



## Annex I

# Transparency in Government Operations

**T**ransparency in government operations is necessary for sound government finances, good governance, and overall fiscal integrity. The Interim Committee in its September 1996 Declaration, “Partnership for Sustainable Global Growth,” stated that “it is essential to enhance the transparency of fiscal policy by persevering with efforts to reduce off-budget transactions and quasi-fiscal deficits” (see the October 1996 *World Economic Outlook*, page xii). Reflecting these concerns, a recently published IMF Occasional Paper<sup>1</sup> addresses many aspects of transparency in government operations, identifying good practices, reviewing major trends in this area, and examining the IMF’s role in promoting fiscal transparency.

### Why Fiscal Transparency?

Fiscal transparency can be defined as openness toward the public at large about government structure and functions, fiscal policy intentions, public sector accounts, and projections. It involves ready access to reliable, comprehensive, timely, understandable, and internationally comparable information on government activities—including those activities undertaken outside the government sector—so that the electorate and financial markets can accurately assess the government’s present and future financial position.

Fiscal transparency is a precondition for sound economic policy. Timely publication of a clearly presented budget document makes it easier for markets to evaluate a government’s intentions and thereby impose a constructive discipline on the government. Transparency increases the political risk of unsustainable policies; conversely, nontransparent practices can result in fiscal profligacy going undetected longer than it otherwise would. Similarly, a transparent public financial accounting system makes it possible for the market to determine what the government has actually done and to compare budgeted and actual financial operations. Fiscal transparency can also foster the confidence of a population in its government.

Nontransparent fiscal practices tend to be destabilizing, to create allocative distortions, and to exacerbate

inequities. These adverse repercussions may not be apparent in the near term, but they may surface later in the form of a severe financial crisis, requiring much costlier remedial action. For instance, nontransparent tax concessions, quasi-fiscal subsidies, and off-budget spending all contribute to fiscal imbalances. The destabilizing consequences of an accumulation of payment arrears and of unfunded contingent liabilities are usually felt with longer lags. More immediately, governments that do not disclose sufficient information to financial markets may incur increased risk premia over time. All taxes and subsidies, as well as economic regulations, alter relative prices and factor returns and cause distortions in resource allocation. But when they are not transparent, the harmful impact of these practices, including the gains accruing to influential interest groups at the expense of poorer and less vocal groups, is hidden from public view and debate.

Admittedly, fiscal transparency may impose upfront costs as the technical capacity and institutions are put in place to establish a centralized information system, to develop reliable forecasting tools, to implement appropriate accounting techniques, and to simplify regulatory practices or make their cost visible. Moreover, there are recurrent, albeit often declining, costs in maintaining these practices and disseminating the generated information. The costs of transforming a culture of secrecy into one of transparency may be at least as large.

Whereas institutional arrangements and accounting practices in the public sector must always be transparent to reap the known benefits, the timing of public disclosure about the formulation of government decisions may require some judgment. Notwithstanding the general presumption that fiscal transparency is desirable, temporary departures from transparency may be justified. Such a situation might arise when the premature announcement of policy measures, such as the introduction of new taxes or subsidies, would weaken their effectiveness or confer unintended windfall gains on some groups.

### Institutions and Behavior

In principle, a basic requirement for transparency in the *overall structure and functions* of government is a clear demarcation of the boundaries between the pub-

<sup>1</sup>Kopits, George, and Jon Craig, *Transparency in Government Operations*, Occasional Paper 158 (Washington: IMF, 1998).

lic and private sectors and, within the former, between different levels of government with respect to the state enterprise sector. Responsibility for expenditures on basic public services and functions needs to be clearly divided between the national and various subnational levels of government. The revenue base of each level of government should be defined unambiguously, possibly accompanied by formula-based arrangements for revenue sharing and intragovernmental transfers.

Within the central government, extrabudgetary operations can, in principle, be an efficient means of pursuing certain tasks for which the spending obligation transcends the annual budget appropriation process. Cases in point are public pension and commodity stabilization schemes. By contrast, in a number of countries, extrabudgetary funds—for example, for military spending—have been created mainly to avoid legislative scrutiny. Moreover, funds originally established for valid reasons have in some instances become highly dysfunctional (for example, in some countries, easy access to old-age and disability pensions is used nontransparently to alleviate unemployment). In other countries, reserves accumulated in commodity stabilization funds—or reserve funds established from the sale of nonrenewable resources—have been diverted to finance consumer subsidies or prestige projects. An important task facing governments is to ensure that adequate and timely information is provided on such activities.

In the public sector, it is necessary to maintain transparency in the relations between the government and the state-owned enterprise sector. Although there are sound reasons for limiting the extent to which this sector is engaged in activities more legitimately carried out by the private sector, where such practices nevertheless occur it is important that they be well documented in publicly available reports. Equally, information on the cost of quasi-fiscal activities conducted by public financial institutions—through multiple exchange rates, preferential credits, and guarantees—should be provided preferably in annual budget documents. Information should also be available on the fiscal costs of restructuring state-owned financial institutions and nonfinancial enterprises. Privatization of such entities must be conducted with as much openness as permitted by sound marketing considerations.

For most public goods and services, it is easy to distinguish between the activities of the public and private sectors. In many countries the government is solely responsible for public administration, internal safety, defense, foreign relations, and macroeconomic policy. Increasingly, however, there are activities (for example, in the education, health care, and public utility sectors) where both sectors may operate concurrently. Indeed, at times, the government may seek to *mandate* the private sector to carry out activities on its behalf; in such cases there is a need for a transparent understanding of the nature and scope of the government's fiscal obligations with respect to the private sector.

Equally, there may be a justification for *regulation* in a number of areas (mainly public health, consumer safety, environmental protection, labor protection, and competition policy). A lack of clarity in the regulatory framework can lead to governance problems, since the costs of compliance, whether borne directly by the regulated entities or indirectly by the rest of the economy, are not visible. In general, the recent deregulation of commodity, labor, and financial markets has contributed to greater transparency in government operations.

In government operations, transparency is critical in the budget process, tax policy and administration, and debt-financing operations. The tasks involved at each stage of the *budget process* are usually specified in some detail in the budget framework law or, less frequently, are based on past conventions and rulings. The draft budget document, preferably incorporating broad fiscal targets and strategy in a multiyear context, and its subsequent legislative debate and approval should normally be open and the outcome published.

At the execution stage, the government should periodically inform both the public and the legislature about the budgetary outcome and how it compares with the objectives. A further test of transparency in budget execution and control involves open public procurement, contracting, and employment practices. Adequate information is also necessary for conducting both financial and performance audits, and the results of such audits should be made public. Finally, it is essential to limit private rent seeking by officials in the public domain through enforcement of conflict-of-interest legislation. Freedom-of-information legislation can help to ensure government transparency and accountability by giving citizens access to public documents and assigning to government the burden of justifying nondisclosure.

Transparency in *tax treatment* entails a well-defined, clearly disseminated, statutory basis for taxation, as well as clear and simple administration. Discretionary tax relief provided to particular individuals or enterprises impairs the transparency and credibility of the tax system. For greater transparency in tax administration, many countries have adopted statutes on taxpayers' rights and obligations, as well as rules of conduct for tax officials. Published estimates of tax expenditures—that is, revenue forgone because of tax preferences—are an important input for the debate of the annual draft budget or tax reform.

Transparency in government *financing operations* has been enhanced by financial deregulation. Many countries are relying on open, market-based financing, which requires provision of adequate data to market participants on the timing of tenders, security issues, coupons offered, prices, and bids and offers accepted. Moreover, governments wishing to access international and domestic financial markets must furnish rating agencies, underwriters, and supervisory agencies with considerable data on the magnitude, terms, and

holders of the public debt and on the government's debt-service capacity. Transparency in debt operations assumes even greater importance in a regulated market because of the distortions introduced by constraints. Transparency in government lending entails adopting clearly specified policy criteria for loans extended, including risk assessment, as well as releasing information on the terms and conditions of the loans.

## Government Accounts

In principle, the general government is universally regarded as providing the most comprehensive coverage of the noncommercial public sector, consisting of the budget as well as social security and other extra-budgetary accounts, consolidated across all levels of government. However, because even the concept of general government may fall short of providing for a full coverage of fiscal operations to the extent that it excludes the quasi-fiscal activities of state-owned financial institutions and nonfinancial enterprises, a number of countries report data for the nonfinancial public sector. Others have expanded coverage to include official financial institutions, thereby encompassing the entire public sector. As a preferable alternative, the concept of *general government activity* is intended to capture accurately the cost of all government functions, including quasi-fiscal activities conducted outside the general government. In the event that the cost of quasi-fiscal activities proves impossible to quantify, transparency would be served by at least listing such activities.

The recording basis of government transactions—namely, cash or accrual—has important implications for the transparency of fiscal performance. Reliance solely on the cash-based approach, although helpful for assessing the first-order impact of government borrowing on inflation and the external balance, can result in a misstatement of the magnitude and timing of fiscal operations. Thus, the accrual-based approach is also useful for gauging the macroeconomic resource repercussions of fiscal policy, especially over the medium to long term. Major distortions under cash-based recording stem from the exclusion of information on accumulation of arrears (especially expenditure arrears), transactions in kind (including issuance of government obligations to suppliers, or tax refunds, or in connection with bank restructuring), and the cost of borrowing at a discount. Increasingly, many view it as desirable to monitor the fiscal accounts on both an accrual and a cash basis.

The *valuation* and *recognition* of assets and liabilities can be critical for the transparency and consistency of government financial statements. In this regard, investment expenditure may be subject to varying treatment (full expensing or depreciation) depending on the analytical purpose at hand. Given the

broader difficulties of valuing public assets, gross (rather than net) measurement of public debt is often the only reliable option. Estimates of government net worth are desirable, but in practice most countries are not yet in a position to prepare such estimates.

In addition, it is necessary to compile and disclose information on commitments and contingent liabilities. Examples of these liabilities are guarantees for credits extended by financial institutions and for deposits in those institutions, many of which are not quantifiable because they are contingent on the realization of the insured occurrence. Estimates of the obligations to future beneficiaries of social insurance for old-age, unemployment, and health care programs that would not appear affordable at current tax and contribution rates may prove useful. They provide a measure of the magnitude of the policy changes that may be required to achieve fiscal sustainability.

Fiscal transparency requires *classifying* data on government operations, ownership, and liabilities into analytically useful categories of flows and stocks. Revenue should be broken down into major tax and nontax categories, and unrequited transfers; financing, including privatization receipts, should be shown below the line. Expenditure must be classified into major functional and economic categories, with debt amortization separated from interest payments and the former placed as a below-the-line negative financing item. Finally, financing flows, as well as the corresponding debt stock, should be disaggregated by currency denomination, maturity, and source.

## Indicators and Projections

The most commonly available direct indicator of the fiscal balance—namely, the *overall balance* of government operations—is transparent only to the extent that it is free of distortions in data coverage, recording, and classification. The overall balance is usefully supplemented by alternative measures subject to the same transparency requirements. This would include measures of the *current balance*, as an indicator of the government's contribution to national saving; the *primary balance*, which is instrumental for determining the fiscal policy effort needed to stabilize or reduce public debt; and the operational balance, for countries that have experienced high inflation and large levels of indebtedness. Most countries also compile some direct indicator of the change in the stock of assets and liabilities, although in the absence of satisfactory data on nonfinancial assets, it is necessary to rely on gross debt measures.

To understand the direction of fiscal policy, the public and financial markets often find it useful to examine *analytical indicators* of the short-run fiscal stance. Perhaps the best known are indicators that remove the effect of cyclical fluctuations or exogenous shocks

from direct measures of the budget balance. Indicators such as the structural balance are used predominantly in the advanced economies. Similarly, assessment of fiscal sustainability—in view of rapidly aging populations, the rising cost of health care, and the rigidity of most social entitlements—should be based on long-term scenarios, showing the evolution of the fiscal balance over several decades. Long-run debt sustainability can be determined by examining current indebtedness levels, the interest rate, the GDP growth rate, and the ratio of the primary budget balance to GDP. In addition, it is useful for governments to provide periodic assessments of the long-term financial viability of government social insurance programs in pensions, health care, and other social assistance programs.

The formulation of fiscal policy, as well as the accompanying public debate on targets and strategy, is usually predicated on projections of future trends in government finances and in overall economic performance. Fiscal projections must be based on realistic and explicitly documented macroeconomic assumptions and parameters (for example, effective tax rates, tax bases). In the publication of short-run fiscal and macroeconomic forecasts, governments should provide baseline projections, which assume unchanged policies, and alternative projections, which incorporate the impact of major policy changes.

## Overall Trends and Priorities

In recent years, many IMF member countries have made major progress toward fiscal transparency. The economies in transition have made the greatest leap toward transparency, although some still have non-transparent fiscal systems. Nevertheless, considerable scope remains for eliminating nontransparent practices in most countries. It is important to keep in mind the distinction between unintended nontransparency (attributable to slow technical and institutional development) and deliberate misrepresentation or suppression of information.

For the advanced economies, the main priority appears to lie in publishing comprehensive information to facilitate the debate over fiscal discipline and long-term fiscal sustainability, particularly concerning entitlement programs associated with population aging. In particular, progress on these issues involves estimates of net unfunded liabilities and quasi-fiscal operations, costing of tax expenditures and regulation, and improved documentation of fiscal projections.

In the developing economies, attention should be focused on institutional reforms—that is, enhancing

transparency mainly in the budget process, taxation, and quasi-fiscal activities of public nonfinancial enterprises and financial institutions—and on the compilation and dissemination of essential fiscal data and projections. The economies in transition share many of the needs of developing countries, but their history of secrecy, including widespread quasi-fiscal activities and data systems oriented to planning rather than to market needs, may make it more difficult for them to move rapidly toward more transparent fiscal practices. In many developing and transition economies, efforts in this area are particularly important for promoting good governance.

## Role of the IMF in Promoting Fiscal Transparency

Article IV consultations, which are regular bilateral policy discussions between the IMF and member governments, provide the main vehicle for the IMF's exercising surveillance over its members' fiscal policies. Both in this context and in the formulation of program conditionality, the IMF may urge country authorities to increase the transparency of fiscal data and practices. The IMF also seeks to enhance transparency in a multilateral context through its World Economic Outlook exercise, drawing in part on internationally comparable measures of fiscal stance and sustainability for major advanced economies.

Finally, the IMF's Fiscal Affairs Department has provided technical assistance over a wide range of public finance issues. Many of the recommendations offered through such assistance seek to promote transparency in tax and budgetary matters. In addition, the IMF's Statistics Department has extended considerable assistance to improve government statistics on the basis of well-established accounting conventions. In particular, the IMF's efforts in the development of the Government Finance Statistics (GFS) methodology and the publication of the GFS database has facilitated internationally comparable cross-country comparisons. The current revision of the GFS guidelines, in line with the 1993 *System of National Accounts* (SNA) standards, is a further step toward improving the transparency and consistency of fiscal statistics. The IMF's Special Data Dissemination Standard (SDDS), aimed at countries accessing international capital markets, represents another important effort to promote transparency in the dissemination of macroeconomic data (in addition, the SDDS is posted on the IMF's public Internet site); fiscal data are included, albeit on a highly aggregated basis.



## Annex II

# Recent Developments in Primary Commodity Markets

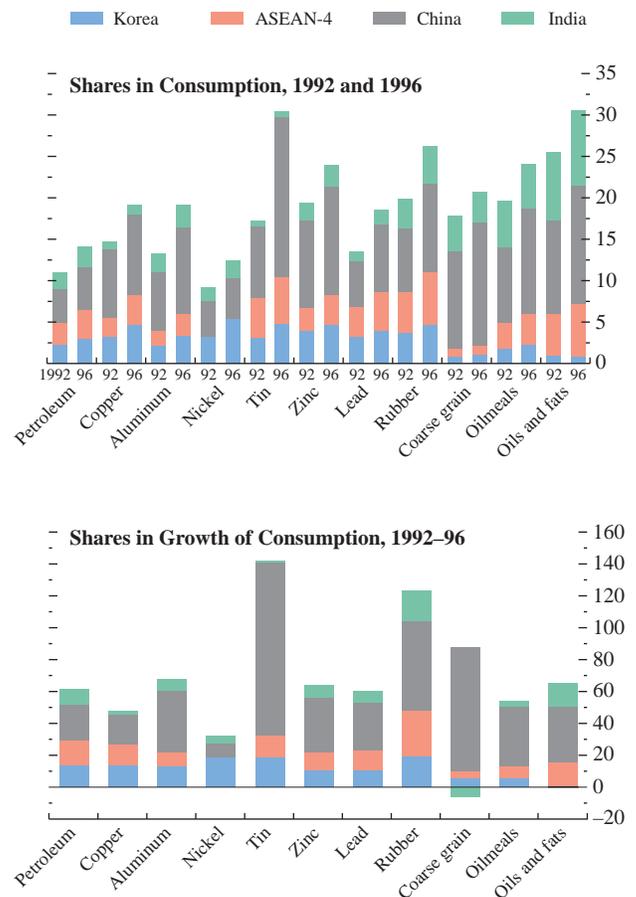
Since mid-1997—that is, just before the beginning of the crisis in Thailand’s financial and foreign exchange markets—prices of *primary commodities as a group* have fallen by more than 10 percent.<sup>1</sup> These price declines are sufficiently great in magnitude to have far reaching implications for producers and consumers around the world.

### Effects of the Asian Crisis

To a large degree these price declines are associated with the Asian crisis. During the early and mid-1990s, consumption of primary commodities in most Asian developing countries increased at rates much higher than in the rest of the world. Asian developing countries accounted for about two-thirds of the increase in world consumption of petroleum products over the period 1992–96, and their share in world consumption increased from 12 percent to 15 percent (Figure 31). Korea and the ASEAN-4 countries (Indonesia, Malaysia, the Philippines, and Thailand), in turn, accounted for about one-half of the increase in consumption of petroleum products in Asian developing countries, and the share of these five countries in world consumption rose from 5 percent to 6½ percent. A similar pattern of growth in consumption is observed for base metals, rubber, coarse grains, oilmeals, and fats and oils. For most of these nonfuel commodities, the share of Asian countries in world consumption in 1996 was much greater than their share in the world consumption of petroleum products. China’s contribution to the growth in the markets for these commodities, however, has tended to be much greater than that of Korea plus the ASEAN-4.

In the countries most directly affected, the Asian crisis has brought in its wake much reduced construction activity, much higher import costs in terms of national currencies, less available credit to finance imports, and, at a minimum, sharp reductions in demand. These

**Figure 31. Selected Asian Countries’ Shares in World Consumption of Primary Commodities**



Sources: International Energy Agency; World Bureau of Metal Statistics; U.S. Department of Agriculture; and International Rubber Study Group.

<sup>1</sup>More precisely, from June 1997 to January 1998 the IMF’s index of primary commodity prices fell by 11 percent in terms of SDRs and about 14 percent in terms of U.S. dollars. The price declines over this period were roughly the same for the IMF’s indicator spot price for *crude petroleum* and its index of prices of *nonfuel primary commodities*. Prices are expressed in terms of SDRs in this annex, unless otherwise indicated.

conditions have led to reductions in the rate of growth of demand, not only in the ASEAN-4 countries and Korea but also, through the spillover and contagion effects of the crisis, in many other countries in Asia and elsewhere. Thus certain commodity markets that as recently as mid-1997 were expected to show a high rate of growth of demand are now facing a period of considerable uncertainty with regard to demand prospects. Furthermore, for some nonfuel commodities such as timber, rice, natural rubber, and vegetable oils, the large depreciations of currencies of the southeast Asian countries may also have had supply effects insofar as they create incentives to increase exports from current inventories and to increase current and prospective production.

### Effects of Weather

This year *weather conditions* generally favorable to crop production have also been an important factor that has tended to weaken the prices of several agricultural commodities. This seems true notwithstanding the unusual weather patterns in many parts of the world that have been attributed to El Niño and have received much press coverage. At least so far, the *adverse* consequences of El Niño for commodity production that are sufficiently great to have discernible effects on world prices for individual commodities have been limited to the fish catches off the west coast of South America and to palm oil production in southeast Asia. Elsewhere—for example, in the case of cereal production in southern Africa—El Niño may have reduced production locally, but the consequence for world prices is not of great importance. In addition, warmer than usual weather this winter in the Northern Hemisphere has reduced the demand for heating oil and hence contributed to the downward trend in the price of petroleum and other energy commodities.

### Developments in Specific Markets

The interplay of the Asian crisis and other factors affecting commodity markets in recent months comes more into focus in a review of developments in *specific primary commodity markets*. Price decreases in excess of 10 percent (with prices measured in terms of SDRs) over the period June 1997 through January 1998 that were in some way associated with the effects of weaker demand from Asian countries were recorded for nearly one-third of the commodities included in the IMF's commodity price index. The price declines for five commodities—copper, nickel, natural rubber, wool, and hides—appear to be associated mainly with the Asian crisis. The Asian crisis also played an important role, but probably not the predominant role, in the price declines of four other commodities—crude

petroleum, timber, zinc, and lead. For certain other commodities, such as aluminum, iron ore, meat, maize, and soybean meal, the effects of weaker demand from Asian countries on prices have so far been offset by other factors. These commodity markets have served as one of the vehicles for the spread of the effects of the Asian crisis throughout the world—mostly adverse for suppliers and mostly favorable for consumers. In the discussion below, the markets for petroleum, copper, aluminum, timber, and natural rubber have been selected for a more detailed review of the pattern of the recent commodity price declines and their global implications.

The decrease in the price of *petroleum* started later than the price declines of most other primary commodities. Beginning in March 1997, stocks of crude petroleum and petroleum products were gradually built up to levels considerably higher than in comparable months in 1996, although still below levels of earlier years (Figure 32). Given strong consumption demand, however, this stock accumulation was insufficient to preclude a 13½ percent price increase (in SDR terms) over the period June to October—mostly occurring at the end of September and early October, when fears were greatest that increasing political tensions relating to developments in the Middle East might lead to some supply disruptions. From October 1997 to late March 1998, petroleum prices fell by more than 25 percent. The IMF's indicator price for crude petroleum fell from \$20 per barrel to about \$14 per barrel.<sup>2</sup> Contributing to this decline were (1) a slowing of demand growth in a number of countries affected by the Asian crisis; (2) a warm winter in the Northern Hemisphere, which reduced the demand for heating oil; (3) an acceleration in the increase in production, particularly in members of the Organization of Petroleum Exporting Countries (OPEC);<sup>3</sup> and (4) inventories of crude and oil products at all stages of the marketing chain considerably greater than last year. In late February after the United Nations agreement with Iraq to expand the oil-for-food program, the petroleum price dipped below \$12 per barrel, but this decline was reversed following the announcement on March 21 of plans by major oil producing countries (both members of OPEC and other producers) to restrict production.

Twenty-five countries depend on petroleum for 20 percent or more of their foreign exchange earnings

<sup>2</sup>The price in late March—in both nominal and real terms—was still marginally higher than in some months of 1986, 1988, and 1994, years when prices dipped to comparatively low levels.

<sup>3</sup>At its Ministerial Meeting on November 26–December 1, OPEC decided to increase its production quotas by 10 percent effective January 1998. The new overall ceiling, however, is somewhat below estimates of production in the final quarter of 1997. The estimates have shown production by some countries persistently above the previously agreed OPEC quotas.

(Table 27). Many of these countries depend heavily on petroleum to finance most of their government expenditure. Sustained lower petroleum prices could have a substantial ripple effect not only in these countries but throughout the world as expenditures on a wide range of goods and services, including investment programs, are cut back. On the positive side, however, lower petroleum prices will help to reduce transportation costs, lower energy costs in manufacturing, and lower heating costs throughout the world.

The fall in the price of *copper* has been large and has had far-reaching implications, in part because of the heavy dependence of a number of countries on copper for foreign exchange earnings. The 33 percent decline in the copper price from June 1997 to January 1998 can be attributed mainly to reduced demand in Asian markets. Korea and the ASEAN-4 countries accounted for about one-fourth of the growth in consumption of copper in the period 1992–96, and the share of these countries in world consumption increased from 5½ percent in 1992 to 8¼ percent in 1996. The price decline occurred notwithstanding the strong demand for refined copper in 1997 in the United States and western Europe, where consumption increased over the 1996 levels by about 4 percent and 3½ percent, respectively.

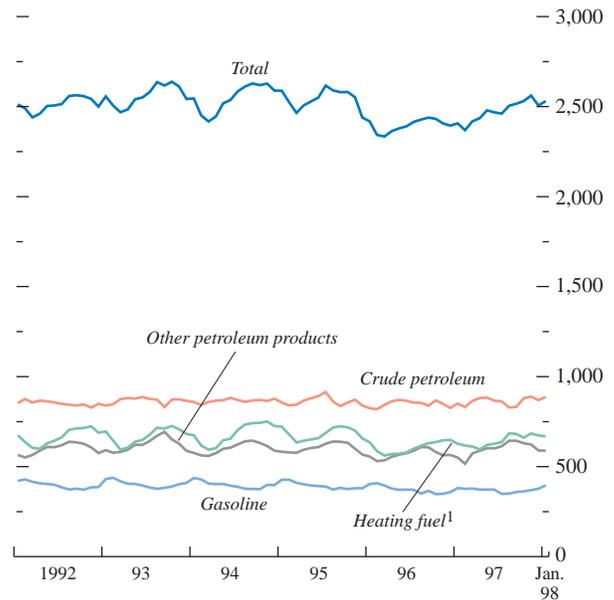
Three countries—Chile, Mongolia, and Zambia—are dependent on copper for 20 percent or more of their foreign exchange earnings, and copper provides more than 10 percent of earnings for four additional countries. Hence the copper market has served as a conduit for the spread of the effects of the Asian crisis to these countries as well as to copper producers and consumers worldwide. Trade reports suggest that the current price decline is more serious for copper producers than the most recent previous downturn, which occurred in 1993, because mining companies recently have had less of their production covered by forward sales.

The *aluminum* market has been able to withstand the poorer demand prospects in Asia with little decline in price. Although the rates of growth in aluminum consumption in Korea and the ASEAN-4 countries in recent years have been almost the same as the rates of growth in copper consumption, the share of these countries in world aluminum consumption remains lower than their share in world copper consumption. More important, the major aluminum producers have shown themselves able to agree on “memoranda of understanding” to idle production capacity in order to reduce stocks, and, partly for this reason, aluminum stocks at the end of 1997 were about one-third lower than they were one year earlier. At the same time, growth in aluminum consumption outside Asia has been strong—particularly in Europe, where the European Aluminum Association has estimated a 6 percent increase in 1997.

The decline in the price of *timber* from June 1997 to January 1998 was in the order of 25 percent.

**Figure 32. Commercial Stocks of Petroleum in OECD Countries**

(In millions of barrels)



Source: International Energy Agency.

<sup>1</sup>Middle distillates and residual fuel oil (that is, products for which a large part is used as heating fuel).

**Table 27. Price Declines for Individual Commodities and Countries Most Affected in Foreign Exchange Earnings**

Commodity	Price Declines, June 1997 to January 1998 (in percent; prices in SDRs)	Countries Depending on Commodity Exports		
		For 50 percent or more of earnings <sup>1</sup>	For 20–49 percent of earnings <sup>1</sup>	For 10–19 percent of earnings <sup>1</sup>
Natural rubber	37			
Copper	33	Zambia	Chile Mongolia	Congo, Dem. Rep. of Kazakhstan Papua New Guinea Peru
Timber	24		Equatorial Guinea Lao P.D.R. Solomon Islands	Cambodia Central African Rep. Gabon Ghana Indonesia Latvia Myanmar New Zealand Papua New Guinea Swaziland
Wool	23			
Nickel	20			
Zinc	16			
Hides	15			
Crude petroleum	13	Angola Bahrain Congo, Rep. of Gabon Iraq Iran, Islamic Rep. of Kuwait Libya Nigeria Oman Qatar Saudi Arabia Venezuela Yemen, Rep. of	Azerbaijan Brunei Darussalam Cameroon Ecuador Equatorial Guinea Norway Papua New Guinea Russia Syrian Arab Rep. Trinidad and Tobago United Arab Emirates	Algeria Colombia Congo, Dem. Rep. of Egypt Indonesia Kazakhstan Mexico Vietnam
Lead	11			
Soybean meal	11			

<sup>1</sup>Earnings from exports of goods and services.

Reflecting in part the segmentation of this market, the price decline has been uneven across types of timber and across geographic markets. The price decline for Asian-grown (meranti) hardwood has been greatest and is attributable to a long period of persistent weak demand in Japan, the principal market, and to the depreciations of the Malaysian, Indonesian, and Thai currencies, which are expected to stimulate increased exports, irrespective of the increased interest recently shown in conservation measures. The cutback in construction activity in southeast Asian countries could also release increased supplies of timber for the export market. By contrast, the price for African-grown (sapele) hardwood in European markets has thus far changed little. Trade sources report that the adjustment has been small because some merchants in the

European market already hold large inventories of meranti timber purchased before the price declines, and because other merchants do not wish to shift from sapele hardwood timber to meranti timber unless there are firm indications that a large price differential is likely to persist.

The weakness in the softwood market reflects “oversupply” in the U.S. and Canadian lumber markets as well as weak demand in Korea and Japan. Production in Canada and the United States increased at a time of weak export demand. The demand by Japanese buyers for softwood was sluggish throughout the second half of 1997, and demand in other Asian countries, particularly Korea, fell sharply in the fourth quarter. This weak Asian demand affected softwood exports from Canada, Russia, and the United States.

European demand for softwood, however, has been somewhat more buoyant, and consumption of sawn softwood in Europe is estimated to have increased in 1997 by about 4 percent, after two years of decline.

The price of *natural rubber* declined by 37 percent over the period June 1997 to January 1998. This decline was the largest of the commodity price declines in this period. In addition, it differs from the price declines of the commodities discussed above in that it was a continuation of a downward trend that began as early as 1996, when world rubber production began to exceed world rubber consumption by a considerable margin and inventories were accumulated. The downward trend gained momentum with the financial crisis and currency depreciation in Thailand, the world's leading producer of natural rubber (with a share of about 30 percent of world natural rubber production). Of more immediate interest to the market than the competitive effect of Thailand's currency depreciation was the fate of the Thai government stockpile of about 122 thousand tons of natural rubber and the purchase operations of the Thai government's Rubber Estate Organization. Another factor in the market for natural rubber has been the possibility of purchases by the buffer stock operating under the provisions of the 1995 International Natural Rubber Agreement.<sup>4</sup>

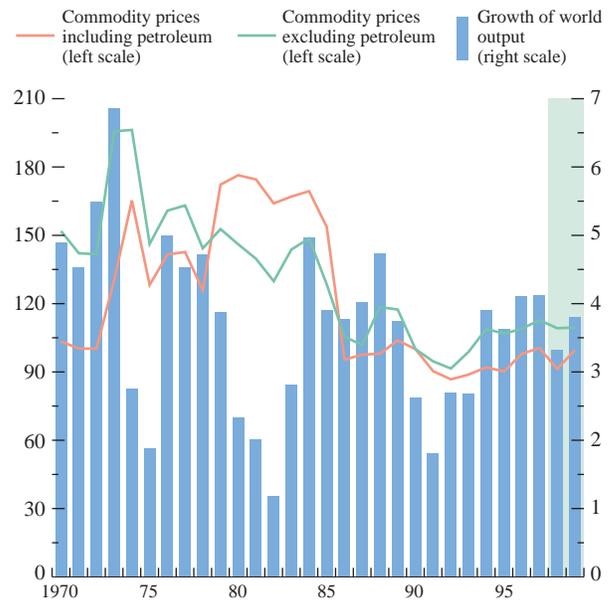
## Near-Term Outlook

The near-term outlook for commodity prices is difficult to assess. It is not clear whether some markets have stabilized after the recent large price movements. As regards the near-term outlook for *petroleum prices*, considerable uncertainty remains about the supply response to the lower prices of early 1998. Prices for more distant deliveries on futures markets in any event are higher than prices for early delivery. In late March, future price quotations for December 1998 were \$1.50 a barrel higher than quotations for May 1998, and quotations for December 1999 were about \$0.40 a barrel higher than for December 1998.

Some factors suggest that the downward trend in *nonfuel commodity prices* may have been arrested. First, weekly data show that the index of nonfuel commodity prices has remained almost unchanged since the beginning of January, whereas during December the index fell each week. Second, the current quota-

<sup>4</sup>The possibility of purchases by the buffer stock manager of the International Natural Rubber Organization (INRO) served to underpin the natural rubber market for a couple of weeks in July. The five-day average of the INRO daily market indicator price dipped below "may buy" level (the lower intervention price), but not below the "must buy" level (the lower trigger price), of the Agreement. However, the INRO prices are specified in terms of Malaysian ringgit and Singapore dollars, and, with the depreciation of the Malaysian ringgit beginning in late July, the INRO price of natural rubber rose above the floor prices of the Agreement.

**Figure 33. Real Commodity Prices and World Output<sup>1</sup>**



<sup>1</sup>Shaded area indicates IMF staff projections.

tions for most futures and forward deliveries show higher prices for the later months of 1998 than for near months; this was not the case for many commodities as recently as December. Third, in February there was some turnaround in the prices of hides, natural rubber, and timber. At the same time, trade and press reports recently have been increasingly pessimistic about the demand for meat, cereals, and feedstuffs produced in the United States and other countries that are traditional exporters of these commodities. On the basis of

futures and forward market prices and other information, the projected level of nonfuel commodity prices for calendar year 1998 is about 2 percent above the current level. Little change is indicated for 1999, in part because substantially lower prices expected for some commodities, especially for arabica coffee, may offset increases in other nonfuel commodity prices. In this scenario, commodity prices in real terms would not be far removed from the level that has tended to prevail since 1986 (Figure 33).