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Regional forecasts and Policy Discussion

In 1989, as in 1988, UNIDO's forecasts and industrial analysis were supplemented by consultations with forecasters from most of the regions into which the forecasts presented in Chapter [2?] are divided. The discussions, at the beginning of March, looked at preliminary UNIDO figures in the light of the country or regional forecasts which each participant presented, as well as other recent forecasts and data, and the views of the participants of general world conditions and the policies necessary to encourage (or permit) development. The participants are listed below.

The prima facie justifications for looking at an international forecast as something more than simply a collection of forecasts for individual countries are first that the international situation is itself an important determinant of countries' performance, through its direct effects on volumes and prices of traded goods and the quantity and cost of capital flows, and second to ensure that forecasts which seem plausible at the country level are consistent among themselves at the world level. The importance of the first, the dependence of countries on each other's performance, has been increasingly questioned in recent years: in years like 1988 there was a strong contrast between high performance in the developed countries and low growth in many developing countries. This was echoed by forecasters, with errors of pessimism for the developed and of excessive optimism for the developing, suggesting serious weaknesses in our understanding of the extent of inter-dependence. The second, consistency, can of course be ensured by calculation, without consultation. The value of discussions among regional forecasters lies, therefore, more in the exchange of information and analysis of economic structures and behaviour, how these may be changing, how areas are using or protecting themselves against outside events, and how external conditions, national policies, and industrial decisions within countries interact.

At the most aggregate level, the participants did not seriously question the importance of international linkages, with Langhammer, for example, noting that parallel interest rate movements showed no 'delinking' even among industrial countries, and concern from all areas at the global effects of such national or regional phenomena as the fiscal and trade imbalances of the United States and the EC's move towards greater economic unity by 1992. But the participants were very conscious of the 1988 errors in forecasting not only the growth rates, but the relative rates of different areas. Among the developing countries, Latin America and Africa had done worse than expected and Asia, better: both South and East Asian countries had relatively good performance. It was necessary to look more closely at the external impact of the high growth by developed countries: trade performance was exceptionally good (8.5% on GATT estimates), but much of this was among the developed, in manufactures, and probably in capital goods reflecting their high levels of investment. It was accompanied by high real interest rates. The expansionary effect on developing countries was therefore smaller, even on a macroeconomic level, than a simple model might suggest.

In looking ahead, the regional forecasters tended to suggest rather lower growth than the UNIDO forecasts, although higher than those of other international forecasters. They were more aware of particular constraints which might hold them below what a supply-based industrial

forecast would suggest, but also were able to take account of possibilities [illegible] improving their performance through policy or structural change, not evident to a demand-based aggregate forecaster. These modifications make an international forecasting exercise even more important than if one assumes that countries' performance is very dependent on 'the world'. If international constraints are binding, then, although it may be interesting to know what will happen, they are not crucial variables for policy-makers if little can be done about them. It is precisely because the international situation is important, but not totally constraining that understanding how it is changing is a serious concern.

Japan

Mutoh stressed the changes that were occurring within the Japanese economy, most of which would tend to reduce the Japanese imbalance with the rest of the world and probably its trend growth in output. The forecast to 1993 was 4.2% in real terms. In the 1970s it succeeded in economising on raw materials (and thus saving imports) and depended heavily on exports for growth. Imports were now stabilising, and there was a shift towards domestic led growth. Potential growth could slow as working time fell (by 10%, to levels comparable with the US or Europe by 1992). This could lower the competitiveness as well as the supply of exports, especially as incomes would still grow. Imports could rise because of the shift to consumption, because of the trend to locating some manufacturing processes abroad to reduce costs (normally to Asian countries), as well as because of any reduction in agricultural protection. These arguments suggest that the international impact of any slowing of Japanese growth might be small.

On the capital side, the participants, particular Shaaeldin, were interested in the prospects for Japanese direct investment: its level and any changes in direction. It might grow less rapidly than in the past, and as most has been market-oriented, it was likely to continue to go mainly to Asia. It was, however, perhaps moving from the NIEs to the ASEAN countries. There were also the Japanese initiatives for capital for indebted or low-income countries,

The discussion suggested that while Japan could have growing importance to net international trade demand, the capital side was more doubtful.

West Europe

Langhammer put forward explanations of why Europe had proved relatively resilient in 1988, notably high investment, a slow response of exports to the revaluation of major currencies against the dollar, with continuing strong consumption. He did not expect these to be repeated, and therefore suggested a lower growth rate (2.5%) for Western Europe than expected by UNIDO. Interest rates would probably rise, changes in indirect taxation would restrain consumption (as Mutoh had also pointed out for Japan), while inflation was increasing because of higher commodity prices and higher capacity utilisation, as well as the tax changes. These constraints would become more important by the second half of the year.

An uncertainty which was raised by UNIDO representatives and several other participants was how the EC's steps to unify its own markets by 1992 would affect other countries. Some direct and immediate effects might restrain trade, notably the application of Community-wide MFA

quotas, and greater cartelisation in other industries, but in the longer run, the stimulus to efficiency, especially through the promotion of internationally competitive service industries, could have a strongly positive effect. Increasing protection against the NIEs in a variety of industries was seen as a problem.

In the next few years, to 1992 and perhaps beyond, slower growth and a turning inward (and perhaps also to Eastern Europe) would mean little stimulus from Western Europe to the rest of the world, but Langhammer was more optimistic looking beyond this period. A more efficient and less protectionist Europe would then have a more positive effect.

Eastern Europe

Structural changes, high inflation, and the growing importance of alternative sources of supply make it difficult to measure the true levels and growth of output in these countries, but Szamuely suggested that performance in 1988 was in most cases extremely poor, and after a decade of poor aggregate performance and structural imbalances, the area is in economic crisis, with serious political consequences. The crisis is also one of confidence, can the leadership find a new successful economic system? In 1988, countries probably continued to borrow abroad, to meet deficits as well as interest payments on existing debt, and this is expected to continue. They are anxious to attract foreign investment. But their depressed and uncertain economies do not provide attractive investment opportunities.

In the countries which are liberalising their economies, notably the USSR, Hungary, and Poland, this should produce better performance, but not in the immediate future. New institutions must be built, legal as well as economic. Inflation is serious, but this partly reflects the restructuring and redistribution. In the longer run, greater openness and greater efficiency could create new trading opportunities for the rest of the world. These could extend to primary commodities as well as manufactures, offering even the least developed countries new markets.

In this area, even more than Western Europe, the regional forecasts suggest that there will be little stimulus to the rest of the world in the short run (and the UNIDO forecasts may prove optimistic), as they are forced to concentrate on their internal restructuring. In the longer run, however, the external effects could be strongly favourable.

Latin America

Elac stressed how the economies of this region were also restructuring to new patterns of output (towards exports) and to meet the consequences of the debt crisis. He and Szamuely thought that Eastern Europe and Latin America differed greatly both in the reasons for their indebtedness and structural problems and in how they were responding. A common problem, however, was inflation, and Elac warned of the difficulties of reducing this once economies had adapted to it. Exports had increased greatly, and new products had been found, so that manufactures in Mexico had tripled in 5 years and non-copper exports in Chile, for example, now exceeded copper. Countries were trying to diversify to increase external income as well as to reduce vulnerability. They were also changing the direction of their international contacts, with regional trade pacts and much more investment from Japan.

The central issue and constraint in the analysis, however, remained debt. Some solution would have to be found this year: therefore,

although its [illegible] was not yet known, it would be. (The meeting took place as the first indications of the 'Brady' Plan were emerging.) The prospects for 1989 remained very poor. In 1988, some forecasts had been much too optimistic because they had not allowed for the serious effects of the transfer of large debt servicing payments out of the region on investment and growth; these would remain a constraint in 1989. But once it was removed, the economic changes that had already taken place suggested that more optimism was possible.

The forecasts for this region thus illustrate particularly clearly the way the performance that could be expected from either a supply or demand based international forecast is subject to constraints: Latin American performance had been worse in 1988 than either had suggested, and would remain so in 1989, in spite of its obvious spare capacity and its remarkable exports, because of the depressing impact of the capital outflows.

Tropical Africa

Throughout the discussions Shaaeldin stressed the more fundamental problems facing Africa. Most countries there have suffered severe continuing falls in per capita income, and even the most optimistic forecasts for the future hope only for a levelling off (3.5% growth for GDP, with population slightly below this). The region is less responsive to external growth than others. There is no recent period of rapid growth to suggest a successful path to which it could return. For 1989, he expected slower growth than the UNIDO projections, with some pick up thereafter, if both domestic policy and external conditions improve. In the short term, stabilisation and shifts from public to private investment were bound to be deflationary.

Manufacturing output had increased rapidly during the 1970s, but the pace had slowed in the 1980s, discouraged by low domestic demand and lack of investment. The structural adjustment programmes tilted domestic prices to favour agriculture, reinforced by liberalisation of imports and foreign exchange regimes, while public sector investment was cut back. In many countries savings and investment ratios continued to fall in 1988. The importance of domestic demand and savings meant that manufacturing was dependent on, and thus would be constrained by, performance in the primary sector.

Structural adjustment was likely to be slow to produce results, and could fail without additional capital. For the longer term, he thought the evidence was still mixed: some of the 'successes' had benefited from higher inflows of capital. Some increases in major export crops had occurred, but these could be explained by rehabilitation or greater political stability, as well as price or other incentives, suggesting that rates of increase could not be sustained once the recovery was complete. Commodity prices were unlikely to rise sufficiently to increase incomes: the major African crops were in surplus, and new suppliers outside the region were expanding. As private capital inflows were not expected, Africa's import capacity and growth depend crucially on the multilateral institutions continuing to increase the volume of their lending, although the level of servicing for existing debt is already too high for many countries.

Improvements in efficiency in the agricultural and manufacturing sectors will lead to greater growth in the long run, although the cut backs in the public sector will be a constraint on investment, and could

hurt human capital formation. There will be difficulties in moving from simple import substitution to second-stage, intermediate and capital goods. On exports, the problems are more on the supply side: lack of infrastructure and economic and political stability, than from either external demand or protection. (For this reason, possible losses of trading preferences from the EC or all industrial countries are not serious worries.) Although a few countries have a promising base from which to increase manufactures, on the whole the gap between Africa and the rest of the world was expected to widen.

The analysis of Africa suggested that for most countries, the most important external impact could come from inflows of capital and technology, rather than variations in external economic performance. In the absence of these, tropical AFrica could move only very slowly to full participation in the world economy. Intra-regional trade and investment were also constrained by lack of infrastructure.

Indian subcontinent

In contrast to most of the regional forecasters, Bhatty was much more optimistic, particularly for India, than the initial UNIDO expectations, stressing the good performance of industry since 1985, and the tendency of official figures to understate performance because of the difficulties in covering small firms. The reduction in fluctuations in agricultural performance (and in particular the reduced vulnerability of the agriculture sector to external events), the growth in incomes which had made spending on non-food a larger, and hence less variable, proportion of income, and diversification and an established infrastructure, in skills as well as capital, had all contributed to a base for good performance. In the medium term aggregate growth of 6% was expected in the Eighth Plan (starting 1990), with consumer durables leading, but also rapid growth of basic and capital goods.

The problems were now in finding the political will to cut declining industries, and also in finding new sources of savings. Up to now household savings have been important, but there is a need to mobilise them from new enterprises and to reform the tax system to cope with new sources of income. The supply of foreign technology was less of a constraint, with European companies in particular willing to supply it separately from direct foreign investment. On trade, Bhatty put more weight on domestic factors (high profits and supply constraints) than external demand or protection.

In the other countries of the region, growth was held back by difficulties in transferring activities from the public to the private sector, and in some war conditions.

China

China has grown exceptionally rapidly in the last few years, but Kuang stressed that this was based on industrial growth (at about 20% in 1988), with agricultural production stagnant or falling, and that the industrial growth had been unbalanced with very rapid increases in light, consumer industries, and slower (although still high) growth in capital and mining industries. The worst imbalance has been high construction investment, associated with high inflation. Encouragement to increase exports diverted some goods, causing domestic shortages and/or higher imports, so that this pattern must be changed. Exports are also now being constrained by protection abroad, notably in the US.

The economy [illegible] clearly over-heated in 1988 with both real [illegible] and [illegible] signalling excess demand. Cuts in construction, lower growth of personal consumption, and steady exports, combined with more emphasis on agriculture, and encouragement of higher savings are intended to correct this. 1989 and 1990 are therefore expected to be years of consolidation, with a slowdown in growth (although at 7.5% it was still expected to be higher than average). This had not been assumed in the initial UNIDO forecasts. Monetary policy to reduce inflation would be difficult to implement because the responsiveness of regional banks to local demand for money makes it difficult to impose central controls.

The Chinese forecast thus suggested that in order to rectify what was seen as an unbalanced and excessive expansion, growth in the short term had to be slower than supply-based forecasts might suggest. This change was not forced by external demand: it could even lead to a worsened balance of payments position as imports are less constrained than exports. The role of regional policy, on exports or investment, was also important.

Middle East

(Discussed in the absence of regional representation.) This area seemed particularly exposed to external influences. The course of the oil price is the most obvious example: on the basis of the relatively pessimistic expectations for growth in most areas in the short term, followed by faster growth in the second half of the 1990s, the price could jump then. Supply conditions could reinforce this pattern: peace in the region could improve supply conditions in the first part of the 1990s, but falls in supplies from alternative areas were expected thereafter. The area's long-run strategy of resource-based industrialisation would need to look carefully at markets and at other factors of production besides cheap energy: in goods such as petrochemicals, its comparative advantage seemed clear, but even low cost metal production might not secure an advantage where there was already over-supply. As the European Mediterranean countries, notably Spain, Portugal, and Greece, saw their wages rise within the EC, other Mediterranean and Middle Eastern countries, which had relatively highly trained labour forces, at lower costs, could benefit. The EC 1992 initiative could cause difficulties to some sectors in the short run, but in the longer run could offer a better export market.

Once again, the group saw serious temporary problems of adjustment to changing markets and supply conditions, with potential financing constraints, but the potential for more rapid development in the longer term.

East and Southeast Asia

(Discussed in the absence of regional representation.) This area was also expected to be particularly vulnerable to external forces, but more from policy than from demand. Growing trade protection by the EC and the US could damage the growth of manufactured exports. On the other hand, they have been able to sustain good performance in spite of past protection, and it can be argued that their growth (which has greatly exceeded that of their export markets) has owed much to domestic policy. They in fact illustrate the importance of being able to make adjustments and transitions to new economic and policy conditions, within their domestic economies (the increases in real wages and shift towards outward investment) as well as external. (The discussions of West and East Asia

[illegible] illustrate by [illegible] the regional point of view to point out domestic forces and constraints; the external are more obvious to external observers.) Even if their growth does slow somewhat, it is still expected to be rapid by developing country or global standards.

Issues arising from the discussion

In the short to medium term (2 to 5 years), most of the regional forecasts were lower than those by UNIDO, but most of the group saw this as a period of adjustment or correction, to be followed by higher growth by the second half of the 1990s, if not before. It is important to distinguish this longer-term optimism from that found in forecasts made in the late 1970s or early 1980s. Then, there was a tendency to assume that there were temporary difficulties that held growth below 'normal', but that in the medium term, there would be a 'return' to a previous path. Now, the problem is explicitly seen as transforming economies to new domestic or regional structures or to new external conditions, followed by new as well as stronger patterns of growth.

At the international level, there may be substantial realignments of trade, within regions, notably in Europe and also within the Soviet Union and China, and between regions, including for example greater commodity trade between Tropical Africa and East Europe. Szamuely emphasised the possibility of considerable changes for East European trade patterns, given its location (geographic, and political, and economic) between West Europe and Asia: as its domestic economic structures change, the resulting changes in its trade could affect the balances of other areas. Other structural changes which could be mentioned are the changing patterns of trade of multinational companies, and the tension between growing awareness of global markets for goods and factors and production and increasing policy pressure towards regional or bilateral trade groups. Langhammer argued strongly that in the long run world performance would be strengthened by these regional reorganisations, notably that of the EC in 1992, and Kutoh was optimistic about increased trade among Japan, China, and East Asia. Bhatty saw growing promise within the South Asian region. He also cited changes in technology, but it was impossible to know who would gain from these. All these processes of restructuring clearly carry risks for the short term. Huang emphasised the uncertainties from the US: the imbalances and the possible ways of correcting them represented serious risks for the world in the short term.

Analytically at least, therefore, the forecasts of slow then faster growth appear to be more firmly based than in the past. This pattern is seen in East and West Europe, Latin America, and China, and perhaps the Middle East. India and Japan were thought to be completing transitions. Africa, as Shaaeldin argued strongly, remains outside this process or any domestic or external development pattern. In terms of 'industrial' country trade impact on 'developing', the discussion suggested relatively little external impulse from East or West Europe in the immediate future, with some improvement later, while Japan would continue to provide some demand, but falling in the future. The very high growth of trade in 1988 appeared to be the result of special conditions and the composition of demand, including in particular the high investment in many areas, and therefore not a sustainable pattern. (But even early in 1989 as the group met, there were some indications of still rapid trade growth.)

[illegible] developing countries are likely to remain [illegible] these forecasts: Latin America may move up, but the Asian countries are likely to remain the most rapidly growing, while sub-Saharan Africa remains depressed. The difficulty of increasing investment and improving performance while servicing large existing debts and without new inflows of capital was, as Elac stressed, a central current problem for Latin American countries. But if the debt servicing could be brought down, adjustments could be made to permit faster growth, even if not at Asian levels. Shaaeldin identified a few African countries where adjustment combined with rapid growth of exports also appeared to give hopes of success. For most, however, the burden of past debt and insufficient new resources did not permit a transition to significant growth in per capita income. Some Asian countries clearly had achieved strong rates and high levels of development so that there was discussion of the reasons for the differences, other than obvious economic characteristics like size and location. Three closely linked factors: timing, transitions, and speed, seemed to emerge.

External capital and markets might not be crucial, but they were clearly helpful, and those countries making the transition to industrial, high investment patterns when capital was cheap and markets expanding rapidly had had an advantage. Countries where domestic infrastructure was still a constraint, as was still true in Africa, but now less so in Latin America, were not able to take advantage of this.

Even countries with recent high growth like India and China were finding it necessary now to move to new industries or different patterns, a normal part of development. How smoothly and rapidly this could be managed would depend on the strength of established interests within the countries and on how favourable domestic and external economic conditions were (to minimise the cost to 'old' industries).

The longer the whole development process took, perhaps because of slow or interrupted external growth, or constraints like existing debt-servicing commitments, the older 'old' industries would be, and therefore perhaps, stronger. If the nature of industry or trade has changed, to require more physical or human infrastructure, for production, transport, or marketing, this may slow, as well as raising the cost of, industrialisation. More favourable external conditions than in the past may be needed to give an impulse or conserve momentum.

The need to look at possibilities for output and trade of services was raised, as they are increasingly closely linked with or substituted for manufacturing. They may provide a more dynamic or a less capital intensive mode, and prospects for trade are improving.

Conclusions

The contrast between the good performance of the last two years in industrial country output and trade and the weak reflection of this in Latin America and Africa focussed attention on the need to ensure that these areas could take advantage of the opportunities expected in the 1990s. Reducing the burden from past borrowing was essential. Whether through interest rate or capital reduction, payments must be reduced to permit Latin American and African countries to achieve satisfactory net investment and growth. Like most forecasters now, the group assumed that this would happen, but there was some discussion of criteria and modalities. Arguments of fairness suggested differentiation by country, by how well they had used the loans or how poor they were, but, on the

other hand, all countries had been affected by the unexpected slow growth and high real interest rates of the early 1980s; there are costs to any elaborate negotiated system (including that operated since 1982); and the history of international negotiations, for example on borders or trade, suggests that simple methods of sharing costs (an agreed formula for tariff reductions, for example) may prove acceptable as fair compromises. As global changes in interest rates and exchange rates have worsened all debtors' positions, fixing these in a way that reduced payments, perhaps based on what might have been expected in the late 1970s, could offer an acceptable formula. Such 'retrospective terms adjustment' is being applied to bilateral official loans to the poorest countries: lenders are converting them to grants. A similar retrospective adjustment to terms that look fair in the light of current policies and conditions could be applied to the commercial or multilateral official lending which remains the burden for Latin American and African countries.

Dealing with the cost of past borrowing, however, is only one condition for future development. For Africa, substantial new capital is clearly required, and for other areas, notably Latin America, it is desirable to improve the rate of development. One clear problem (not only for developing countries) was seen in the still high level of real interest rates. If these in fact reflect higher inflation expectations in the markets than among forecasters (an argument which may seem stronger by mid-1989), then new mechanisms of capital inflow, to rearrange the short term cash outflows, may be sufficient. If, however, they reflect a permanent change to higher rates because of greater caution and uncertainty on the part of lenders, or if they are the result of the industrial countries' efforts to manage world exchange rates under asymmetrical adjustment, then they may be a serious impediment to using external capital as long as these fears or such a policy continues. A switch from lending to equity investment does not provide an answer as the return investors would require would also be based on interest rates. Most of these forecasts, and others, effectively assume that real interest rates will remain high for the foreseeable future. It is not yet clear whether the investment boom of 1988 was only a delayed reaction to the lower interest rates of the mid 1980s or a shift back to the greater willingness to accept risk that is essential to sustained growth.

This implies that it is necessary to consider how to increase concessionary inflows of capital and how to mobilise domestic savings. External assistance would need to provide general, programme support, as well as project assistance. This might be achieved for Africa, but Latin America would have to look more to domestic savings. It might be better able to offer some hope of returns high enough to attract capital even at present required rates of return.

Much of the discussion had looked at micro-economic problems, sectoral questions of the type discussed in the Global Report, and how to improve response of individual decision-makers to these as well as national, aggregate relationships. Elac particularly stressed the need to look at the management of economic responses. In contrast, aggregate questions like the 'role of the public sector' appeared not as issues in themselves, but rather pragmatic problems in particular circumstances. Diversification remains an element of strategy, but the need to look at which industries are chosen in the light of other countries' choices was clear from, for example, the discussions of the Middle East and Africa, so that it becomes an element of industrial strategy not simply of macroeconomic risk reduction. The synchronised movements in commodity

prices [illegible] have been a sharp reminder that trying to use an apparent trend from the past as a policy tool for the future may fail if others have made the same observations. It is difficult to identify general rules about appropriate industrialisation strategies as relative capital and technology intensities change and also, as Szamuely pointed out, as industries move to greater emphasis on orientation to markets, away from determination by resources. In all these circumstances, transfers of technology may assume a greater importance relative to transfers of capital.

If developing countries can attain positions where they can respond, opportunities from the rest of the world could be favourable. Output was expected to expand, and trade could follow, certainly for manufactures to industrial countries; probably for intra-trade in Asia, and possibly in Africa and latin America; and in the longer term, for commodities to Eastern Europe and China. The GATT Uruguay round was looking (even in March) more favourable than had been feared in December, and, in some commodities, more than had been expected before it began. The faster than expected growth and higher than expected investment in 1988 in the industrial countries could indicate that they were making the structural adjustments long identified as necessary by UNIDO and other international organisations: this would favour trade and could reduce pressure for increasing protection. This optimism, however, should not be exaggerated: expected growth rates of output and trade are still not at 1960s levels (although comparisons no longer seem absurd), and while some forecasters did not find protectionism a major problem, it clearly remains so, not least for the two largest countries: China (where Huang particularly mentioned it as a constraint) and India (one of the most conspicuous participants in the Uruguay round).

By focussing on the regional conditions and constraints which modify expected economic performance, the group brought out how these may prevent a region from responding to 'world' conditions or allow it to do better. It also reminded the participants of the role of non-economic constraints: the respect for rules which conditions debt and trade actions and also the respect for social criteria which governs national policies. The interaction of the three forces, economic development, international order, and national responsibilities, can be recognised, although not resolved, in such a discussion.

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Append list of participants.