The Fund and Bank papers on non-fuel primary commodity market prospects make interesting reading. Although a number of points emerge clearly from both papers, such as the limited prospects for a strong recovery of commodity prices in coming years, there seems to be some ambiguity on other matters. The Fund paper argues that there is no compelling evidence for the theorem of a persistent long-run downward trend in commodity prices, but the Bank paper is less clear and apparently less sanguine; for instance, it states that "In a substantial part of the developing world,...persistently low primary commodity prices, in combination with high levels of debt, are likely to constrain growth rates well into the 1990s." Such apparent differences in emphasis are perhaps almost inevitable in this type of coproduction, but they do not make it easier for the reader to form an opinion.

An analysis of the underlying causes of primary commodity price movements is essential for making as sound as possible price projections and for devising any strategy with regard to adverse price movements. Although this is a complex matter, there seems to be broad agreement that factors such as a slowdown of economic activity in industrial countries, technological innovation, oversupply, and market disruption on account of agricultural policies in industrial countries have led to depressed commodity prices in recent years. The problem lies mainly in assessing the relative importance of these factors. Here the papers provide some guidance, but also raise some important questions.

Slower growth in industrial countries, with its effects on the demand for primary commodities, has exerted downward pressure on commodity prices during the 1980s. In theory, if growth were to accelerate, commodity prices would benefit; however, it appears unlikely that the historically high average growth rates of the 1960s and early 1970s will soon recur in the industrial countries. The main reason for this outlook is that potential output in these countries has declined, in some cases quite dramatically--as noted in SM/87/40 (2/12/87)--and it is unlikely that this decline could be reversed in a relatively short time span. Moreover, per capita growth rates in industrial countries are currently not much lower than actual growth rates, and in some cases, earlier per capita growth. In Germany, which has a declining population, per capita growth even exceeds real GNP growth. Therefore, slower growth, coupled with the expectation that policies will be geared toward keeping inflation low, makes it unlikely that any sharp increases in overall demand from industrial countries for raw materials will appear in the coming years.

Technological advances that reduce demand--particularly for metals--constitute a structural element in the outlook for commodity markets. Not surprisingly, macroeconomic specialists have been slow to recognize this factor, the importance of which is difficult to assess. I found the staff's earlier treatment of this matter, including a few examples in the September 1986 World Economic Outlook, quite enlightening. Perhaps I am mistaken, but I had the feeling that the technological factor is downplayed somewhat in the present paper.

The Fund paper appears relatively optimistic that the oversupply of primary commodities, especially foodstuffs, will change, in part because industrial countries are re-examining their agricultural policies. Changes in these policies will of course also mitigate the disruptive effect that they have sometimes had on developing countries. The increasing realization, among a wider public, of the costs of such policies for industrial countries themselves--on which the Bank paper contains some interesting material--constitutes a basis for cautious optimism in this area. The inclusion of agriculture in the Uruguay Round of Multilateral Trade Negotiations could prove to be a significant step in this process. All in all, I agree with the staff's projection of some improvement in the outlook for primary producers' export proceeds in the medium term.

Mrs. Filardo made the following statement:

The papers prepared by the World Bank and Fund staffs provide a good historical and analytical background of the origins of falling commodity prices and the deterioration of developing countries' terms of trade. In offering an adequate analysis of the impact that agricultural policies of industrial countries have on these nations, commenting on commodity policies of developing countries, and providing some forecasts related to consumption, trade, and prices of commodities, these papers allow us to evaluate the problem in a more realistic perspective. While we agree with the conclusion of the Bank paper that accelerated world economic growth and development are the only hope for solving the commodity policy dilemma of developing countries, other essentially related problems still in need of a solution will require time, political willingness to implement adequate macroeconomic policies and structural reforms, and international cooperation to enhance world trade and financial support.

Between 1980 and 1986 the world price index of non-fuel commodities plummeted from 100 to 68 in real terms, showing commodity prices at their lowest level since the 1930s. In 1986 alone, the unit value of petroleum exports in U.S. dollars fell by 47 percent. The main factors affecting commodity prices have been demand and supply. Economic activity of industrial nations has slowed down; and their demand accounts for 80 percent of world imports. Another adverse factor has been the substantial increase in supply as a result of good weather conditions and an abrupt fall, in real terms, of fertilizer prices.

Even though forecasts are subject to great uncertainty, these papers assume that consumption, production, and prices of commodities will recover. This recovery will be at a slower pace by 2000 and will depend mainly on the economic activity of industrial countries, population growth, inflation and exchange rate developments, and sectoral policies. On the supply side, it will depend on the reduction of excess stocks that exist in many markets, and on weather conditions for agricultural products. In the short run, it is clear that demand and supply factors could not be expected to provide great momentum for price increases. The rationale behind this is twofold: (1) the annual growth in real GDP for seven industrial countries over the period 1980-86 averaged 2.2 percent, compared with an average 3.3 percent in the 1970s, while annual growth in industrial production averaged 1.8 percent in the same period, compared with 3.4 percent in the 1970s. The recovery of economic activity after the 1981-82 recession has remained weak even in 1986, and growth in industrial production in seven industrial countries actually fell from 8.5 percent in 1984 to 1 percent in 1986; (2) record agricultural crops and peak capacity for metals coincided with decelerating economic growth in industrial countries, causing an increase in stocks--measured by the stock index for all commodities--of 30 percent from 1983 to 1986. If stocks are added to production, the total supply of food commodities rose by 14.2 percent between 1983 and 1986, the largest three-year increase since 1960.

Economic activity in industrial nations is determined by their macroeconomic policies and structural reforms in different sectors. The deceleration in the pace of economic activity in the 1980s, stemming mainly from the large internal and external imbalances, was fueled by inappropriate monetary, exchange rate, and trade policies. While the recent Paris agreement among the industrial countries promotes policy coordination, and surplus nations are committed to stimulate their economies through expansionary demand policies, the persistence of those imbalances could hamper the stability of the exchange markets and intensify protectionist pressures. In this connection, fiscal deficits remain an area of serious concern. While monetary policies have recently been better coordinated, financial innovations in most industrial nations have constrained monetary authorities in their efforts to meet their monetary targets. International cooperation is crucial to reinforce policy coordination.

Radical reforms in the areas of trade liberalization and agricultural policy are not expected soon. Mounting protectionist pressures have emerged, and increases in both tariff and nontariff barriers are restraining imports--particularly of agricultural products, textiles, and steel--from developing countries into industrial nations. Even though governments are committed to starting a new round of negotiations for trade liberalization, it will take years to come to a consensus and to implement the outcome of these negotiations. Agricultural policy in industrial nations has aimed at protecting farmers' incomes through a combination of trade restrictions, price support, and cost-reducing subsidies. These measures, which stimulate production, have led to overproduction, stock accumulation, and intervention in world markets to reduce prices. Even though the Bank paper concludes that it is very difficult to determine winners and losers, this implies a high economic cost for industrial nations and market losses for developing countries. The most impressive figures relate to the annual budgetary cost of agricultural protection for consumers and taxpayers, and the benefit to producers--estimated at US$35 billion in 1985 dollars, for the United States, the EEC, and Japan--without taking into account the real output forgone because of deficiency losses. To change this policy unilaterally will not be possible, at least not until budgetary cost pressures prevail. For political reasons, governments want to protect farmers' incomes. Simultaneously, farmer groups are adept at defending previous policy gains. Therefore, the only way to improve agricultural policies in industrial nations will be through international cooperation, and this will take time.

Meanwhile, developing countries that depend heavily on export commodities will be affected adversely by economic activity and the domestic policies of industrial nations. To reduce their vulnerability to the different shocks, developing countries have to embark on structural reform programs for improving their allocation of resources, to help to accelerate growth and diversify their economies. Nevertheless, supply-side policies take years to be implemented and require adequate financial support. The question, then, is: where do we stand today in terms of the debt-servicing capacity of commodity-exporting countries and their ability to obtain financial resources in order to resume growth? In addition to the weakness of their economic recovery during 1986, which hindered their debt-servicing capacity, the developing countries--with the exception of some Asian nations--faced a sharply reduced flow of bank lending. Moreover, this lending was not voluntary; on the contrary, financial flows to developing countries have been linked to macroeconomic and structural policies monitored by the Fund, or by the World Bank. Alternatively, a number of creditors provide a financing package with multiple monitoring arrangements that risk cross-conditionality. These trends have strained normal debtor-creditor relations and threaten the developing countries' ability to achieve sustainable growth; those countries face a vicious circle of a lack of financial resources and inadequate access to export markets.

Strong international cooperation is needed to overcome world economic problems, but good examples of economic policy behavior on the part of industrial nations are crucial for developing countries to continue in their adjustment process. In the meantime, multilateral institutions have to fulfill their role in supporting the adjustment and reform efforts of developing countries, with advice and financial resources.

Mr. McCormack stated that as the Executive Directors of the World Bank had had the opportunity to discuss the issue the previous day, and the Fund Board had had its preliminary discussion on the experience with the compensatory financing facility (EBM/87/37, 3/3/87), he could be brief. Certainly, the numbers cited in the Bank and Fund papers were disturbing; moreover, the causes of the present state of commodity prices lay in both supply and demand factors that were unlikely to change quickly, and posed very serious problems.

The implications of the present situation were serious, in particular for the management of the debt problem, Mr. McCormack noted. Developing countries that were commodity exporters must continue to adjust their economic policies to reflect the new reality, and to diversify their economies to the maximum extent possible. He would also emphasize the last sentence of the Executive Summary of the Bank report: "it is only through the acceleration of global growth and broad-based development that the commodity problem can be resolved." The onus thus fell equally upon the industrial countries to adopt policies that will stimulate the global economy if commodity receipts were to improve. Recent improvements in policy coordination are encouraging in that regard. Sectoral policies were an important element of the industrial policies that must be addressed. His Canadian authorities in particular felt that modifications to costly agricultural policies, the costs of which were amply demonstrated in the Bank paper, were needed to improve the prospects for agricultural commodity exporters. Without timely action on all those fronts, it might be hard to realize even the modest improvement in prices over the medium term that was cautiously projected in the papers before the Board.

Mr. Salehkhou made the following statement:

Discussion of the two papers before us is long overdue. The analysis of short-term developments and long-term trends of primary commodity prices, the examination of the underlying factors that might explain such trends, and the construction of short- and medium-term scenarios for raw materials in general help put in perspective a number of important issues being addressed by the Fund and the World Bank. Prominent among these issues is the lack of progress in most developing countries' efforts to adjust and to sustain heavy external financial obligations, in spite of generally far-reaching reforms and prolonged Fund and World Bank support. Market prospects for raw materials are equally relevant to the assessment of the various debt strategies and proposals, and to the sustainability at the global and systematic levels of current trade and growth policies in both industrial and developing economies.

Concern about the steady deterioration of primary commodity prices in the 1980s is reinforced by the data in these papers, which indicate in particular that in real terms, primary commodity prices are at their lowest level since the 1930s, that the short-term prospects for their recovery are very weak, that by 2000 real prices will still be below the extremely depressed levels of 1985, and that the conditions necessary for the reversal of current trends over the medium and long term are far from being actively addressed. Misconceptions about the beneficial impact of low raw materials prices for consumer economies are also highlighted by the analysis of the interactions between consumer and producer economies, and by the evidence of the adverse implications that the prolonged depression of primary commodity markets has on world trade, external debt, domestic financial policies, and structural adjustment in both industrial and developing countries.

Despite the specificity of each commodity market, the staff analysis does point to a number of common causes that appear to have been crucial to the current situation and to earlier trends of primary commodity prices. Low real economic growth in the industrial countries in the 1980s is certainly the major factor behind the steady price deterioration--and the unsatisfactory short- and medium-term forecasts. As noted in the Fund paper, the performance of the seven major industrial economies with respect to growth, industrial production, and gross domestic investment was significantly lower than that of the 1970s, with the more recent period showing a longer recession and a weaker recovery. Other major factors include the market disruptions caused by specific industrial countries' policies, the excessive oversupply in most commodity markets, and the steady decline in the use of raw materials in relation to GNP, which reflect, inter alia, the increasing importance of services in the respective economies, the expanded research and development efforts being undertaken out of concern for the depletion of natural resources, and the trend toward smaller and lighter consumer products. While the marked deceleration of the rate of inflation in the 1980s, the maintenance of relatively high international interest rates, and the recent sharp depreciation of the U.S. dollar have also contributed somewhat to the depression of commodity prices, it is the role of inadequate economic and financial policies that should be of major concern.

The excessive dependence of many developing countries on primary commodities for their growth and for the financing of government budgets as well as the balance of payments is reflected in the generally sharp deterioration experienced by those economies as a result of adverse price movements. Output diversification typically has lagged behind in these countries. While recent adjustment efforts have focused on the need for the productive base of those economies to expand beyond the traditional export sectors--through better allocation of resources and greater emphasis on efficiency--the positive effects of such efforts can be felt only over the long term. More important, exogenous factors have significantly complicated these efforts. The heavy burden of external debt and the virtual drying up of external financing have exacerbated the adverse effects of declining primary commodity prices and have forced the concerned economies to adopt severe austerity programs which, by curtailing investment and imports, have actually precluded meaningful progress toward diversification. External obligations have also led in many instances to an excessive expansion of primary commodity production and to further price depression. More important, diversification and adjustment efforts in primary commodity economies have been affected adversely by trade practices in the industrial countries.

In examining these practices, the staff papers concentrate on agricultural policies in the United States, the EEC, and Japan, which have substantially contributed to the oversupply of farm products and to the dangerous protectionist environment of the past few years. However, these practices are by no means limited to agriculture. Significant trade barriers are directed specifically at many products for which developing countries appear to enjoy a comparative advantage. The experience with other exports, such as textiles and petrochemicals, is equally indicative of the adverse implications of the trade policies of industrial countries and should also have been discussed in the staff papers, especially in view of the direct impact of such barriers on the diversification of primary commodity-exporting economies.

The cause for concern about industrial countries' agricultural policies is, however, well illustrated in the papers; they have adequately exposed the internal and international imbalances resulting from the industrial countries' maintenance of domestic producer prices well above world market prices, and from their effective shields against external competitiveness. These policies contrast sharply with the pressures exerted by industrial countries and with their preaching, through the Fund and the World Bank, for greater trade liberalization and for more efficient allocation of resources in the developing economies and internationally. These policies also indicate the scope of structural adjustment that is required in the large industrial countries so as to promote fairer primary commodity prices, facilitate orderly adjustment and diversification in commodity-exporting countries, and reduce the rigidities and imbalances within their own economies.

The Fund and the World Bank could play a major role in dealing with current difficulties. While their contribution to adjustment and diversification in the developing countries has generally been aimed in the right direction, it is reinforced by the recent emphasis on sectoral development and efficiency, as well as by the availability of an adequate inflow of interim external resources to help mitigate the initial shock of the needed reforms. The Fund's compensatory financing facility has also been instrumental in helping primary commodity exporters to weather the effects of price fluctuations while adopting corrective measures, although pressures to tighten the conditionality of the compensatory financing facility are increasingly weakening its effectiveness. Flexibility in adjusting Fund and World Bank programs to take into account further deterioration in commodity markets would also ensure a higher degree of success in the implementation of these programs. It should be noted, however, that in spite of the Fund's systemic responsibilities, its role in stressing the inadequacy of industrial countries' trade policies and acting toward their elimination remains insignificant. A more prominent analysis, in both multilateral and bilateral surveillance, of the industrial countries' trade and protectionist policies is required, not only in view of the asymmetry of the Fund procedures but, more important, in view of the adverse implications of such policies for other members and for the international monetary system.

Mr. Foot said that because his World Bank colleague had made a lengthy statement at the meeting of the Bank's committee of the whole on the preceding day, he could be brief. He had found that the Bank and Fund papers provided a good analysis of commodity prices during the 1980s. There was evidence of a persistent long-term downward trend in commodity prices, but it was possible to take different views of the data that were available.

In two minor ways, the report was not entirely consistent with his authorities' own forecasts, Mr. Foot added. Too little emphasis might have been placed on structural factors in the explanation of the recent sharp declines in commodity prices, and the short-term forecasts of food prices might have been too optimistic about the length of the recovery in response to the changes in supply that were assumed to follow from the low prices of 1986-87.

In his view, the papers made a powerful case in favor of more market-oriented agricultural policies in both the developed and developing countries, Mr. Foot concluded.

Mr. Morales made the following statement:

> During the current decade the prices of the non-fuel primary commodities have experienced a declining trend. Prices are at their lowest levels in real terms since the depression of the 1930s and the decline has occurred across the whole spectrum of primary products. At the same time, virtually all the developing countries depend heavily on the production of these primary commodities for their export earnings, and in aggregate, primary commodities account for half their exports. As a consequence, by 1986 the terms of trade of these countries were 20 percent lower than in 1980. The sharp deterioration in the terms of trade has emerged in an environment characterized by high real interest rates, sluggish external demand, and scarce external finance. All the developing countries, especially the highly indebted ones, were forced to make drastic cuts in their import levels, usually along with reductions in consumption and investment. In the light of such circumstances, the developing nations were bound to find that their ability to achieve the required sustained economic growth was totally constrained, and that their capability for servicing their external indebtedness was highly impaired. Furthermore, the prospects of a recovery in the prices of the primary products are slim: by 2000, they are expected still to be 4 percent below their 1985 levels.
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> Prices of primary commodities fluctuate in direct relation to the economic activity of the industrial countries, and therefore, it is necessary to have an acceleration in world growth above what has been projected. It is also necessary to have adequate macroeconomic policies, which while maintaining the recent positive

developments in economic performance--mainly the reduction in inflation rates and decreases in interest rates--will concentrate on sharply accelerating the pace of growth for the years to come. The surveillance role of the Fund should be strengthened to help ensure this development.

Another aspect of the commodity market prospects relates to agricultural protectionism in the industrial countries. Without doubt, the $33 billion of resources that these countries use to subsidize the agricultural sector is likely to generate wide distortions in the world economy. The examples mentioned in the World Bank paper are clearly illustrative of this point. Protectionist policies in the agricultural sector of the industrial countries should be avoided, and every effort should be made by individual countries and in the context of world trade negotiations to pursue this goal actively, because the world economy will benefit from a more liberal environment for trade.

Finally, the trend that is clearly foreseen for the next 15 years in the terms of trade of the developing nations will be an additional constraint on the success of policies that could permit those nations to overcome the debt problem. In this connection, the negative effects that the terms of trade could have on the generation of trade surpluses will damage a country's potential to increase savings to levels that would enable it not only to make the necessary investment expenditures but also to make debt payments. The deterioration in the terms of trade will require additional net borrowing, which will worsen creditworthiness and lengthen the time needed for a country to alleviate its debt burden. Some people consider that one of the important reasons behind the terms of trade deterioration for many developing countries is their simultaneous adjustment toward lower account deficits. This type of adjustment is partly sought by countries, partly unavoidable, and partly the consequence of the retrenchment of commercial bank lending. Staff comment on the importance of this phenomenon and on how the Fund can address it would be helpful.

Ms. Bush said that it was important for the Development Committee to review the outlook for primary commodity prices, in view of the impact on the balance of payments and payments prospects of developing countries, and given the debt problems that had beset developing countries in recent years. Such a discussion was also important in the light of the secular, as well as the cyclical, trends in commodity markets. The secular trends reinforced the concerns that her chair had raised at EBM/87/37 (3/3/87) about the downward trends of a number of commodity prices. Those downward trends were related to several factors, including technological changes and alterations in consumer tastes. Those changes, which raised doubts that prices on commodity markets would fully recover their former levels, reinforced the need to promote diversification of exports in developing countries and to reduce dependence on basic commodity exports. Those changes were also the basis for her chair's position that the compensatory financing facility should not be used to encourage production of materials that might not recover much in the medium and long term from the earnings shortfall.

The World Bank paper rightly emphasized the importance of the role of domestic policies of developing countries in reducing their dependence on a limited basket of commodities, Ms. Bush remarked. Unfortunately, the discriminatory policies against producers of primary commodities in some developing countries--by which prices were kept low to satisfy urban dwellers, or commodity exports were taxed heavily--often had an adverse effect on the willingness of producers to provide those commodities for export, and at the same time those policies did not succeed in keeping costs down for manufacturing. Such inward-looking policies had often resulted in only limited diversification into manufacturing, and sometimes had led to an insufficient ability to produce food for domestic consumption.

Many developing countries had begun to address those issues, Ms. Bush went on. The impact of exchange rate policies and trade restrictions was often stronger than that of sector-specific taxes or subsidies. Macroeconomic and structural policies were being developed in response to the problems facing the developing countries, which was particularly important. It was noteworthy that the effects of the changes in commodity prices had not been uniform for all the developing countries.

She agreed with Mr. Nimatallah that both the industrial and developing countries had to deal with those problems, Ms. Bush stated. Growth in industrial countries was obviously quite important. In addition, the coordination of policies by industrial countries that were typically large importers of commodities and other products from developing countries was important in dealing with the commodity price issue. Finally, it was necessary to foster multilateral efforts to reach satisfactory agreement on the particular problems associated with trade and agriculture.

Mr. Zecchini made the following statement:

> We concur with the basic thrust of the Fund staff's analysis and assessment. The function of this Fund paper is not clear, however; it contains no policy discussion, while the World Bank paper does. We would appreciate comments by the staff on this point, as well as the staff's opinion on the document prepared by the World Bank staff.
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> In the face of the two lines of thought as to price developments, that is, the rising trend hypothesis based on the relative scarcity of the supply of natural resources and the hypothesis of a secular downward trend, we believe that there is not enough evidence to support either hypothesis. Periods of rising trends

can give way to periods of declining trends as a result not only of supply constraints or demand trends, but also of policy approaches of major producer and consumer countries. There is no strong evidence of a continuing deterioration of the terms of trade for the exporters of primary products, but the terms of trade might maintain approximately the present positions in the near future. In 1987, we do not envisage a strong recovery of the prices of primary products, but we can expect a stabilization of prices. It would be interesting to explore better the relationship between world price changes and the changes in the external value of the U.S. dollar or of the currency in which these commodity prices are denominated.

Two general conclusions can be drawn from the Fund paper: (1) prices of primary products are not expected to fall significantly in 1987 and it is most likely that they are bottoming out currently; (2) to the extent that the terms of trade of primary product exporters or the real prices of these commodities are not going to recover rapidly, these countries and the financial community have to adjust to this situation, which will persist in the near future.

We do not think that the two documents provide adequate policy recommendations. For instance, criticism of the agricultural policies in industrial countries is not based on an adequate analysis of the economic and financial rationale of these policies. Therefore, we consider that these two documents offer a broad overview of some evidence and some projections that cannot themselves elicit a policy debate aimed at taking specific decisions. This overview has to be followed by more in-depth analyses and discussions in appropriate forums, before any policy conclusion can be reached.

Mr. Puro stated that the subject of primary commodity markets was very important for the entire world economic community. He welcomed the analysis in the staff papers and looked forward to the discussion in the Development Committee. The papers presented the state of and outlook for primary commodity markets quite well. He generally agreed with the conclusions in the documents and with previous speakers that commodity market problems had to be addressed by industrial and developing countries alike. Sustained economic growth was needed in the industrial countries, as was a rollback of protectionism. In developing countries, it was essential to improve the allocation of resources and, particularly, to diversify production.

It was clear that the Fund had an important role to play in defining the measures needed to address those problems, Mr. Puro remarked. The Fund's present policies, both in surveillance and lending, had been in the right direction and, as pointed out by Mr. Grosche, some results were emerging. However, the tasks were huge. Therefore, continuous and strengthened cooperative efforts needed to be taken in order to stabilize the developments in the primary commodity markets.

Mr. Yamazaki stated that he could broadly support the thrust of the staff papers, which seemed generally appropriate. Given the importance of the overall issue for the world economy, and particularly the large number of developing countries identified as the predominant exporters of non-fuel primary commodities, it was quite appropriate to take up the issue in the forthcoming Development Committee.

Admittedly, the importance of the issue and the factors that influenced the developments were complicated, interrelated, and very hard to tackle, Mr. Yamazaki noted. Some, like the weather, were beyond anybody's control. That did not, by any means, reduce the importance of the issue. In that context, he had been impressed by Mr. Grosche's statement with regard to the issue's relevance to debt problems, and with respect to the role to be pursued by the Fund and the Bank, which, of course, required them to cooperate closely.

At the same time, the efforts of the developing countries themselves were important, Mr. Yamazaki said. As was rightly pointed out by Mr. Ismael and others, further export diversification should be initiated. The concessional funds that flowed from the industrial countries and international institutions could support those efforts. He expected that a very fruitful discussion would be held in the next Development Committee meeting.

Mr. Mustafa made the following statement:

> The Fund and Bank papers before us deal with past developments and prospects of the non-fuel primary commodity markets and provide a useful analysis of their serious adverse implications, particularly with regard to the developing countries exporting predominantly primary commodities. The tendency of primary commodity prices to fluctuate widely, albeit in a declining secular trend, has had a significant impact on the export earnings of developing countries, which has complicated their ability to sustain import levels and development efforts. During the past two decades, the buoyancy of primary commodity prices in the 1970s gave way to a substantial weakening in the 1980s, and real commodity prices in 1986 were at their lowest level since the depression of the 1930s. Moreover, future price movements are not likely to deviate substantially from historical trends, particularly in the absence of strengthening corrective policy responses.
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> It would be helpful to have staff comments on the rationale for the exclusion of oil from consideration with other primary commodities. I noted that some effort was made in Appendix I of

one of the world economic outlook papers (SM/87/54, 2/25/87) to distinguish between the markets for oil and other primary commodities. It was argued there that the two markets differ in nature, particularly on the supply side, and that the relatively similar behavior of oil and non-oil commodity prices in the recent past can be explained partly by the coincidental occurrence of unrelated factors and developments. Apart from arguing the underlying reasoning of such a distinction, one can point to dissimilarities between the markets of other non-oil primary commodities. At any rate, differences between the markets for oil and non-oil primary commodities may justify analyzing the oil market separately in studies of primary commodity markets, but does not necessarily justify its total exclusion. Despite the decline in the oil market in recent years, oil continues to be an important commodity for both exporters and importers. The attention paid to the decline in the oil market in recent years and its adverse implications for a large number of developing countries is hardly adequate compared with the substantial interest in oil market developments during the 1970s.

The findings of the two papers call for appropriate policy responses to alleviate the impact of short-term fluctuations and the secular decline in primary commodity prices. This will require action on both the demand and supply sides as well as increased cooperation between industrial countries and developing countries to help the developing countries diversify their economies and reduce their dependence on primary commodity exports. The Fund and the Bank also have an important role to play in meeting the developing countries' needs for short- and long-term financing to cope with export shortfalls and enhance growth-oriented adjustment.

The papers highlight four major factors accounting for the depressed commodity markets. Three demand side factors relate to industrial countries: slow economic growth, continued reductions in the intensity of the use of raw materials in production, and market disruptions owing to the agricultural policies of industrial countries. Slow economic growth is the major factor behind cyclical movements, whereas agricultural policies have their main impact on long-term trends. The continued reduction in the intensity of the use of raw materials in the production processes in industrial countries also has the potential of contributing significantly to the secular decline in commodity prices. Appropriate action by industrial countries is therefore required to alleviate the adverse consequences of these factors.

The fourth factor contributing to the depressed commodity markets relates to oversupply because of past investments in the producing countries. These countries also have to devise effective policies to cope with the short-term fluctuations and the secular decline in export prices of commodities. For the year-to-year price fluctuations, national buffer schemes in producing countries may be a good response, but they are constrained by the availability of external financing. Domestic bank financing may add to inflationary pressures and restrict credit to other deserving sectors. Moreover, the need for foreign exchange may be too pressing to restrict exports despite low international prices. Hence, foreign financing on appropriate terms may be indispensable.

The demand for primary commodities is income and price inelastic, which has an important bearing on the allocation of scarce resources among competing uses in the producer countries in the context of the secular decline in commodity prices. The argument made in the Bank paper for maximizing export revenues by raising rather than restraining output of primary commodities is not entirely convincing, except in the case of increasing output through greater efficiency. The developing countries will have to compare the relative returns on new investments in these commodities and other import-substituting activities, including manufacturing based on these commodities.

Mr. Song commented that he would not repeat the statement made by his colleague in the preceding day's discussion by the Executive Directors of the World Bank, and indicated that he could go along with the views expressed by the majority of speakers thus far. In any event, the commodity issue was one aspect of the global economic problem and its resolution should be in the context of the world economy as a whole. The issue was surely a key item for the Development Committee meeting.

Mr. Santos said that he welcomed the discussion on the non-fuel primary commodity markets in the 1980s. Primary commodities were of crucial importance for the countries of his constituency and for developing countries in general. The discussion was therefore timely because developments in non-fuel commodity markets over the past few years had been disappointing. In addition, the medium- and long-term prospects were not reassuring. Those developments were even more disquieting because developing countries were facing declining terms of trade and were experiencing increasing outflows of their export receipts, most of which were directed at servicing their external debts.

As experience had shown, the decline in commodity prices in the 1980s had complicated the already severe adjustment problems of many developing countries and significantly hurt their economic performance. Most of the programs supported by the Fund had been inoperative largely because of the wide fluctuations in export prices, and their consequent adverse impact on fiscal revenues. In that regard, he thought that the Fund staff paper should have been a little more ambitious in scope and should have included an evaluation of the consequences of those fluctuations on the performance of the Fund-supported adjustment programs being implemented.

Moreover, as other Directors had noted, there was a clear need for a new plan of action by the Fund to help those countries to offset the losses in their export earnings.

He was in broad agreement with the staff that both the industrial and developing countries had to adjust their policies to the changing scenario. As prospects for better commodity prices were based on the level of economic activity in the industrial countries, those countries should improve their macroeconomic management, accelerate their growth, and avoid establishing protectionist measures in order to maintain an open world trade environment. By doing so they would greatly boost the prospects of the developing countries.

The staff representative from the Research Department remarked that the purpose of the Fund paper had been to supplement the broader, more comprehensive coverage provided in the Bank paper with additional details on the short- to medium-term prospects for the movements in commodity prices. In that respect, the Fund paper had had a limited scope, and it might have been more apt to number the two papers accordingly, namely, to make the Bank paper the primary paper and the Fund paper the supplement. The Fund staff had also collaborated with the Bank staff in the preparation of the Bank paper, particularly in Section 1, dealing with the market situation, and Section 5, discussing the policies that were in operation to deal with the question of the instability of earnings from primary commodities. The Fund staff was in broad agreement with the conclusions and policy recommendations of the World Bank paper.

The Fund paper had not provided an analysis of Fund policies because the Development Committee had requested--in its communiqués following the April 1986 and September 1986 meetings--a study on market prospects of raw materials, and an analysis of the impact of industrial countries' agricultural policies in the economic prospects of developing countries, but had not specified a need for any discussion or analysis of policies, the staff representative commented. The staff had therefore prepared a paper to serve as background for any discussion by the Committee. Some policy discussion of the issue, however, had already taken place within the context of the review of the compensatory financing facility by the Executive Board. The more narrowly focused Fund paper had not included a discussion of oil prices, although the more comprehensive Bank paper did cover both oil and non-oil market prospects.

Although the projections for real commodity prices might have appeared to differ in the Bank and Fund papers, in fact the two projections were not in conflict, the staff representative from the Research Department explained. The real prices of commodities, which had declined by 19 percent in 1986, were expected to decline by 14 percent in 1987; and even though it was expected that real prices would increase modestly after 1987, it was not likely that they would attain the 1985 level by 2000.

The Executive Secretary of the Development Committee noted that the provisional agenda for the forthcoming Development Committee meeting had been circulated to members (DC/87/1, 3/5/87). The Chairman of the Development Committee would soon circulate his opening statement, which was intended to help focus the debate among the Committee members. Finally, he had been pleased to hear from the Fund staff that the two documents--EB/CW/DC/87/2 (2/25/87) and Supplement 1 (3/2/87)--would be circulated to the Development Committee as one paper. Because the Development Committee was a joint committee of the Bank and the Fund, it was appropriate for the study requested by that Committee to be a joint presentation, in line with the wording of its last communiqué.

The Acting Chairman made the following summing up:

Directors agreed that the issue of non-fuel primary commodity developments needed to be seen in a global context. They stressed that non-fuel commodity price developments had had a negative impact on the world economy in several ways. First, they noted, the commodity price developments had added to the difficulty in solving debt problems facing a number of countries. Although sub-Saharan African countries had been hit particularly hard, other debtor countries also faced problems owing to the decline in commodity prices. In that context, they also noted, the price decline had worsened the climate in which a number of economic adjustment programs had been launched during the 1980s. Second, non-fuel commodity price developments had undermined the growth and development prospects of developing countries by negatively affecting invest ment as well as consumption, Directors added. Third, they observed, the developments in commodity prices had also had a negative impact on the general stability of the international monetary system. At the same time, it was recognized that general world economic conditions--including developments in the business cycle, especially the recession in the early 1980s, and high interest rates--had had a negative feedback effect on commodity prices. Thus, the effort to resolve commodity price and production problems needed to be seen in a global context, and, given their interdependence, all countries had important responsibilities in that effort.

Directors remarked that the commodity price prospects outlined in the reports of the World Bank and the Fund were indeed sobering. While recognizing the uncertainties surrounding any judgment about developments in the commodity markets, some Directors considered that the staff's outlook was perhaps too negative. In that connection, they stressed that economic factors and market forces had an important impact on commodity price developments, that the elasticity of supply might be higher than expected, and, in turn, that recent commodity price developments might set in motion reactions on the demand side that could strengthen the future outlook for commodity prices. At the same time, it was acknowledged that technological and structural changes, many of which had been in response to earlier commodity price developments, might hamper the recovery of commodity prices in the immediate future.

With respect to the role of industrial countries in influencing commodity developments, Directors agreed that macroeconomic conditions in the industrial world would have an important impact on commodity price prospects; that indeed, at a minimum, it was necessary to maintain economic growth in the range of 3 percent; and that it was also important to achieve interest rate conditions and rates of inflation that were conducive to greater macroeconomic stability. A number of Directors stressed that it was important for the industrial countries to focus on eliminating subsidies and adjusting general commodity and industrial policies that had a direct impact on commodity production and the export possibilities of the developing countries.

The negative impact of the industrial countries' protectionism against commodity imports was underscored by a number of speakers. Some Directors suggested that the papers did not give enough attention to the recent developments in agricultural trade policies in industrial countries. A few speakers pointed to the planned improvements in the agricultural policies of the European Communities. Directors also observed that the plan of industrial and developing countries to address agricultural trade problems in the context of the Uruguay Round should have a positive impact on the export prospects of developing countries.

Directors stressed that it was essential for the developing countries to pursue economic diversification to reduce the dependence of individual countries on a single commodity, and that those diversification efforts would require appropriate macroeconomic, as well as structural, policies. It was also suggested that developing countries address policies that discriminated against commodities: for example, producer prices that discouraged production, and export taxes that often worked to discourage exports.

With respect to the roles of the Bank and the Fund, Directors stated that it was important for the Fund to support sound macroeconomic policies--both in the developing and the industrial countries--that were conducive to creating a world economic environment that would promote a recovery in the commodity markets. A number of Directors noted the useful role that the Fund could continue to play in assisting industrial countries to improve the coordination of their economic policies. In discussing the Fund's role vis-à-vis the developing countries, several Directors said that the compensatory financing facility should be more responsive in helping countries faced with commodity price declines; interest was also expressed in providing concessional support in conjunction with lending under that facility. At the same time, however, other speakers were of the view that the compensatory financing facility should not be seen as a facility to finance secular declines in commodity prices or to encourage uneconomic production.

With respect to the role of the World Bank, Directors indicated that its continued support for structural changes in developing countries, as well as its support for projects--both of which would be aimed at helping the countries diversify their export and domestic production bases--would help to alleviate the problems that declining commodity prices caused for those countries.

Finally, Directors underscored the importance of continued close collaboration between the World Bank and the Fund in all their efforts to overcome the difficulties posed by recent commodity price movements.