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EBS/85/47

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March 11, 1985

To: Members of the Executive Board

From: The Secretary

Subject: The World Economy to 1990 - Prospects and Issues

The attached paper, summarizing short- and medium-term prospects for the world economy and presenting a number of key policy issues, has been scheduled for Executive Board discussion on Monday, April 1 and Wednesday, April 3, 1985, together with two companion papers entitled "World Economic Outlook: Current Situation and Short-Term Prospects" (EBS/85/48) and "World Economic Outlook: Medium-Term Scenarios" (EBS/85/49). "World Economic Outlook: Statistical Appendix" (EBS/85/50) includes statistical tables common to the above two companion papers.

The following additional papers, constituting some of the analytical framework of the current World Economic Outlook exercise, are being issued as background documentation for the Executive Board discussions:

1.	Fiscal Policy in the Major Industrial Countries	SM/85/70
2.	Monetary Developments in Major Industrial Countries	SM/85/71
3.	Non-Oil Primary Commodity Price Developments and Prospects	SM/85/72
4.	World Oil Situation	SM/85/73
5.	Economic Developments in Eastern Europe and the U.S.S.R.	SM/85/74
6.	Estimating Growth Potential in Industrial Countries	SM/85/75
7.	Domestic and International Effects of the U.S. Fiscal Position	SM/85/76
8.	Structural Policies in Industrial Countries	SM/85/77

9.	Developing Countries: Impact of the External Environment and Domestic Policies on Economic Performance	SM/85/78
10.	Trends in Capital Flows to Developing Countries	SM/85/79
11.	Medium-Term Projections by Staffs of the Bank and the Fund: A Note on Differences in Methodology and Assumptions	SM/85/80

It is planned to release the above material in publication form shortly after Interim and Development Committee meetings. If Executive Directors have any particular comments, they are requested to communicate them to the contact person(s) mentioned in the Secretary's transmittal note for each of the documents. In view of the tight publication timetable, it is requested that any comments be given as far as possible by April 1, 1985 and, in any case, not later than the close of business on Wednesday, April 3, 1985.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Crockett (ext. 8982).

Att: (1)

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INTERNATIONAL MONETARY FUND

The World Economy to 1990: Prospects and Issues

Prepared by the Research Department

(In consultation with the Area Departments, the Exchange and Trade Relations Department and the Fiscal Affairs Department)

Approved by Wm. C. Hood

March 11, 1985

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The World Economy to 1990: Prospects and Issues

I. Introduction

The present paper summarizes short- and medium-term prospects for the world economy and presents a number of key policy issues that arise for member countries in this context. The paper should be read in conjunction with the analysis presented in two supplementary reports, "World Economic Outlook: Current Situation and Short-Term Prospects" (EBS/85/48) and "World Economic Outlook: Medium-Term Scenarios" (EBS/85/49). These two papers, together with the Statistical Appendix (EBS/85/50), and Supplementary Notes (SM/85/70-80), constitute the quantitative and analytical framework within which the discussion in the present paper is conducted.

As usual, the short-term projections are the outcome of a comprehensive interdepartmental forecasting exercise that draws on the expertise of country specialists from the Area Departments. The exercise is coordinated in the Research Department, which ensures that individual country projections are made on a similar basis and makes modifications where necessary to ensure consistency with global trends. The conventions employed in generating the forecasts are set out in more detail in the introductory notes to the statistical tables.

The medium-term scenarios are considerably more detailed than those of past World Economic Outlook exercises. They are intended to show a possible evolution of the world economy under some definition of "most likely" policies and to indicate the sensitivity of this outcome to specified alternative settings of policies that could be considered a significant possibility.

The plan of this paper is as follows: Section II analyzes the current situation and short-term prospects of the world economy, while Section III discusses the relationship between policies and outcomes in the medium term. These sections form the background for the review of policy issues in the remainder of the paper. Section IV deals with issues of medium-term economic management in industrial countries; Section V with policies in developing countries, and Section VI with issues that relate to the functioning of the international economic system more generally. A selection of summary statistical tables is included as an annex in the present paper, for the convenience of readers.

II. Current Situation and Short-Term Outlook

1. Introduction

The performance of the world economy in 1984 turned out to be considerably better than had been expected at the beginning of the year. Output grew robustly in the industrial countries, especially the United States and Japan; inflation continued to decline; and the developing countries saw a noteworthy improvement both in their balance of payments position and in their domestic growth performance. Fears that the debt situation might deteriorate did not materialize.

All the same, many policy problems remain. Some, indeed have become more difficult for being left unattended over the past year. The imbalance in current account positions among industrial countries, for example, has intensified, and disparities in fiscal stance have continued. Unemployment in Europe has remained intractable. And living standards in developing countries, while at last rising on a weighted average basis, have a long way to go before regaining the levels of five years back.

2. Output and employment

Real GNP growth in industrial countries was 4 3/4 percent in 1984, the best performance since 1976 (Table 1). As in 1983, the U.S. economy had the strongest gain in output, with particularly rapid growth in demand during the first half of the year. Elsewhere in the industrial world, the pace of output growth picked up in Japan, while expansion in Europe did no more than keep pace with the estimated rise in productive potential.

An encouraging feature of developments in the past year is the strengthening of investment. In the United States, business capital formation has grown even faster than might have been expected on cyclical grounds, while in the United Kingdom, Japan, and some other countries, such spending, although starting from a low base, has also shown notable increases. Less encouraging has been the persistence of a lopsided geographic pattern of demand growth, with domestic demand growing faster than output in the United States and, to a lesser extent in the United Kingdom, while most other countries received stimulus from the net foreign balance. This pattern of demand growth has helped spread the benefits of recovery, but it has been associated with a widening of current account imbalances.

For 1985 and 1986, the expansion in the industrial countries is expected to slow to about 3 percent a year, but to have a pattern that is more balanced geographically. In the United States, the continuation of cautious monetary policies, together with a lessening fiscal stimulus, is expected to hold the growth of demand well below last year's pace. However, the strength of such underlying factors as household incomes, consumer confidence, and investment intentions makes it unlikely that this moderation in demand growth would lead to any significant weakness in activity. In Japan and Europe, the strengthening of domestic demand, which was an important feature of developments in 1984, seems likely to continue in 1985 and to largely offset some slowing in export growth.

The recovery of output is gradually spreading to the developing countries. The growth of real GDP in these countries rose from 1 1/2 percent in 1982-83, to 3 3/4 percent in 1984 (Table 1). While many fuel exporting countries continued to be affected by the weakness in oil demand, growth in the non-fuel exporters accelerated from some 2 1/2 percent per annum in 1982-83 to 4 1/2 percent in 1984. 1/

The improved performance in developing countries reflected the strength of exports, particularly in those countries that made progress in adjustment following the financial difficulties they had encountered in earlier years. Overall, exports grew by 8 percent in volume. Countries that rely predominantly on commercial sources for financing their current account, and which had had the weakest performance in 1982-83, rebounded most strongly in 1984. After having declined by 0.6 percent in 1983, output in these countries grew by over 3 percent in 1984. Countries that are more reliant on official financing--often poorer countries with greater dependence on primary commodity exports--benefited less from the upturn in the world economy. Growth in sub-Saharan Africa, for example, averaged only 1.5 percent in 1984, and in the developing world at large, half of all countries had growth of 2 3/4 percent or less.

As to the future, a slight further acceleration in the average growth rate of developing countries is projected for both 1985 and 1986. This acceleration reflects the continued recovery in the industrial world and the beneficial effects of adjustment measures in developing countries themselves. In evaluating the rather limited increase in average growth that is projected, two considerations should be borne in mind: first, the fact that additional resources no longer have to be diverted to bring about an improvement in the balance of payments means that virtually all of the expansion in output will be available to increase domestic absorption; second, the fact that the acceleration in growth is concentrated in groups of countries with below-average rates of growth in 1984 means that the geographic basis of recovery will be widened. Thus, for the first time in several years, the economies of each major region and group of countries are projected to grow at least as fast as their populations.

1/ For a definition of the country categories used in this paper, see "World Economic Outlook: Statistical Appendix" (EBS/85/50).

The recovery in output is benefiting the employment situation, although the lack of satisfactory statistics precludes a quantitative assessment for most developing countries. In the industrial world, employment increased rapidly in the United States and Canada in 1984, and at least stopped falling in Europe. However, with continued labor force growth, unemployment rates reached new highs in several European countries, including the four largest ones. In the seven major industrial countries taken together, unemployment averaged 7.7 percent of the labor force in 1984, only 1 percentage point below the recession peak. 1985 seems likely to bring a stabilization in the unemployment situation in Europe, even though some countries, including France, are expected to experience a further rise. For industrial countries as a group, joblessness is expected to decline by about 1/4 of 1 percentage point.

Unemployment in developing countries cannot be tracked by available statistics, in part because changes in employment are manifested partly in changes in the rate of rural-urban migration and in underemployment in traditional pursuits. There can be little doubt that such underemployment has increased substantially in recent years; and that the rates of output growth achieved in 1984 and projected for 1985 and 1986 will do little more than stabilize the situation.

3. Inflation and interest rates

Fears that recovery might lead to a resurgence of inflationary pressures have so far proved unfounded. For the industrial countries as a whole, the increase in the GNP deflator slowed from 4.9 percent in 1983 to 4.1 percent in 1984 (Table 2). Much of the improvement stemmed from reductions in inflation in some of the higher inflation countries, notably France and Italy. This process is expected to continue, with inflation for the group as a whole falling to around 3 3/4 percent in 1985 and holding steady at that rate in 1986.

Several factors have contributed to the improvement in inflation performance. By far the most important has been the determination of national authorities, especially in the larger countries, to reestablish a noninflationary environment. A more proximate cause has been the weakness of oil and commodity prices. At the same time, the recovery itself has contributed to a cyclical improvement in productivity that has helped restrain costs. Despite wage increases of 5-6 percent per annum, unit labor costs in manufacturing rose by only 1 percent in 1983 and actually declined slightly in 1984. This cyclical decline in costs permitted corporate profits to recover strongly in a number of countries.

A welcome development in late 1984 and the early part of 1985 was the easing in short-term interest rates in the United States. This change reversed the rise in rates that had occurred from early in 1983 up to the middle of last year, and appears to have reflected primarily the slackening in the pace of demand growth and diminished near-term inflationary expectations. Interest rates in the other major countries (except the United Kingdom) have generally been steadier and lower in real terms than those in the United States.

Despite the downward trend in U.S. interest rates just noted and the lower rates prevailing in other financial centers, real yields remain surprisingly high in a historical perspective. In January 1985 the average of short-term rates in the five principal financial centers, after adjustment for current inflation, was 4 1/2 percent; while the corresponding long-term rate was over 6 percent. These yields are 3 1/2 percentage points and 4 percentage points, respectively, above the average for 1960-80. While real interest rates are expected to fall gradually in the medium term, no decline (and even some increase) is assumed in the near-term forecast.

Inflation in developing countries (Table 2) has been reduced only to a limited extent. The median rate of inflation fell from 14.5 percent in 1980 to 10.7 percent in 1982, but progress since then has been slight. Median price increases in 1984 remained at 10 percent, considerably above the typical inflation rate among these countries in the late 1960s and early 1970s. The inflationary situation is, however, substantially more serious in several of the larger Latin American countries and in Israel, where annual rates of price increase have accelerated into triple digits. These developments are reflected in the weighted average inflation rates for the developing countries, which show a steady acceleration from about 20 percent in 1977-79 to almost 38 percent last year.

The policies that are being implemented in developing countries under programs of financial stabilization are expected to arrest this rise in weighted average inflation in 1985, and to bring about a significant reduction (to 22 1/2 percent) in 1986. It needs to be remembered, however that similar reductions have been projected by the staff in the past, but have failed to materialize as a result of policy slippages in high-inflation countries.

4. Adjustment and debt

The past several years have witnessed major shifts in the global pattern of current account balances: for the major oil exporting countries in the Middle East the swing from a surplus of $100 billion in 1980 to moderate deficits from 1983 onwards; for other developing countries the dramatic reduction in their deficit (from $113 billion in 1981 to

$38 billion in 1984); the large deterioration in the U.S. balance (from an $11 billion surplus in 1981 to a $93 billion deficit in 1984); and the partly compensating $65 billion improvement in the balances of other industrial countries over the same period (Table 5).

One encouraging feature of these developments is the strengthening in the external position of the indebted developing countries. This strengthening exceeds earlier expectations by a substantial margin and has gone a long way toward restoring a current account position that could be considered sustainable in the medium term. The degree of adjustment has, however, varied widely across countries. By far the largest adjustments, in proportionate terms, have been undertaken by the seven major borrowing countries. 1/ Responding to financing constraints, the combined current account deficit of these countries fell from $40 billion in 1982 (18 1/2 percent of their exports of goods and services) to only $1 1/2 billion (1 percent of such earnings) in 1984. Other countries that borrow primarily from commercial creditors have also sharply adjusted their current account positions. Official financing, however, has been much better sustained in the past few years, and the current account deficits of countries relying primarily on this source of credit have changed much less.

An important factor behind the reduction in the current account deficits of indebted developing countries has been the virtual cessation of spontaneous private lending since the onset of the debt crisis in 1982. Some $130 billion of new net private funds was lent, largely spontaneously, in 1981-82, but only some $30 billion in 1983-84, (of which only $7 billion was outside the framework of restructuring arrangements). In these changed circumstances, adjustment was swift, with countries reducing their financing requirements in 1984 to amounts that, in the aggregate, were no greater than the finance available through official lending and non-debt-creating flows. In the event, developing countries were able to replenish their reserves by $22 billion in 1984.

Although the aggregate current account deficit of indebted developing countries is now unusually low in relation to exports of goods and services, little change in the deficit is foreseen for 1985 and 1986. For countries that borrow from market sources, this reflects the desire of the countries concerned and their creditors to reduce debt ratios to normal levels. Deficits of the size being projected would permit a further significant increase in reserves, and require only modest borrowing from commercial bank sources.

The rapid adjustment that has been achieved by developing countries and the change in their access to private financing has brought about significant alterations in the composition and rate of growth of their external debt (Table 7). The growth of debt slowed sharply from 18 percent per annum in 1978-81 to 4 1/2 percent in 1984. Moreover, with the

1/ Argentina, Brazil, Indonesia, Korea, Mexico, Philippines, and Venezuela.

resurgence of trade in 1984, ratios of debt to exports began to recede significantly from their very high levels of 1983, a trend which is projected to continue in 1985-86.

These developments do not, however, apply in anything like the same degree to all indebted countries. Countries that borrow predominantly from official creditors did not face such a sharp curtailment of access to financing after 1982, and the shift in their current account positions has been correspondingly less. As a result, the debt to exports ratio of these countries continued to mount in 1983 and 1984, and is not expected to stabilize until 1986.

Debt service payments remain very high and show signs of easing only very gradually in relation to exports of goods and services, despite very large rescheduling operations. For the group of indebted developing countries as a whole, the debt service ratio in 1984 was 22 1/2 percent, marginally higher than in the previous year. Interest rates were slightly higher, on average, than in 1983, and the relief provided by new reschedulings was largely offset by the ending of grace periods on the large borrowings of a few years earlier. Little change in average debt service ratios is expected in 1985 and 1986.

Among the industrial countries, the most striking feature of the global payments situation is the large deterioration that has taken place in the U.S. current account position. This deterioration partly reflects the relative strength of the cyclical upswing in the United States in the past two years and the weakness of important export markets in Latin American and other indebted countries. However, it also owes much to the very sharp real appreciation of the U.S. dollar over the past four years. By February 1985 the dollar was over 50 percent above its level in late 1980 in real effective terms, and some 10 percent higher than it had been six months previously. This prolonged appreciation reflects interest rate differentials arising from the strong demand for funds in the United States by both the Government and private sector borrowers, and the attractiveness of the United States as an investment outlet for the rest of the world's savings. The continued rise of the dollar in the second half of 1984 is more difficult to explain, occurring as it did against the background of a marked narrowing in interest differentials, and a further deterioration in the current account.

The counterpart to the deterioration in the U.S. balance has been an improvement in the position of every other industrial country except the United Kingdom. Japan accounts for almost half of this improvement and had a surplus in 1984 of $35 billion. Because of the lagged impact of past exchange rate developments, an increase in the imbalance in current account positions among industrial countries is expected for 1985-86. On the conventional assumption of unchanged nominal exchange rates (from

November 1984) the current account deficit of the United States is projected to reach almost $150 billion in 1986, while the surplus of Japan would be around $45 billion.

III. Medium-Term Prospects

To provide a background for discussion of the medium-term policy issues dealt with in the next part of this paper, detailed scenarios for the possible course of the world economy to 1990 have been prepared. The scenario analysis involves projecting future developments on the basis of policies deemed most likely in the judgment of country specialists (the "baseline" scenario), and then analyzing the sensitivity of these developments to alternative settings of policies ("variant" scenarios).

1. The baseline scenario

The baseline scenario for industrial countries is constructed on the basis of the assumption that the U.S. administration will achieve some success in reducing the fiscal deficit, but that not all the expenditure cuts presently under discussion will be adopted. Specifically, it is assumed that about half the cuts proposed by the administration will be phased in during 1986-88, and will be sufficient to reduce the 1988 deficit, relative to what it would otherwise be, by just over 1 percent of GDP. Deficit reduction plans in countries other than the United States are assumed to be implemented broadly as planned, and a nonaccommodative stance of monetary policy is expected to be retained in all major industrial countries. Among developing countries, those with adjustment programs in place are assumed to implement them as planned, with some allowance for "normal" slippages. Those developing countries that do not have programs with the Fund are assumed to maintain broadly the present thrust of policies.

On the basis of these policy assumptions, an average rate of growth of slightly over 3 percent in the industrial countries is projected over the period to 1990. This results in a slight reduction in unemployment in each of the major regions of the industrial world. However, unemployment in Europe, which is considered to be at least partly attributable to structural weakness in labor markets, declines only to 9 3/4 percent in 1990, about 1 percentage point below the current level. Interest rates are expected to be somewhat lower by 1990, in real terms, than in early 1985, reflecting lower borrowing requirements by governments, and increased confidence in medium-term price stability. It is assumed that real interest rates on short-term Euro-dollar deposits would have fallen to about 3 1/2 percent by 1990, roughly midway between the yields prevailing in 1983-84 and the average on comparable assets in the period 1960-80.

Inflation in industrial countries will of course depend on the firmness with which financial policies are pursued. There is no strong reason, however, to expect a significant acceleration from recent price trends; on the other hand, no further decline has been assumed. In commodity markets, the impact of sustained moderate growth in industrial countries is assumed to be roughly balanced by expanding supply, as producers in developing countries continue to increase output. Non-oil primary commodities prices are thus expected to rise broadly in line with prices of manufactured goods exported by industrialized countries. Oil prices are a special case: it is assumed that prices will remain stable in U.S. dollar terms at their February 1985 level until the end of 1986; and thereafter will rise in line with world trade prices in general.

In appraising the implications of these trends for exchange rate and balance of payments developments, particular attention has been paid to the question of sustainability. Maintenance of the real exchange rate for the U.S. dollar at the level of November 1984 would imply an increase in the U.S. deficit on current account to the equivalent of 4 1/2 percent of GNP by 1990. (The figure would be about 5 percent if the calculation was based on rates prevailing in January-February 1985.) Furthermore, the implications that a deficit of this size would have for interest payments abroad would make increases in the deficit self-perpetuating.

While this situation is, in the staff's judgment, unsustainable, it is much more difficult to say when, how, and by how much present trends will change. For convenience, it is assumed in the baseline scenario that the U.S. dollar will depreciate by 5 percent a year, in real terms, from 1987 onwards against all other industrial country currencies, except the Canadian dollar. Since this is a rather arbitrary assumption, undue significance should not be attached to it. It implies that the underlying current account of the United States would remain in substantial deficit (of about 3 percent of GNP) in 1990. Continued improvement in the U.S. current account position after 1990 would thus be required.

These baseline developments in industrial countries form the background against which external adjustment and domestic growth prospects in developing countries can be assessed. The assumed rate of growth in industrial countries should lead to a rate of increase of developing country exports of 5-6 percent in real terms. The import capacity of developing countries will be further affected by changes in terms of trade (not expected to be significant) and by the availability of financing. Only a modest acceleration is expected in the use of private bank credit to finance developing countries' current deficits over the period to 1990. This reflects an expectation of continued caution on the part of creditors, and the desire on the part of borrowers to reduce their vulnerability to future debt difficulties by scaling back their debt-export ratios.

Nevertheless, trade-related credit from both banks and non-banks is expected to grow sufficiently to enable developing countries to increase their imports at a rate somewhat higher than the growth of their exports, permitting growth in GDP averaging about 4 3/4 percent per annum. This average growth rate conceals significant differences among groups of countries, however. Asian countries tend to benefit most from export growth and achieve average growth rates of GDP close to 6 percent. At the other extreme, the smaller low-income countries, dependent for the most part on primary commodity exports and slowly-growing official financing, are projected to have GDP growth below the average.

Current account deficits, expressed as a ratio to exports of goods and services, are expected to remain at much the same level as in 1984. This would permit a fairly significant reduction in the ratio of external debt to exports. For all indebted developing countries taken together, the debt ratio would decline from 158 percent in 1983 to 108 percent in 1990. The decline is even more dramatic for those countries whose debt ratios had risen most before and during the debt crisis. The projected reduction in debt ratios for the seven largest borrowers, for example, is from 255 percent in 1983 to 150 percent in 1990. Countries dependent on official sources of finance, by contrast, are expected actually to experience an increase in average debt ratios, from 245 percent in 1983 to 260 percent in 1990.

For those countries that are likely to have a sizable reduction in their debt ratio, and whose economic growth over the 1980s is expected to be considerably less than in the past, the question arises whether they might not be led to relax their adjustment efforts. At least four considerations are relevant in this context. First, although the aggregate debt ratio would decline substantially from the 1983 peak, it would still be little different from the level prevailing in 1980, and would be considerably higher than the corresponding figure for 1974. Second, debt service ratios would fall relatively less than the ratio of debt to exports, since debt service payments have been kept down in recent years by rescheduling arrangements. By 1990, the average debt service ratio of indebted developing countries in the baseline scenario is still over 20 percent--well above the ratio prevailing throughout the 1970s, when real interest rates were lower and principal repayments had not had time to build up. Third, some part of the projected decline in debt and debt service ratios is attributable to the assumed depreciation in the exchange rate for the U.S. dollar, which tends to increase the dollar value of exports by more than debt. There can be no guarantee that the exchange rate pattern assumed by the staff will actually materialize. Last, the events of the past several years have led both debtors and creditors to reappraise the sustainable equilibrium level for external debt. While such an equilibrium level is hard to quantify with any precision, it is clearly lower than the levels actually prevailing over the last few years.

2. Consequences of alternative policies

An obvious, but nevertheless important, conclusion to be drawn from the analysis of alternative scenarios is that the policies pursued by member countries can make a considerable difference to economic outcomes. This is especially important in the case of the industrial countries, since economic outcomes in the industrial world constitute the external environment within which developing countries' efforts to resume sustainable growth must take place.

As far as the industrial countries are concerned, 1/ the medium-term outlook is significantly affected by the extent to which reductions in fiscal deficits are implemented. If significant slippage were to occur from the budgetary strengthening that is assumed in the baseline scenario and if such slippage were accompanied by less success in structural policies, there would be a notable worsening of economic prospects. Interest rates would be likely to rise in the short term, increasing the likelihood that an unforeseen check to demand growth would be converted into a recession. The continued build-up in both the budget deficit and the external current account deficit of the United States would give rise to additional uncertainties about the sustainability of the current exchange rate pattern. Quite apart from these enhanced risks of instability, the phenomenon of "crowding out" would reduce potential growth. Under this "worse policies" scenario, the staff would therefore expect that interest rates in industrial countries would be significantly higher than in the baseline scenario, and that output growth would average only about 2 percent per annum over 1987-90 (against just over 3 percent per annum in the baseline scenario). Other consequences of worse policies in the industrial countries include a sharp, rather than a gradual, decline in the U.S. dollar, a sharp recession, and a further rise in unemployment in European countries.

Better policies are defined as a more substantial attack on the fiscal deficit in the United States (in which cuts equal in magnitude to the Administration's current request are made) and a more effective approach to structural problems in European countries. Such policies yield somewhat lower interest rates, and stronger growth in private investment. It is estimated that output growth in such a scenario could reach 3 1/2 percent in the industrial countries as a group. The outcome for exchange rates is not expected to be greatly different from that of the baseline scenario, though it is considered that the risks of volatility would be diminished.

1/ Detailed discussion of the implications of alternative policy scenarios for both the industrial and the developing countries may be found in the paper, "World Economic Outlook: Medium-Term Scenarios" (EBS/85/49).

Developing countries are affected by developments in industrial countries, as well as by the policies they themselves pursue. Given the variety of situations faced by countries in the developing world, detailed discussion of the outcomes of alternative scenarios is not feasible in the space available here. However, a few major conclusions of particular significance warrant emphasis.

First, alternative policies make a substantial difference to economic outcomes in developing countries. Better policies in industrial countries could result in an improvement in the international environment that would add more than 1 1/2 percentage points per annum to the rate of growth attained by developing countries. Even in the absence of such policies in industrial countries, better policies in developing countries could add almost 1 percent to growth performance.

Second, downside risks are judged more significant than upside risks. Because the "most likely" policies assumed in the baseline scenario are already fairly good for most countries, the scope for slippage is greater than the scope for improvement. In particular, if "worse" industrial country policies led to the kind of outcome described above, developing country growth could be cut by some 2 1/2 percentage points.

Third, outcomes are likely to vary most in respect of economic growth and relatively little in terms of current account developments. This is because of the primary importance of availability of financing in determining current account trends. In fact, current account deficits are rather larger under "better policies" than under "worse policies," precisely because of the reactions of external creditors to the policy stance in borrowing countries.

Fourth, economic developments in the major borrowers are relatively more sensitive to policies in industrial countries, while developments in those countries that rely on official financing are more responsive to changes in their own policies. It is estimated that better policies in the industrial countries could add as much as 1 3/4 percentage points per annum to the growth rate of the major borrowers, while worse policies could cut growth by over 3 percentage points. Such a cu[illegible]uld, of course, call into question the maintenance of the social consensus these countries require to implement domestic adjustment strategies, and would adversely affect the stability of the international monetary system.

Fifth, the position of the smaller low-income countries, particularly those in sub-Saharan Africa, remains precarious. Economic growth in Africa is below the average of developing countries in all the scenario variants, despite the high rate of population growth in this region. "Worse policies," whether in the industrial or in the developing countries, lead to an outcome in which little or no growth in per capita incomes in Africa would be achieved.

IV. Policy Issues in Industrial Countries

1. Introduction

For some time now, most of the major industrial countries have had a medium-term strategy for combating inflation and restoring sustainable growth. Key elements of this strategy have been the restoration of financial stability and an improvement in incentives and market efficiency. Implementation of the strategy has been recognized to require a gradual reduction in monetary expansion and firm restraint over the growth of government expenditure.

These policies have had a number of notable successes. Inflation has been brought down more rapidly than expected and has remained down even when economic recovery got under way. Growth has resumed, albeit at a fairly modest rate outside the United States and Japan. And private investment appears to be responding in some countries to better incentives and an improved climate of stability.

Nevertheless, these successes have been accompanied by a number of important failures. Unemployment in European countries remains far above levels that could be regarded as acceptable and is more than twice the rate prevailing five years ago. The large deficit in the U.S. federal budget and the growing imbalance in external payments positions raise questions about the future stability of the recovery that is now under way. A further source of uncertainty is to be found in the high and variable real rates of interest that have persisted since 1980-81.

These problems pose a number of issues for the industrial countries as they approach the task of framing economic policies for the remainder of the decade of the 1980s. A first question is whether recent shortcomings in economic performance reflect deficiencies in the economic strategy that has been espoused, or whether they can be attributed to failures in the way the strategy has been implemented. A key issue in this regard is whether demand management policies should be used more actively to stimulate economic activity in countries where recovery has been delayed.

A second set of questions concerns the structural functioning of the industrial economies, and is given importance by the continuation of high unemployment levels in Europe. To the extent that employment and structural change are impeded by rigidities and distortions, how may government policy best approach the task of counteracting these rigidities? This general problem covers a variety of particular issues, but a more general one is whether the focus of government efforts requires direct involvement in the process of structural change (say through industrial policy), or rather policies to ensure that incentives to private initiative are adequate and operating effectively.

A third set of issues concerns the interaction of economic policies among countries. Despite a welcome convergence of inflation rates, policy stances in industrial countries have differed in certain important respects over the past several years. In such circumstances, can the mechanism of exchange rate flexibility be relied on to remove sources of tension and permit the reconciliation of individual national objectives? A particular question in this regard is whether the pattern of exchange rates and current account balances that has resulted from the current configuration of policies among the major countries is sustainable; or whether it threatens difficulties that need to be addressed, both at the level of national policies and at the level of multilateral surveillance.

The remainder of this section is devoted to an elaboration of these three sets of issues.

2. Fiscal and monetary policies in the medium term

Four key features of the industrial countries' economic policy strategy, at least in its design, have been:

(i) A gradual decline in target growth rates for monetary aggregates, consistent with bringing inflation down and keeping it down;

(ii) Firm restraint over the aggregate level of government expenditure, in order to reduce the relative role of the public sector in the economy at large;

(iii) A sustained strengthening in governments' fiscal positions, in order to leave a greater share of available saving to the private sector, and

(iv) The avoidance of cyclical "fine-tuning" of demand management, to encourage a climate of greater certainty about the constancy of government policy.

If the first two of these features of the strategy still command widespread assent, the latter two have come in for more questioning. Specifically, it is pointed out that economic recovery has been strongest in the United States, where fiscal stimulus has been most marked. Those countries where the fiscal stance has been most restrained have, by contrast, experienced only modest recovery in domestic demand. Therefore, runs the argument, why not change the emphasis of fiscal policy in countries outside the United States?

Superficially plausible as this argument is, it overlooks a number of complexities in the situation. First, it is not the case that the whole of the difference between output growth in the United States and European countries can be attributed to conventional budgetary stimulus.

In the United States, expansion has owed much to declines in inflation and in interest rates, as well as to improvements in fiscal incentives and in the flexibility with which U.S. markets have functioned. In Europe, by contrast, recovery has been retarded by structural factors, including high wage costs (relative to output prices) and other market rigidities. Second, higher government deficits tend to generate short-term increases in activity at the expense of reducing the share of private sector saving that is available for investment to support longer-term growth. The United States is perhaps uniquely placed in having been able to attract substantial inflows of foreign savings that have enabled it to combine a strong boom in private investment with a widening fiscal deficit, an option that is not open to all countries. Third, a steady growth in the ratio of public sector debt to GNP will tend to erode the flexibility of fiscal policy in the longer run. A significant shift in European countries' fiscal policy, such as to make a sizable dent in existing unemployment levels, would rekindle longer-term fears about the trend in debt and the dangers of monetization. A small shift, on the other hand, might avoid such fears, but would have only marginal direct impact on activity, and could well undermine credibility in the longer-term constancy of policy.

A particular reason for not using discretionary changes (whether fiscal or monetary) as an active tool of countercyclical policy, is that the lags involved seriously compromise their effectiveness. On many occasions in the past, stimulative policies, introduced in response to apparent weakness in the economy, have had their principal effect when activity was already recovering strongly.

In the staff's view, the basic demand management strategy being followed by most countries outside the United States is broadly appropriate and is bearing fruit. Domestic demand has been picking up in Japan and a number of European countries, and investment is recovering. Growing confidence in the medium-term stability of policy has been an important feature of this development, and it would be a mistake to jeopardize such confidence by trying to force the pace of expansion. In the case of countries where the balance of payments is strong and inflation at very low levels, there may be some scope to moderate the pace at which medium-term fiscal objectives are approached. In general, however, recent trends give no grounds for change in the basic course of fiscal and monetary policy in the European countries and Japan.

In the United States, the situation is different. The United States has enjoyed considerable success in improving market incentives and revitalizing its domestic economy while bringing inflation down to a relatively low level. At the same time, however, the fiscal deficit has grown rapidly, to over 5 percent of GNP (at the federal level) in 1983-84. While this ratio is only slightly higher than the average of other industrial countries, its significance lies in the speed with which it has grown, and its current magnitude in relation to the savings of the U.S. private sector. The federal fiscal deficit is thus an important factor behind the maintenance of high levels of real interest rates in the United States, and the unprecedented net inflows of savings from abroad. These latter, in turn, are the source of the persistent upward pressure on the U.S. dollar and the erosion in the U.S. balance of payments position.

Some of the short-term consequences of the expansionary U.S. fiscal position have been beneficial. Output growth in the United States has been more rapid than might otherwise have been the case, and a significant part of the increase in demand has spilled abroad, helping to underpin the recovery of output in other countries. Even in the short term, however, U.S. fiscal policy has had some undesirable effects, particularly in the field of interest rate and exchange rate developments and in the absorption of savings from abroad. Over a longer time span, these adverse effects could well increase. The deficit threatens to build in financial imbalances that could undermine the capacity to achieve satisfactory, sustainable, growth. Publc debt is now rising rapidly in terms of GDP, and its servicing will pre-empt a growing share of budgetary resources. If foreign savings became less readily available, there could well be a sharp increase in U.S. domestic interest rates, that would tend to crowd out private investment. It is imperative, therefore, to bring about an early policy change in this key area in which one essential part of the economic strategy of industrial countries is not being implemented.

The U.S. Administration has put forward a package of deficit reduction measures that would reduce the budget deficit (relative to what it would otherwise be) by about 2 percent of GNP by 1988. If adopted, this would be an important step, but two points need to be made. First, on the basis of the staff's output projections, the reduction from current levels would be considerably smaller than 2 percent of GNP, since the underlying deficit is on an upward trend. Second, the deficit would remain well above the level that is desirable in the longer term and would, indeed, do no more than stabilize the debt-to-GNP ratio at an uncomfortably high level. Thus, the size of the package proposed by the Administration (without prejudice to its composition) is close to the minimum required, and it will need to be followed by additional measures in subsequent years.

3. Structural policies

An important reason for the better performance of the United States and Japanese economies over the past two years, as compared with Europe, lies in the flexibility with which labor and goods markets in these two countries have responded to changing circumstances. A willingness to deal with rigidities, e.g., through deregulation, has been viewed as an integral part of the overall economic strategy, particularly in the United States. The perception of greater dynamism in the United States and structural rigidities in Europe must be regarded as an important factor contributing to capital flows to the United States from the rest of the world. Dealing with such structural problems would therefore contribute to a more sustainable pattern of international payments flows, as well as to an improved economic performance in European countries.

In drawing attention to the problems of Europe, sources of rigidity that are common to all industrial countries should not be overlooked. One of these has its roots in the position of declining industries in a period of structural change. Too frequently, the response of industries which encounter a decline in demand for their output is to seek protection from foreign competition. If economies cannot operate flexibly enough to absorb displaced workers, these pressures will be all the more insistent.

At the heart of the inflexibilities which are impeding recovery in Europe lies resistance to two kinds of structural change. The first is a change in the industrial structure, brought about by the emergence of high-technology processes, and the displacement of some older industries by new products or by producers in newly industrializing countries. (Resistance to these changes is by no means confined to Europe, of course.) The second is a change in labor markets that has made earlier rates of increase of real wages no longer compatible with full employment.

Concerning the first adjustment problem, that of industrial structure, there are two rather distinct philosophical approaches (which are much less distinct in their practical application). The first approach is that the efficient management of structural change requires the active involvement of government to identify new technologies, encourage research, provide education and other infrastructure, assist with financing and start-up costs, and promote export markets. The panoply of expenditure, taxation, and regulatory instruments can be mobilized in this endeavor. Such an industrial policy can also embrace the planned decline of older industries, again through the use of fiscal instruments as well as direct assistance (financial and educational) to displaced workers.

Although some might be attracted by such an approach, it carries with with it a number of important risks. In market-oriented economies, governgovernments are generally not equipped for the function of identifying new products and processes. The political process is more likely to channel available funds to the protection of existing activities (which have workers with with votes) than to the promotion of new ones (which do not).

Moreover, if widely adopted, industrial policies could lead to international frictions as countries competed to achieve export-led dominance in new technologies. Even in those countries where government support for industrial restructuring has been most effectively used--Japan, for example--its success has depended on initiatives that have usually originated in the private sector.

More important than the adoption of specific schemes to promote structural change is the pursuit of policies that allow enterprises (public and private) to adapt flexibly to changing circumstances. To a considerable extent, this involves ensuring that labor and financial markets work efficiently, and that regulations and controls do not unintentionally perpetuate existing inflexibilities. These policies, of course, do involve governments in taking a view about changing industrial structure: education policy, for example, requires decisions to be taken concerning needs that can only be seen imperfectly.

The second major structural rigidity, which is again most apparent in European countries, is in the functioning of labor markets. Real wages continued to rise rapidly in Europe after the late 1960s, despite the fact that productivity increases were slowing down and higher energy prices were eroding the share of gross revenue available for distribution to domestic factors of production. The rise in the share of value added going to wage costs (which for this purpose includes social charges on employment) led employers to progressively economize on the employment of labor. Rigidities in labor markets have been one factor preventing an adjustment in real wages, although some adjustment has taken place in recent years under pressure of high unemployment.

As with the reaction to industrial structural change, the solutions offered to the problem of structural unemployment have reflected two divergent philosophies. On the one hand, governments have sometimes sought to cushion the effects of a decline in the demand for labor by promoting work-sharing arrangements, encouraging early retirement, and providing incentives for the repatriation of foreign workers. Measures that had the expressed objective of reducing wage costs or increasing the incentive for job search have often been rejected as having ugly social connotations. On the other hand, there has recently been an increasing and welcome focus on measures that would tend to increase the underlying demand for labor. Such measures, which are discussed in more detail in Supplementary Note 8, include reducing employment costs through a variety of techniques: modification of indexation practices, reduction or abolition of employment-based taxes, and the adjustment of minimum wages, especially for young workers where the unemployment problem is most severe. Other techniques for improving the attractiveness of employing labor are the withdrawal of subsidies that reduce the cost of capital (and thus tend to encourage undue labor-capital substitution); reduction of taxes that fall primarily on the employment of labor; and reform of legal frameworks that inhibit the flexible management of the work force (and thus make employers unwilling to employ workers they might subsequently wish to release).

4. International interactions

The third set of medium-term policy issues to be discussed in this section concerns the interaction of economic policies in a world of floating exchange rates. There is, of course, no dissent from the proposition that domestic economic policies have an international dimension, and that policies in each country should be subject to multilateral surveillance in conjunction with trading and investment partners. There is much less agreement, however, concerning the extent to which deliberate harmonization of policies (as opposed to the passive avoidance of "manipulation") is required.

One view holds that, if each country separately pursues objectives of sustainable growth and price stability, the mechanism of flexible exchange markets, against the background of a liberal trade and investment system, will suffice to harmonize any divergences in policy stance among individual countries. In this view, the appreciation of the U.S. dollar is a natural reaction to the dynamism of the U.S. economy and the swing in the investment/savings balance in the United States. It also reflects the high saving propensity of the Japanese economy and the moderateness of the revival of private investment in European countries. In such circumstances, the appreciation of the dollar and the widening of the U.S. current account deficit have served an important purpose in reconciling divergent policy trends with less disparity in economic performance than might otherwise have occurred. A final implication of this view is that exchange market trends are capable of reacting smoothly in the other direction should circumstances change.

The other view is that exchange markets are not capable of ensuring such a benign result, partly because of the volatility of expectations, and partly because of the uncertainty surrounding government policies. Such a view sees the present value of the U.S. dollar as being unsustainable, and liable to provoke unpredictable consequences. The deficit that is in prospect for the United States, and the surpluses of some other countries (notably Japan) are without historical precedent, and imply an accumulation of international claims and liabilities that it is hard to imagine persisting. The fact that such a pattern is viewed as subject to reversal does not mean, of course, that the corrective process is bound to occur in a disorderly way. A timely improvement in the U.S. fiscal position, and efforts to improve the investment climate in Europe, combined with the maintenance of adequate growth in domestic demand in Japan, could bring about the realignment in exchange rates without serious disruption. The time remaining to bring about such a result is not unlimited, however.

For the medium term, an implication of the foregoing is that domestic policies among the major countries should be framed so as to avoid, as far as possible, exchange rate movements that are associated with such large imbalances in payments positions. No one country is solely responsible, of course. The solution requires a consistent approach to policy formation--not, it must be emphasized, in an effort to make policy stances uniform across countries, but to ensure that interactions in policies among countries operate to strengthen the prospect of attaining sustainable growth and financial stability.

V. Policy Issues in Developing Countries

1. Introduction

Under the pressure of external financing constraints, developing countries have achieved a dramatic turnaround in their external payments position in the past three years. The current account deficit of indebted developing countries, after having reached $113 billion in 1981, fell to some $38 billion in 1984. Expressed as a share of exports of goods and services, the decline was from 21 percent to 7 percent, the lowest such figure since comparable statistics began to be assembled in the mid-1960s. The decline in external deficits has been even greater among those developing countries that borrow predominantly from commercial sources: for this group, which includes most of the largest borrowers, average deficits are now around 2 percent of exports.

The improvement in the external position has been accompanied, at least in 1984, by an acceleration of growth. Output rose by about 4 percent for the indebted countries as a group, 2 percentage points faster than in the preceding two years. Nevertheless, this growth rate remains well below the rates achieved in most of the period up to 1980, and is lower than the growth achieved in industrial countries--an unusual feature for the second year of global expansion. An acceleration to 4 3/4 percent is projected in the staff's medium-term scenario, but this would still leave living standards growing more slowly than they did in the previous three decades.

Against this background, the policy issues that confront developing countries revolve around ways in which development can be accelerated while maintaining a sustainable external position. A first question in this regard is how a sustainable external position can be measured. For example, are the low current account deficits that have just been mentioned indicative of "overadjustment," that should be reversed in the coming years? A second set of issues concerns domestic adjustment measures. Does the achievement of external balance mean that the structure of demand has now been restored to an appropriate pattern, and that henceforth primary emphasis can be given to the prudent expansion of demand? Standing behind these questions are fundamental issues of development strategy. Should development be outward looking, based on export and import growth and full involvement in world markets, or more domestically based, relying on import substitution and a measure of protection from unpredictable developments in the world economy?

These three issues - external adjustment, domestic adjustment, and development strategy - are the heart of the discussion in this section. The presentation is necessarily brief, and a number of the subjects that are touched on here are dealt with in more detail in Supplementary Note 9.

2. External adjustment

The fact that in the baseline medium-term scenario external deficits are quite low in relation to exports of goods and services, while economic growth is only moderate, leads to the question whether additional recourse to foreign resources would not be desirable to speed the process of raising living standards. It would be hard to deny that higher inflows of resources would help promote development to the extent that they made possible additional productive capital formation. Accepting this, however, there are a number of good reasons why developing countries should adopt a cautious attitude to incurring further debt.

In the first place, comparisons of actual current account deficits with their historical pattern can be misleading. With the benefit of hindsight, it can be seen that the relatively high current account deficits of the past led to situations in which many countries became overindebted. Rectifying this situation necessarily involves a period during which current account deficits will be below their long-run sustainable level. Furthermore, it may be noted that while the aggregate current account deficit of developing countries is now much lower in relation to exports of goods and services than it was a decade ago, the decline when measured in relation to investment or GDP is much less. (The aggregate current account deficit of indebted developing countries in 1984 is less than half that of 1967-76 in relation to exports of goods and services, but still about four fifths that of 1967-76 in relation to domestic investment).

A second reason for developing countries to exercise caution in allowing their current account deficits to rise is the greater prospective cost of interest charges. The real interest cost of additional debt, which was low or negative during much of the 1970s, rose to an average of 8-10 percent during 1982-84 (if the U.S. GNP deflator is used as the basis for adjusting nominal interest rates to real). Interest rates are not expected to remain so high, but they are nevertheless likely to be considerably higher than they were in the 1970s. At the margin, this tilts the balance of advantage for indebted countries toward a reduced rate of accumulation of new debt.

A third reason for maintaining reasonably strong current accounts is the need to be protected against unforeseen developments in the world economy. The experience of the past three years provides strong evidence of the costs, in terms of domestic development objectives, of an inability to finance the external position. Countries that avoided debt servicing problems grew 5 percentage points per annum faster during 1980-84 than those that encountered such problems, even though the respective growth rates of the two groups had been identical in 1967-76. It may well be desirable for countries to accept the short-run costs of lesser absorption of goods from abroad to lower the risks of more serious adverse consequences in the longer run.

Fourth, it needs to be recognized that despite improvements in the position of developing countries taken as a group, many individual countries continue to have a very fragile payments position. The low-income countries of sub-Saharan Africa, for example, need to undertake considerable further adjustment before their payments positions could be considered to have returned to a viable level.

Lastly, of course, developing countries will find their capacity to run external deficits limited by the willingness of creditors to finance them. It is extremely difficult to project how external creditors (particularly private lenders) will react if, as expected, the external position of indebted countries shows marked signs of improvement over the rest of the decade. Given the impact of recent experience, however, it seems reasonable to suppose that their willingness to substantially increase their exposure in developing countries will hinge on clear evidence that domestic economic performance has been set on a sustainably better track. The issue of optimal balance of payments adjustment is thus linked with the issue of domestic adjustment.

3. Domestic adjustment

The fact that external deficits in developing countries have now been reduced to levels that are, broadly speaking, in the "sustainable" range, has led some observers to suggest that there could be an easing in some of the measures that have been used to secure this improvement. Specifically, it is suggested that demand restraint could be relaxed and that a faster rate of domestic demand growth would ease pressures on living standards.

While it is true that there is now room for domestic absorption to grow more rapidly than in the past few years, it would be a considerable mistake to try to achieve this through a generalized easing of fiscal and monetary policies. Needed structural adjustments in the domestic economies of indebted countries have only just begun, and could be set back if the policies that support them are prematurely abandoned. The evidence presented in the staff's analysis of the current situation in developing countries (EBS/85/48, Section III.4) shows that the resources used to improve the external position came from cuts in investment to a much greater extent than from higher saving. Overall savings in developing countries were essentially unchanged, as a share of GDP, from 1981 to 1984. The share of output spent on investment meanwhile fell from 26 percent of GDP in 1981 to 23 percent in 1984.

A major task for policymakers in developing countries is to provide for an increase in the investment ratio, and to ensure that this is met primarily from higher domestic saving. Fiscal, monetary, and exchange rate policies all have a key role to play in this effort. Fiscal policies are crucial, because they remain the principal way in which national authorities can influence the aggregate level of domestic savings. Budget deficits in developing countries were allowed to widen dangerously in the early 1980s, reaching the equivalent of 5 1/2 percent of GDP in 1983. Some reduction, to 4 1/2 percent of GDP, was achieved in 1984, but at such a level, these deficits are still considerably above those prevailing in the late 1970s. Given the scarcity of private savings in developing countries, it is particularly important that the share pre-empted to finance budget deficits be further reduced.

Efforts to further reduce budgetary deficits will greatly facilitate the task of bringing down rates of monetary and credit expansion and thus curbing inflationary pressures. Failure to make satisfactory progress on the inflation front must be considered one of the most disturbing features of economic developments in a number of major indebted countries. This failure has impeded the task of reviving investment and improving resource allocation. Better price stability, accompanied by realistic interest rates, would have potential to unlock savings in many developing countries that are presently hoarded in unproductive forms.

Exchange rate policy has an important role in domestic, as well as external, adjustment. The maintenance of a realistic exchange rate helps ensure that the difficult task of keeping domestic demand and supply growing together is not circumvented by excess absorption of resources from abroad. Of course, the exchange rate is also of crucial importance in facilitating the medium-term structural adjustment of an economy. This adjustment is closely tied in with the development strategy being pursued by the authorities.

4. Development strategy

Considerable attention has been given in the development literature to the advantages of an "outward-looking" strategy of economic development. Such a strategy can exploit the dynamism of world markets, promote the exchange of technological know-how, attract foreign financial resources, and encourage the emergence of a set of relative prices that facilitates efficient resource allocation. To set against these advantages, greater involvement in world markets naturally involves greater vulnerability to developments originating in these markets--such as fluctuations in export demand, increases in interest costs, adverse terms of trade shifts, and protectionist measures. An important issue facing national authorities in developing countries is the extent to which the potential advantages of outward-looking policies are offset by this vulnerability to outside disturbances.

The essential characteristics of an "outward-looking" approach include: factor prices that are permitted to reflect relative scarcities; goods prices that respond to relative prices in world markets; and an emphasis on encouraging those types of output that enjoy at least a reasonable degree of comparative advantage. This approach is not synonymous with an "export-oriented" strategy, since certain types of import-substituting production are also likely to be encouraged. For example, in the case of countries where domestic producer prices in the agricultural sector have been held down, outward-oriented policies can lead to increases in output that both increase export supplies and hold down imports. The essential point is to make the best possible use of existing resources.

The extent to which "outward-looking" policies by developing countries are pursued is not independent of developments in the rest of the world. An increase in the degree of protectionism in industrial countries is likely to shift the policy emphasis in developing countries--particularly in those with large industrial sectors and domestic markets--toward the "inward-looking" side. To a lesser but still significant degree, the same applies to the import policies pursued by developing countries with respect to trade among themselves. Two points need to be made in this regard. First, industrial countries bear a significant responsibility not to take actions that undermine the well-conceived structural policies of developing countries. Second, while protectionism limits the scope for export-led growth, it does not invalidate the presumption that the price structure in developing countries should reflect relative scarcities of factors of production.

A number of specific measures can be taken to steer an economy in an "outward-looking" direction. Such measures must be based, in the first instance, on <u>demand management policies</u> that help restore financial stability and prevent the emergence of an inflationary dynamic. High and rising rates of inflation are both symptom and cause of a relative price structure that fails to perform effectively its function of rationing scarce resources. Efficient resource allocation must also be based on realistic interest and exchange rates, without which the proper relationships between saving and consumption and between foreign and domestic goods cannot be maintained.

The kinds of policies that are required to give effect to an outward-looking strategy are microeconomic as well as macroeconomic in nature. Most are country specific, but some are sufficiently general that they can be briefly summarized. Pricing policies have in practice often tended to favor urban consumers at the expense of rural producers. This bias is not only regressive from an income distribution viewpoint, it tends to lower national savings, raise urban unemployment, discourage agricultural investment, and reduce the availability of export supplies. Exchange rate overvaluation is often used as an adjunct to such policies, tilting the thrust of incentives even further away from export promotion, and leading to complex rationing systems for imports that are open to abuse and often lead to shortages of needed inputs. Such problems are particularly prevalent in sub-Saharan Africa, where the scenario exercise reveals the possibility of serious backsliding from recent welcome moves toward more realistic exchange rates.

Besides pricing policies, developing countries need to give attention to the subject of managerial efficiency in public enterprises. Such enterprises often serve social as well as economic goals, so it is not always possible that they should be managed according to purely financial criteria. Nevertheless, it is much more frequently the case that too little attention is paid to matters of economic efficiency than too much.

Another important area that often requires structural reform is in public sector investment. The cutbacks in such investment made necessary by the financial constraints of recent years provide a good opportunity to re-evaluate both the general strategy and the precise implementation of investment plans. The World Bank is uniquely placed to aid its member countries in such a process of re-evaluation.

Finally, there is considerable scope in many countries for the rationalization of existing regulations and controls. Such regulations and controls can inhibit new capital formation and reduce the efficiency of existing investment. Examples of the kinds of regulation that are worth re-examining are: restraints on foreign direct investment; foreign exchange surrender requirements; rules on local participation in enterprise management; requirements for official authorization for day-to-day operational decisions; tight controls over industrial location; protection from foreign competition; controls on the availability of foreign exchange for replacement parts; and other restraints on the foreign exchange market.

VI. The Role of the International Community

The preceding two sections have discussed policy issues facing industrial and developing countries as they individually approach the task of framing their domestic and external policies. In addition, however, there are important issues that have to be dealt with collectively by the international community. Three that will be discussed here are: financial flows to low-income developing countries; protectionism; and the role of the Fund in enhancing the working of the international monetary system.

Flows of official development assistance (ODA) have been under considerable pressure during the past few years, as a result of budgetary stringency in industrialized member countries. Nevertheless, a review of recent and prospective trends in low-income countries serves to underscore the importance of concerted efforts to increase these flows. Put in human terms, the need for effective foreign assistance cannot be refuted. Output growth among countries dependent on official assistance (other than China and India) has been only 2 1/2 percent for the past four years, and under the staff's baseline scenario is expected to accelerate only to 3 3/4 percent in the remainder of the decade.

Many countries, of course, have had an even weaker performance. Per capita income levels in sub-Saharan Africa in 1984 were approximately where they were a decade ago, with only modest improvement envisaged for the remainder of the 1980s. These countries will need substantial assistance of a concessional character if they are to accomplish the structural reforms that will eventually permit their transition to a less aid-dependent situation. Without such assistance, they will continue to rely on primary product exports, and be as vulnerable as ever to wide swings in foreign exchange earnings. In recent years, however, ODA to African countries has declined significantly, the result of limitations in the aggregate volume of funds available, and disillusionment with the pace of reform in recipient countries. Debtors and creditors will have to work together, both bilaterally and with agencies such as the World Bank, to ensure that viable projects are identified, that suitable financing is made available, and that the adjustment efforts required of the poorest countries are not made unrealistically large by the debt service burdens resulting from earlier borrowing at unsustainable rates.

If poorer countries are to pursue the objective of export diversification, it is all the more crucial that the shadow of protectionism should be lifted from the international trade scene. Protectionist pressures are an almost inevitable concomitant of structural change. Few who are concerned with international trade and financial issues doubt that the medium-term consequences of protectionism rapidly overwhelm any temporary advantages that measures of protection may bring to the country that adopts them. Yet political systems have found such pressures hard to resist. The answer presumably lies in two complementary approaches. First, all countries, developed and developing, must renew their commitment to combat protectionism and find ways of collectively strengthening their will to achieve this purpose. Second, the inflexibilities that make structural change so difficult, in social and economic terms, must be tackled.

The role of the Fund is likely to be rather different in the second half of the 1980s from the first. With the improved external position of many heavily indebted countries, the need for massive financial assistance from the Fund may well diminish. Nevertheless, if the process of transition to better economic performance is to be smoothly managed, continued close involvement by the international community, acting through the Fund, will remain vitally important.

One aspect of this involvement is the need to maintain international confidence in the commitment of individual countries to continued pursuit of appropriate financial policies, even after formal Fund programs are no longer in effect. In appropriate cases the procedure of enhanced surveillance can be a useful technique for providing analysis and policy advice. For some other countries, continued financial assistance from the Fund may be needed to encourage the participation of other lenders in financing a medium-term program of structural change. Where such a program exists, the expertise of the World Bank will naturally be of key importance.

In the industrial world, the Fund's principal role lies in its ongoing surveillance responsibilities under Article IV. The present report has drawn attention to the importance of appropriate policies in the industrial countries, both to underpin the growth of incomes and employment in these countries, and to enhance the environment for adjustment and economic development in the rest of the world. In this regard it is essential that in exercising surveillance, attention be given not only to actual developments with regard to growth and inflation in individual countries, but to how policy stances in various member countries interact, and the problems that such interactions can create.

Table 1. World Output, 1967-86 1/

(Changes, in percent)

	Average 1967-76 2/	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
World	4.5	4.5	4.4	3.5	2.0	1.6	0.6	2.6	4.3	3.4	3.4
Industrial countries	3.7	4.0	4.1	3.5	1.3	1.6	-0.2	2.6	4.8	3.2	2.9
Canada	4.8	2.0	3.6	3.2	1.1	3.3	-4.4	3.3	4.9	3.3	2.6
United States	2.8	5.5	5.0	2.8	-0.3	2.5	-2.1	3.7	6.9	3.6	2.9
Japan	7.4	5.3	5.1	5.2	4.8	4.0	3.3	3.4	5.4	4.3	4.3
France 3/	4.7	3.1	3.8	3.3	1.1	0.2	1.8	0.8	1.6	1.9	2.0
Germany, Fed. Rep. of	3.5	2.8	3.4	4.0	1.9	-0.2	-1.1	1.3	2.6	2.5	2.9
Italy 3/	4.3	1.9	2.7	4.9	3.9	0.2	-0.4	-1.2	3.0	2.3	2.3
United Kingdom 3/	2.2	3.0	4.0	3.2	-2.6	-1.4	2.4	3.2	2.0	3.0	2.5
Other industrial countries	4.2	1.7	2.0	3.2	2.1	0.6	0.6	1.6	3.2	2.3	2.4
All industrial countries	3.7	4.0	4.1	3.5	1.3	1.6	-0.2	2.6	4.8	3.2	2.9
Of which,											
Seven major countries above	3.6	4.4	4.5	3.6	1.2	1.8	-0.3	2.8	5.1	3.4	3.0
European countries	3.8	2.5	3.1	3.5	1.5	-0.2	0.5	1.4	2.4	2.3	2.4
Developing countries	6.2	5.8	5.3	4.5	3.4	2.4	1.6	1.5	3.7	4.0	4.5
Median growth rate	4.9	5.1	6.0	4.9	3.7	3.3	1.5	1.4	2.8	3.0	3.3
By region											
Africa	4.8	4.3	1.4	4.2	3.7	0.9	0.1	-0.2	2.2	2.9	3.6
Asia	5.2	7.3	9.4	4.8	4.7	5.8	5.1	7.1	6.4	5.8	5.8
Europe	6.0	5.4	5.4	3.8	1.6	2.5	2.2	1.3	2.5	3.2	3.4
Middle East	9.5	6.9	1.9	1.8	-1.8	-0.7	0.3	0.6	2.3	2.9	3.6
Western Hemisphere	6.1	5.2	4.1	6.1	5.3	1.0	-1.0	-3.1	2.4	3.2	4.2
By analytical criteria											
Fuel exporters	8.2	5.7	2.9	3.7	1.0	1.2	-0.2	-0.8	2.0	3.0	3.8
Other developing countries	5.4	5.9	6.3	4.8	4.3	3.0	2.5	2.7	4.4	4.4	4.8
Market borrowers	6.3	5.7	4.7	6.1	4.4	2.2	0.2	-0.6	3.1	3.6	4.4
Official borrowers	3.5	4.9	4.8	2.2	3.0	3.3	1.9	2.5	3.2	3.6	3.6
Other countries 3/	5.5	4.5	4.7	2.3	2.9	0.8	1.7	3.5	3.1	3.6	3.5

1/ Real GDP (or GNP) for industrial and developing countries and real net material product (NMP) for other countries. Except where otherwise noted, composites for the country groups are averages of percentage changes for individual countries weighted by the average U.S. dollar value of their respective GDPs (GNPs or NMPs where applicable) over the preceding three years. Because of the uncertainty surrounding the valuation of the composite NMP of the other countries, they have been assigned--somewhat arbitrarily--a weight of 20 percent in the calculation of the growth of world output. For classification of countries in groups shown here, see the introduction to this appendix. Estimates do not include China for the period prior to 1978.

2/ Compound annual rates of change.

3/ The U.S.S.R. and other countries of Eastern Europe that are not members of the Fund.

Table 2. Inflation, 1967-86 1/

(In percent)

	Average 1967-76 2/	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Industrial countries 3/	6.7	7.5	7.6	8.0	9.2	8.7	7.2	4.9	4.1	3.8	3.8
United States	5.6	5.8	7.4	8.7	9.2	9.6	6.0	3.8	3.8	3.6	4.0
Other industrial countries 3/	7.6	8.7	7.8	7.5	9.2	8.3	7.8	5.6	4.4	4.0	3.6
Of which,											
Japan	7.9	5.7	4.6	2.6	2.8	2.7	1.7	0.7	0.7	1.4	1.3
Germany	5.1	3.7	4.2	4.0	4.5	4.2	4.7	3.2	1.9	2.2	2.3
Developing countries 4/	14.3	24.8	18.8	21.5	27.3	26.1	24.7	33.0	37.7	34.8	22.6
Median inflation rates	7.6	11.2	9.8	11.5	14.5	13.3	10.7	9.8	10.0	9.3	8.0
By region 4/											
Africa	8.5	18.8	16.9	16.7	16.6	21.4	13.4	19.0	17.8	16.1	12.7
Asia	11.3	7.8	4.0	8.0	13.1	10.6	6.2	6.6	6.9	5.5	5.4
Europe	8.8	15.1	19.8	25.9	37.9	24.0	23.8	23.2	28.0	22.4	19.0
Middle East	8.3	18.0	12.8	11.1	17.4	15.6	12.7	12.7	16.5	17.3	15.1
Western Hemisphere	24.5	49.9	41.9	46.5	54.0	58.6	65.5	100.5	119.8	113.7	59.7
By analytical criteria 4/											
Fuel exporters	9.4	18.1	12.5	11.8	15.9	16.4	18.0	25.5	20.1	15.3	12.1
Other developing countries	16.2	28.0	21.4	25.7	32.2	30.6	28.0	36.9	47.1	45.0	27.9
Market borrowers	18.7	32.6	28.2	31.8	36.3	38.7	38.5	55.5	65.7	60.3	35.0
Official borrowers	14.3	17.3	13.7	19.5	22.3	28.4	17.2	21.9	15.8	13.8	13.4

1/ As measured by changes in GNP deflators for industrial countries and changes in consumer prices for developing countries. For classification of countries in groups shown here, see the introduction to the Statistical Appendix (EBS/85/50).

2/ Compound annual rates of change.

3/ Averages of percentage changes in GNP deflators for individual countries weighted by the average U.S.dollar value of their respective GNPs over the preceding three years.

4/ Except where otherwise noted, percentage changes of geometric averages of indices of consumer prices for individual countries weighted by the average U.S. dollar value of their respective GDPs over the preceding three years. Estimates exclude China prior to 1978.

Table 3. Summary Financial Indicators, 1977-86

(In percent)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
I. Major industrial countries										
A. Fiscal balances of central governments 1/										
Seven major countries	-3.2	-3.4	-3.0	-3.5	-3.8	-4.7	-5.7	-5.1	-5.2	-4.9
Of which,										
United States	-2.7	-2.0	-1.2	-2.4	-2.5	-4.3	-5.8	-5.0	-5.7	-5.3
Japan	-5.1	-5.3	-6.2	-6.3	-6.0	-6.0	-5.8	-5.6	-5.1	-4.8
Germany, Fed. Rep. of	-2.2	-2.1	-1.8	-1.7	-2.2	-1.9	-2.0	-1.6	-1.2	-1.0
B. Fiscal impulses of central governments 2/										
Seven major countries	-0.1	0.6	-0.2	-0.1	-0.2	-0.1	0.9	0.1	0.2	-0.4
Of which										
United States	0.2	--	-0.8	0.4	0.1	0.4	1.7	0.5	0.8	-0.3
Japan	0.2	0.2	1.0	0.2	-0.3	-0.2	-0.5	0.2	-0.5	-0.6
Germany, Fed. Rep. of	-0.5	0.1	0.1	-0.4	-0.8	-1.8	-0.3	-0.2	-0.3	--
C. Growth of monetary aggregates 3/										
Narrow money										
Seven major countries	8.8	11.1	9.8	5.7	6.6	7.3	10.2	6.8	5.4	5.4
Of which,										
United States	7.6	8.2	7.7	6.3	7.1	6.6	11.1	6.5	4.4	5.2
Japan	7.0	10.1	10.7	2.6	3.3	5.8	3.6	2.8	2.5	2.5
Germany, Fed. Rep. of	8.3	13.3	7.5	2.4	1.1	3.6	10.3	2.8	4.1	4.8
Broad money										
Seven major countries	12.2	11.0	10.7	9.5	9.9	9.6	10.5	7.5	7.2	6.8
Of which,										
United States	12.7	8.5	8.3	8.1	9.5	9.5	12.6	7.6	7.4	6.9
Japan	11.4	11.7	11.9	9.2	8.9	9.2	7.4	7.8	7.6	7.5
Germany, Fed. Rep. of	9.4	10.6	9.0	5.3	6.4	6.5	6.6	3.7	4.8	4.8
D. Interest rates 4/										
Three-month Eurodollars	6.4	8.8	12.1	14.2	16.8	13.2	9.6	10.8	9.5	9.0
II. Developing countries										
A. Fiscal balances of central governments 1/										
Weighted average	-2.7	-3.3	-2.4	-1.3	-3.3	-4.9	-5.4	-4.5	-3.5	
Median	-3.7	-3.9	-3.6	-4.5	-6.1	-6.5	-6.7	-5.2	-4.5	
B. Growth of monetary aggregates 5/										
Weighted averages	36.2	28.8	36.7	35.3	36.4	34.8	39.1	43.2	35.7	
Median	19.3	19.5	17.7	20.5	19.1	18.9	17.0	15.5	13.7	

1/ In percent of GNP/GDP.
2/ For definition of fiscal impulses, see "World Economic Outlook: Supplementary Note 1--Fiscal Policy in the Major Industrial Countries" (SM/85/70). See also footnotes to Appendix Table 15. It should be noted that estimates for the industrial and developing countries are not necessarily comparable, in part because of the exclusion of the so-called "monetary correction" from the estimates for some of the high inflation developing countries.
3/ For definitions of monetary aggregates, see footnotes 1 and 3 to Appendix Table 13.
4/ London Interbank Offer Rate on three-month U.S. dollar deposits.
5/ Money and quasi-money. For method of calculation, see Appendix Table 17.

Table 4. Summary of World Trade Volumes and Prices, 1967-86 1/

(Percentage changes)

	Average 1967-76 2/	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
World trade 3/											
Volume	7.7	4.7	5.5	6.6	1.5	0.7	-2.2	2.2	8.8	5.3	5.3
Unit value (in U.S. dollar terms)	8.7	9.2	9.9	18.5	19.8	-1.2	-4.2	-4.5	-1.7	-0.0	3.1
(in SDR terms) 4/	7.1	8.0	2.5	14.9	18.9	9.0	2.4	-1.3	2.4	2.4	3.1
Volume of trade											
Exports											
Industrial countries	8.0	5.1	5.9	7.1	3.6	3.4	-2.2	2.5	10.0	5.1	5.2
Developing countries	6.0	2.5	3.9	5.4	-2.6	-4.0	-7.2	0.9	8.0	5.5	5.8
Fuel exporters	5.3	1.0	-1.9	2.0	-10.9	-12.6	-15.1	-5.7	2.5	2.1	3.7
Non-fuel exporters	6.8	4.0	9.4	9.0	9.0	7.0	1.0	6.2	12.0	7.6	7.0
Imports											
Industrial countries	7.5	4.2	5.0	8.4	-1.7	-2.5	-0.6	4.3	12.3	6.1	5.5
Developing countries	8.4	9.5	7.0	4.9	8.3	7.3	-3.9	-3.6	2.5	4.7	5.6
Fuel exporters	15.1	13.3	4.2	-4.3	13.0	20.5	-0.7	-12.9	-4.9	2.5	2.5
Non-fuel exporters	6.3	7.5	8.5	9.6	6.4	1.6	-5.5	1.5	5.9	5.6	6.8
Unit value of trade (in SDR terms) 4/											
Exports											
Industrial countries	6.2	6.9	5.4	11.8	12.6	6.0	2.9	-0.5	1.7	2.1	3.7
Developing countries	11.2	10.8	-3.7	25.4	35.2	13.8	1.4	-3.2	3.5	2.3	2.2
Fuel exporters	18.7	8.6	-5.8	39.7	57.6	19.6	1.9	-7.5	2.9	1.1	0.6
Non-fuel exporters	6.1	13.2	-1.7	13.0	12.8	7.1	0.9	0.6	4.0	3.1	3.2
Imports											
Industrial countries	7.2	8.1	2.4	15.6	20.9	8.3	0.9	-2.5	1.9	2.0	3.4
Developing countries	6.9	6.8	3.1	13.2	17.3	12.4	3.1	-1.1	3.2	3.2	3.1
Fuel exporters	6.5	7.6	4.3	10.1	12.3	10.3	3.0	--	2.8	2.7	3.5
Non-fuel exporters	7.0	6.3	2.5	14.8	19.6	13.4	3.2	-1.7	3.4	3.4	2.9
Terms of trade											
Industrial countries	-0.9	-1.1	2.9	-3.3	-6.8	-2.1	1.9	2.1	-0.2	0.1	0.4
Developing countries	4.1	3.7	-6.7	10.8	15.2	1.2	-1.7	-2.1	0.3	-0.8	-0.9
Fuel exporters	11.4	1.0	-9.7	26.9	40.4	3.5	-1.1	-7.5	0.1	-1.6	-2.8
Non-fuel exporters	-0.8	6.5	-4.1	-1.6	-5.7	-5.5	-2.2	2.4	0.6	-0.3	0.2
Memorandum											
World trade prices (in U.S. dollar terms) for major commodity groups 5/											
Manufactures	7.5	8.0	14.5	13.9	11.1	-6.0	-2.1	-4.1	-3.0	0.2	3.9
Oil	21.7	9.6	0.4	46.4	63.0	9.9	-3.8	-12.3	-1.9	-2.0	--
Non-oil primary commodities (market prices)	7.4	21.2	-4.1	16.3	8.3	-15.2	-12.3	7.8	2.5	-2.3	5.0

1/ For classification of countries in groups shown here, see the introduction to the Statistical Appendix (EBS/85/50). Excludes data for China prior to 1978.
2/ Compound annual rates of change.
3/ Averages based on data for the two groups of countries shown separately below and on partly estimated data for other countries (mainly the U.S.S.R. and other nonmember countries of Eastern Europe and, for years prior to 1978, China).
4/ For years prior to 1970, an imputed value of US$1.00 has been assigned to the SDR.
5/ As represented, respectively, by (1) the United Nations export unit value index for the manufactures of the developed countries; (2) the oil export unit values of the oil exporting countries; and (3) the International Financial Statistics index of market quotations for non-oil primary commodities.

Table 5. Summary of Payments Balances on Current Account, 1977-86 1/

(In billions of U.S. dollars)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Industrial countries	-2.4	31.9	-5.6	-38.8	3.1	1.2	1.9	-34.9	-49.0	-56.4
United States	-11.7	-12.3	2.6	6.6	10.7	-3.8	-35.5	-93.3	-117.5	-140.2
Other industrial countries	9.3	44.2	-8.2	-45.4	-7.7	5.0	37.4	58.4	68.5	83.8
Of which,										
Japan	11.3	17.0	-7.9	-9.5	6.2	8.1	22.2	36.4	40.9	48.8
Germany	8.5	13.4	0.1	-8.3	0.8	10.2	10.0	12.6	17.4	20.8
Developing countries	-0.1	-36.2	0.2	22.6	-56.3	-99.6	-70.5	-43.9	-44.2	-44.4
By region										
Africa	-10.4	-15.4	-6.6	-5.3	-25.2	-24.4	-15.5	-10.9	-9.8	-8.8
Asia	-0.9	-8.9	-15.2	-21.8	-23.4	-19.8	-16.3	-7.9	-8.2	-8.7
Europe	-9.0	-7.1	-9.9	-12.5	-10.5	-6.7	-5.3	-3.3	-2.7	-1.8
Middle East	31.8	14.5	53.7	91.6	45.8	-6.5	-21.7	-16.3	-16.1	-18.3
Western Hemisphere	-11.6	-19.4	-21.7	-29.3	-43.1	-42.1	-11.7	-5.5	-7.5	-6.8
By analytical criteria										
Fuel exporters	25.0	-0.7	54.0	100.1	34.7	-23.4	-17.0	-5.7	-8.9	-11.1
Other developing countries	-25.1	-35.5	-53.8	-77.5	-91.0	-76.2	-53.6	-38.2	-35.3	-33.3
Market borrowers	-19.5	-32.8	-30.3	-35.6	-72.2	-73.6	-29.8	-8.4	-8.6	-5.8
Official borrowers	-8.4	-11.5	-12.9	-16.9	-19.3	-18.0	-15.4	-16.8	-17.2	-17.0
Other countries 2/	-6.9	-3.5	-2.1	-3.0	-2.8	2.6	4.9	6.7	6.3	6.7
Total 3/	-9.5	-7.8	-7.6	-19.1	-56.0	-95.8	-63.8	-72.1	-86.8	-94.1
Memorandum										
Total, by selected categories										
Trade balance	16.0	16.1	20.8	29.2	19.6	-0.9	15.7	19.2	7.2	5.1
Timing asymmetry 4/	5.6	13.9	23.0	7.9	-1.3	-11.8	4.8	6.5	6.4	10.0
Residual asymmetry	10.4	2.2	-2.2	21.3	20.8	10.9	11.0	12.7	0.9	-4.9
Services and private transfers	-25.5	-23.9	-28.4	-48.3	-75.6	-94.8	-79.5	-91.4	-94.1	-99.1
(in percent of service payments)	-6.9	-5.3	-5.0	-6.8	-9.4	-11.8	-10.6	-11.8	-11.7	-11.6

1/ On goods, services, and private transfers. For classification of countries in groups shown here, see the introduction to the Statistical Appendix (EBS/85/50).

2/ Covers estimated balances on current transactions only in convertible currencies of the U.S.S.R. and other nonmember countries of Eastern Europe.

3/ Reflects errors, omissions, and asymmetries in reported balance of payments statistics on current account, plus balance of listed groups with countries not included.

4/ Staff estimates of the difference between the beginning-of-year and end-of-year "float," that is, the value of those exports that have not yet been recorded as imports (usually because the goods are in transit or because of delays in the processing of the documentation). The estimates should be viewed only as rough orders of magnitude.

Table 6. Indebted Developing Countries--By Class of Creditor: Current Account Financing, 1977-86

(In billions of U.S. dollars)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Indebted developing Countries										
Current account deficit 2/	36.9	56.8	61.7	77.0	112.6	102.9	59.4	37.9	38.2	36.7
Non-debt-creating flows	14.9	17.6	24.7	24.4	28.0	28.6	22.9	22.7	25.1	26.9
Official transfers	8.3	8.3	11.7	12.5	13.5	13.0	12.9	13.1	14.8	15.4
Direct investment flows, net	6.0	7.9	10.1	9.4	14.0	12.8	9.9	9.1	9.9	11.0
SDR allocations, valuation adjustments, and gold monetization	0.6	1.4	2.9	2.5	0.5	2.9	0.1	0.5	0.5	0.5
Use of reserves	-10.7	-13.5	-21.5	-18.4	1.6	14.4	-9.5	-22.3	-11.2	-11.0
Asset transactions, net 3/	-6.2	-4.9	-7.8	-7.8	-17.4	-12.9	-8.2	-5.8	-9.1	-11.2
Recorded errors and omissions 4/	-6.5	-4.9	-3.4	-19.1	-19.7	-24.9	-11.4	-3.6	--	--
Net external borrowing	45.5	62.5	69.7	97.9	120.1	97.7	65.7	46.9	33.3	32.0
Reserve-related liabilities	3.4	1.5	-0.8	4.2	8.9	19.2	17.3	3.7	-5.0	-2.6
Liabilities, constituting foreign authorities' reserves 5/	2.0	1.4	-1.3	1.9	0.9	1.1	-1.3	-0.2	0.9	2.1
Use of Fund credit 6/	-0.2	-0.4	0.2	1.5	6.0	7.0	11.0	5.3	1.8	-5.4
Arrears	1.6	0.5	0.4	0.8	2.0	11.1	7.5	-1.3	-7.7	0.8
Long-term borrowing from official creditors, net 7/	13.8	16.2	18.1	24.1	27.1	30.4	29.3	29.5	28.5	24.4
Other net external borrowing 8/	28.2	44.8	52.4	69.7	84.1	48.1	19.1	13.6	9.8	10.2
Long-term	13.5	34.9	42.8	39.3	60.9	34.7	36.4	24.5	31.3	8.1
From banks 9/	8.1	27.7	29.7	23.9	32.8	21.4	38.0	23.0	31.3	8.0
Other	5.4	7.3	13.1	15.4	28.2	13.2	-1.5	1.5	---	0.1
Short-term	14.7	9.8	9.6	30.4	23.1	13.4	-17.3	-10.9	-21.4	2.1
Memorandum item										
Other net external borrowing, excluding arrears	26.6	44.3	52.0	68.9	82.1	37.0	11.6	14.9	17.6	9.4
Of which,										
Market borrowers										
Current account deficit 3/	19.5	32.8	30.3	35.6	72.2	73.6	29.8	8.4	8.6	5.8
Non-debt-creating flows, net	5.8	8.7	11.1	10.1	13.1	15.5	9.8	9.5	10.2	11.2
Official transfers	0.8	1.0	1.2	1.3	1.8	1.9	2.2	2.2	2.3	2.4
Direct investment flows, net	4.5	6.4	7.8	7.6	11.1	10.5	7.5	6.8	7.5	8.3
SDR allocations, valuation adjustments and gold monetization	0.6	1.4	2.2	1.2	0.2	3.0	--	0.4	0.4	0.5
Use of reserves	-6.0	-10.5	-18.2	-17.3	2.4	22.3	-4.6	-18.8	-9.3	-9.4
Asset transactions, net 3/	-3.8	-2.9	-4.1	-4.7	-14.1	-9.9	-4.1	-3.9	-7.1	-8.9
Recorded errors and omissions 4/	-4.6	-4.3	-3.5	-19.7	-20.5	-24.2	-10.5	-2.8	--	--
Net external borrowing	28.1	41.8	45.0	67.1	91.3	70.0	39.3	24.3	14.8	12.9
Reserve-related liabilities	0.5	-0.9	-1.9	0.8	2.4	13.8	14.8	2.3	-5.2	-2.1
Liabilities constituting foreign authorities' reserves 5/	0.6	--	-1.5	0.2	0.5	1.6	-1.1	-0.2	-0.1	-0.1
Use of Fund credit 6/	-0.1	-0.9	-0.4	0.6	1.8	3.0	7.3	4.3	3.1	-2.4
Arrears	--	--	--	--	--	9.2	8.6	-1.7	-8.1	0.3
Long-term borrowing from official creditors, net 7/	5.5	6.5	5.3	6.9	8.4	11.7	15.5	11.5	14.0	10.1

Table 6.(concluded). Indebted Developing Countries--By Class of Creditor: Current Account Financing, 1977-86 1/

(In billions of U.S. dollars)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Other net external borrowing 8/	22.1	36.2	41.5	59.5	80.6	44.5	9.0	10.5	6.0	5.0
Long-term	10.6	29.9	32.5	31.7	57.8	31.8	27.0	24.0	29.7	4.6
From banks 9/	6.3	23.2	20.9	18.9	31.0	19.8	30.1	23.2	31.7	5.2
Other	4.2	6.7	11.5	12.8	26.8	12.0	-3.1	0.8	-2.0	-0.6
Short-term	11.6	6.3	9.1	27.8	22.8	12.7	-18.0	-13.5	-23.7	0.4
Memorandum item										
Other net external borrowing, excluding arrears	22.1	36.2	41.5	59.5	80.5	35.3	0.4	12.3	14.1	4.7
Official borrowers										
Current account deficit 2/	8.4	11.5	12.9	16.9	19.3	18.0	15.4	16.8	17.2	17.0
Non-debt-creating flows, net	4.9	4.6	7.2	8.0	8.5	7.8	7.1	7.0	7.1	7.2
Official transfers	4.2	3.9	6.3	7.1	7.4	7.2	6.5	6.4	6.6	6.6
Direct investment flows, net	0.7	0.7	0.7	0.5	1.0	0.7	0.5	0.5	0.5	0.6
SDR allocations, valuation adjustments, and gold monetization	--	--	0.2	0.4	0.1	--	--	0.1	--	--
Use of reserves	-1.9	-0.6	-0.9	-0.5	0.3	0.8	-0.9	1.5	1.4	1.3
Asset transactions, net 3/	-0.4	-0.2	-0.7	-0.9	-0.6	-0.5	-0.5	-0.5	-0.4	-0.4
Recorded errors and omissions 4/	--	0.9	--	-0.3	0.3	-1.1	-0.6	--	--	--
Net external borrowing	5.8	6.8	7.4	10.7	10.8	10.9	10.3	8.9	9.0	9.0
Reserve-related liabilities	0.3	0.8	0.3	2.2	2.8	3.5	1.8	0.8	0.1	-0.7
Liabilities constituting foreign authorities' reserves 5/	0.1	0.3	--	1.5	0.6	0.3	-0.1	0.1	--	0.2
Use of Fund credit 6/	--	0.2	0.5	0.2	1.8	1.3	1.6	0.4	-0.4	-1.3
Arrears	0.1	0.2	-0.2	0.5	0.5	1.9	0.3	0.3	0.4	0.4
Long-term borrowing from official creditors, net 7/	3.1	4.2	6.5	8.4	9.2	9.2	7.7	9.0	7.1	9.5
Other net external borrowing 8/	2.4	1.9	0.6	0.1	-1.2	-1.8	0.8	-0.9	1.8	0.2
Long-term	1.5	1.5	0.1	--	-0.8	-0.9	1.1	-0.3	0.9	0.1
Short-term	0.9	0.3	0.4	0.1	-0.4	-0.9	-0.3	-0.6	0.9	0.1
Memorandum item										
Other net external borrowing, excluding arrears	2.3	1.6	0.7	-0.4	-1.7	-3.7	0.5	-1.2	1.4	-0.3

Note: Except where otherwise footnoted, estimates shown here are based on national balance of payments statistics, which are not always easily reconcilable with year-to-year changes in either debtor- or creditor-reported debt statistics, mainly because the balance of payments statistics include valuation adjustments as well as changes in liabilities.

1/ For classification of countries in groups shown here, see the introduction to the Statistical Appendix (EBS/85/50).
2/ Net total of balances on goods, services, and private transfers, as defined in the Fund's Balance of Payments Statistics (with sign reversed).
3/ Pertains primarily to export credit.
4/ Positioned here on the presumption that estimates reflect primarily unrecorded capital outflows.
5/ Comprises short-term borrowing by monetary authorities from other monetary authorities.
6/ Projected use of Fund credit does not take into account prospective programs.
7/ Estimates, based on debt statistics reported in Appendix Tables 45 and 46 of net disbursements by official creditors (other than monetary institutions).
8/ Residually calculated. Except for minor discrepancies in coverage, amounts shown reflect almost exclusively net external borrowing from private creditors.
9/ Refers only to long-term lending by banks guaranteed by government of debtor country. Bank lending also accounts for large fractions of unguaranteed long-term flows (included in "other" long-term flows) and short-term flows.

Table 7. Indebted Developing Countries: External Debt and Debt Service, 1977-86 1/

(In percent of exports of goods and services, except where otherwise noted)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
I. External Debt										
Indebted developing countries	126.7	132.4	119.4	110.4	123.3	148.0	157.9	151.3	148.5	141.5
(In billions of U.S. dollars)	332.4	398.3	470.9	565.0	660.5	747.0	790.7	827.7	865.3	895.5
Africa	112.1	123.7	106.0	87.3	111.7	145.6	160.4	161.7	162.8	154.6
Asia	87.5	81.6	73.4	70.5	72.9	85.7	90.4	85.5	86.3	84.7
Europe	117.8	126.0	118.0	117.8	115.4	121.5	129.1	127.0	121.4	110.9
Non-oil Middle East	165.7	168.4	155.8	129.2	136.8	151.4	173.6	175.6	183.6	181.9
Western Hemisphere	191.8	215.0	194.7	183.3	210.9	270.7	294.1	280.0	269.6	257.6
Market borrowers	119.2	125.5	111.3	102.8	118.6	147.0	155.5	146.4	141.9	133.8
Official borrowers	149.3	163.0	152.8	156.8	179.5	219.2	244.7	257.8	267.1	268.0
Countries with recent debt servicing problems	171.7	195.8	178.1	167.1	194.5	246.0	268.1	256.8	245.8	230.8
Countries without debt servicing problems	95.3	91.9	81.6	73.6	78.3	91.1	97.0	94.2	95.8	93.6
II. Debt service payments										
Indebted developing countries	15.1	18.7	18.9	17.3	20.9	24.6	22.2	22.5	23.1	22.0
(In billions of U.S. dollars)	39.5	56.4	74.7	88.5	111.9	123.9	111.1	123.1	134.5	139.4
Africa	11.9	15.6	15.0	14.4	16.7	20.9	23.7	28.3	30.0	27.7
Asia	7.9	9.8	8.9	8.1	9.6	11.3	10.7	10.9	11.2	11.0
Europe	13.9	16.2	18.2	18.3	21.0	22.8	24.6	26.2	26.2	23.6
Non-oil Middle East	15.4	15.4	17.3	17.0	21.3	22.5	24.2	24.7	26.1	25.0
Western Hemisphere	28.7	37.8	38.9	33.5	41.5	51.6	41.1	39.4	40.5	40.0
Market borrowers	16.1	20.7	21.0	18.5	22.6	27.3	23.9	23.8	23.9	22.6
Official borrowers	12.1	12.8	11.9	12.4	14.4	15.5	17.1	19.8	22.4	21.8
Countries with recent debt servicing problems	22.3	29.6	30.2	26.9	33.8	41.6	36.2	36.6	38.2	36.8
Countries without debt servicing problems	10.0	11.8	11.7	11.0	12.7	14.6	14.4	14.9	14.9	14.1

1/ For definition of groups shown here, see the introduction to the Statistical Appendix (EBS/85/50). Debt export ratios show the ratio of total debt at the end of a year to exports of goods and services in that year. Debt service payments and ratios refer to all interest payments plus amortization of payments on long-term debt.

Table 8. Indebted Developing Countries: Outcome of Medium-Term Baseline Scenario 1/

	Average 1977-81	1982	1983	1984	1985	1986	Average 1987-90
				(In percent)			
Industrial countries							
Growth rate of real GNP	2.9	-0.2	2.6	4.8	3.2	2.9	3.1
Real 3-month LIBOR 2/	3.5	7.0	5.7	6.7	5.0	5.0	3.9
GNP deflator	8.2	7.2	4.9	4.1	3.8	3.8	3.7
World economy							
Change in world prices of manufactures in U.S. dollars	8.3	-2.1	-4.1	-3.0	0.2	3.9	7.5
Terms of trade of non-oil primary commodities 3/	-3.0	-10.2	-11.9	5.5	-2.5	1.1	0.0
Indebted developing countries							
Growth rate of total external private credit 4/	20.4	13.0	3.6	2.5	1.6	2.1	5.4
Growth rate of real GDP	4.9	2.0	1.8	3.9	4.2	4.6	4.8
Growth rate of import volume	7.3	-6.0	-3.3	5.0	5.5	6.4	6.8
Growth rate of export volume	5.6	-0.7	5.5	10.8	6.2	6.4	5.6

	Average 1977-81	1982	1983	1984	1985	1986	1988	1990
		(Ratio to exports of goods and services, in percent)						
Current account balance	-16.9	-20.4	-11.9	-6.9	-6.5	-5.8	-6.5	-7.5
Total external debt	122.4	148.0	157.9	151.3	148.5	141.5	122.8	107.7
Debt service payments	18.6	24.6	22.2	22.5	23.1	22.0	24.8	20.5
Interest payments	8.7	14.3	13.5	13.0	12.7	11.4	10.4	8.6
Amortization payments	9.9	10.2	8.7	9.5	10.4	10.6	14.3	11.9

1/ Includes material from Table 3, "World Economic Outlook: Medium-Term Scenarios" (EBS/85/49), as well as from tables of the Statistical Appendix (EBS/85/50).
2/ London interbank offer rate on U.S. dollar deposits, deflated by U.S. GNP deflator.
3/ With respect to manufactures prices.
4/ In U.S. dollars. Includes trade financing.