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LDC Commodity Earnings: Buffeted by Structural Change



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An Intelligence Assessment

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*GI 85-10094
April 1985*

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An Intelligence Assessment

This paper was prepared by 
Office of Global Issues. Comments and queries are
welcome and may be directed to the Chief,
Economics Division, OGI, 

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**LDC Commodity
Earnings: Buffeted by
Structural Change**

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Overview

*Information available
as of 20 March 1985
was used in this report.*

Earnings of the less developed countries from nonoil primary commodities are not likely to rise significantly over the next several years. We expect earnings by 1990 to rise no higher than 15 percent over their 1983 level of \$92 billion. Although this is higher than the nearly \$100 billion earnings peak of 1980, we estimate these earnings will be just high enough to offset debt service payments. This outlook is made with the assumption of no disruption of the current economic recovery and its associated low inflation, high real interest rates, and a strong dollar.

Underlying the cyclical economic factors that determine LDC earnings is a wide range of long-term structural changes in the commodity markets themselves. Worldwide demand for these commodities is being restrained by new technologies, changing consumer preferences, and government protection of domestic producers. On the supply side, LDCs are raising domestic production of commodities they have traditionally imported, encouraging commodity exports to boost foreign exchange earnings, and cutting their own commodity imports to reduce currency outflows. The resulting weak demand and abundant supplies will contribute to historically low commodity prices.

This earnings outlook will have implications in several arenas:

- LDCs as a group will be unable to depend on expanded commodity earnings to fuel economic growth or help them improve their debt situation.
- The growing geographic dispersion of commodity production will stabilize supplies and limit price increases from any temporary supply shortfalls that may occur in major producing regions.
- Increased competition among commodity producers might nurture even higher levels of protectionism in both LDCs and the developed countries—pushing prices and earnings yet lower. This is likely to aggravate North-South tensions and raise LDC demands for economic concessions by the industrial countries.
- Expanding LDC output, combined with lagging US competitiveness, will hurt US producers of such commodities as copper, grain, soybeans, meat, poultry, rice, and sugar.

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Although this is the most likely earnings outcome, alternative assumptions about the world economy lead to scenarios with greater impact. A prolonged period of negligible economic growth, accompanied by high real interest rates, low inflation, and a strong dollar, could push earnings down to \$90 billion—comparable to their 1981 low. Such an outcome would lead to further economic hardship and political unrest in LDCs. By contrast, a short, sharp recession could shake out marginal producers and reduce protectionism by increasing the cost of subsidies. An ensuing strong recovery characterized by high inflation could push LDC commodity earnings to about \$130 billion by 1990.

Regardless of which scenario prevails, the ongoing structural changes in commodity trade will remain a long-term problem for those LDCs dependent on commodity exports. LDCs that fare best in these soft commodity markets probably will be the larger countries with greater resources—such as Brazil, Indonesia, Malaysia, Argentina, and Chile. These LDCs are in the best position to expand commodity production, diversify into new exports, and engage in value-adding commodity processing. The numerous smaller LDCs that depend on commodity exports for the majority of their earnings will be less able to raise export volume. As a result, LDCs as a group might face increasing difficulty obtaining consensus on a wide variety of issues as the larger LDCs capable of maintaining earnings develop national agendas that are different from those of the lower-income LDCs.

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LDC Commodity Earnings: Buffeted by Structural Change

Introduction

More than a third of nonoil export earnings in the developing countries comes from mineral and agricultural commodity exports. These earnings are roughly equal to the annual foreign debt service payments by the less developed countries, according to our estimates. Because of this importance, the health of the developing economies and their ability to service their foreign debt will depend in large measure on the outlook for LDC commodity trade—both prices and export volumes. The outlook is dramatically different from that of a decade ago largely because of the structural changes that have occurred in commodity markets during the interim.

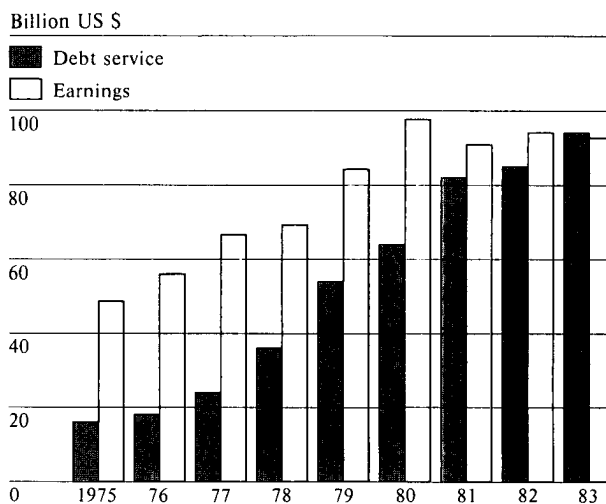
The Rise and Fall of LDC Commodity Earnings

Over the past decade, commodity producers have experienced both boom and bust:

- In the mid-to-late 1970s, high rates of inflation and rising commodity demand caused by strong global economic growth fueled unprecedented increases in commodity prices, export volumes, and LDC commodity-export earnings. These earnings almost tripled during the period between the 1974/75 and 1980 recessions, reaching nearly \$100 billion annually. Healthy LDC earnings, in turn, facilitated heavy borrowing by LDCs from Western banks eager to lend recycled OPEC funds (figure 1).
- The short, sharp recession of 1980, followed by the prolonged 1981/82 contraction, sent commodity prices tumbling and cut export volumes. The reduced level of manufacturing hit Western imports of mineral and industrial material commodities, such as rubber and timber, and the consumption of foodstuffs stagnated as LDCs became less able to pay for food imports.

In all, nominal commodity prices fell 25 percent (expressed in dollars) between their peak in 1980 and

Figure 1
Nonoil LDCs: Commodity Earnings and Debt Service, 1975-83



their late 1981 lows; real export earnings in the LDCs fell 17 percent. As a result of these trends, Third World commodity producers ended 1982 in very poor shape.

The Current Recovery: Leaving Commodities Behind

As the global economy came out of recession in 1983, many observers looked for a repeat of the commodity price boom that followed the 1974/75 recession—and a parallel increase in LDC export revenues. Prices did rise in 1983, but remained about 15 percent below their 1980 peak. Moreover, a slight drop in export

volume led to a decline in earnings. In 1984 prices dropped back to near their recession low, but preliminary estimates indicate that a sharp increase in export volume led to a small rise in overall commodity earnings. We estimate that, in real terms, LDC commodity export earnings in 1984 were comparable to 1978—more than 15 percent below their 1980 peak of \$100 billion. [redacted]

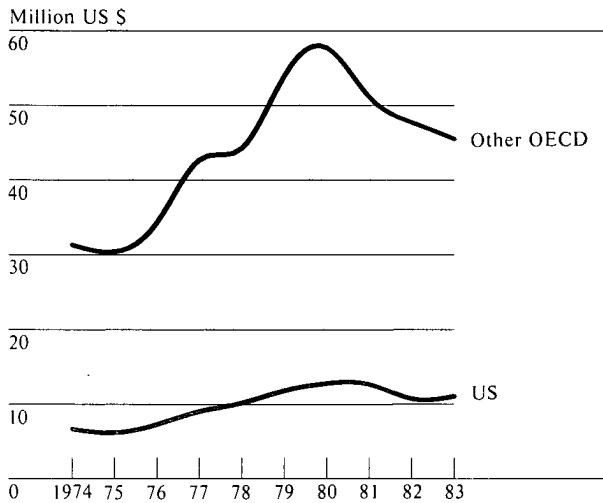
Although demand for commodities historically has been closely linked to economic activity in the developed West—which purchases about 60 percent of LDC commodity exports—differences between the current and previous recoveries have restrained demand for commodities:

- The strong dollar has made commodities—which are generally denominated in dollars—more expensive to non-US customers. For example, since their peak in 1980, *The Economist* index of commodity prices has fallen 25 percent in dollar terms, but prices quoted in British pounds have risen more than 50 percent. This is particularly damaging to LDCs that depend on non-US markets for sales—such as African and Pacific Basin exporters.
- High real interest rates and low inflation have prevailed in sharp contrast to previous recoveries. High interest rates discourage construction and manufacturing of metal-intensive consumer durables by raising the cost of borrowing. Moreover, high returns on financial instruments make investments in commodity stockpiles and inventories less desirable. At low rates of inflation, traders and consumers have less incentive to hold physical stocks as a hedge against future price increases or declining currency values.
- Lagging growth in Europe and Japan has caused commodity imports by non-US OECD countries to fall dramatically since 1980, and US imports have remained more or less steady despite a robust recovery (figure 2). [redacted]

**Structural Trends in Commodity Markets:
A Growing Cause for Concern**

Underlying these cyclical factors are a number of structural trends that will continue to suppress commodity earnings in the 1980s. Changing consumption

**Figure 2
Commodity Imports From Nonoil LDCs:
US Versus Other OECD, 1974-83**



[redacted]
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patterns and a general lack of new markets for commodity exports will continue to erode demand. On the supply side, export-promotion policies and improving production techniques will virtually assure a continuation of glutted markets. [redacted]

Shift in Consumption Patterns

Changing consumption patterns are cutting into demand for both mineral and agricultural products:

- Many commodities are facing serious challenges from *substitutes*. Inputs to manufacturing, such as copper and other metals, natural rubber, and natural fibers, are being replaced by cheaper synthetics. Sugar use, for example, is under extreme pressure from the growing use of alternative sweeteners—especially high fructose corn syrup and Aspartame.
- *Production innovations* are reducing the amount of a commodity required to produce a given product or eliminating its need entirely. For example, industry studies show that advances in tin-plating techniques

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are cutting the amount of tin in each unit of output. Microwave communications, satellites, and optical fibers are making long-distance copper cables obsolete. The demand for cocoa, beef, and other food commodities is being reduced by the use of extenders.

- The growth of the *recycling* industry in the United States is likely to spread to Japan and Europe, further dampening demand for imports of primary commodities such as copper and aluminum. In the aluminum industry, for example, recycling has increased from 9 percent of consumption in 1979 to 17 percent in 1983, according to Bureau of Mines studies.
- Changing *consumer preferences* have decreased beef, sugar, and coffee consumption in the United States and increased the consumption of poultry and noncaloric sweeteners. The oil shocks of the 1970s have led consumers to buy smaller, lighter weight cars, which have a lower metal content.
- The rising role of *services* in the OECD economies is weakening the link between economic activity and commodity demand. The reduced importance of heavy industry has meant materials prices have risen more slowly than general commodity prices during the current recovery, when historically the opposite was true (figure 3).

These structural changes are illustrated by the declining percentage of commodities consumed for each unit of economic activity or GNP. For example, during 1973 in the United States, 1.41 tons of copper were consumed for every billion dollars of real GNP. By 1983 this factor fell to 0.96 ton per billion dollars. Similar declines are occurring in the tin, iron, rubber, coffee, and sugar markets of the developed West.

[Redacted]

Few Growth Markets

The prospect of stagnant commodity demand in the developed countries has led some observers to argue that LDCs must look to other regions for significant market growth. Although LDC imports of commodities rose faster than those of the OECD in the 1960-80 period, the LDC share of total world imports was only 19 percent in 1983, according to GATT and World Bank data. Any large gains are likely to be delayed for several reasons and therefore not likely to

substantially boost exporter earnings. Austerity programs caused by debt problems will limit imports of foodstuffs and hinder the industrial growth required to support mineral demand. Moreover, wealthier LDCs may begin to copy the consumption patterns of the developed countries by adopting high-technology products, such as plastics, largely skipping the mineral-intensive, heavy industry growth seen in the OECD countries. For example, new telecommunications systems in LDCs are likely to rely more on microwave technologies than on copper cables. [Redacted]

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The centrally planned economies will not provide the growth markets needed to lift LDC earnings. The Soviet Union is mineral rich and does not represent a large potential outlet for LDC mineral exports, although it does buy some tin and bauxite. In the agricultural arena where chronically poor harvests have led the USSR to become the world's largest grain and sugar importer—benefiting, among others, both Argentina and Cuba—buying is likely to slow somewhat, according to our estimates. No major increases in commodity imports are foreseen because of increasing domestic production and hard currency constraints. [Redacted]

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China is a major exporter of rice, fruits, vegetables, and soybeans and, because of agricultural reforms and good weather in recent years, has shifted from being a major importer to a significant exporter of grain and cotton. On the materials side, China may boost purchases of construction and industrial materials over the short run as it develops its industrial base. In the long run, we believe it has the potential for self-sufficiency in most of these commodities also. [Redacted]

LDC Commodity Policies

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On the supply side of the equation, LDC exporters have helped ensure that commodity prices will remain depressed. The increasing need for foreign exchange, which arose out of the LDC debt crisis, led many countries to increase export volumes even during periods of weak prices. Although encouraging commodity exports to boost earnings might be the optimal strategy for any given LDC, it will hold overall LDC earnings down by depressing world commodity prices. [Redacted]

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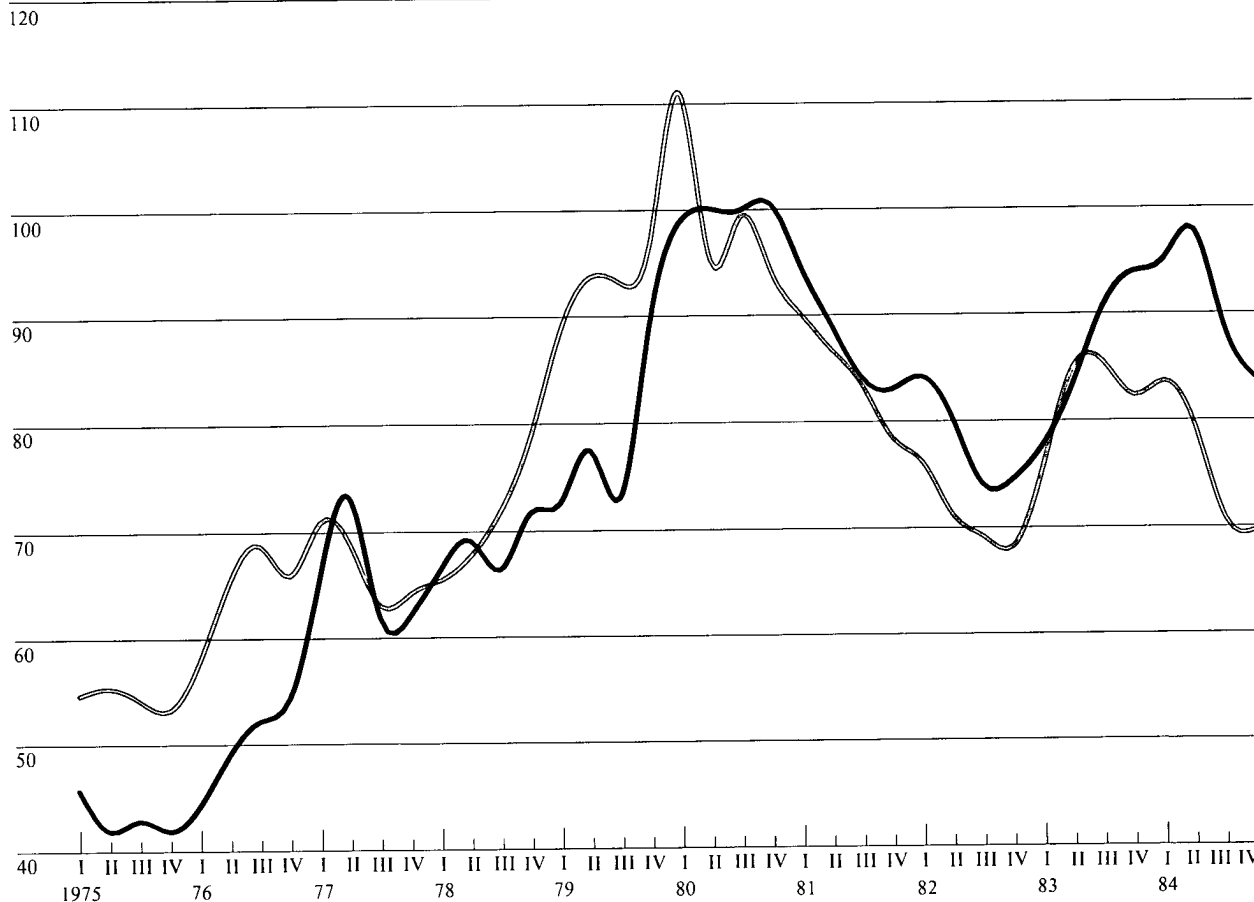
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Figure 3
Commodity Prices: Foodstuffs and Industrial Materials, 1975-84

Index: 1980=100

— Foodstuffs
— Industrial materials



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Although our analysis indicates overall investment in LDCs has been curtailed by austerity programs, excess indebtedness, and high interest rates, investment in commodity-export industries has not suffered as badly. Indeed, there are signs that some LDC governments are using their influence over investment allocation to funnel funds toward commodity production—at the expense of development of other industries. In any case, output will remain high as projects

started by investments made before the debt crunch continue to produce for several years. For example, cocoa and coffee trees planted in the late 1970s will be productive for several decades.

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LDCs are also promoting the production of export commodities by raising the price paid to producers. This is particularly true in agriculture, where state commodity agencies—often under pressure from the IMF or the World Bank—are setting farm prices closer to remunerative levels. This has recently been done in Nigeria, Ghana, and Zambia, according to Embassy reporting. Recent austerity programs that involve currency devaluation have also encouraged production by raising the local value of export goods in return for hard currency. Although fiscal cutbacks in many LDCs have reduced the funds available for subsidies, the need for foreign exchange means governments are more likely to reduce support for commodities consumed domestically than for export commodities. Finally, even for those LDCs that are net commodity importers, such policies restrain imports and reduce global demand. [redacted]

Overproduction is being exacerbated by the rapid development and diffusion of technologies that are lowering production costs and raising yields. For example, Asian rice yields per acre increased 60 percent between 1963 and 1983, according to US Department of Agriculture statistics. The simple introduction of the Cameroon weevil into Southeast Asia has greatly enhanced palm oil production there; Malaysian palm oil production has more than doubled since 1977. New exploration and extraction techniques are progressively enlarging potential mineral reserves in many LDCs despite declining ore grades in existing mines. For example, hydrometallurgical techniques have enabled copper producers to efficiently extract metal from material once considered waste, [redacted] Although this trend bodes well for export volumes, increased production will put further downward pressure on world prices. [redacted]

Protectionism

Global agricultural protectionism will also depress world prices and limit export volume increases. Countries of the industrialized West are likely to continue to protect their domestic commodity-producing sectors with export subsidies and import barriers because of the influence of powerful farm and labor lobbies. For example, Japanese consumers pay several times the world price for rice and beef, and sugar costs EC consumers five times the world price. The Common Agricultural Policy (CAP)—initiated in the early

1960s to promote agricultural self-sufficiency in the community—has changed the EC from a major outlet for LDC commodity exports to a major competitor. The EC now sells both wheat and sugar on the world markets at prices substantially below what it pays farmers to produce them. Until the burden of these protectionist measures exceeds the willingness of taxpayers and consumers to bear them, we see little hope for a reduction in such government interventions.

[redacted]

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Economic forces are spreading protectionism beyond the OECD countries to the LDCs themselves. In their efforts to improve their balance-of-payments positions, LDCs are likely to further restrict imports of basic commodities while trying to increase food self-sufficiency. There are signs that several of the newly industrializing countries (NICs) are beginning to emulate the protectionist policies of the wealthier countries. For example, South Korea maintains domestic rice prices at three to four times the world level, according to Embassy reporting. Such a trend would be especially harmful to commodity exporters because the NICs are perhaps the best potential growth market for commodities. [redacted]

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Earnings Prospects to 1990

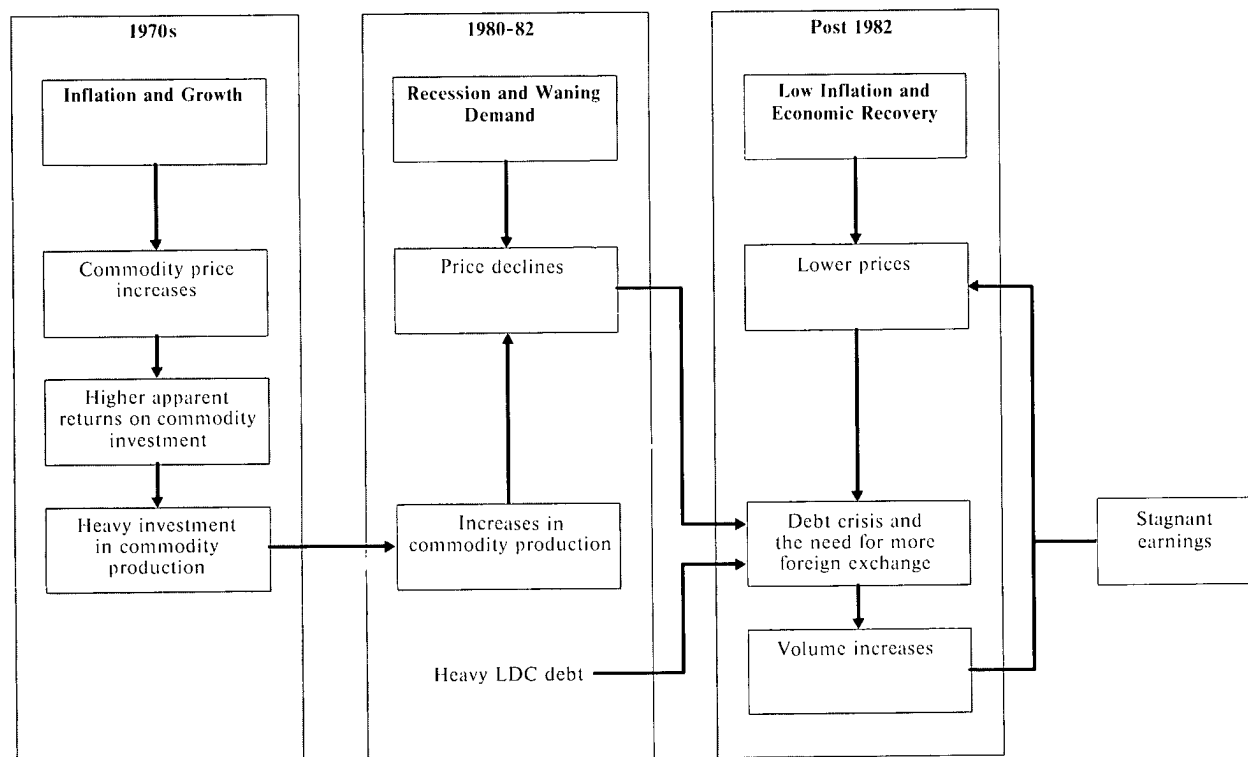
We believe that by 1990 LDC commodity export earnings will increase slowly to as much as \$105 billion. This earnings level would be 15 percent over the 1983 level in nominal terms but could mean little or no growth in real terms. This scenario assumes that the structural changes underlying the commodity markets will continue and no major shifts will occur in the growth path of the current economic recovery:

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- Global economic growth at about 3 percent annually through the end of the decade will be necessary to support this earnings outcome. Growth significantly slower than this could erase any volume increases.
- A strong US dollar—largely the result of continued high real interest rates and faster growth in the United States than in the rest of the OECD—will

Figure 4
Boom and Bust Cycle: The Road to Stagnant Earnings



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dampen commodity demand by making foreign importers of commodities face expensive currency transactions when buying dollar-denominated commodities.

- Low inflation held down by the strong dollar will prevent the type of inflation-driven commodity price increases that occurred in the 1970s (figure 4 and table 1).

Although we believe that slow growth in commodity export earnings through the rest of the decade is the most probable outcome, we have examined the condi-

tions required to produce more pessimistic and optimistic cases. Earnings projections under these scenarios are based on historical analogues.

**A Pessimistic Case:
 Declining Revenues**

If the current economic recovery lapses into a prolonged period of negligible growth, by 1990 earnings could drift down to their 1981 low point of about \$90

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Table 1
The Outlook for Commodity Markets:
Winners and Losers

Factor	Trend	LDC Export Volume Effect	LDC Export Price Effect	Winners	Losers
OECD growth	Moderate	Higher	Moderate rise	Producers	Current consumers, importers
Dollar strength	Continuing strong	Lower	Lower	US importers	Exporters to non-US markets
Interest rates	Falling	Higher	Moderate rise	Producers	Consumers
Inflation	Low	Lower	Slow rise	Consumers	Producers
Protectionism					
Subsidies	Lower	Higher	Higher	LDC exporters	Western producers, importers
Barriers	Higher	Lower	Lower	Exporters with access past barriers	Exporters without access
Changing consumption patterns	Reduced commodity intensity	Lower	Lower	Consumers	Producers
LDC supply policies	Pushing exports	Higher	Lower	Wealthier LDCs	Unstable and smaller LDCs
Production technologies	Lower cost output	Higher	Lower	LDCs with access to capital	Poorer LDCs
Value-added production	Gradual increase	Higher	Higher	Larger LDCs with access to capital	Smaller LDCs
Diversification	Gradual	Higher	Lower	Resource-rich LDCs	Resource-poor LDCs

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billion—a few percentage points below 1983 earnings. Such a period of economic stagnation could be accompanied by high real interest rates, very low inflation, and a strong dollar. Such an earnings decline, along with the high debt service payments required by high interest rates, would push many LDCs to face further readjustment of their domestic economies, possibly leading to a rise in political unrest. Overall commodity demand would suffer directly from reduced industrial activity and consumer spending in the importing countries. A slowdown in manufacturing would hit minerals prices hardest. High interest rates, low inflation, and the strong dollar would discourage holding stocks of minerals for speculative purposes while evaporating the credit needed to finance international trade. Higher cost Western farmers and mining companies might, in the face of low demand and world

prices, succeed in persuading governments to raise more protectionist barriers against LDC imports. Tighter trade financing coupled with more protectionism would accelerate the growing use of countertrade. On the supply side, LDCs facing falling prices would have difficulty maintaining their “export at any cost” philosophy because there would be few buyers. []

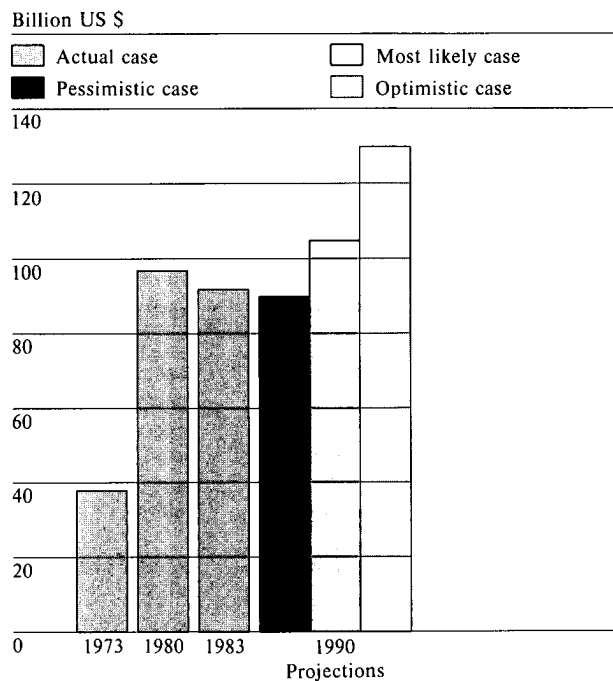
An Optimistic Case:
Rising Volume and Prices

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Although we doubt that commodity export earnings will rise much above their 1980 peak during this decade, we can envision a scenario under which export

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Figure 5
Nonoil LDC Commodity Export Earnings



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earnings increase significantly—perhaps to as high as \$130 billion (figure 5). We believe such an increase could be brought on by a short, sharp recession—necessary to trim excess producers from the markets—followed by a robust global recovery. This favorable outcome assumes governments do not increase protection of their commodity industries. For the high-cost, marginal mineral producers in the industrialized countries, another recession in the near future would produce a shakeout of inefficient producers. On the agricultural side, such a recession, if accompanied by a weaker dollar or sharply reduced US farm support prices, could put strong pressure on the EC export restitution and domestic price support system. The increased value of EC currencies would make European agricultural goods more expensive, and, as the gap between EC and world market prices widened, deficits could force the CAP system to collapse of its own weight.

With LDC exporters facing fewer protectionist barriers and less competition, a strong recovery following such a recession could raise prices sharply. If interest rates and the value of the dollar remained low, commodity demand by non-US importers would be heavier and the cost of holding stocks, low. Moreover, sustained double-digit inflation skewed in favor of commodity prices—like the inflation during the growth period of the 1970s—would make holding physical stocks more attractive for the speculator and user alike. This increased demand along with good weather and political stability in the exporting LDCs could sharply raise overall earnings.

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Country Impacts

Unlike the 1970s when the rising tide of prices lifted the earnings of all the commodity exporters, the stagnant prices we foresee for the late 1980s will leave behind those LDCs that cannot expand their export volumes. The larger, resource-rich LDCs will be able to maintain some earnings growth by increasing their export volume, diversifying into new products, and engaging in value-added production. In contrast, the smaller, resource-poor exporters will find it increasingly difficult to raise export earnings in an era of restrictive trade practices. These disparities become evident in the more important markets (table 2):

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- *Copper.* Chile, the largest and lowest cost producer of copper, will probably continue pushing exports—helping to keep copper prices low. For the smaller producers, such as Peru, Zaire, and Zambia, which cannot match Chile’s volume increases, earnings will stagnate or decline. In addition, Brazil is expanding copper output significantly to substantially reduce its imports, and Mexico may soon become a net copper exporter.
- *Rubber.* Major expansion plans by the three big producers—Malaysia, Indonesia, and Thailand—will keep supplies plentiful. Smaller producers, such as Sri Lanka and Liberia that respectively depend on rubber for 11 and 17 percent of export earnings, will be less able to boost volume to compensate for low prices.

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**Table 2
Commodity Markets: Representative
Country Performances**

Market	Likely To Do Well	Likely To Do Poorly
Copper	Chile Brazil Mexico	Peru Zaire Zambia
Rubber	Malaysia Indonesia Thailand	Sri Lanka Liberia
Tin	Brazil	Bolivia
Cocoa	Brazil Malaysia	Ghana Togo Benin Cameroon
Sugar	Brazil India China	Caribbean countries Fiji
Cotton	China	Pakistan Egypt Nicaragua Paraguay Mali Sudan
Iron ore	Brazil	Liberia Mauritania

- *Tin.* Although Bolivia, which relies on tin for a third of its export earnings, has had critical production problems, Brazil more than tripled its tin exports between 1980 and 1984. The Association of Tin Producing Countries, made up of Bolivia, Nigeria, Malaysia, Indonesia, and Thailand, blames Brazil for weak tin prices, but the market is also beset by declining tin use, chronic overproduction, and rampant smuggling. Indeed, little or no increase in prices or volumes is likely.
- *Cocoa.* West African countries, such as Ghana, Togo, Benin, and Cameroon, depend on cocoa for 10 to 45 percent of earnings but probably will continue to lose market shares to Brazil and the wealthier Asian producers. Since 1980 production has fallen 16 percent in West Africa, but it has risen 79 percent in Asia—largely because of a tripling of output by Malaysia.
- *Sugar.* Because of high production in Brazil, Asia, and the EC, sugar prices have been pushed to their lowest level in real terms since the 1930s. This has

**International Commodity Agreements:
Ailing But Not Dead**

Price-maintenance international commodity agreements (ICAs) exist for cocoa, tin, rubber, and coffee. The ostensible purpose of such ICAs is to stabilize international prices around long-term trends through the use of bufferstocks and export quotas. Despite ongoing efforts within the UN community, it is unlikely that many new ICAs will be negotiated to add to the existing four:

- *The tin agreement, set to expire July 1987, is beset by huge stocks, declining demand, rampant smuggling, and expanding exports by nonmembers.*
- *Cocoa talks aimed at renewing the ICA set to expire in September 1985 are making little headway. Differences exist over the level of target prices and what kind of export quotas should supplement the existing bufferstock.*
- *The natural rubber agreement, also due to expire later this year, is entering renegotiation. A proposed pact provision assuring that suppliers will not try to affect rubber prices unilaterally is the first obstacle.*
- *The coffee agreement, scheduled to run to 1989, is plagued by disputes over the amount of coffee released to the market and the allocation of export quotas.*

Last year the sugar agreement lost its price-maintenance provisions, and efforts to form a tea pact failed. Ratification of the Common Fund (CF), an UNCTAD initiative that would finance price-stabilizing bufferstocks for a wide range of commodities, is unlikely after nine years of effort because of the reluctance of the United States and existing ICAs to join the CF. (C NF)

The failure of such agreements may spark LDC interest in other measures. Already there is a trend toward administrative agreements designed to facilitate increased market information and product research. Commodities governed by such pacts include sugar, jute, bananas, wheat, and tropical timber.

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severely hurt exports and earnings in scores of sugar-exporting countries, particularly smaller ones such as Belize, Fiji, and the Dominican Republic, where sugar accounts for 35 to 90 percent of earnings. Meanwhile, the sugar-producing giants—Brazil, India, and China—have boosted production 35 to 65 percent since 1980.

- *Cotton.* In the past four years Chinese cotton production has almost doubled to 21.3 million bales—nearly a third of global output. During crop year 1979/80 China imported 20 percent of the cotton traded on the world market, but this year it is expected to account for 5 percent of world exports—a trend the Chinese Government intends to encourage. In addition to taking traditional US markets, these exports will hurt Pakistan, Egypt, Nicaragua, Paraguay, Mali, and Sudan, where cotton exports accounted for 10 to 50 percent of earnings in 1983.
- *Iron ore.* Next year Brazil's giant new Carajas mine will begin producing magnesium, nickel, bauxite, and large amounts of low-cost, high-grade iron ore. Some estimates put 1988 iron ore output from Carajas at 5 percent of world production. Carajas's output, along with new mines in Australia and expected declining world demand through 1990, will keep ore prices down—undercutting earnings for Mauritania and Liberia, which depend on iron ore for roughly half of their export earnings. [redacted]

LDCs able to enter into *value-added* production—such as crushing soybeans into meal and extracting the vegetable oil or refining chromite into ferrochromium—can partially offset the impact of lower prices by selling more expensive, processed products. Only the larger, more stable LDCs will succeed with this approach, however, because of the investment required and the need for an adequate supply of raw inputs. Indonesia, for example, has reduced log exports and increased lumber-product exports by building 80 plywood factories since 1974; it has more factories planned. In contrast, according to Embassy reporting, an effort to grind cocoa beans in Ghana is beset by electric power outages. [redacted]

Some LDCs are making effective use of taxation and export price incentives to encourage commodity processing. According to Embassy reports, Malaysia, for example, imposes high taxes on raw palm oil exports to effectively subsidize refined vegetable oil exports.

Similarly, production and export incentives have made Brazil one of the world's leading exporters of frozen concentrated orange juice and soy products. [redacted]

The smaller LDC producers whose economies rely heavily on earnings from one or two commodities will be most hurt by the growing *geographic dispersion* of production. This, along with a growing list of commodity substitutes, will tend to limit price increases when major producing regions experience temporary supply shortfalls. For minerals, labor strikes become less significant as more countries open new mines for copper, iron ore, tin, and other minerals. Sugar crops in Europe will keep supplies up during bad weather in the tropical regions, while West African droughts have already become less critical for cocoa prices as production rises elsewhere. This means that a country with a shortfall will be less able to count on sharp temporary price rises to offset low earnings from longer term soft markets. Furthermore, those LDCs that diversify their export base will buffer their economies from the price swings of any single commodity. [redacted]

On balance, those LDCs that succeed in these export markets are likely to be the larger countries with greater resources and stability. The countries most able to continue diversification into a wider range of commodity exports while developing their commodity-processing industries are Brazil, Malaysia, Indonesia, and Thailand. Other large LDCs will depend on volume increases of their export mainstays. Argentina plans to significantly increase its grain exports, and Chile is expanding its copper production. Most smaller LDCs—whose economies are usually dependent on commodity exports—will face stagnant world prices and only marginal improvements in their export volume. [redacted]

Implications

The relatively small increase we foresee for commodity earnings during the rest of the decade will contribute little to overall LDC growth prospects. Assuming no major changes in the level of LDC debt over the

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next several years, commodity export earnings are likely to remain just high enough to offset debt service payments. Such prior claims on future earnings will preclude LDC use of their agricultural and mineral resources to fuel the kind of rapid economic development experienced in the 1970s. Moreover, continued LDC emphasis on expanding commodity export volume will draw resources away from efforts to diversify into manufactured exports and develop domestic industries. [redacted]

Chronically low commodity prices could increase demands by LDCs in international forums for some form of economic redress. Given the general ineffectiveness and current problems of price-maintenance international commodity agreements, we see little likelihood that the LDCs will push hard on this front. One initiative that LDCs might focus their efforts on, however, is the creation of a compensatory financing facility under the auspices of the UN Conference on Trade and Development. Such a fund in theory would be similar to, but much larger than, the current IMF facility used to compensate LDCs facing temporary earnings shortfalls because of low export prices. [redacted]

At the same time, however, the circumstances that would lead to such demands could increase LDC difficulty in obtaining consensus on a wide variety of economic and political issues. The larger LDCs capable of maintaining earnings through increases in export volume will begin to develop national agendas that are different from those of the smaller, struggling LDCs. Such a split would leave these lower-income LDCs without their traditional strong allies in North-South discussions and could well weaken the overall negotiating strength of such LDC alliances as the Group of 77. [redacted]

Worldwide trade tensions probably will be raised as exporters in both LDCs and the developed West face low world prices, diminishing markets, and more import barriers. These developments will put further competitive pressure on US commodity producers. Because US copper producers have the world's highest break-even production costs—45 percent higher than that of the lowest cost producer, Chile—they will face increasing difficulty competing against copper imports. Japanese and European steel producers have signed long-term contracts to buy cheap iron ore from

Brazil's Carajas mine. This decline in input costs for these foreign steelmakers will further undercut the competitiveness of US producers and add to OECD trade disputes. On the agricultural front, without current import quotas, which keep domestic sugar prices at roughly five times the world market level, many US sugar producers would not survive the competition from subsidized and low-cost foreign exporters. [redacted]

The depressed markets faced by LDC commodity producers also plague US exporters. Expanding grain exports by the major grain exporters—Argentina, Canada, Australia, and the EC—along with increased food self-sufficiency in other countries—China, India, Saudi Arabia, and Zimbabwe—will cause outlets for US grain to shrink. Similarly, increased exports of soybeans and poultry from Brazil, beef from Argentina and the EC, and rice from Thailand are eroding US markets for those commodities. [redacted]

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