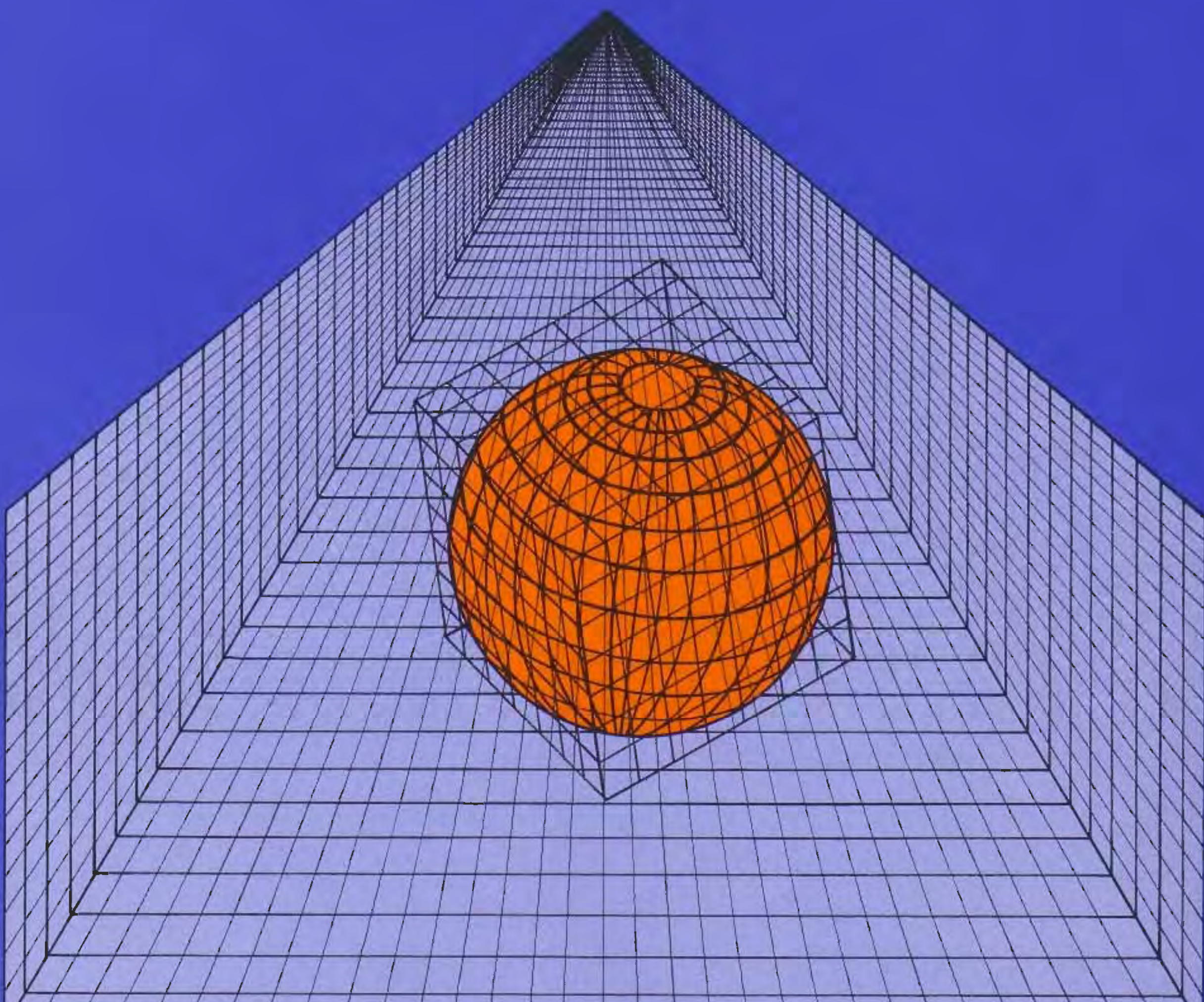
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT REPORT, 1984



UNITED NATIONS

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
Geneva

Trade and Development Report, 1984

Report by the secretariat

of the

United Nations Conference on Trade and Development

UNITED NATIONS
New York, 1985

NOTE

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

*
* *

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries.

*
* *

*
* *

Editorial note

A pre-publication text of this report, subject to final revision, was issued in July 1984 (UNCTAD/TDR/4 (Vol. I) and Corr.1 and UNCTAD/TDR/4 (Vol. II) and Corr.1).

The first report in this series was issued in printed form in September 1981, with the symbol TD/B/863/Rev.1 (Sales No. E.81.II.D.12), the second in October 1982, with the symbol UNCTAD/TDR/2/Rev.1 (Sales No. E.82.II.D.12) and the third in January 1984, with the symbol UNCTAD/TDR/3/Rev.1 (Sales No. E.83.II.D.13 and corrigendum).

The present text was finalized in September 1984 and is based on information and data available in June 1984.

UNCTAD/TDR/4/Rev.1

UNITED NATIONS PUBLICATION

Sales No. E.84.II.D.23

01800P

ISBN 92-1-112181-7

Contents

Summary of the report

Part I

The continuing world economic crisis

Part II

The evolution of the trade and payments system

Part III

Toward reform of the system

Chapter

Annexes

List of Text Tables

List of charts

Abbreviations

BIS - Bank for International Settlements
CCCN - Customs Co-operation Council Nomenclature
CFF - Compensatory Financing Facility (of IMF)
c.i.f. - cost, insurance and freight
CMEA - Council for Mutual Economic Assistance
DAC - Development Assistance Committee (of OECD)
ECDC - economic co-operation among developing countries
ECE - Economic Commission for Europe
EEC - European Economic Community
EFF - Extended Fund Facility (of IMF)
EFTA - European Free Trade Association
FAO - Food and Agriculture Organization of the United Nations
f.o.b. - free on board
GAB - General Arrangements to Borrow
GATT - General Agreement on Tariffs and Trade
GDP - gross domestic product
GNP - gross national product
GSP - generalized system of preferences
IBRD - International Bank for Reconstruction and Development (World Bank)
IDA - International Development Association
IECGF - international export credit guarantee facility
IMF - International Monetary Fund
LIBOR - London Inter-Bank Offered Rate
MFA - Multifibre Arrangement
MFN - most-favoured-nation
MTNs - multilateral trade negotiations
NMP - net material product
NTBs - non-tariff barriers
NTMs - non-tariff measures
ODA - official development assistance
OECD - Organisation for Economic Co-operation and Development
OF - Oil Facility (of IMF)
OPEC - Organization of the Petroleum Exporting Countries
QRs - quantitative restrictions
SAL - Structural Adjustment Lending (of the World Bank)
SDRs - special drawing rights
SFF - Supplementary Financing Facility (of IMF)
SITC - Standard International Trade Classification (revision 1)
TCDC - technical co-operation among developing countries
TF - Trust Fund (of IMF)
UNCTAD - United Nations Conference on Trade and Development
UNDP - United Nations Development Programme
VERs - voluntary export restraints

Explanatory notes

The term "dollars" ($) refers to United States dollars unless otherwise stated.
The term "billion" signifies 1,000 million.
Annual rates of growth and change refer to compound rates.
Exports are valued f.o.b. and imports c.i.f. unless otherwise specified.
Use of a hyphen (-) between dates representing years, e.g. 1965-1966, signifies the full period involved, including the initial and final years.
An oblique stroke (/) between two years, e.g. 1980/81, signifies a fiscal or crop year.

In the tables:

One dot (.) indicates that the data are not applicable.
Two dots (..) indicate that the data are not available, or are not separately reported.
A dash (-) indicates that the amount is nil or negligible.
A plus (+) before a figure indicates an increase; a minus sign (-) before a figure indicates a decrease. Details and percentages do not necessarily add up to totals, because of rounding.
Except where otherwise specified, figures in brackets are estimates.

The designations employed and the presentation of material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries. The classifications used are intended for statistical convenience and do not necessarily imply any judgement regarding the stage of development of any particular country.

References in tables and in the text to "countries" are to countries, territories or areas as appropriate.

FOREWORD

The fourth annual *Trade and Development Report*, like its predecessors, begins with an account of recent and prospective trends in the world economy as a whole and its constituent parts. The focus of this account, which is contained in Part I, is on the quantitative impact on trade and development of the functioning of the world economy over a relatively short time span.

The Report goes on to examine, in Part II, the evolution of the trade and payments system over the last three decades. The focus here is on the qualitative and structural changes that have occurred in the regimes governing international monetary, financial and trade relations.

Part III analyzes how the underlying structure of the international trade and payments system has affected, and how it has in turn been affected by, the actual performance of national economies, and the system's place in the processes that determine how world income is generated, distributed and expanded; its main focus is conceptual. It then proceeds to draw a number of broad conclusions regarding the adequacy of the present system and its reform from the standpoint of growth, trade and development.

These themes are important in their own right as well as topical. The processes and mechanisms of international economic intercourse are being once again critically re-examined, singly and as a whole, by a wide range of analysis and by different interests. And the question of the role of governmental and intergovernmental institutions, on the one hand, and of private market forces on the other, is the subject of renewed controversy within and among nations. The analysis contained in this Report has a close bearing on such issues. It may also help to elucidate whether current or alternative approaches to international economic co-operation can best succeed in bringing about the recovery in rates of employment and development that is a shared international purpose.

Samani Jiva

Secretary-General of UNCTAD

Blank page

Page blanche

SUMMARY

A. THE CONTINUING WORLD ECONOMIC CRISIS[1]

1. During 1983 most developing countries experienced a continuation of the severe crisis which has afflicted them for several years, and in some parts of the developing world this crisis intensified. Output in developing countries and territories is estimated to have declined by more than 1 per cent in 1983 following a negligible increase in 1982. In much of the developing world levels of per capita output fell for the third consecutive year and were below those recorded in 1979. The impact of this continuous economic decline is increasingly being felt in the social as well as in the economic sphere. Unemployment, under-employment and poverty are on the rise in many of these countries. Social infrastructures and public services are frequently under severe pressure. There is growing evidence of difficulty in insulating health and education from the effects of the economic crisis. Physical investment is also being severely constrained in a large number of countries, reflecting both a drying-up of private investment in the face of economic recession or contraction and the atrophy of public investment following pressures to reduce public expenditure. The impact of the crisis on health, education and investment places future development in jeopardy.

2. The forces underlying this severe set-back to development have been gathering for a number of years. Although the precise causes vary from region to region and from country to country, severe strains in external payments are a common, underlying factor. The debt crises in Africa, in Latin America and in some countries of Asia have been characterized by a cut-back in new private financial flows, which, in the case of Latin America, was particularly severe and became the dominant feature of the behaviour of external receipts. The modest growth of world trade and hesitant rise of commodity prices have failed to produce a decided recovery of export earnings. In addition, adverse weather conditions affected agricultural output in a number of countries, particularly in Africa, thereby reducing exports and increasing the need for essential imports. Oil-exporting developing countries suffered a particularly severe drop in their export earnings, as energy conservation and the development of productive capacity outside the major developing oil exporters compounded the impact of the overall economic recession. These adverse developments affecting the external accounts left many countries with no choice but to cut back sharply on imports, reinforcing the cut-back as necessary with restrictive fiscal and monetary policies.

3. A different situation existed for a number of developing countries in South and East Asia, where growth was on the whole satisfactory. In East Asia, the major exporters of manufactures enjoyed a significant increase in export demand from the United States, which buoyed up their economies. In South Asia, the large size of some countries, their lesser degree of openness, the relatively low level of indebtedness and the relatively large dependence of the region on concessional financial flows have provided the region with some insulation from external shocks during the past several years.

4. While the economic crisis continued or deepened for most developing countries, the experience of developed market-economy countries in 1983 was different. There, output rose by 2.3 per cent in 1983, as compared with a small decline in 1982. Moreover, changes in output in the latter half of 1983 and during the opening months of 1984 have made it clear that further acceleration in output in these countries is occurring. The developed market-economy countries as a group are thus emerging from the most protracted recession of the post-war period. Moreover, the pace of inflation in most countries has slowed appreciably and the current expansion is proceeding without signs of a re-emergence of

[1] See part I.

inflationary pressures.

5. The experience of individual developed market-economy countries varied considerably within this overall picture. The most remarkable turnaround was that of the United States, in which GDP rose by 3.4 per cent in 1983 after having recorded a decline of 1.9 per cent in 1982. The seasonally-adjusted annual rates of growth for the second and third quarters, 9.7 and 7.6 per cent respectively, were particularly impressive. The expansion of the United States economy was no less vigorous during the first quarter of 1984.

6. Considered as a whole, the impact in 1983 of increased United States imports on developing countries was marginal. The United States accounts for only about one-fifth of total exports of developing countries - less than the share of Europe and also less than that of the developing countries themselves. Thus, despite an increase of about $3.2 billion in exports to the United States, developing countries' total exports fell by about $35 billion in current terms in 1983 from the 1982 level.

7. Transmission of recovery to developing countries will be hampered by the level of indebtedness of many of them, as well as by protectionism. The increase in interest rates during recent months is a strongly negative factor for most debtor developing countries. Imports will be constrained by the amount of debt service to be paid which, short of a significant decrease in interest rates, will increase in 1984 and 1985 for developing countries as a whole. For some countries, higher interest payments will offset a large part of the higher export earnings resulting from recovery in the developed market-economy countries.

8. Even assuming some increase in capital flows, the rate of growth of the volume of imports will have to remain significantly below that of exports. Since developing countries account for about a quarter of the total exports of developed market-economy countries, this discrepancy will influence world demand in such a way as to reduce the transmission of economic recovery among developed market-economy countries themselves. However, if increased capital flows are accompanied by a significant expansion of export volumes, economic growth in developing countries, which is likely to resume at a modest rate in 1984, could accelerate slightly in 1985 despite the weakening foreseen in growth in the developed market-economy countries.

9. After three years of stagnation or decline, the net material product (NMP) of the socialist countries of Eastern Europe other than the Soviet Union rose by 3.4 per cent in 1983 (reflecting, in particular, high growth in Poland). In the Soviet Union growth of NMP seems to have continued in 1983 at the rate of about 4 per cent reached in 1982. Prospects in 1984 for the socialist countries of Eastern Europe, as a whole, are for a rate of growth similar to the 3.8 per cent recorded in 1983.

10. In China, progress towards the attainment of targets set by the country's 1981-1985 Plan continued in 1983 at the same rapid pace as in 1981 and 1982. In fact, a number of the Plan's targets had already been reached by the end of 1983, when national income grew at a rate of 9 per cent.

B. THE EVOLUTION OF THE TRADE AND PAYMENTS SYSTEM

1. Introduction[2]

11. The economic performance reported above is in large part the direct result of past and present policy decisions and stances taken by the governments of developed and developing countries. But in an open economy, the interaction of national economies and of national policy decisions is of considerable importance in shaping the overall outcome of such decisions. Thus, the operation of the trade and payments system, which governs these interactions, is of critical importance in determining the performance of national economies.

[2] See part II, chapter I.

12. While the importance of the functioning of the trade and payments system has been recognized throughout the post-war period, the evolution of the world economy itself has worked to increase its significance. Over the last three decades the ratio of exports to GDP has doubled for the world, for developed market-economy countries and for the developing countries, each taken as a whole. The ratio for the socialist countries of Eastern Europe has also risen significantly. Thus, for all groups of countries a much larger share of domestic output and employment is now accounted for by foreign sales. However, as countries have become more "open" to foreign trade, the role of the trade regime in influencing the allocation of resources has grown (except in centrally-planned economies). This, together with the increased financial integration of countries, especially the major developed market-economy countries, has meant that the chances that national economies will experience inflation or deflation in response to changes in the macro-economic policies of other countries, or to changes in exchange rates and in protectionism, have increased considerably. In sum, increased economic integration has heightened the potential for expansionary or contractionary impulses to be transmitted throughout the world economy.

13. Accordingly, an important characteristic of the trade and payments system is the manner in which it helps to promote efficiency, growth and stability and shape domestic policies in ways that are consistent with collective as well as national prosperity. The recent changes in the main characteristics of the system must therefore be evaluated against these criteria.

2. The post-war international trade and payments system[3]

14. The international trade and payments system established at the end of the Second World War were based on the recognition that deliberate system-building was indispensable if the world economy was to attain high, stable and growing levels of output and employment and if countries were to benefit from active participation in international trade and finance. This conviction stemmed directly from the experience of the inter-war years, which had been characterized by competitive devaluation, pervasive trade restrictions, bilateral trade and payments arrangements, financial collapse and economic depression. An important feature of this disintegration was the collapse of commodity prices and the inability of developing countries (at the time, Latin American countries) to meet their external debt-service payments.

15. The framers of the post-war arrangements sought to put in place a system that would be supportive of national efforts to achieve full employment, while at the same time allowing countries to reap the benefits that would result from the progressive liberalization of trade and payments.

16. The International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) were designed to facilitate the attainment of national growth and employment objectives by allowing countries to deal with problems of the external sector through means that were not incompatible with collective prosperity. In particular, the monetary arrangements embodied in IMF were founded on the principle that exchange rates should not be influenced by speculative pressures but would be fixed by governments. The par values declared to the Fund were not to be defended at the cost of unreasonably high unemployment but could be adjusted to correct a fundamental disequilibrium. More important, however, was the determination of the members of IMF to eschew recourse to exchange rates as an active instrument for obtaining full employment. In brief, the monetary arrangements sought to ensure that exchange rates reflected countries' underlying competitiveness in trade as well as to prevent these rates from being disrupted by private capital movements or "beggar-my-neighbour" policies.

17. As regards long-term capital flows, it was expected that international lending would eventually revive as the traditional capital-exporting countries recovered from the effects of the war. However, in order to meet the

[3] See part II, chapter II.

financing needs of the war-torn and developing countries, to accelerate the revival of confidence and supplement the activities of private lenders, the World Bank (IBRD) was created and empowered to borrow in private capital markets for the purpose of making long-term loans.

18. Commitments in the areas of employment, economic development and reconstruction, the stabilization of commodity markets and commercial policy were to be made in the context of the Havana Charter. In the event, the International Trade Organization envisaged by the Havana Charter did not come into being. But the commercial policy chapter of the Charter gave birth to the General Agreement on Tariffs and Trade (GATT), which was designed to serve a market-oriented system in which tariffs were the principal device for regulating import competition.

3. The evolution of the trade regime[4]

19. The evolution of the trade regime since the inception of GATT has been marked by two quite different trends. On the one hand, trade has been liberalized as a result of a series of rounds of trade negotiations addressed primarily toward the reduction of tariffs and of quantitative restrictions that fall within the ambit of GATT. These negotiations met with considerable success, with the average level of industrial tariffs being reduced from about 40 per cent in the mid-1930s to approximately 7 per cent after the Tokyo Round. However, these results varied considerably across sectors: liberalization was more complete in sectors characterized by a high degree of horizontal division of labour among the developed market-economy countries. Protection of vertically-integrated industries, and in particular activities relating to processing of raw materials, remained relatively high, however, and tariff liberalization was effectively resisted in certain sectors, notably agriculture, textiles, clothing and footwear and leather goods. The process of tariff liberalization that did occur was greatly facilitated by the adherence to the unconditional most-favoured nation (MFN) clause and the broad notion of reciprocity which emerged in the post-war years.

20. The trend towards liberalization worked towards the more efficient use of markets as tariffs came down, and allowed for some play of market forces where they did not.

21. At the same time, there has been a trend toward the increased use of protective trade measures of a discretionary character which has accelerated in recent years and which is moving the trading system toward a regime of managed trade. These measures were designed to shield domestic producers from external shocks; and they fell outside the jurisdiction of GATT or involved derogations from GATT rules, as in the case of Multifibre Arrangement (MFA). The tendency toward managed trade began with the removal from the application of multilateral disciplines of trade in agricultural products; but voluntary restraint and other forms of discretionary protectionism have recently taken on much wider significance. Again, the incidence of various forms of non-tariff impediments to trade varies among sectors. There is a clear tendency for labour-intensive goods to encounter the highest application of non-tariff barriers within the manufacturing sector. The prevalence and spread of measures which regulate quantities traded in certain markets has had a number of consequences for the efficiency of the trading system. First, insulating certain markets from changes in prices or quantities has intensified the impact of cyclical swings in prices or output on others. In addition, it has reduced considerably the capacity of the world market system to allocate output efficiently. For example, in the case of a quota, the quantity of imports is strictly limited, irrespective of the competitiveness of foreign producers, while under a variable levy any increase in efficiency reflected in lower prices is offset by a corresponding increase of the levy.

22. A further important implication of the rise in non-tariff barriers relates to the potential for trade liberalization itself. Since such barriers are not easily identifiable and their res-

[4] See part II, chapter III.

trictiveness is more difficult to measure, the negotiations to reduce such barriers are inherently more difficult than those relating to tariff reductions. This difficulty has been compounded by the failure to develop a satisfactory notion of reciprocity, as well as by the emergence of the concept of conditional most-favoured nation treatment.

23. The trading system has thus been subject to contradictory trends, with a growing tendency for the direct management of trade to gain the upper hand.

4. The rise of private capital flows[5]

24. The expansion of trade which occurred in the 1950s and 1960s was accompanied by a substantial rise in international capital flows. In the 1950s this took the form primarily of official flows and private foreign direct investment, which together accounted for more than 80 per cent of world financial flows during the period 1950-1954. However, a major turning point occurred with the relaxation of payments restrictions in Western Europe, which gave rise to a marked expansion of portfolio investment and international bank lending - a growing proportion of which took the form of lending through offshore and Eurocurrency markets. A further marked shift in international borrowing and lending patterns in favour of private capital markets began in the early 1970s, and this shift has become the most notable characteristic of the past decade.

25. This phenomenon, which is sometimes referred to as the privatization of the international financial system, profoundly transformed the manner in which that system functions. By the early 1970s, for example, the liquid assets at the disposal of participants in the private international financial markets vastly exceeded official reserves. The availability of these liquid assets in such magnitudes led directly to the breakdown of the Bretton Woods arrangements relating to exchange rates; moreover, the preponderance of private, as opposed to official, liquid assets has grown steadily and rapidly since.

26. The expansion of bank lending was made possible by innovatory measures to deal with a number of important potential obstacles to international bank lending. The incidence of risk of default of a single borrower was lessened by the practice of syndication, whereby a large number of banks together provided credits required by an individual borrower. The earnings risk to the banks on medium-term credits was virtually eliminated by the introduction of floating interest rates, which allowed the interest rate on such credits to be adjusted at three or six-month intervals to reflect changes in the costs of money to the banks. This mechanism enabled the costs and benefits derived from any change in interest rates to be passed on from the banks to the borrowers. From the borrower's side, the attractiveness of Eurocurrency loans stemmed from their flexibility and convenience. Demand for such loans also increased rapidly after the emergence of sizeable payments imbalances in the mid-1970s.

27. The expanded share of international financing in the form of bank lending left the international financial system highly vulnerable to certain kinds of shocks. Although banking practices covered individual banks from various sorts of risks, no protection was provided against risk arising out of unfavourable changes simultaneously affecting many borrowers. Thus, syndication of loans provides no protection against widespread inability of borrowers to service debt, and variable interest rate loans preserve the earnings of banks when interest rates rise, but only by impairing the capacity of borrowers to repay the loans, thereby reducing the quality of the banks' loan portfolio.

28. The sharp rise in interest rates that occurred in international capital markets in 1979 and the recession in developed market-economy countries that followed shortly thereafter created conditions which led to the current crisis in the international financial system. By 1982 there were signs that certain developing country borrowers were facing serious liquidity difficulties in the management of their external debts and payments. When Mexico found itself unable to meet

[5] See part II, chapter IV.

payments due on its public external debt, the creditworthiness of sovereign borrowers everywhere in the developing world was subjected to reassessment. Whereas previously banks had looked upon sovereign borrowers as being relatively free of risk, with export earnings stagnant or growing only slowly and interest costs rising dramatically, their views on a substantial number of larger debtors changed drastically. In the light of this, banks cut back substantially their lending to developing countries and much of the lending that has taken place has been involuntary in character. The result has been an accentuation of the swings in foreign-exchange availabilities, on account of the impact on developing countries of recession and higher interest rates. Thus, the private financial system has operated in a pro-cyclical fashion, accentuating the deflationary impact on developing countries of events in the world economy.

5. The changing role of multilateral institutions[6]

29. The counterpart of the rapid rise in private capital markets as a source of external financing for developing countries has been the relative contraction of the role of multilateral institutions.

30. The 1960s were characterized by a number of important innovations in the monetary sphere, including a sizeable increase in IMF quotas, the establishment of the IMF Compensatory Financing Facility and the Buffer Stock Facility, the establishment of the General Arrangements to Borrow and agreement on creating special drawing rights.

31. The 1960s were also a period of institutional evolution and increased activity for the multilateral development finance institutions. By 1973 these multilateral institutions (World Bank group, regional development banks, United Nations agencies and European regional funds) accounted for almost a third of total net financial commitments of the developed market-economy countries.

32. The sudden emergence in 1974-1975 of large payments imbalances, which were mainly structural in character, confronted the multilateral institutions with a major challenge, to which they responded with a number of measures. The Oil Facility was established in IMF, as were the Extended Fund Facility, the Supplementary Finance Facility, the Trust Fund and the Subsidy Account. But these innovations, important as they were, fell short of the needs for payments financing by developing countries, with the result that the larger part of these needs was met by borrowing from private capital markets. Indeed, the size of the Fund shrank during the 1970s relative to trade and the size of the payments deficits of its member countries.

33. The multilateral lending institutions grew rapidly during the 1970s, with the combined commitments of the World Bank and the International Development Association more than doubling between 1974 and 1979. Innovation also characterized the operation of these institutions, with the World Bank introducing cofinancing and the Intermediate Financing Facility (Third Window). Nevertheless, there was a fall in the relative importance of these lending institutions as a source of development finance, compared to private financial markets.

34. The period since 1979 has been characterized by a growing stringency of official sources of finance relative to needs.

35. During 1979-1982, IMF responded to increased payments pressures on its members by initiating the policy of expanded access and by borrowing funds from member countries for on-lending at market-related interest rates. Fund quotas were increased in 1980, but this failed to reverse the downward trend in the ratio of Fund quotas to world trade and payments imbalances. The use of Fund credit by developing countries rose sharply in 1980 and again in 1981, reflecting the deterioration in their current-account positions. During the same period, the World Bank responded to the difficulties facing developing countries by taking a number of measures to enhance its usefulness to members, including the introduction of structural adjustment loans, designed

[6] See part II, chapter V.

to assist countries in overcoming structural impediments to payments adjustment. However, the resources so allocated were limited to 10 per cent of total lending and did not constitute an addition to total resources.

36. Following the outbreak of difficulty in servicing commercial bank debt in 1982, IMF took on a new and central role in managing the crisis. The Fund has sought to assist countries in difficulty by making available its own resources, by helping to mobilize financing from other sources, and by fostering the necessary improvement in external balances through domestic programmes consistent with the amount of external financing available. The programmes that countries have had to put in place have almost uniformly been associated with a sharp deceleration in growth or with actual declines in output. This reflects, at least in part, the inability of IMF to provide sufficient resources to support adjustment programmes compatible with growth.

37. The progressive atrophy of the multilateral financial system has thus played a major role in determining recent economic performance.

6. The evolution of the exchange-rate regime[7]

38. The relative atrophy of the financial resources at the disposal of official institutions, both national and international, has had implications that go beyond the sources, distribution and magnitude of payments finance. This atrophy has also been closely associated with the evolution of the exchange-rate regime. The abandonment of attempts to re-establish a viable system of par values in the two years following the suspension by the United States in 1971 of the convertibility of the dollar into gold reflected recognition by monetary officials of that country that its diminished share in holdings in total international liquidity made it impossible for them to influence decisively the course of exchange rates in the face of massive movements of private flows across foreign exchange markets. The move to float exchange rates, however, also reflected past shortcomings in the operation of the adjustable peg system, which had provided private markets relatively costless and risk-free opportunities for profitable speculation. In addition, it was widely believed that, since private markets consisted of a multitude of individual profit-oriented decision-makers who utilized all the relevant information efficiently, floating would result in exchange rates moving in the direction and at the speed necessary to adjust the underlying balance-of-payments accounts. In addition, floating exchange rates were expected to give countries greater policy autonomy.

39. In the event, the regime of floating exchange rates gave rise to a substantial increase in the instability of rates and to extended periods during which exchange rates have failed to reflect the combined influence of underlying competitiveness in trade and differences in medium-term savings performance and return on investment. This has resulted in part from the use of exchange markets as a vehicle for achieving short-term capital gains (or avoiding losses), a process in which it is more important to judge accurately the mood of the market and its probable level a week or a month in the future than it is to recognize the direction of fundamental change. Instability and misalignment of exchange rates have also reflected the changed character of monetary policy in major money market centres. With monetary policy directed toward targeting the money supply, the rate of interest has been allowed to find its own level in financial markets. The result has been sharp swings in interest rates, capital flows and exchange rates.

40. On both counts, therefore, the value of exchange rates to markets as an indication of the directions in which savings and traded goods should flow has been diminished. The uncertainties created in the minds of entrepreneurs regarding the rate of return on alternative uses of their funds has tended to impede long-term investment in tradeable production, particularly by smaller firms and by developing countries. Exchange-rate uncertainty and volatility has also had adverse consequences for macro-economic policy making in developed and developing

[7] See part II, chapter VI.

countries and has been a factor prompting governments to impose trade restrictions, particularly restrictions of a quantitative character.

7. Conclusions

41. The differences between the regimes established four decades ago and those in force today are striking. The post-war system was designed to protect levels of activity to the greatest extent possible from external constraints and external monetary and financial disturbances while securing the benefits of progressive liberalization of trade. To this end, exchange rates were to be fixed by governments on the basis of multilateral consultation and, barring fundamental disequilibrium, sustained in the face of short-term disturbances by the use of official reserves and, when necessary, by recourse to official balance-of-payments finance provided through IMF. It was assumed that short-term capital movements would be controlled and that countries would pursue full employment policies.

42. The present arrangements, by contrast, are geared toward ensuring freedom for international capital markets, which have assumed a predominant role in determining the availability of payments finance and the pattern of exchange rates. Although the process of tariff reduction continues, the trade regime is increasingly characterized by recourse to discretionary restrictions lacking any underlying economic rationale and unfettered by any internationally-agreed set of guidelines. Deficit countries are for the most part required to adjust external imbalances by means of deflation and the pressures on governments of major industrial countries to pursue full employment objectives have dramatically weakened. The potential for instability and crisis in the world economy and the vulnerability of employment, trade and development have thereby been increased.

C. TOWARD REFORM OF THE SYSTEM

1. Introduction[8]

43. The past decade has been characterized by an overall slowing down in the pace of economic advance throughout the world economy, and by greater instability in output. It has been a period of significant change in national economies, and one in which all countries - developed and developing alike - have had to make far-reaching adaptations in their economies and re-orient their policies.

44. Such changes are an integral part of a growing world economy, which requires national policies to adapt continuously to spontaneous developments at home and to new realities in their external environment. An efficient system of trade and payments must succeed in providing discipline and incentives to countries to undertake necessary changes without forcing them to respond to changing external conditions unnecessarily, excessively, or too rapidly, and without generating further disturbances at the international level.

2. Systems performance and growth[9]

45. The overall system of international trade and payments is made up of individual systems governing monetary and financial relations, trade and commodity markets. Each has a separate and distinct identity, its own "rules of the game" and institutions, and may be evaluated in terms of the way it fulfils the principal tasks assigned to it - for example, the trade regime in allocating efficiently current production; the financial system in allocating current savings; and so forth. In the most recent period, it is clear that the growth of protectionism has

[8] See part III, chapter I.
[9] See part III, chapter II.

reduced the effectiveness of the trade regime, and the debt crisis that of the financial system. The individual systems, however, have a substantial number of important interlinkages, and thus the operation of one system may influence the efficiency with which another fulfils its task.

46. There is growing evidence that these interlinkages are increasingly operating in such a way that policy decisions or stances in one system are diminishing the effectiveness of the operation of other systems. For example, the failure of the payments system to provide adequate balance-of-payments finance to deficit countries has obliged many of those countries to impose trade restrictions. The monetary system has thereby operated in a way that obstructs the processes of trade liberalization, which is a central objective of the trading system. Exchange-rate flexibility has reduced the efficacy of tariffs as a protective device, thereby inducing countries to resort to non-tariff barriers to counteract the effects of instability and uncertainty in exchange rates. This has reduced the capacity of the trading regime to allocate appropriately output, and has made the process of trade negotiation more difficult. It has also removed a substantial proportion of trade from the effects of price competition. As a consequence, exchange-rate changes are now a less effective tool for balance-of-payments adjustment than previously, and the efficiency of the payments regime has been reduced. The rise in barriers to trade has also interfered with the process of long-term lending by making it more difficult for debtor countries to earn the foreign exchange they require to service external debt.

47. The insufficiency of balance-of-payments financing has been particularly felt by countries dependent on exports of commodities subject to sharp price fluctuations, which have been obliged to incur unnecessary and, at times, heavy adjustment costs in response to self-reversing price variations. Shortages of trade finance have also contributed to the emergence of a variety of trade practices, including countertrade, which, while succeeding in reducing the need for liquidity, have introduced distortions into trade flows.

48. The interaction of systems has thus played an important role in fostering and accentuating trends, which result in poorer performance for each of them.

49. A further critical question is how well the systems governing money, finance, trade and commodity markets, taken individually and collectively, are now able to support the process of income generation in the world economy. A primary concern, in this regard, is the way the system transmits inflationary and deflationary forces among countries.

50. In recent years, commodity and financial markets have served to amplify the transmission of deflationary impulses from developed to developing countries - impulses which have themselves strengthened because of the stance and mix of macro-economic policies adopted by developed countries.

51. First, the flexibility of commodity prices translates (as in the past) even relatively small declines in demand in developed countries into substantial reductions in the value of the developing countries' export earnings. Demand has been more unstable in recent years; at the same time, exceptionally high rates of interest have caused holdings of commodity stocks to be reduced, putting further downward pressure on commodity prices and earnings.

52. A second factor has been the recent accumulation by developing countries of a relatively large stock of debt at variable interest rates, which has served to translate higher interest rates in developed countries into higher debt-service payments by developing countries. Finally, the importance of the role of bank credit in covering the current-account deficit of many developing countries, combined with the way bankers make their lending decisions, has caused the capital-account balance of those developing countries to swing substantially and pro-cyclically, by following and reinforcing the deterioration in the current-account balance.

53. The amplification of the impact on developing countries of the macro-economic policies in developed countries has been the joint result of the stance and mix of those policies - including, in particular, the tightness of monetary policy - and the structural fea-

tures of commodity and financial markets. Their incidence on developing countries has reflected such factors as the extent of dependence on commodities and bank credit and the volume of variable interest debt.

54. In addition to amplifying the transmission of deflation from developed to developing countries, the system of trade and payments has tended to encourage or even enforce national policy responses which contribute further to the propagation of deflation, particularly in developing countries. Central to this tendency have been the inadequate availability of official balance-of-payments finance and the contraction of payments finance provided through private channels. These inadequacies have prevented adjustment processes in developing countries designed to deal with underlying payments problems in a context of growth, and have forced adjustment to be more narrowly focused on policies designed to improve rapidly the balance of trade. Consequently, an inordinate part of the adjustment process has taken the form of cutbacks in imports. When these involved either investment goods or raw materials and spare parts, they have had a direct impact on levels of current and prospective output. They also reduce the demand for other countries' exports, including those of developed countries, and thereby reinforce recessionary tendencies in those economies.

55. The intense downward pressure on production and external payments resulting from these circumstances places a high priority on export expansion. These pressures, however, can lead to policy actions that serve to weaken unnecessarily the performance of national economies. For example, although individual commodity exporting countries may feel they could increase earnings by increasing production, if most producers follow this course of action, the end result is likely to be lower commodity prices and earnings for all. Pressures on producing countries to raise the profitability of commodity production, for example, by devaluing their currencies by more than the rate of domestic inflation, thus run a considerable risk of being counterproductive.

56. Reduction of domestic demand in a deficit country is sometimes seen as a necessary condition for shifting current domestic output from home consumption to exports. For a handful of developing countries, including some of the most heavily indebted, such a process may produce a significant improvement in the external accounts. For most developing countries, however, the limited range of domestic output and the limited domestic consumption of exported goods preclude significant gains via this route. Imposing demand deflation on these countries thus cannot be seen as part of a process of restoring growth and a viable external payments situation.

57. When export expansion by deficit developing countries is possible in the short to medium run, it will have an impact on its trading partners and the trading system: in developed countries, the rise in imports will mean that the demand for domestic output will be reduced, and recessionary tendencies reinforced; increased imports in the face of unemployment and idle capacity will lead to an intensification of protectionist pressures, and a growing tendency on the part of importing countries to challenge the policies pursued by developing countries to promote their exports.

58. Thus, when payments problems of developing countries reflect macro-economic imbalances, and particularly recessions, in the rest of the world, reduction of those deficits serves to widen the underlying imbalance and to reduce employment, output and development. These adverse effects, which are currently in evidence, could be avoided if payments deficits were to be addressed through measures that would include a decline in interest rates, a stimulus to demand in developed countries and an increase in net capital flows to developing countries. In this way, the burden of external payments adjustment would be shared by surplus and deficit countries and would take place in a context of expansion rather than contraction.

59. The rapid accumulation of debt by many developing countries has been closely associated with mechanisms previously described. Because of the present overhang of indebtedness of a number of developing countries, the present and prospective expansion of the economies of the developed world will have a limited impact on them. Given their need to allocate additional foreign exchange earnings to the fur-

ther improvement of external imbalances, the elimination of debt arrears and the restoration of official reserves to more normal levels, export growth will only be partially translated into import growth.

60. Thus, for developing countries, the systems of money and finance, trade and commodity markets have operated during the period of downturn by amplifying the negative forces emanating from the economic performance of the developed countries, and will be operating during the upturn, at least initially, by dampening the positive effects of recovery in the developed market-economy countries.

3. Toward reform of the system[10]

61. Both the trade and payments system and national economies have been left in a weakened condition by the experience of the past several years. Their capacity to bear additional strain is therefore limited. The prospect of a downturn in activity in the developed market-economy countries during the next one to two years must therefore be a cause of concern for the system itself. Prudent policy planning calls for an urgent examination of how the trade and payments system may be re-ordered and restructured so as to promote better economic performance of national economies. A viable system needs not only to reaffirm the emphasis on employment and growth that underlay the design of the post-war systems but also to complete that commitment by establishing mechanisms to ensure adequate growth opportunities for all members of the system. This feature - the establishment of a development consensus as one of the guiding principles of the system - is little more than the logical extension of the original rationale of the Bretton Woods arrangement.

62. The necessary consideration of the need for reform of the trade and payments system is unlikely to occur under the present arrangements for international economic discussion, which separate from one another the ever more closely connected problems of development, employment, debt, trade and payments balances. One major failing that results is that decisions on the international monetary and financial system, although having a deep impact on real economic activity in both developed and developing countries, are circumscribed by the perspectives of narrow monetary and financial considerations. At the same time, the agenda of international monetary negotiations is being shaped in restricted groups in which developing countries are not represented.

63. What is required is an alternative approach which would seek to reform the trade and payments system on the basis of the interdependence of the problems in these fields and of the mutual dependence of employment and development. Efforts to implement such an approach would necessarily require governments to grapple with a number of very basic and fundamental issues.

64. Among the more important of these are the following questions:

(a) How and to what extent is it possible for major countries, in designing policies having important consequences on other countries, to take into account the needs of the system?

(b) What are the mechanisms available to remove the bias of the system against full employment and development?

(c) How can the system be made better able to resist the propagation of cyclical fluctuations?

(d) What is the proper domain of the system as regards its membership?

(e) What is the proper domain of governmental intervention with regard to international transactions?

(f) Can a trade regime be devised that provides a common framework for trade in manufactures, agricultural products and services?

(g) How can the international system be endowed with mechanisms that allow necessary adjustments in policies and in national econo-

[10] See part III, chapter III.

mies to go forward in the context of growth and development?

(h) In the monetary sphere, what is the feasible scope of official action, particularly in the areas of liquidity creation and exchange rates?

(i) How can a reasonably predictable and growing flow of development finance consistent with development needs be secured?

(j) What institutional arrangements need to be put in place to ensure, through time, coherence and consistency in the formulation of policies relating to trade and those relating to payments so that they may promote full employment and development?

65. Although these fundamental, underlying issues form the core of any agenda for reform, there are a number of immediate and urgent issues that will need to be given special attention. Foremost among these is the question of debt.

66. A multitude of proposals have been put forward with regard to the way in which current debt problems might be alleviated. One of the more important issues in this regard, however, is the way in which the resolution of present difficulties can be made compatible with high and rising financial flows to debtor countries in future years, which is an issue that can only be adequately addressed in the context of a broader discussion of the evolution of the financial system in the years to come. The debt problem is also closely related to the conduct of monetary policies in developed market-economy countries, the growth of activity in those economies, and the access of developing countries to foreign markets. Thus, the debt question can only be satisfactorily resolved in the context of reform of the system of trade and payments. At the same time, the system itself will inevitably be affected, and its long-term evolution heavily influenced, by decisions regarding debt in the immediate future.

Part I

THE CONTINUING WORLD ECONOMIC CRISIS

Chapter I

INTRODUCTION

67. During 1983 output in developing countries and territories is estimated to have declined by more than 1 per cent, following a negligible increase in output in 1982 (see table 1). These low or negative growth rates were the result of both demand and supply factors. First, there were widespread contractions of domestic demand, associated with worsening external payments positions and difficulties in servicing external debt, which in turn reflected in large part high interest rates and reduced access to international capital markets. Second, there were reductions in oil output in the major oil-exporting countries and a slowing in the growth of their non-oil output. Third, there was a poor performance in the agricultural sector in a number of African countries. For the non-oil exporting developing countries as a group output expanded by 2 per cent in 1983, following a 1 per cent rate of growth in 1982. Within this group, however, experience varied considerably. Developing countries in Latin America suffered a decline of about 3 per cent in output while in Africa there was a modest rise of 1 per cent. A number of countries in South and East Asia, on the other hand, experienced relatively buoyant growth, with output for the region as a whole rising by more than 5 per cent. Furthermore, even within these geographical regions experience varied considerably: for example, in Africa 12 countries out of 32 for which data are available actually experienced declines in output in 1983, while the remaining 20 countries had an average growth of 4.2 per cent.

68. Except for a number of developing countries in South and East Asia, 1983 therefore marked the continuation and, in a large number of countries, intensification of the severe crisis which has afflicted most developing countries for several years. In much of the developing world levels of per capita output fell for the third consecutive year, and were below those recorded in 1979. The impact of this continuous economic decline is increasingly being felt in the social as well as in the economic sphere. Unemployment, under-employment and poverty are on the rise in many of these countries. Social infrastructures and public services are frequently under severe pressure. There is growing evidence of difficulty in insulating health and education from the effects of the economic crisis. Physical investment is also being severely constrained in a large number of countries, reflecting both a drying-up of private investment in the face of economic recession or contraction and the atrophy of public investment following pressures to reduce public expenditure. The impact of the crisis on health, education and investment places future growth and development in jeopardy.

69. The forces underlying this severe set-back to development have been gathering for a number of years. Although the precise causes vary from region to region and from country to country, severe strains in external payments are a common, underlying factor. The debt crises in Africa, in Latin America and in some countries of Asia have been characterized by a cut-back in new private financial flows, which, in the case of Latin America, was particularly severe and became the dominant feature of the behaviour of external receipts. The modest growth of world trade and hesitant rise of commodity prices have failed to produce a decided recovery of export earnings. In addition, adverse weather conditions affected agricultural output in a number of countries, particularly in Africa, thereby reducing exports and increasing the need for essential imports. These adverse developments affecting the external accounts left many countries with no choice but to cut back sharply on

Table 1

World output by major countries and country groups, *a/* 1975-1985
(Percentage change)

Country or country group	Actual: 1975-1980 (Annual average)	Actual: 1981	Actual: 1982	Estimate: 1983	Forecast *b/*: 1984	Forecast *b/*: 1985
World *c/*	3.8	1.6	0.0	1.9	3.5	3.1
Developed market-economy countries *d/*	3.5	1.7	-0.2	2.3	3.9	2.9
North America	3.6	2.7	-2.1	3.4	5.5	3.1
Western Europe	3.0	0.0	0.3	1.1	2.1	2.3
Japan	5.1	4.0	3.0	3.0	4.5	3.5
Others	2.5	4.1	-0.2	0.9	2.2	2.6
Developing countries and territories *e/*	5.1	1.2	0.9	-1.3	2.1	3.7
Major oil exporters	5.1	0.7	0.7	-3.2	1.8	3.2
Oil sector	1.3	-17.3	-3.3	-8.9	0.5	3.1
Non-oil sector	6.9	5.2	1.2	-0.8	2.4	3.2
Other oil exporters	5.7	5.6	2.8	0.1	3.5	4.9
Net oil-importing countries	5.0	1.3	1.0	2.1	3.2	4.4
of which:						
Exporters of manufactures	5.9	-1.5	0.3	0.6	2.3	4.4
Least developed countries	3.4	3.3	2.0	3.2	3.9	3.9
China *f/*	4.9	3.0	7.4	9.0	6.6	6.3
Socialist countries of Eastern Europe *g/*	4.1	2.0	3.1	3.8	3.7	3.9

Source: UNCTAD secretariat calculations, based on official national and international sources.

a/ For definition of country groupings, see the explanatory notes at the beginning of this report and the note to annex table A.1.
b/ See note *c/* to annex table I.
c/ Excluding China and the socialist countries of Eastern Europe.
d/ Gross domestic product/gross national product.
e/ Gross domestic product.
f/ National income.
g/ Net material product.

imports, reinforcing the cut-back as necessary with restrictive fiscal and monetary policies.[11]

70. While the economic crisis continued or deepened for most developing countries, the experience of developed market-economy countries in 1983 was different. There, output rose by 2.3 per cent in 1983, as compared with a small decline in 1982. Moreover, changes in output in the latter half of 1983 and during the opening months of 1984 have made it clear that further acceleration in output in these countries is occurring. The developed market-economy countries as a group are thus emerging from the most protracted recession of the post-war period. Moreover, pace of inflation in most countries has slowed appreciably and the current expansion is proceeding without signs of a re-emergence of inflationary pressures.

[11] The situation of developing countries is described in greater detail in part I, chapter III.

71. The experience of individual developed market-economy countries varied considerably within this overall picture. The most remarkable turnaround was that of the United States and Canada: output in North America in 1983 grew by 3.4 per cent, as compared with a drop of more than 2 per cent in 1982. In both countries the expansion was led by industry, where output rose by 16 and 18 per cent, respectively. The strength of the performance of the United States economy resulted in a reduced rate of unemployment; in developed market-economy countries of Europe, expansion resulted only in some slowing of the rate of increase of unemployment.

72. The growth of output in the economies of the socialist countries of Eastern Europe accelerated modestly in 1983, confirming the pattern of improvement that first became apparent in 1982. Again, however, the experience of individual countries varied considerably, with the most notable improvement in performance taking place in Poland.[12]

73. The patterns of change in the world economy in 1983 allow some preliminary evaluation of the current international approach to the economic crisis of developing countries. This approach has been characterized by the premise that economic recovery in the developed world, together with strenuous adjustment measures by debtor developing countries and with financial support - usually at levels below the net financial receipts of only a few years ago - mobilized directly and indirectly by IMF, would allow debtor developing countries to resolve the problems of reconciling growth with a manageable external financial situation. It is still much too early to undertake a thorough analysis of the validity of this approach, which it was never envisaged could prove successful within the span of one year (or even two). However, some broad indications are already evident as to how this process has been working, at least initially, and it should be recalled that 1983 was a year of vigorous upswing in the economies of North America. Indeed, the degree of acceleration in that region is unlikely to be matched elsewhere in the developed market-economy countries in the coming months or even in North America itself. The behaviour of the mechanisms that link the North American economy to those of developing countries and the extent to which this vigorous expansion was transmitted by those mechanisms from North America to the developing countries is thus of considerable interest in securing some insight into the degree of success so far of the strategy being followed.

74. In order to examine these matters in greater detail, chapter II, after recalling the main characteristics of the United States recovery influencing its impact abroad, provides a brief analysis of the direct transmission of growth from North America to developing countries via trade. It then examines more generally the behaviour of the two main channels linking recovery in the developed market-economy countries to the economies of the developing countries: the commodity and the financial markets. Chapter III examines in greater detail the recent economic experience of developing countries and chapter IV sketches briefly the salient features of the present upturn in industrialized countries.

[12] For a more detailed discussion of developments in the economies of developed market-economy countries and the socialist countries of Eastern Europe, see chapter IV below.

Chapter II

THE TRANSMISSION OF RECOVERY TO DEVELOPING COUNTRIES

A. Introduction

75. The vigorous economic expansion in the United States has had a considerable effect on the rest of the world economy. This expansion is being driven by what one senior United States monetary official has called "the most expansive fiscal policy our country has ever experienced in peace-time history".[13]

76. This expansion has had two unusual characteristics: it has led to a much larger decline in the net exports of the United States than was typical of earlier recoveries in that country, due mainly to a sharp rise in imports, which has been an important vehicle for the transmission of growth from the United States to other countries; and it has been characterized by interest rates that, while lower in 1983 than in 1982, were still high in real terms. Moreover, the continued vigorous expansion of the United States economy in 1984 has been accompanied by a further rise in interest rates.[14]

77. Unusually high import growth and unusually high interest rates are thus the hallmarks of the current expansion in the United States. The following sections examine some of the implications for developing countries.

B. Trade implications for developing countries of the resumption of economic growth in the United States

78. Economic recovery in the United States, which started toward the end of 1982, has triggered a buoyant rise in import demand in that country, thereby imparting a stimulus to those countries which have substantial trade links with the United States. How significant has this stimulus been for the developing countries and what could be expected in the case of a more generalized resumption of growth in the world economy? The following analysis attempts to throw some light on this question. It deals with the direct transmission of growth impulses, that is to say with the impact on developing country trade with the United States of the increase in the latter's import demand. Buoyancy in the United States import demand also undoubtedly had indirect trade effects on developing countries: the expansion in the United States contributed to higher growth in other developed market-economy countries, particularly Canada and Japan, so that a part of any increased imports of these countries from developing countries must be attributed, indirectly, to the United States recovery. However, such indirect effects are difficult to measure; they were probably insignificant in 1983, and will increasingly become part of the more general increase in developing country exports arising from the spread of recovery in the developed market-economy countries.

79. The magnitude of the direct trade effects on developing countries of the United States recovery will be heavily influenced by the extent of the overall rise in United States imports resulting from recovery and the relative importance of that country as a market for developing countries. As shown in

---

[13] Statement by Mr. Lyle E. Gramley, member, Board of Governors of the United States Federal Reserve System, before the Mid-America Committee, 12 April 1984 (cited in Bank for International Settlements, Press Review No. 103, 28 May 1984).

[14] The upturn in the United States economy and the factors that have allowed an expansion of investment to occur in the face of high interest rates are examined in chapter IV, below. The implications for other countries of the emerging compatibility of high interest rates and vigorous growth in the United States are examined in section D of the present chapter.

Table 2

Developing countries and territories: structure of exports
(Percentage share by destinations, by major commodity groups, 1982)

Destination / Commodity group	World	Developed market-economy countries				Socialist countries		Developing countries
		Total	USA	Europe	Japan	Europe	Asia	
All products	100	64.8	18.8	28.3	14.6	4.0	1.0	30.2
All food items	100	53.2	15.5	28.1	7.5	18.1	1.9	26.8
Agricultural raw materials	100	56.2	8.0	27.5	18.0	7.4	5.2	31.2
Ores and metals	100	68.6	15.7	29.6	21.6	5.2	1.2	25.0
Fuels	100	69.6	16.7	31.4	20.4	1.6	0.1	28.7
Manufactures	100	59.8	28.3	20.5	6.2	1.4	2.0	36.8

Source: United Nations, *Monthly Bulletin of Statistics,* May 1984.

table 2, the United States accounts for a significant, but by no means preponderant, part of the world market for developing countries. In all of the commodity groups listed, developing countries themselves are a more important market for their exports than is the United States. Europe is also a more important market for developing countries than the United States for all commodity groups other than manufactures. For manufactures, however, the United States represents a significant market for the developing countries, and it is indeed here that its weight is greatest.

80. The large increase in the volume of imports into the United States in 1983 started from the very low levels prevalent during the protracted and deep recession in that country during the preceding years. Moreover, there has been a high correlation between the direction of the changes in the volume of imports into the United States and that of the changes in real GDP in that country during the recent past, both of which have been systematically in the same direction (see table 3). However, it should be noted that the decline in import volume was much more pronounced in 1980-1982 than in the previous recession. As a consequence, the import volume in 1983 was about 1 per cent lower than in 1979, whereas in 1976 it was as much as 6 per cent above the 1973 level. Thus, recovery in the United States has been a somewhat less powerful engine of growth in the world economy during the present recovery than in the preceding one.

81. However, it should be stressed that it was only during the second quarter of 1983 that the value of United States imports ceased to decrease[15] and that it was only during the fourth quarter of 1983 that the increase in imports was particularly significant.[16] It is true that net imports (imports minus exports) started to increase earlier in the year, but this increase was mainly the result of decreases in exports along a trend which preceded the recovery. It should also be pointed out that, because of a decline in the unit value of United States imports, the rate of increase in the volume of imports, estimated at over 10 per cent in 1983, is about twice the corresponding rate of increase in current prices. The impact of the United States recovery on levels of output in other countries was thus greater than its impact on their external earnings measured in dollars.

[15] Measured from balance-of-payments statistics, and expressed on a year-to-year basis to eliminate seasonal influences.

[16] The increase of United States imports in the fourth quarter of 1983 over the fourth quarter of 1982 represents about 80 per cent of the annual increase in 1983 over 1982.

Table 3

United States: gross domestic product and imports, 1971-1983
(Annual percentage growth and index numbers of volume)

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
	Growth over previous year												
GDP	3.1	5.4	5.5	-0.7	-0.7	4.9	5.2	4.7	2.3	-0.2	3.0	-1.7	3.5
Imports	9.0	13.4	4.6	-1.7	-11.5	22.0	12.3	8.0	1.4	-8.0	2.2	-4.3	10.4
	Index numbers (imports)												
Memo Item:													
1973=100			100	98	87	106	..	..					
1979=100									100	92	94	90	99

Sources: OECD, *Economic Outlook,* No. 34, December 1983, and *Monthly Statistics of Foreign Trade* (various issues).

82. On average, the value of United States imports increased at a rate of 5.3 per cent in 1983, following a decline of 7.5 per cent in 1982. At a lower level of aggregation the rates of increase (in value terms) varied widely among different commodity groups during the year (see table 4). A particularly fast rate of growth was observed in 1983 in the case of imports of manufactures (almost 13 per cent) following a year of near stagnation. Fuel imports, reflecting declines in both unit value and volume, continued the decline already observed in 1982. The value of primary imports, i.e., foodstuffs and raw materials, increased only modestly in 1983, but the positive rate (about 3 per cent) was a net improvement over the decline of more than 13 per cent recorded in 1982, a year in which primary export prices fell steeply. Thus, the trade benefits of the United States recovery were felt almost exclusively by exporters of manufactures, although the recovery also put an end to the decline in United States imports of primary commodities.

83. United States imports from the developing countries in current values increased at a rate somewhat lower than that of imports from all sources in 1983, reflecting mainly the marked decline in imports of fuels, since imports from the developing countries of both primary commodities (non-fuels) and manufactures increased at rates considerably higher than for the corresponding imports from all sources.

84. An examination at a more disaggregated product level suggests that the developing countries shared in the fast rise of world exports to the United States in a large number of categories of manufactures. However, for their traditional exports in these categories, United States imports from the developing countries did not rise more rapidly than its total imports. Nevertheless, developing countries did succeed in expanding their share of markets in which they account for only a marginal proportion of consumption. To illustrate this, table 5 has been designed to bring together data concerning the dollar value of sales by United States manufacturers and of imports into the United States of nine groups of manufactures, where a rough concordance can be obtained between the two types of data. Since, apart from stock movements, the total supply of a given manufactured product in the country is made up of imports and of domestic production, changes in the share of the two sources in the total supply are reflected in their relative rates of change. The table shows annual growth rates of (i) the current value of shipments by United States manufacturers, i.e., domestic supply, and (ii) United States imports from the world as well as from the developing countries in

Table 4

United States: imports by main categories, 1982-1983
(Annual growth rate of values in current prices)

From	Primary commodities	Fuels	Manufactures	Total
Developing countries				
1982	-14.1	-25.9	3.4	-15.2
1983	8.1	-12.3	24.3	4.5
Socialist countries of Eastern Europe and Asia				
1982	-39.7	51.3	8.8	2.5
1983	5.3	-20.3	10.9	3.8
Developed market-economy countries				
1982	-10.7	3.3	0.8	-1.0
1983	-0.1	-8.0	9.1	5.8
World				
1982	-13.3	-20.0	1.3	-7.5
1983	2.9	-11.0	12.9	5.3

Source: United Nations trade tapes.

Note: Primary commodities: SITC 0+1+2+4+67+68; fuels: SITC 3; manufactures: SITC 5-9 *less* 67 and 68.

1983. For reference, the table also provides statistics on the relative importance of imports from the developing countries as a source of supply, i.e., the percentage share of these imports in apparent consumption in the United States.[17] As can be seen from the table, the increases in the supplies of a large number of manufactured products in the United States had been met by fast inflows of imports from abroad in 1983. Thus, in all categories of manufactures except two (transport equipment and primary metals) imports increased faster than sales from domestic manufacturers. The differences in the growth rates were particularly marked in the case of machinery and other manufactured goods, petroleum and coal products, and paper and allied products. In food products, however, domestic sales and imports increased at roughly the same pace.

[17] The high degree of aggregation used in the table was dictated by the availability of statistics concerning the relationship between imports from developing countries and apparent consumption. Apparent consumption is defined as production plus imports less exports. Due to the lack of data, the shares of imports from developing countries in both the United States and Canada taken together has been used. However, due to the large weight of the United States economy, these shares should be quite close to those calculated for this country alone. For example, in 1975, a year for which separate calculations for the United States existed, the share of imports of manufactures from the developing countries amounted to 2.01 per cent. This compares with the corresponding share of 2.16 for North America, i.e., United States and Canada taken together, in 1974-1975. See UNCTAD, *Handbook of International Trade and Development Statistics*, various issues.

Table 5

United States: domestic shipments by manufacturers and imports, 1982-1983
(Annual growth rate, in current United States dollars)

Value of domestic shipments by US manufacturers *a/*	Increase	Imports	Increase *b/*
Textile mill products	9.6	Textiles and clothing (5.8)	A 17.2 B 18.9
Petroleum and coal products	-7.4	Petroleum and coal products (5.2)	A 14.8 B 10.7
Machinery, instruments and related products	3.9	Machinery and other manufactures (1.9)	A 15.3 B 23.4
Primary metals	6.7	Ferrous and non-ferrous metals (1.7)	A -4.6 B 35.4
Food, tobacco and kindred products	4.4	Food, beverages and tobacco (1.1)	A 5.2 B 5.8
Rubber, plastics, chemical and allied products	7.8	Rubber and chemicals (0.8)	A 13.8 B 44.8
Paper and allied products	7.4	Wood products, paper printing (0.6)	A 22.7 B 31.1
Stone, clay and glass products	10.8	Non-metallic mineral products (0.5)	A 18.4 B 35.7
Transport equipment	21.7	Transport equipment (0.2)	A 14.4 B 53.0

Sources: United States Department of Commerce, *Survey of Current Business* (various issues); United Nations trade tapes; UNCTAD, *Handbook of International Trade and Development Statistics, 1983* (United Nations publication, Sales No. E/F.83.II.D.2).

Note: Figures in brackets refer to the percentage shares of imports from developing countries in apparent consumption in North America in 1978-1979.

a/ Total sales based on data for 11 months.
b/ A: from world; B: from developing countries.

85. As far as imports from the developing countries are concerned, these had grown most rapidly for those manufactures in which the shares of imports from those countries were very small in relation to consumption. In other words, the starting bases for these imports were relatively small. For example, imports of transport equipment from the developing countries grew by over 50 per cent in 1983, but still accounted for a negligible share (0.2 per cent) of consumption. Likewise, the fast growth rate of imports from the developing countries of rubber and chemical products, paper and allied products, as well as non-metallic mineral products, was associated with shares in consumption of much less than 1 per cent. Relatively fast growth of imports from the developing countries also occurred in the case of ferrous and non-ferrous metals, machinery and other manufactures, where these imports amounted to between 1 and 2 per cent of apparent consumption. In sharp

contrast, in the case of textiles and clothing, where the share of developing country imports in consumption was much more substantial (5.8 per cent), the growth rate of imports from the developing countries was only slightly above that of imports from the world. An equally large share in consumption can also be observed in the case of petroleum and coal products (5.2 per cent), where once again the performance of developing countries was not particularly impressive.

86. The commodity composition of the rise in United States import demand was one determinant of the distribution of the rise among exporting countries. Table 6 explores the changes in export earnings of various groups of developing countries from trade with the United States and the significance of these changes for the overall trade of the developing countries. The statistics have been compiled first, for countries which have recently experienced difficulty in meeting scheduled debt-service payments, with a further classification by geographical region. Other developing countries have been grouped according to traditional criteria.

87. As can be seen from the table, with the exception of the major petroleum-exporting countries and countries in Africa experiencing debt difficulties, all country groups recorded increases in their exports to the United States in 1983. The rates of increase were very marked in some cases, and especially for the major exporters of manufactures not experiencing debt difficulties (24 per cent). The rates observed for the debtor countries were also quite large, except for the African countries, whose performance reflected mainly the decline in exports of the major petroleum exporters among them. In general, the increases in exports to the United States proved insufficient to yield overall increases in the value of export earnings in 1983. In fact, with the sole exception of the major exporters of manufactures, all the other country groups recorded declines in total exports during the year. The rates of decline were particularly pronounced in the case of the petroleum-exporting countries and the African countries experiencing debt difficulties. Moreover, with one exception, the declines in total exports that occurred were accompanied by a fall in imports, and this fall was particularly steep in the case of countries experiencing debt-servicing difficulties.

88. In sum, for the majority of the developing countries, the resumption of economic growth in the United States was not sufficient in itself to yield an overall increase in export earnings during 1983, despite a buoyant rise in sales to that market; nor was it sufficient to allow most countries to avoid a fall in imports. The major exception was the case of the major exporters of manufactures not experiencing debt-servicing difficulties. These countries succeeded in increasing their exports to the United States at a particularly rapid rate, and this translated into an overall rise in export earnings.[18] Thus, for those countries that had, up to 1983, avoided debt problems, the United States recovery was a powerful vehicle for staying on this course.

C. The behaviour of commodity markets

89. For many developing countries the pattern of changes in export earnings in 1983 was determined by the behaviour of commodity prices. Here, the direct impact of recovery in the United States was governed by a number of factors. The impact of recovery in the United States on demand for commodities was determined in part by the importance of the United States in total world trade of the commodities in question. The influence of higher demand on prices, in turn, was determined by supply conditions, and in particular by the current state of stocks. As regards the impact of the United States on demand, as may be seen from table 7, its role in commodity markets is relatively small: Europe has 4 to 5 times the

[18] The developing countries in question are located in the Pacific Basin and have higher-than-average trade links with other countries, developed and developing, in the Basin. This fact, together with the above-average growth of all countries in the Basin, also helped sustain their overall export earnings.

Table 6

Developing countries: exports and imports in 1983
(Percentage increase over 1982, based on values in current dollars)

	EXPORTS		IMPORTS
	Total	*of which to:* United States	Total
Countries with debt-servicing difficulties:			
Latin America *a/*	-0.6	9.2	-27.1
Africa *b/*	-23.2	-40.5	-32.7
Africa excluding Nigeria	-8.5	-4.3	-8.7
Others *c/*	-2.6	10.8	-4.0
Other countries:	-7.7	6.3	-4.5
Major exporters of manufactures *d/*	8.8	24.1	2.1
Major petroleum exporters *e/*	-16.4	-15.0	-9.1
Least developed countries *f/*	-2.6	5.7	-7.0
All other developing countries	-2.6	12.0	-3.8

Source: United Nations trade tapes.

a/ Argentina, Bolivia, Brazil, Chile, Costa Rica, Dominican Republic, Ecuador, Guyana, Jamaica, Mexico, Nicaragua, Peru, Venezuela.
b/ Central African Republic, Ivory Coast, Liberia, Madagascar, Malawi, Nigeria, Senegal, Sierra Leone, Sudan, Togo, Uganda, Zaire, Zambia.
c/ Philippines, Yugoslavia.
d/ Hong Kong, Republic of Korea, Singapore, Taiwan Province of China.
e/ Algeria, Angola, Bahrain, Brunei, Congo, Gabon, Indonesia, Iran (Islamic Republic of), Iraq, Kuwait, Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Trinidad and Tobago, United Arab Emirates.
f/ Excluding Central African Republic, Malawi, Sierra Leone, Sudan, Togo, Uganda.

weight of the United States in these markets. On this score alone, then, one would expect a situation of expansion in North America and relative stagnation in Europe to have had at best a modest impact on prices.

90. In fact at the beginning of 1983, prices of "industrial" commodities, i.e., agricultural raw materials, minerals and ores responded quickly to the increasing demand generated by the economic recovery which was on its way in North America, and to the lowering of nominal interest rates which encouraged the reconstitution of stocks. Expectations of a stronger and wider recovery encouraged speculative buying. However, markets weakened around the middle of the year as clear signs of recovery outside North America failed to materialize and as the existence of producer stocks and/or idle capacity appeared to ensure plentiful and accessible supplies.

91. As regards agricultural commodities, improved price performance reflected primarily restrictions in export supply, resulting both from natural conditions and from national and international policies; such was the case for vegetable oil and oilseeds and for food and tropical beverages (see below).

92. All in all, following a steep two-year drop of more than 30 per cent, the UNCTAD combined price index of non-oil primary commodities exported by developing countries was on average 5.8 per cent higher in 1983 than in

Table 7

Structure of world exports in 1982
(Percentage share by destination, by major commodity groups)

Destination / Commodity group	World	Developed market-economy countries: Total	USA	Europe	Japan	Socialist countries of Eastern Europe	Socialist countries of Asia	Developing countries
All products	100	64.7	12.5	40.8	6.4	8.0	1.1	26.2
All food items	100	60.5	8.4	42.2	7.1	12.0	2.0	25.6
Agricultural raw materials	100	65.2	8.2	42.1	12.0	12.0	4.0	18.9
Ores and metals	100	64.0	12.0	41.0	7.6	11.7	2.0	22.4
Fuels	100	72.1	14.5	41.0	14.0	5.7	0.2	22.0
Manufactured goods	100	63.2	13.0	40.7	2.5	7.4	1.0	28.4

Source: United Nations, *Monthly Bulletin of Statististics*, May 1984.

1982 when measured in current United States dollars, and about 10 per cent higher when measured in terms of SDRs, the difference being explained by the strength of the dollar *vis-a-vis* other currencies. The following paragraphs comment briefly on developments in major individual commodity markets.

1. Food and tropical beverages

93. A shortage in export supply resulting in part from national policies was the main factor which boosted the prices of food and tropical beverages which were on average 5.5 per cent higher in 1983 than in the previous year.

(a) Sugar

94. Unfavourable harvest conditions in the European Economic Community (EEC) in early 1983 gave rise to the expectation of a significant reduction in available supplies of sugar and to a consequent marked increase in sugar prices during May to August. In September, supply prospects improved and since then the price has continued to decline. In the first half of 1984 the price of sugar was 27 per cent less than the 1983 average. For the whole of the 1983-1984 season world production of sugar is likely to be 6 per cent lower than in the preceding season. Nevertheless, there is little prospect of a significant reduction in the substantial stocks (estimated at 40 million tons) which were built up in 1981-1982 and 1982-1983, when world production exceeded 100 million tons per annum. In view of the highly inelastic nature of sugar consumption with respect to both income and price, and of huge stocks and favourable weather conditions in major beet regions in the spring of 1984, the price of sugar is expected to remain at a low level.

(b) Grains

95. In 1983 the price of rice decreased by 5 per cent, and the price of wheat by 1.8 per cent. On the other hand, the price of maize, under the influence of a prolonged heat wave in the United States, together with the implementation of the United States Government's policy of acreage reduction and payments-in-kind, rose by about 21 per cent.

Table 8

Changes in world market prices of primary commodities exported by developing countries, 1981-1984
(Percentage increase over previous year or corresponding period thereof)

	1981	1982	1983	1983 I	1983 II	1983 III	1983 IV	1984 I	1984 IIa/
	Annual			Quarterly					
Food and tropical beverages	-19.7	-18.2	5.5	-12.0	4.4	16.7	18.6	15.9	7.4
Vegetable oilseeds and oils	-3.2	-23.0	23.4	-17.3	-3.0	53.4	72.3	89.5	78.0
Agricultural raw materials	-13.6	-12.3	7.0	-3.0	6.1	10.2	12.9	13.5	0.7
Minerals, ores and metals	-13.6	-11.4	0.0	-5.4	2.4	2.5	-0.8	-1.6	-4.7
Total primary commodities (excluding petroleum)									
Denominated in US dollars	-15.6	-16.1	5.8	-9.0	4.8	14.0	16.2	14.7	7.3
Denominated in SDRs	-7.5	-9.8	9.9	-5.2	8.1	16.5	18.3	20.0	10.8
Crude petroleum	10.2	-4.3	-11.6	-6.0	-13.3	-13.5	-13.5	-9.5	0.0
Manufactures b/	-5.0	-2.0	-4.3	-3.2	-4.3	-4.4	-2.3	...	...

Sources: UNCTAD, *Monthly Commodity Price Bulletin*; United Nations, *Monthly Bulletin of Statistics* (various issues); UNCTAD secretariat calculations.

a/ Estimated.
b/ Price index for exports of manufactures from developed market-economy countries.

(c) Cocoa

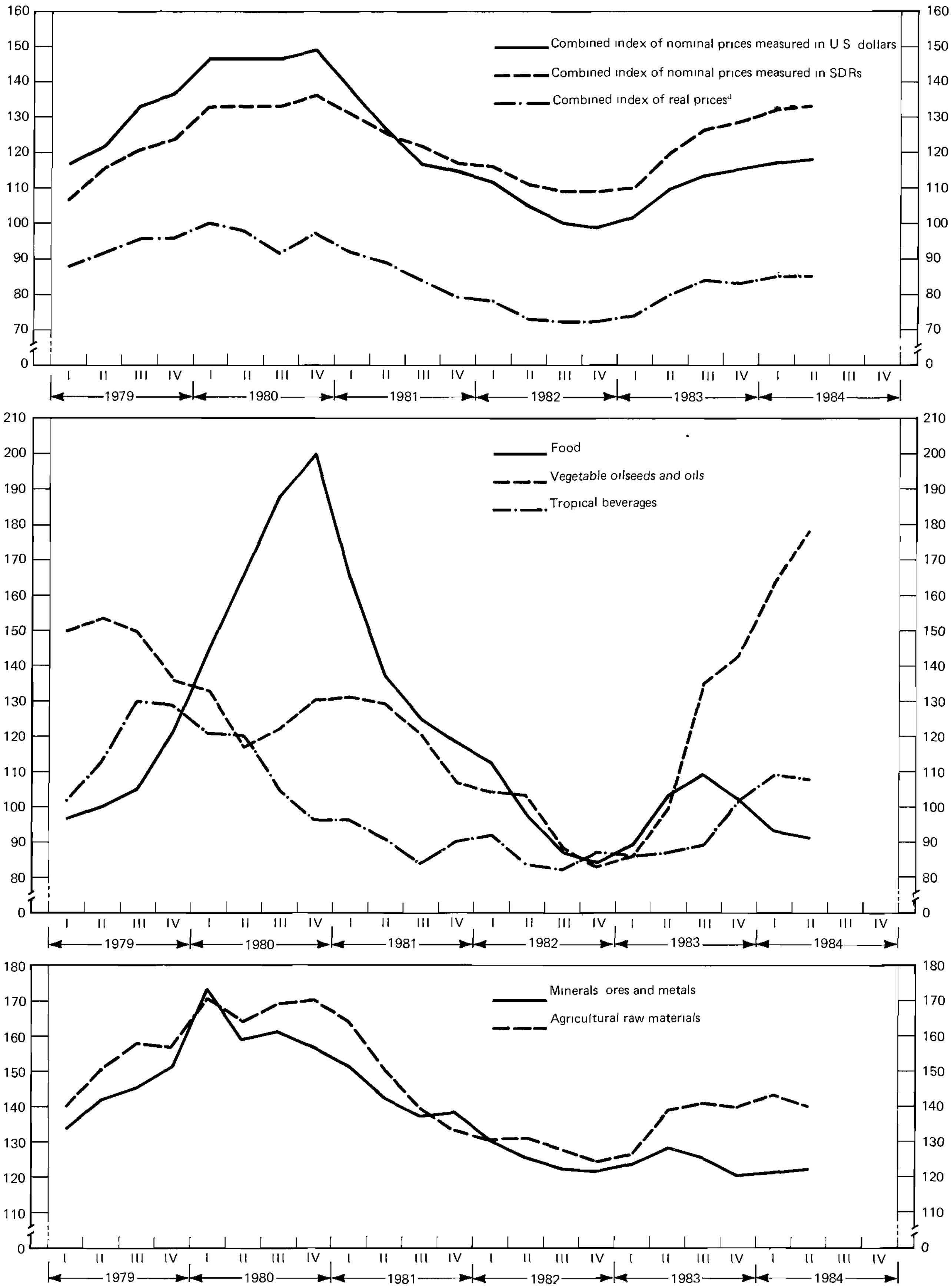
96. A number of different factors contributed to the strengthening of tropical beverage prices in 1983. The price of cocoa rose by about 21.5 per cent as a consequence of the current supply deficit. Drought in the Ivory Coast and bush fires in Nigeria and Ghana severely affected their cocoa production. After five years in which production exceeded consumption, world output of cocoa dropped to 1.5 million tons in 1982-1983 against 1.7 million tons in the previous year. At the same time, consumption of cocoa increased and was running at a level some 105,000 tons higher than production. The 1983-1984 season is again expected to reveal a supply deficit of about 50,000-80,000 tons and thus the price of cocoa, which increased by about 20 per cent in the first half of 1984, is likely to remain at this high level over the whole year.

(d) Coffee

97. Coffee prices remained buoyant throughout the first three quarters of 1983 and increased towards the end of the year. This was due, *inter alia*, to seasonal factors, the low stock level in consumer countries and high tea prices. It should be stressed, however, that the most important factor inhibiting excess supply of coffee was the imposition of tight export quotas under the International Coffee Agreement. With world production running well above world consumption, as well as huge carry-over stocks, estimated to account for 64 per cent of annual demand in the 1983-1984 season, even a frost in Brazil would be less likely to affect prices than in the past. Although coffee prices have continued to rise in the first half of 1984, possible releases in export quotas by the International Coffee Organization may bring this upward trend to an end.

Chart 1

Monthly indices of free market prices of selected primary commodities exported by developing countries
(1975-1977=100)



Source UNCTAD, *Monthly Commodity Price Bulletin*

[a] Combined index in U S dollars divided by the United Nations index of export unit values of manufactured goods

(e) Tea

98. The increased demand for tea engendered by the rebuilding of inventories and the selective Indian ban on tea exports boosted tea prices in the fourth quarter of 1983. Over the last two decades, world tea production grew at an annual rate of about 3 per cent. Since 1980, however, a lower increase in production, of about 2 per cent, has been coupled with higher growth than previously in consumption in producer countries. In 1984, high tea prices are likely to be sustained.

2. Vegetable oilseeds and oils

99. Prices of vegetable oilseeds and oils recovered after three years of depression and experienced the largest percentage increase among all major commodity groups. For the whole group the index in 1983 stood at a level 23 per cent higher than in 1982, owing to a reduction in supply resulting from the United States acreage reduction and weather-related difficulties such as floods in Malaysia which diminished palm oil production by some 20 per cent. Supplies of oilseeds and oil products worldwide remain tight. Prices have continued to rise during the first half of 1984.

3. Agricultural raw materials

100. Prices of agricultural raw materials were on average 7 per cent higher in 1983 than in 1982 and continued to increase in the first half of 1984, during which period the average price was 4 per cent over the 1983 average. There have been two main developments in the raw materials market: a significant increase in the price of natural rubber and a steep drop in timber prices. A fairly high level of rubber prices, which persisted in the first half of 1984, is threatened by the large stocks of some 280,000 tons of surplus rubber held by the buffer stock of the International Rubber Organization which was built up mainly during 1982 in order to prevent prices from collapsing. With the expected recovery in building, and in view of supply constraints based on ecological considerations, the price of timber is likely to rise slightly in the course of 1984.

4. Minerals, ores and metals

101. Despite an increase of about 2 per cent in prices of non-ferrous metals, prices of minerals and metals as a group did not record any changes in 1983, as compared with 1982.

(a) Phosphate rock

102. The price of phosphate rock has declined by about 33 per cent over the last two years. The expectation that the extension of cereal acreage would induce an increase in demand has not yet materialized. The intention to increase the price of phosphate rock announced by major producers early in 1984 was met by resistance from the major buyers and, as a consequence, the price increase is almost negligible.

(b) Copper

103. Stock replenishment in anticipation of a possible stoppage of production in the United States prior to negotiation of new labour contracts boosted the price of copper in the first half of 1983. In the course of the year, copper stocks increased significantly, owing to the reactivation of a substantial proportion of production capacity which had hitherto lain idle. As recovery did not prove to be sufficiently widespread, copper prices declined towards the end of 1983. Although the price of copper remained low during the first half of 1984, rising demand in some developed countries, together with a steady decline in stocks, are likely to brighten the price outlook for the rest of 1984.

(c) Aluminium

104. Aluminium prices rose over the whole of 1983 to a higher level than copper for the first time ever. The most important reason seems to have been the fact that aluminium supplies are controlled by a relatively small

number of major producers who are able to cut back output as much as required in order to bring supply and demand into balance at satisfactory price levels in comparison to production costs.

(d) Lead

105. The price of lead declined in 1983 for the third consecutive year, and even the increased demand for lead during the fourth quarter of 1983 did not improve the market situation. Despite a further moderate increase in lead prices during the first half of 1984, prospects are not very bright. The changeover towards smaller, lighter batteries with a longer life means that less lead is required per unit, and lead used in petrol is also likely to be completely eliminated for environmental reasons.

(e) Zinc

106. After a moderate increase of 2.5 per cent in 1983 over 1982, the price of zinc jumped by about 30 per cent in the first half of 1984 above the average for 1983. However, in June, as expectations returned towards a more balanced supply/demand situation, the price of zinc fell.

5. Crude petroleum

107. With regard to oil, the continuing weakness of world demand during 1983 affected in particular the member States of the Organization of the Petroleum Exporting Countries (OPEC). While world crude oil production was only marginally lower in 1983 than in 1982, production by OPEC members was about 8 per cent down. This resulted in a further reduction of OPEC's share in world petroleum production which, over the last 10 years, has slumped from 53 per cent in 1973 to 32.5 per cent in 1983, and led to a reduction of the official price in March 1983. There were two slight improvements in spot prices, towards the end of November 1983 and in January 1984, but these reflected seasonal fluctuations rather than any changes stemming from increased demand. The expected increase in world demand for oil in 1985 of about 2.5 per cent is unlikely to have any impact on oil prices. In the light of low-capacity utilization, it is felt that the reaction of producers to a heavier demand would be the expansion of production, rather than an increase in prices.

6. Overall prospects

108. In the light of the above overview of recent commodity price movements and the short-term outlook, prices of non-oil commodities exported by developing countries are likely to maintain an upward trend in 1984 and 1985. Although forecasting commodity prices is subject to a wide margin of error, with the deceleration of growth foreseen in the United States for 1984-1985, and the relatively moderate pace of recovery in most of the rest of the industrial world, the non-oil commodity price index is expected to rise less in 1984 and 1985 than in 1983. As unit values of exports of manufactures from developed market-economy countries are expected to increase gradually in 1984 and 1985, the terms of trade of non-oil commodity prices are likely to improve in 1984 and to deteriorate slightly in 1985.

109. For the first and second quarters of 1984, the UNCTAD price index of non-oil primary commodities exported by developing countries, measured in United States dollars, were respectively 14.7 and 7.3 per cent higher than during the corresponding quarters of 1983. These increases, reflecting a further strengthening of tropical beverages and vegetable oil prices, while mineral and metal prices still remain at their depressed levels, seem to indicate a tendency towards a deceleration of the overall rise of prices.

D. International capital markets

110. Whereas economic recovery in North America increased the earnings of developing countries from the export of manufactures, the impact on their economies transmitted through capital markets has so far been decidedly negative. The negative effects have not been confined to the behaviour of interest rates on variable interest

Table 9

Current-account balances: *a/*
major countries and country groups, 1982-1985
(Billions of dollars)

Country or country group	1982	1983 (Estimated)	1984 Forecast	1985 Forecast
Developed market-economy countries *b/*	-4.6	-5.2	-17.8	-23.6
Canada	2.0	0.8	-0.3	-2.5
France	-9.5	-2.0	2.5	3.5
Germany, Fed. Rep. of	10.6	9.0	12.3	13.0
Italy	-5.2	0.5	2.0	0.4
Japan	8.1	22.3	33.0	36.5
United Kingdom	12.4	6.0	6.0	4.0
United States	-3.5	-34.5	-70.2	-79.0
Other countries	-19.7	-7.3	-3.1	0.5
Developing countries *c/*	-88.3	-69.8	-63.6	-56.2
Major oil exporters *d/*	-17.2	-21.4	-20.0	-13.3
Other oil exporters *d/*	-8.2	-7.1	-6.7	-6.9
Net oil-importing countries *d/*	-62.9	-41.3	-36.9	-36.0
Exporters of manufactures *d/*	-21.8	-5.2	-4.2	-3.5
Least developed countries	-8.0	-6.9	-7.3	-8.1
Other net oil-importers	-33.1	-29.2	-25.4	-24.4
China	6.9	3.8	2.0	-0.4
Socialist countries of Eastern Europe *b/*	5.0	9.0	9.0	9.0
Statistical discrepancy *e/*	-81.0	-62.2	-70.4	-71.2

Source: UNCTAD secretariat calculations, based on official national and international sources.

a/ Goods, services and private transfers.

b/ As defined in the UNCTAD *Handbook of International Trade and Development Statistics*, but excluding Yugoslavia.

c/ All countries, territories and areas not included in other groups.

d/ For definition see the general note to annex table A.1.

e/ The statistical discrepancy is composed of a (usually positive) discrepancy on merchandise trade mainly due to timing asymmetries and a negative discrepancy on services reflecting, in the main, under-reporting of interest income, receipts from sales of transportation services, and remittances. While the latter discrepancy has been increasing systematically over time, accounting for the largest part of the overall discrepancy, the timing asymmetry has tended to increase during periods of accelerating inflation and to decline in periods of decelerating inflation. The declining rate of price increases of traded goods in 1982 compared with 1981, which accounted for a reduction in the timing asymmetry, contributed to two-thirds of the overall statistical discrepancy in that year.

rate loans in international markets, although these were the most important. There have also been spillover effects on interest rates associated with officially-guaranteed export credits. Moreover, the improved attractiveness of lending to United States residents as United States interest rates rose has undoubtedly been a contributing factor to the slower increase in foreign bank claims on developing countries which occurred in 1983.

111. High and growing United States demand for investible funds reflects, in part, the growing budget deficit in that country. But it also reflects recent changes in the tax treatment of corporations that have allowed growing private investment demand to emerge in the face of high interest rates.[19] This has introduced a substantial new asymmetry into world financial markets: whereas domestic borrowers and investors in the United States are provided with fiscal mechanisms that offset the impact of higher interest rates, no such mechanism exists elsewhere. While other countries are, at least in principle, also able to give fiscal relief to those who have borrowed abroad, thereby influencing the profitability of investment expressed in domestic currency, there is no way in which borrowers can avoid the full brunt of the higher foreign-exchange transfer that results from high interest rates. Where this transfer is substantial relative to other payments abroad, and where balance-of-payments constraints are an important impediment to growth, as in most developing countries, United States interest rates may have a more immediate impact on output abroad than they do in the United States itself.

112. It is against this background that high interest rates in combination with declining capital flows drastically reduced net financial transfers to developing countries in 1982 and 1983. Together with stagnant export earnings and the strengthening dollar, this placed an increasing number of debtor countries in a situation where they could not meet scheduled payments of debt service without unacceptably large reductions in essential imports. The incipient financial crisis provoked by this situation was initially surmounted as international rescue packages, including official support as well as fresh bank credit, were arranged. None the less, in recent months considerable nervousness spread throughout capital markets as some arrears in interest payments owed to banks in the United States approached 90 days, this being the limit after which United States banks are required to declare a loan as a non-performing asset. This suggests that confidence in the market system has not yet been totally restored and reflects the continuing concern about the magnitude of the unsolved debt problems and uncertainties about interest and exchange rates.

113. Since 1982, activity on the international capital markets has slowed down to an unprecedented extent, the impact being felt the hardest by the non-OPEC developing countries. According to the figures on net asset/liability position of banks reporting to the Bank for International Settlements (BIS), the net flow[20] of banking funds to these countries, which in 1982 had fallen to $15 billion, from $31 billion in 1981, dropped further to only $2 billion in 1983. Since net interest payments by developing countries on assets and liabilities to banks amounted to more than $15 billion during the year, these countries made total net payments to banks of at least $13 billion during 1983. On the other hand, OPEC countries became the largest net recipient of funds. Net flows to them amounted to $23.3 billion in 1983, of which $13.6 billion was accounted for by a contraction in the banks' liabilities *vis-a-vis* these countries. Within the group of developed market-economy countries, the United States became a net recipient of funds, while the other countries reporting to BIS turned into net suppliers. The social-

---

[19] See chapter IV below, section A, 2.

[20] Bank for International Settlements, *International Banking Statistics 1973-1983* (Basle, April 1984), pp. 35-36. Net flows of the banking system are defined as the difference between the changes in the BIS reporting banks' assets and liabilities. This concept is different from the one used in describing net flows in connection with debt. In the latter case net flows in a given time period are defined as disbursements less payments, i.e., change in the assets of banks.

ist countries of Eastern Europe remained net suppliers of funds but net outflows from them were reduced by almost $3 billion.

114. The changes in the net asset/liability positions described above reflect to a large extent the slowdown in net borrowing from the banks. In the case of developing countries, short-term borrowing declined dramatically, while medium- and long-term flows grew primarily as a result of the restructuring agreements reached in 1983. This increase, however, masks the slowdown in new borrowing at medium term in international markets which can be seen from the analysis of gross borrowing in 1983. According to OECD data, gross borrowing on these markets contracted in 1983 to $158 billion from $179 billion in the previous year.[21] A decline in medium-term bank loans by $31 billion was only partly offset by a $1.8 billion increase in foreign bond issues and a $8.1 billion increase in the other international facilities. The contraction among the developed market-economy countries was fairly widespread. As regards the non-oil exporting developing countries, gross borrowing in 1983 amounted to $17.5 billion, compared to $21.9 billion in 1982. Even though rescheduled amounts are included in gross borrowing only to the extent that new loans are extended or financing terms have been changed (i.e., managed loans), the recorded credits are still misleading because of the significant amounts of the "managed" loans. Thus, if such amounts are excluded, "spontaneous" gross borrowing by non-oil exporting developing countries in 1983 came to only $9.7 billion, compared to $21.9 billion in 1982. In addition, the gross borrowing at the rate of $32 billion per year registered during the first quarter of 1984 has been affected by the inclusion of a $6.5 billion loan to Brazil in the context of the IMF-backed rescheduling package. If this amount is excluded, new lending has contracted further to around $6 billion (at an annual rate). Thus, on the whole, it is expected that borrowing on the international capital markets by non-oil exporting developing countries will remain in 1984 at its 1983 level, with a similar proportion of the additional financing being provided again through "managed" loans. Oil-exporting developing countries, in general, are likely to increase their borrowing on the international markets since many of them are not expected to continue to finance their current-account deficits through a further run-down of their existing external assets.

115. Apart from the trends in financing flows discussed above, the overall picture regarding the terms and conditions of finance facing developing countries has become less clear since the average terms and conditions have been influenced by those applied to the "managed" loans. On the whole, the developing countries continued to face the same stiff terms in 1983 as they did in 1982. Average maturity remained at about 7.5 years, with the longer maturity period of the "managed" loans compensating for shorter maturities accepted by some developing countries on newly-arranged loans. Similarly, the average size of loans did not change significantly either. Conversely, the average spreads paid by developing countries have continued to increase, to reach 1.70 percentage points in 1983. The difference between the spreads on new loans to residents of developed market-economy countries and those to residents of non-oil exporting developing countries has also widened steadily, from around 0.3 percentage points in 1980 to over 1.0 in 1983. A reversal of some of the above trends has been observable during the past few months. Among the several factors contributing to it, it seems that the easing of conditions on new "managed" loans has been one of the most important. Other recent features have been longer maturities, with more favourable grace periods, narrower spreads and, in some cases, reduced participation and renegotiation fees. However, the most significant change in recent months has been the rise in interest rates themselves. At end-June 1984 key Euromarket interest rates stood 2 1/2 percentage points above the levels of end-1983, thereby adding, if

[21] These figures include bank loans, wholly or partly out of Eurocurrency funds, traditional foreign and international bond issues and other international medium-term bank facilities, such as stand-by facilities to back up the issue of other financial instruments, as well as precautionary credit lines arranged in the context of take-over bids.

these levels persist throughout the year, more than $6 billion to the gross interest payments due from developing countries, or about $4 billion to their net interest payments.

116. Following the rise in interest rates on international capital markets in 1980 and 1981, OECD governments in June 1982 raised minimum interest rates on export credits for different categories of countries by about 1 percentage point. An exception was made, however, for the poorer countries, constituting Category III, for which interest rates remained at 10 per cent. These higher rates remained in force until October 1983, when, following declines in market rates of interest, a new agreement on minimum interest rates and maximum repayment terms was reached, which reduced interest rates from 0.5 to 0.6 of a percentage point for most developing countries. For countries in Category I (per capita GNP over $4,000) interest rates have been retained at their previous level. For countries in Category II (per capita GNP $681-4,000) interest rates have been reduced from a level of 10.85-11.35 per cent per year to 10.3-10.7 per cent. Finally, the rates applicable to countries in Category III (per capita GNP under $681) have been reduced by one-half of a percentage point to 9.5 per cent per year. The agreement also sets generally applicable rules for extending export credits with official financing support in currencies in which the commercial lending rates are below the relevant minimum matrix rates. Commercial interest reference rates have been established for these "low rate" currencies according to agreed guidelines. These currencies and rates can be used by competitors in all participating countries for the purpose of extending export credits. In all cases, however, a margin of 0.2 per cent is to be added to the relevant reference rate in case of official financial support. An automatic mechanism has been introduced for the adjustment of the minimum interest rates mentioned above every six months in accordance with the movements in a representative international weighted average interest rate. Thus, while it is clear that the reduction in minimum interest rates improves at least temporarily the conditions offered to countries in Categories II and III, it is difficult to assess the impact of the other provisions of the agreement on the situation of developing countries. In general, however, the intended direction of the successive agreements has been towards phasing out the subsidy element in export credits. Thus, terms and conditions for export credits have been gradually losing their attractiveness although, on the whole, they still remain more favourable than those for international bank lending. Furthermore, given the limited scope for bank borrowing by the heavily indebted countries, export credit finance will remain more attractive also because of its wider accessibility, since perceptions of creditworthiness are slower to change and are considerably less important than in the case of bank loans. In recent years the worsening of terms and conditions for export credits has to some extent been mitigated by increased use of "associated financing" (use of aid in association with export credits and other market funds). A tighter control over such arrangements, presently under consideration, would be an important factor in stiffening even further the conditions on export credits.

E. Conclusion

117. The vigorous economic expansion that characterized the economies of North America in 1983, and which is continuing and spreading in 1984, has brought some benefits to developing countries. Earnings from exports to the United States have risen for many of them, sometimes sharply. These improvements, however, have not yet been translated into an improved overall external situation, except for those exporters of manufactures that have been free of debt-servicing difficulties. Generally speaking, the increase in exports to the United States was not sufficient to offset declines in shipments to other markets, which are more important for developing countries. Nor is the United States a sufficiently large importer of primary commodities to have provoked a strong recovery in commodity prices - although the upturn in North America certainly contributed to the more favourable trend in commodity prices evident since early 1983.

118. As recovery spreads to Europe during the course of 1984, its favourable effect on developing country

export earnings should become more pronounced. However, the rise in interest rates, caused by continued rapid economic expansion and persistent fiscal deficits in the United States, will be a factor working in the opposite direction, the extent of which will depend on the course of interest rates during the remainder of 1984 and will also vary greatly from country to country. In Africa the expected rise in export earnings is extremely modest; by and large, however, it will not be offset by rises in interest rates. For countries with large amounts of outstanding debt contracted at variable interest rates, on the other hand, the rise in interest rates will vitiate the impact of higher export earnings. As regards Latin American countries, for example, the increase in export earnings in 1984 might amount to $6-7 billion; but should interest rates in 1984 be on average 2 1/2 percentage points above 1983 - which now appears quite possible - higher interest payments would offset two-thirds of the increase in export earnings.

119. For a large number of developing countries possibilities of increasing imports in 1984 are likely to be extremely modest. Thus, the present and prospective pattern of recovery in the developed market-economy countries, together with present national and international policies, hold little prospect for a resumption of satisfactory growth in those parts of the developing world where recent economic performance has been poor.

Chapter III

DEVELOPING COUNTRIES AND CHINA

A. Developing countries

1. Recent developments and prospects for economic growth in 1984-1985

120. Developing countries in general suffered a further significant economic setback in 1983. Moreover, this setback came on the heels of three years of increasingly severe economic difficulties, which have reduced the resilience of many of their economies and diminished their capacity to bring about the structural adjustments necessary for renewed growth. On the other hand, growth in a number of developing countries in South and East Asia was vigorous in 1983, with output expanding by about 5 per cent.

121. The overall pace and pattern of growth in the developing world in 1983 was greatly influenced by the incidence of debt-servicing difficulties. Countries that had encountered problems in servicing debt and that had been obliged to seek rescheduling, either in 1983 or 1982, were often faced with the task of reducing substantially their current-account deficits, almost invariably in the context of IMF programmes designed to reduce internal as well as external indebtedness. With export growth sluggish, the task of reducing external deficits inevitably fell with particular severity on measures that had the effect of reducing imports and growth. In most countries that had so far been able to avoid rescheduling, on the other hand, the need to reduce external deficits was less acute (if it existed at all) and increased exports allowed some advance in imports and growth. As will be seen in the description that follows, these diverse experiences characterized all groups of countries; they were particularly evident, however, as regards the major exporters of manufactures.

122. In 1983, output in the major exporters of manufactures continued to be modest as output in Brazil, the largest economy in the group, declined, reflecting the cost of adjustment undertaken by the country in view of its payments difficulties. Brazil was able to move its trade balance from a surplus of $0.7 billion in 1982 to one of about $6.5 billion in 1983, mainly by a sharp curtailment of imports. Conversely, the other countries in the group experienced positive growth. In Argentina, modest growth resumed, thanks to a significant increase in industrial output, but in as much as overall output had declined by 11 per cent in 1981-1982, it is still far below its 1980 level. The Asian countries in this category, on the other hand, have performed exceedingly well relative to other countries, reflecting in part the direct benefits of recovery in the United States. (For instance, three-quarters of the Republic of Korea's export growth came from increased exports to the United States.) Their GDP growth rates, which averaged about 5 per cent in 1983, nevertheless remained well below those experienced in the period 1975-1980.

123. The economies of the least developed countries have always faced special problems, with their dependence on the vagaries of weather and on a narrow export base (agriculture accounts for approximately one half of their GDP). Annual growth has been erratic, but during the 1970s it slightly exceeded on average the rate of population growth. During the past two years, due to adverse weather conditions in Africa, as well as in Asia, output growth has dropped further. The situation has been dramatic in some African countries where the drought has persisted for a number of years, and the resulting level of agricultural output has not only reduced exports, but also involved increased commercial imports to meet food needs not covered by food aid.

124. The recession has also affected the pace of economic development in the oil-exporting countries. Oil production and exports in many of these countries have declined since 1979, more particularly in 1981 and 1982, as

the recession in developed market-economy countries, compounded by the impact of energy conservation, increases in production capacity outside the traditional oil-exporting areas and the development of other energy sources, reduced the demand for oil imports from the major oil exporters. By the end of 1983, the payments difficulties faced by some countries had led for the first time to a significant reduction in imports and to the curtailment of development spending on the non-oil sector, in which output also declined for the first time. Thus, in 1983, overall growth became negative.

125. Divergent trends in overall economic activity are evident in the various regions, with growth in the larger countries and in others, changes in the composition of exports. Thus, in countries in the Western Hemisphere output declined in both 1982 and 1983. Although the decline was fairly widespread,[22] the further deterioration observed in 1983 was mainly due to the restrictive policies adopted in Brazil and Mexico, in order to improve their payments positions. In East Asia, if the major exporters of manufactures are excluded, performance has not been above the average for the net oil-importing countries, and furthermore GDP growth has been only half of that recorded during the period 1975-1980. South Asia has been the region most insulated from the recession. While India, with its large weight, necessarily influences importantly the average, in most countries of the group, while growth was lower than for developing countries as a whole during the period 1975-1980, it remained remarkably stable over the period 1981-1983. Growth slowed in 1982 as a result of unfavourable weather conditions in India and other countries, but accelerated again in 1983. The performance of South Asia reflects, amongst other things, the large size of the countries involved, the importance of their domestic sectors, the low external indebtedness of the region (17.1 per cent of their combined GDP in 1982) and a greater dependence on concessional financial flows (the share of concessional debt in total debt was almost 80 per cent in 1982).

126. Output in sub-Saharan Africa (excluding Nigeria), which fell behind population growth, continued to stagnate in 1983. The droughts which have afflicted the region have exacerbated an already dramatic situation, which has been compounded by the serious debt problems facing many of these countries. Their debt, although small in absolute size, corresponds to about 45 per cent of their GDP, and more than 50 per cent of it is non-concessional, reflecting the borrowing undertaken by many countries for the purpose of broadening their productive base in the aftermath of the price increases of mineral raw materials. Hence, the African developing countries have been doubly hurt by the recession, through increased interest rates and the decline in their exports.

127. As regards the outlook for developing countries as a whole in 1984, the prospects that improvements in export earnings will be translated into increased import levels and renewed output growth are limited, as no significant change is expected in net financial flows to them; indeed, they may even decline further. Hence, growth for developing countries as a whole is expected to be around 2.1 per cent in 1984 and 3.7 per cent in 1985, with the recovery spreading very slowly.

2. Social conditions

128. Discouraging as they are, the statistics on overall economic activity, even on a per capita basis, do not adequately portray the difficulties faced by the inhabitants of developing countries. Unfortunately, however, either the data on the impact of the recession are not available or the traditionally used measures respond only with a considerable time lag to economic fluctuations and, therefore, do not reflect short-term changes in social conditions. Hence, any discussion on the effects of recession on social welfare conditions has to be based on fragmentary, selective and qualitative information.

---

[22] Out of 20 countries reported upon by the Economic Commission for Latin America and the Caribbean, 12 experienced actual declines in output in both 1982 and 1983.

129. A report prepared by the Department of International Economic and Social Affairs of the United Nations Secretariat[23] on the progress achieved since 1981 in the area of social development concludes that the available evidence gives a mixed picture. With regard to poverty defined as material or physical deprivation, it stated that progress in global terms has not been entirely blocked by the recent recession. Thus, in some parts of the developing world, notably in Asia, large groups have improved their standard of living. Elsewhere though, particularly in Africa, poverty has increased dramatically. Not only material deprivation, but also insecurity has worsened. In many countries of Latin America both the poor and the middle-income groups have experienced worsening living conditions. Disparities in income and opportunities have widened and only a small fraction of the population has preserved its standard of living. The decline in income not only has reduced current consumption, but also has led to a curtailment of expenditures on social infrastructure, which has a long-term effect in terms of loss of future welfare and increased vulnerability to external shocks. It has been estimated[24] that, in a developing country, a given percentage drop in GNP often leads to a much greater reduction in social expenditure.

130. Employment statistics of developing countries provide limited information because of the large informal sector of their economies.[25] Thus, in the past, economic fluctuations were reflected in under-employment. With growing urbanization and industrialization in the 1970s, employment in the formal sector increased and economic fluctuations have recently come to be more directly reflected in open unemployment. The recession has enlarged such unemployment in the formal sector, in addition to exacerbating the problem of under-employment in the informal sector. Fragmentary data for Latin America show that, out of 13 reporting countries in that region, 8 reported increased urban unemployment in 1983.[26]

131. A strong commitment of developing countries to education and literacy has continued in spite of austerity programmes and budgetary constraints. While, in some countries, education budgets have been scaled down, in others, particularly in Africa and West Asia, levels of spending have been maintained, or even increased. On the other hand, fragmentary evidence suggests that the recent recession has interrupted, if not reversed, the trend of improvement in school attendance. Furthermore, evidence also suggests that attendance at first level, and sometimes even enrolment, levelled off, or declined, in absolute terms during the early 1980s.

132. With regard to health, it appears that disparities in health conditions, which were already high, have increased in countries affected seriously by the recession. While some indicators, like infant mortality (in countries where data exist), have continued to decline, there is evidence that there is a deterioration in other health indicators such as nutrition. For instance, in Costa Rica, the number of children treated for malnutrition has doubled over the past three years and in Brazil the decline in infant mortality has been accompanied by an increasing share of infant deaths due to malnutrition.

3. Trade balances and terms of trade

133. As mentioned earlier, economic deterioration in 1983 was linked to developments in international trade. In that year continued reductions in import volumes and declines in import prices led to an overall decrease in import values for the second year running. On the other hand, growth in export volumes resumed in 1983, but was rather sluggish, first, because faster

[23] "Social aspects of development", report of the Secretary-General (A/39/171-E/1984/54).

[24] UNICEF, *The State of the World's Children, 1984* (New York: Oxford University Press, 1984), chapter 18, p. 142.

[25] For a discussion of the informal sector see the study by the UNCTAD secretariat, "Services and the development process" (TD/B/1008 and Corr.1), annex I, section A.2.

[26] *Summary of the Economic Survey of Latin America, 1983* (E/1984/71), table 5.

export growth of the net oil-importing countries was partly offset by continuing declines in the major oil-exporting countries, and second, because of continued sluggish economic activity in Europe. The terms of trade of developing countries as a whole fell slightly as a result of contradictory movements in terms of trade of oil and non-oil-exporting developing countries.

(a) Imports

134. The increasingly divergent behaviour of imports among the various groups of developing countries is worthy of note. The oil-exporting countries were the only group to suffer an absolute decline in 1983 in import volume as against increases in previous years. With prices falling in 1983 and with the limited prospects for increased oil exports in the near future, imports were reduced, especially in those countries facing balance-of-payments problems, in particular debt-servicing problems. For instance, import volumes fell by more than 60 per cent in Venezuela and by more than 40 per cent, for the second consecutive year, in Mexico. The other net oil exporters were able to maintain imports at approximately the same level as in 1982. As regards net oil-importing countries, a fall in import prices in 1983 permitted these countries to increase somewhat their import volumes, while still keeping import values below their 1982 level. Growth of import volume amounted to about 1.1 per cent and to a large extent was accounted for by the major exporters of manufactures, where the volume increase was 5.1 per cent. The increase was confined essentially to the Asian countries; in Brazil and Argentina there was a decline in the volume of imports, about 16 and 14 per cent, respectively, as a result of cuts made in response to their external financing difficulties. Conversely, the least developed countries, a large number of which are in sub-Saharan Africa, constrained by the combination of continued declines in export growth (see below) and reduced levels of export credits, due in some cases to debt-servicing difficulties, were forced to cut their imports by about 3 per cent for the second consecutive year.

135. The contraction of import volumes in 1983 was common to all regions although there was considerable variation among them. As can be seen from annex table A.2, Latin America and sub-Saharan Africa - two regions in which countries with severe balance-of-payments problems or large exports of oil carry a heavy weight - registered the largest declines in 1983, by 19.1 and 24.5 per cent, respectively. Although the average for each region is heavily influenced by certain large countries, imports fell in most countries of both regions. In North Africa and West Asia, import volumes declined by 6.8 and 10.6 per cent, respectively, reflecting the reductions in oil-exporting countries; imports also fell in South Asia. Only in East Asia was there continued growth, although at rates lower than in 1982.

(b) Exports, terms of trade and purchasing power of exports

136. The overall export performance of developing countries improved slightly in 1983 as export volumes increased by 1.1 per cent; but they remained far below their 1980 levels. Exports from the major oil exporters continued to decrease, but much more slowly than in the two previous years because increased demand in the United States, reflecting both a severe winter and increased economic activity, compensated partly for continued sluggish demand in Europe and the net oil-importing developing countries. Export growth in other oil-exporting countries slowed down, but only slightly, reflecting these countries' gains in market penetration. Export growth in net oil-importing countries fell to 2.8 per cent in 1983, from 4.0 per cent in 1982; were it not for the major exporters of manufactures there would have been an absolute decline. In those countries, export volumes rose by 10.1 per cent, after a slight decline in 1982. However, this growth was still significantly lower than that achieved in the period 1975-1980. The impetus for renewed export growth in 1983 was clearly provided by recovery in the United States, which is a major trading partner of all the countries in the group. Growth was particularly high in the Republic of Korea, Taiwan Province of China and Brazil and more modest in Singapore, Hong Kong and Argentina. On the other hand, export

prices declined in all countries of the group.

137. In contrast to the modest results in export volume growth, the terms of trade of net oil-importing countries showed a fairly significant improvement after five years of continuous decline and a cumulative loss of 24 per cent. This improvement, which has only partly compensated for the previous losses, resulted almost entirely from the reduction in import prices, reflecting the movements in the prices of oil and manufactured imports. The least developed countries were the only ones to register an increase in their export prices, because of the larger share of primary commodities in their total exports. This, however, was not sufficient to offset the decreases in the volume of exports, and the rise in the purchasing power of their exports was thus more limited than the improvement in their terms of trade. In the other groups of net oil-importing countries, the net result of price and volume movements was an increase in the purchasing power of their exports equal to or greater than that of their terms of trade.

(c) Prospects

138. In 1984 the terms of trade of net oil-importing developing countries are expected to further improve, though only modestly, as first, prices of manufactured exports rise more than those of commodities other than oil, and, second, prices of cil stabilize at the end-1983 level. The recovery under way in the developed market-economy countries has improved the outlook for export volume growth and consequently for export earnings. The extent to which these earnings will be able to pay for a higher volume of imports, however, is limited, as no improvement is expected in the terms of trade for developing countries as a whole in 1984 and 1985.

139. Export volume growth is expected to spread to the remaining groups of countries and to average about 4 per cent in 1984. The rise for exporters of manufactures is expected to remain above this average, but somewhat below the growth achieved in 1983. Import volume growth in the net oil-importing countries is expected to be modest, at about 4-5 per cent in 1984, but with considerable variation among countries and regions. In East Asia import volume growth is forecast to be in the range of 5-6 per cent and in South Asia, somewhat lower, owing to import substitution in fuel and improved food supplies. The highest growth in 1984 will be in Latin America, but from relatively low absolute levels after two years of sharp cuts in imports. This growth, however, is expected to slow down to only 2.5 per cent in 1985 as the major countries in the region try to consolidate improvements in their trade balances. Many African countries will have to devote a large share of their increased imports to food; according to FAO, increased allocations of food aid are not yet sufficient to cover the increased food deficit in the drought-ridden countries.

4. The balance of payments

140. In 1982, the current-account balance of developing countries as a whole deteriorated sharply, as the decline in the major oil-exporting countries more than offset the significant improvement in the net oil-importing countries. In 1983, the aggregate deficit declined by more than 20 per cent due almost entirely to the improvement in the current-account position of the net oil-importing countries. Another decline in the overall deficit is expected in 1984, as the position of the major oil exporters improves slightly.

141. The deterioration in the current-account position of the major oil exporters continued in 1982 and, as most countries in the group fell into deficit, the balance for these countries as a whole also turned into deficit. This shift resulted almost entirely from a further significant reduction in their export volumes, whereas imports of goods and services declined only slightly from their 1981 level. In contrast, in 1983 imports declined significantly, thus stabilizing the deficit at about the same level as in the previous year, despite a further reduction in export volumes and a 12 per cent drop in export prices. As already mentioned, it is expected that the recovery in the world economy will result in increases of export volumes in 1984 and of both volumes and prices

in 1985. These changes, along with expected continuing restraint on imports, mainly by those countries facing financing constraints, will lead to further improvements in these countries' current-account balances. Thus, their deficit, which in 1982 and 1983 amounted to $17 billion and $21 billion, respectively, is expected to drop to $13 billion by 1985. The other oil-exporting countries, whose current accounts had all fallen into deficit by 1982, managed to improve their combined position only slightly in 1983. No significant changes are expected for these countries in 1984 and 1985.

142. During the past two years the net oil-importing countries have experienced a considerable improvement in their current-account position. From 1981 to 1983 their combined current-account deficit declined by 38 per cent, to about $41 billion. However, this improvement has been almost entirely due to large-scale import compression rather than to export expansion, with the exception of a small number of countries, traditionally trading with the United States, which were able to benefit from the earlier recovery in the economy of that country. With the improvement in the terms of trade in 1984 and more widespread resumption of exports, the current-account deficit of the net oil-importing countries is expected to improve further in 1984 and to stabilize in 1985.

143. The performance of the various sub-groups of the net oil-importing countries has not been homogeneous over the past two years. Thus, the current-account deficit of the major exporters of manufactures, which include some of the major borrowers, registered an overall reduction of 75 per cent during 1981-1983, most of it in 1983. For this group the improvement in the trade balance was dominated by the increase in export values by 8.1 per cent, with exports increasing significantly in all countries, except Argentina, where export growth was only slight. A smaller part of the improvement was attributable to imports, which decreased by 3.5 per cent, entirely due to declines in Argentina and Brazil. The least developed countries have not been able to improve their current-account balances because import contraction for them means cutting into essential imports. Not having access to commercial lending, these countries have had to practice such adjustment during both recessions. The prospects for these countries remain poor for both 1984 and 1985.

144. In recent years the deficit on account of net investment income has become an increasingly important component of the current-account deficit of developing countries, reflecting both the accumulation of debt, especially debt at variable interest rates, and higher interest rates. In 1983, as both the level of private borrowing and interest rates declined, the deficit in investment income also declined. Arrears in interest payments also contributed to this decline. Given the size of accumulated debt, net outflows on this account will remain fairly high for a number of years, even if interest rates decline, implying that current-account deficits of developing countries have become more difficult to compress, particularly since adjustment through contraction of imports cannot continue much longer. In addition, the unpredictable variability of these payments induced by fluctuations in interest rates, which may not coincide with fluctuations in trade, can offset the effects of any adjustment efforts on the part of developing countries: this was indeed the situation in early 1984.

5. Financing of the current-account deficits of developing countries

145. Since most of the larger current-account surplus countries had deficits in 1982 and 1983, and are expected to continue to do so in the next two years, the classification of developing countries into surplus and deficit ones, for the purpose of financing, which was employed in previous reports in this series, has been abandoned. Since, however, many of the former surplus countries have substantial liquid assets, the financing of their current-account deficits comes from sources different from those of the remaining countries. Therefore, their inclusion among the deficit countries has affected to some extent the overall composition of the sources of financing. For instance, the largest part in the reduction of reserves in 1982 was accounted for by the major oil exporters.

Table 10

Deficit of developing countries: Sources of financing, 1982-1985
(Billions of dollars)

	1982	1983	1984	1985
Current-account deficit	88.3	69.8	63.6	56.2
Increase in official reserves	-31.4	-1.3	5.8	4.0
Total net capital flows	56.9	68.5	69.4	60.2
Official bilateral flows on concessional terms	17.7	18.0	18.5	19.2
Grants *a/*	10.9	11.0	11.5	12.2
Medium- and long-term loans	6.8	7.0	7.0	7.0
Other medium- and long-term official bilateral loans	5.2	5.0	5.2	5.4
Multilateral institutions	11.5	11.5	12.0	12.5
Private flows	57.6	42.5	33.3	26.7
Direct investment	11.6	10.0	10.0	10.0
Export credits	6.7	5.5	5.8	6.2
Bilateral portfolio investment	2.7	1.0	0.5	0.5
Other international bank lending	36.6	26.0	17.0	10.0
Medium- and long-term	22.6	30.0	26.0	10.0
Short-term	14.0	-4.0	-9.0	0.0
IMF lending	5.7	11.1	6.2	2.2
Other capital, unrecorded flows, errors and omissions	-40.8	-19.6	-5.8	-5.8
of which: Flows among developing countries *b/*	-5.5	-5.5	-5.5	-5.5
Memo item:				
Total interest *c/* and profit remittances	43.6	41.6	49.7	57.0
Net transfer	13.3	26.9	19.7	3.2

Source: UNCTAD secretariat calculations, based on international sources.

a/ Excluding technical assistance.
b/ I.e., between countries members of OPEC and other developing countries.
c/ Balance-of-payments basis; excludes interest on short-term debt or on IMF drawings.

146. Despite the reduction of the deficit by approximately $20 billion, associated with the cutback in commercial bank lending, the financing requirements of developing countries remained at the same high level of 1982 as net oil-importing countries sought to rebuild their badly depleted reserves, and as the major oil-exporting countries reduced drawing on their reserves. Thus, while reserves were reduced by $31.4 billion in 1982, withdrawals in 1983 were limited to only $3 billion.

147. Private flows, which declined in absolute terms, accounted for a much smaller share of the total net flows. This trend will continue, since total banking flows are expected to slow down even more in relation to financing requirements. Conversely, net medium- and long-term borrowing has increased, reflecting the effect of restructuring short-term debt into longer maturities and the increased borrowing by the major oil exporters. Of the other private flows, only export credits are expected to grow slightly, with the resumption of import growth in developing countries.

148. The flow of official development assistance (ODA) in the form of concessional loans and grants appears to have increased marginally from 1982 to 1983, and maintaining these levels constant in real terms appears to be as much as

can be expected on present policies, despite the efforts of some Development Assistance Committee (DAC) donors to increase their ODA as a percentage of GNP. Moreover, because of continued current-account deficits in many OPEC countries, no further increase is expected in their net flows to other developing countries. Concessional loans are not expected to change significantly in 1984 and 1985.

149. A sizeable increase in donor disbursements to multilateral agencies in 1982, which reversed the decline in 1981, allowed the latter to maintain the level of their disbursements. On the whole, flows from multilateral lending institutions remained approximately constant in real terms during 1975-1982. However, net flows must have stagnated in 1983. An increase in multilateral loans is expected for 1984 and 1985 with the introduction of the new instruments introduced on co-financing with respect to commercial loans and of the Special Assistance Programme of the World Bank, but this will be partly offset by the reduction in International Development Association (IDA) lending. Thus, the improvement in the balance between IDA loans and regular lending, which occurred in 1983 after an abrupt deterioration in 1982, is expected to be temporary as the new agreement on the seventh replenishment of IDA at the level of $9 billion represents a 24 per cent reduction in real terms from the average annual commitment levels for the sixth replenishment.

150. IMF, continuing its policy of greater participation in balance-of-payments finance which it initiated in the late 1970s, increased significantly its lending in 1983. This increase, however, is considered temporary and, according to the Fund, its lending should be reduced by 1985 to one-fifth of the level achieved in 1983.

151. Private flows are expected to decline gradually from their 1983 level. Hence, the balance between official and private flows in financing the current-account deficit of developing countries as a whole in 1984 and 1985 is expected to change in favour of official flows.

6. Debt and debt service

152. The evolution of debt in developing countries during 1982 and 1983 has been characterized by the contraction of bank lending, essentially of a short-term nature, after the financial difficulties of some of the major borrowers around the middle of August 1982 and the increased number of countries which were forced to seek restructuring of their debts. On the positive side, the decline in nominal interest rates during 1983 has lightened the nominal debt burden of those countries for which a large share of their debt is at variable interest rates, although the improvement was partly offset by the strengthening of the dollar in 1983. Recent upward movements of United States rates have raised fears that the improvement in 1983 was only temporary.

153. As regards borrowing in internal financial markets, the contraction of new flows related mainly to short-term debt. It is estimated that short-term borrowing fell by about 15 per cent in 1983. Medium- and long-term borrowing in these markets continued to grow, reflecting, among other things, the partial conversion of short-term debt to debt with longer maturities. Nevertheless, even for this kind of debt, net borrowing fell short of debt-service payments, thus resulting in a net transfer from developing countries in their transactions with banks of about $7 billion in 1982 and $21 billion in 1983.[27]

154. The increasing number of countries which sought rescheduling in 1982 and 1983 and of those which are expected to seek additional debt reorganization in 1984 suggests that, although a major financial crisis might have been avoided, the debt problem continues to weigh heavily on developing countries despite the vigorous measures which have been undertaken to improve their trade balances.

155. Table 11, which provides data on the evolution of medium- and long-term

[27] Based on World Bank estimates and statistics. The classification of countries used by the World Bank does not correspond completely with that generally used in the present report.

Table 11

Net debtor developing countries: *a/*
net capital flows, debt service and debt-service ratios, 1982-1985
(Billions of dollars)

	1982	1983	1984	1985
Debt outstanding, end of year b/	513.8	568.8	609.0	648.2
Debt service				
Medium- and long-term loans	90.6	83.3	86.7	115.1
IMF lending	2.2	2.8	4.3	6.1
Total	92.8	86.1	91.0	121.2
of which:				
Debt amortization	47.6	43.3	44.0	70.9
Ratios (percentages)				
Medium- and long-term loans outstanding to exports *c/*	161.4	181.3	183.0	179.4
Interest on medium- and long-term loans to exports	14.2	13.6	14.1	13.9
Debt service to exports	29.2	27.4	27.3	33.5

Source: UNCTAD secretariat calculations, based on international sources.

a/ Excluding developing countries, territories or areas with net foreign assets greater than $1 billion in 1982. Those were Brunei, Hong Kong, Iraq, Iran (Islamic Republic of), Kuwait, Lebanon, Libyan Arab Jamahiriya, Saudi Arabia, Singapore, Taiwan Province of China, Trinidad and Tobago and United Arab Emirates.

b/ Medium- and long-term only, including IMF drawings outstanding.

c/ Goods and services.

external debt and related debt-service payments of net-debtor developing countries,[28] shows that the total outstanding and disbursed debt of developing countries will rise at gradually decreasing rates in both 1984 and 1985, to reach $648 billion at the end of 1985. The impact of the recent rescheduling arrangements has been to reduce amortization payments by approximately $45 billion from what they would otherwise have been over the period 1983-1984. Thus, amortization payments, which in 1983 were 9 per cent lower than in 1982, are expected to remain at about the same level in 1984. However, by 1985 these payments, under the assumption of no additional rescheduling, would rise by about $2.7 billion. Interest payments, under the assumption of stabilized interest rates, should continue to increase along with outstanding debt. On the whole, the effect of the combined movements of amortization and interest payments and of export earnings would be to stabilize the ratio of debt service to export earnings in 1984. A reversal of this situation is expected in 1985, since export earnings are unlikely to match the expected rate of growth of debt-service payments. Meeting these payments would therefore imply either further reductions in imports which would jeopardize any significant resumption of growth, or sharply higher gross borrowing, which seems highly unlikely. Substantial debt rescheduling in 1985 would therefore appear to be unavoidable.

[28] For the purpose of the present analysis those countries have been excluded for which the level of debt is closely matched or exceeded by official reserves and other external assets. No such distinction was made for the analyses of the financing of current-account deficits, since most of these countries have exhibited current-account deficits during the past two years.

B. China

156. The significant progress made by the Chinese economy in 1981 and 1982 towards the attainment of the targets set by the country's 1981-1985 Plan continued at the same rapid pace, so that many of the five-year targets had already been achieved by the end of 1983. In 1983 national income grew by 9 per cent, resulting in an average growth rate of more than 7 per cent annually for the period 1981-1983, in contrast to the 4 per cent annual target implied by the Plan. Agriculture enjoyed a second record year and output increased by 10.5 per cent, giving an average growth of 6.6 per cent over the period 1981-1983; within industry, however, heavy industry grew at the rate of 12.4 per cent and light industry at 8.7 per cent, reversing the trend of the previous two years when growth in heavy industry was limited to 2.6 per cent, as compared with a 9.0 per cent growth in light industry, in accordance with the Plan's aim to improve the balance among industrial sectors. Thus, while the growth in both heavy and light industries has surpassed by far the targets set for each sector separately, the resurgence of heavy industry would suggest difficulties in the implementation of the policies intended to reduce the pressure of demand on certain problem sectors, such as energy and transport, and to free resources for their development. For instance, shortages of energy continued, despite an increase of 6.7 per cent in primary energy production and a much higher-than-average growth of most energy equipment (mining equipment: 27.8 per cent; power generating equipment: 66.6 per cent). Electricity output, in particular, increased by 7.2 per cent, but was unable to catch up with demand, and thus about 20 per cent of industrial capacity remained idle.

157. Nevertheless, the country's continued efforts to affect the composition of investment by controlling the scale of capital construction investment have been fruitful. Of total investment in capital construction in 1983, that covered by the national budget increased by 25 per cent, while that covered by local and other sources decreased by 8.3 per cent. Investment from domestic loans was down by 26.3 per cent. With regard to sectoral composition, the proportion of investment in productive projects, outside the energy and transport sectors, decreased from 25.9 per cent in 1982 to 23.9 per cent. Conversely, investment in energy and transport increased its share in total investment from 28.6 per cent in 1982 to 34.4 per cent in 1983. This increase was also at the expense of investment in infrastructure, whose share in total investment thus decreased from 45.5 per cent to 41.7 per cent during the same period.

158. Progress in reducing inflation and returning to a balanced budget has proved more difficult with rapid growth. In 1983 inflation seemed to have picked up as prices of certain commodities, particularly vegetables, fruit and marine products registered fairly large increases. The prices of certain raw materials also rose and the Government was forced to peg them, despite the fact that such increases were considered necessary to bring prices into line with real production costs. The Government deficit, however, has not been eliminated, remaining at the same level as in 1982.

159. After three years of import restraints under the readjustment programme, import volumes increased by 29.4 per cent in 1983. Export volumes, which had increased by 6.6 per cent in 1982, grew further in 1983, but only by 10.5 per cent. In spite of the slower growth of exports relative to imports, the trade balance on a customs basis registered a surplus of $0.8 billion, far below the surplus of $3.0 billion of 1982. Similarly, the surplus on the current account was reduced to about $3.5 billion. These developments seem to indicate that the present current-account surplus is only temporary and that, as China pursues its modernization programme, it may give way to increasing current-account deficits, for which substantial capital flows, both private and in the form of international financial aid, would be needed during the remainder of the decade.

160. Further strong growth of the economy is predicted for 1984. The annual plan sets the growth rate for the whole economy at 6.6 per cent, for the agricultural sector at 1.8 per cent and for industry, mining and energy at 13.2 per cent. Slightly lower rates, with the exception of the agricultural sector, are forecast by the econometric model of China incorporated in project LINK.

Chapter IV

INDUSTRIALIZED COUNTRIES

A. Developed market-economy countries

1. Recent developments

161. Output in developed market-economy countries as a whole grew by 2.3 per cent in 1983, after virtual stagnation in 1982. This expansion reflected, in the main, the sharp improvement in North America, where both the United States and Canada recorded positive growth rates of GDP in 1983, after sizeable declines in 1982. In contrast, the growth performance of two other major developed market-economy countries, in western Europe, was relatively modest, and in a third there was an actual decline of GDP in 1983. The improvement in the growth rate of the smaller developed market-economy countries taken together was also very modest, amounting to an increase over 1982 of only around half a percentage point.

162. The primary stimulus to expansion in 1983 was the fiscal policy pursued in the United States, where the federal budget was expansionary even on a cyclically-adjusted basis. In the other major developed market-economy countries, however, the fiscal stance appears to have tightened during the year, so that in 1983 there was on average no significant change in the budget deficits as a percentage of GNP in the seven major countries.

163. These differences in fiscal stance, and in resulting rates of growth of income and output, generated large shifts in current account of the balance of payments among the developed market-economy countries. The most significant change was the large deterioration in the current account of the United States, estimated at over $30 billion, which was offset to a large extent by the widening Japanese surplus and the reductions in the deficits of France, Italy and the smaller developed market-economy countries during the year.

164. Thus, while lower exports had a negative influence on overall domestic activity, the large deterioration in the trade account of the United States imparted, albeit in an uneven manner, an impetus to activity elsewhere, and markedly in Japan and Canada and some small European economies during 1983. Moreover, signs of inprovement in the export sector also became evident in other western European countries by mid-1983.

165. The recovery of domestic demand in many countries was characterized by higher consumer expenditure, reflecting in part more optimistic consumer expectations and the deferral of purchases during the recession. This growth in consumer spending occurred even when real disposable income advanced slowly or not at all. Thus, household savings rates were estimated to have fallen significantly in many countries in 1983.

166. The expansion of income and output that occurred in 1983 was accompanied by a considerable easing of inflationary pressures. For the developed market-economy countries taken together, inflation rates, as measured by the private consumption deflator, averaged 5.5 per cent in 1983, i.e., about 2 percentage points lower than in 1982. On the other hand, while the unemployment situation improved in some countries, most notably in the United States, it remained a major social pre-occupation.

167. Despite these general trends, 1983 was characterized by considerable diversity of economic experience. The expansion in the United States was quite vigorous.[29] Canada recovered rapidly from the recent recession and the Japanese economy responded strongly to the stimulus provided by exports.

[29] The recent experience of the United States is discussed in section 2 below.

However, activity was sluggish in most western European countries, with the major exceptions of the United Kingdom and the Federal Republic of Germany.

168. Strong demand in the United States spilled over in 1983 into Canada, where consumer demand also revived, in response to declines in interest rates and to the easing of inflation during the year. Real GNP is estimated to have increased by 3 per cent in 1983, after a decline of about 4.5 per cent in 1982.

169. The Japanese economy also strengthened markedly during the course of 1983. Stock reductions by manufacturers appeared to have been completed by the first quarter of the year but, most of all, export performance improved steadily owing in a large part to demand from the United States. Thus, the Japanese trade surplus widened substantially in 1983 in spite of the strengthening of the yen against currencies other than the dollar and of the restraints on imports of a wide range of products from Japan. However, in spite of the stimulus from exports which led to some increase in investment in plant and equipment, total domestic demand remained weak and housebuilding and public investment even declined. GNP is estimated to have increased by about 3 per cent in 1983, as it did in 1982. This increase in output, however, proved insufficient to prevent the unemployment rate from inching upwards in 1983 despite substantial employment growth during the year.

170. In contrast to the situation in North America, economic recovery in western Europe was, on average, very sluggish and GNP is estimated to have increased by about 1 per cent during 1983, after having virtually stagnated in 1982.

171. Those sectors which had been most supportive of expansion during previous recoveries, namely business investment and exports, were not so expansionary in 1983, largely because of the prevailing high rates of interest which, together with the absence of fiscal stimulus, tended to discourage investment. Export performance was dampened by depressed demand from the developing countries, while the impact of recovery in the United States was limited, since western Europe is a less important market than it is for other countries. Nevertheless, the impact of higher demand in the United States began to be felt in some countries by the middle of the year.

172. The growth that did occur in western Europe during 1983 was mainly due to domestic demand, which is estimated to have accounted for up to three-quarters of the growth of output in the European Economic Community (EEC) during the year. Nevertheless, the contribution of net exports was also significant, especially in some small countries outside EEC.

173. Even within western Europe, however, there was much diversity of experience. Among the major developed market-economy countries, the highest growth occurred in the Federal Republic of Germany and the United Kingdom (1.2 and 3.1 per cent, respectively). Activity in the Federal Republic of Germany was supported by a revival of private consumption, which had actually fallen during the preceding two years. This growth in consumption took place in spite of an estimated fall in real incomes, and was thus accompanied by a sizeable drop in the savings rate. Stockbuilding and fixed capital formation also contributed to the growth of demand. In the United Kingdom also private consumption played a prominent role, and there were strong increases in fixed investment (especially housebuilding and construction outside the manufacturing sector) and government consumption.

174. In other EEC countries growth was modest and output actually fell in Italy. In countries other than the members of EEC growth in 1983 exceeded that of the Community.

175. Since growth in EEC was quite modest, average unemployment exceeded 10 per cent in 1983, i.e., about one percentage point higher than in 1982.

2. The role of United States policy and economic performance

176. The current economic upswing in many developed market-economy countries owes much to the vigorous expansion of the United States economy. This expansion has been shaped both as regards its magnitude and its major characteristics by measures taken by

the United States authorities over the past several years to deal with the underlying problems of the United States economy.

177. In the second half of the 1970s, the United States economy grew more slowly than in the 1950s and 1960s. This slowdown was accompanied by a faster rate of inflation, which progressively introduced considerable distortion into the economy. Typical in this respect was the long period of negative real interest rates, which diverted savings from investment in financial assets. As the 1970s came to a close, the view increasingly gained acceptance that the policy stance of the mid-1970s was inadequate and that there was need to bring about a fundamental adjustment of the United States economy in order to restore stability and accelerate growth. A frontal attack on inflation was seen as the key element in this adjustment.

178. These changed perceptions were first reflected in the shift in the stance relating to monetary policy which occurred in late 1979, when the Federal Reserve Bank began setting monetary policy in terms of a target for the growth of monetary aggregates. This resulted in a steep increase in interest rates which, together with the failure to offset the expenditure effects of the oil price increase, provoked a sharp but short recession in the second quarter of 1980. Output growth recovered immediately thereafter and continued to expand, at an uneven rate, until the third quarter of 1981.

179. During the next 15 months - up to the fourth quarter of 1982 - real GNP fell 3 per cent, or at an annual rate of 2.4 per cent (see table 12). By the end of 1982, this downturn had produced the highest rate of unemployment since World War II. Capacity utilization in manufacturing fell to 69 per cent, industrial production having fallen 12 per cent from August 1981 to November 1982.

180. The steepness of this downturn was greatly influenced by the behaviour of United States exports. As may be seen from table 12, the recession as measured by changes in final domestic purchases was much more shallow and much more short-lived than when measured by changes in GNP. Indeed, the fall in United States exports between the third quarter of 1981 and the fourth quarter of 1982 accounts for more than two-thirds of the reduction in real GNP over that period. The situation in the fourth quarter of 1982 is particularly striking: final domestic purchases were rising vigorously, signalling that recovery had already begun, while GNP continued to decline. The financial crisis in developing countries and the sharp reduction in their imports from the United States was a particularly important factor in this situation.

181. The policy package put in place by the United States Government consisted primarily[30] of the Economic Recovery Tax Act of 1981, which reduced personal income taxes by 23 per cent,[31] and the Accelerated Cost Recovery System, which reduced corporate income taxes, mainly through liberalized business depreciation allowances and increased tax investment credits.[32]

182. The impact of these fiscal measures, together with changes in monetary policy, had an important bearing on the timing and character of the United States recovery. As regards fiscal policy, the impact was mainly through lower tax rates; changes in federal expenditure policy since 1981 have altered the composition but have had little effect on total federal outlays other than interest payments.[33] The composition but have had little effect on total Federal outlays stimulative effect of fiscal policy on aggregate demand is best judged in terms of the

[30] The policy approach also called for a substantial easing of government regulations impinging on private corporations.

[31] The Act called for a 5 per cent reduction of income taxes in October 1981 and further 10 per cent reductions in mid-year 1982 and 1983.

[32] It is estimated that a little more than one-fifth of these tax reductions was rescinded or offset by the Tax Equity and Fiscal Responsibility Act of 1982.

[33] The change in composition may itself have had some impact on expansion but this is difficult to ascertain. For example, a given decrease in social outlays by the federal Government may have a more depressive effect on aggregate demand than the stimulative effect of an equal increase in interest payments.

Table 12

The United States recession and recovery: 1978-1983
(Seasonally-adjusted annual rates of change, in per cent)

Year or quarter	GNP *a/*	Final domestic purchases *b/*	Cyclically-adjusted federal deficit *b/*	M1 *c/*	M2 *d/*	Federal funds rate (%)
1978	5.0	4.4	2.2	6.7	4.7	7.9
1979	2.8	2.6	1.6	7.1	8.2	11.2
1980	-0.4	-0.2	2.2	6.5	9.0	13.4
1981						
I	8.7	6.0	1.5	)		
II	0.6	0.2	1.5	) 6.9	11.3	17.2
III	3.5	2.9	2.0	)		
IV	-5.0	-2.4	2.5	) 5.6	8.4	15.6
1982						
I	-5.6	-0.1	2.2	)		
II	1.0	-0.4	2.2	) 5.7	4.6	14.4
III	-1.0	1.0	3.2	)		
IV	-1.3	4.8	4.3	)11.1	14.4	10.2
1983						
I	2.6	1.2	3.4	)		
II	9.7	9.0	3.3	)13.5	11.8	8.7
III	7.6	5.2	4.4	)		
IV	5.0	5.9	-	) 5.6	7.5	9.4

Source: United States Department of Commerce, *Survey of Current Business* (various issues); *Federal Reserve Bulletin* (various issues).

a/ Measured at 1972 prices.

b/ Measured as a percentage of the trend rate of GNP; see Frank de Leeuw and Thomas M. Holloway, "Cyclical adjustment of the federal budget and federal debt", *Survey of Current Business*, December 1983.

c/ Consists of (1) currency outside the Treasury, federal reserve banks and the vaults of commercial banks; (2) travellers' cheques of non-bank issuers; (3) demand deposits at all commercial banks; and (4) negotiable order of withdrawal and automatic transfer service accounts, and demand deposits at mutual savings banks.

d/ M1 plus money-market deposit accounts, savings and time deposits at all depository institutions, repurchase agreements at commercial banks and Eurodollars held by United States residents.

cyclically-adjusted budget deficit. As shown in table 12, on the basis of this measure fiscal policy became more expansionary in the second half of 1982, and once more in the second half of 1983. All in all, the cyclically-adjusted deficit as a proportion of GNP tripled from the first quarter of 1981 to the third quarter of 1983.

183. Around the middle of 1982, it became evident that the rate of inflation had been reduced significantly: consumer prices, which had risen 13.5 per cent in 1980 and 10 per cent in 1981, advanced at an annual rate of only 1.2 per cent in the second half of 1982. At the same time, the Federal Reserve Bank began to relax monetary policy, with money supply (measured on either of the two bases shown in table 12) growing considerably faster than in 1980 and 1981; consequently, the federal funds rate fell steeply, reaching about 9 per cent in

December 1982, as compared with more than 14 per cent in June.

184. The United States economy responded promptly to these stimuli. The 1 July 1982 tax cut in personal income taxes resulted in a reduction in personal tax payments at an annual rate of more than $17 billion in the third quarter. The combination of the tax cut and lower interest rates gave rise to increased consumer expenditure in *late 1982*, *particularly* on housing and automobiles. This turnaround gradually broadened in 1983 to include a vigorous expansion of consumer purchases of all durable goods. As capacity utilization improved, the recovery spread equally into business fixed investment. The turnaround in the United States economy thus reflected the well-understood effects of fiscal stimulus accompanied by some degree of monetary accommodation.

185. The present expansion in the United States economy has a number of features which distinguish it from previous upturns. In the first place, although as mentioned above there was a significant easing up after mid-1982, monetary policy has on the whole remained quite restrictive. The shift of the federal budget into a substantial structural deficit, together with the rapid acceleration of the economy and a sizeable increase in fixed investment, has prevented interest rates from falling as much as they otherwise would have done. Thus, the United States expansion has proceeded in the face of unprecedented levels of real interest rates.

186. Against this background, it is of interest to note that the contribution by business fixed investment to the growth of GNP in 1983 was more than twice as large as in a typical post-war economic recovery. Indeed, gross fixed investment as a whole (i.e., including housing) accounted for 44 per cent of the increase in final domestic expenditure during 1983. The remarkable performance of investment in the face of high interest rates has been made possible by recent fiscal measures, in particular the Accelerated Cost Recovery System. The treatment of interest expenses as tax deductible, together with the changes in depreciation allowances and similar measures which have increased substantially the after-tax real rate of return on investment,[34] together enabled high real interest rates to persist side-by-side with a vigorous expansion of investment.

187. The other salient feature of the current United States expansion is the decline in net exports, which was more than double that observed in the 1975 recovery. This decline was linked to the behaviour of interest rates, which attracted capital flows to the United States, thereby maintaining the value of the dollar *vis-a-vis* other currencies at levels considerably higher than would otherwise have occurred. Together with the strong expansion in demand, this induced a substantial increase in imports.

188. These two salient characteristics of the current United States recovery have important implications for the rest of the world. First, it must now be concluded that a large part of the private sector in the United States has adapted itself to the levels of interest rates that prevailed during 1983. Whereas previously it had been assumed by many observers that a vigorous United States recovery that included substantial growth of investment would require an easing of interest rates to levels below those of early 1983, this did not turn out to be the case.[35]

[34] The Council of Economic Advisors has estimated that the real before-tax rate of return on investment of equity required to provide a 4 per cent real after-tax return would, in 1984, be less than one-half of the 1975-1979 average for investment in construction machinery, general industrial equipment, and transportation equipment. The reduction would be about 30 per cent for industrial buildings. See *Economic Report of the President to the Congress, 1982*, (Washington, D.C., 1982) p. 122 and table 5-5.

[35] This is not to say that high interest rates are without consequences for the real economy in the United States. Among other things, there is evidence that they have had an important influence on the sectoral distribution of new investment; moreover, in the long run persistently high real interest rates would most probably be associated with a lower share of investment in GDP and hence, slower growth of output and employment than would otherwise be the case.

There do not, therefore, appear to be any compelling forces in the United States economy moving it toward lower interest rates in the short term. On the contrary, the experience so far during 1984 has been of a tightening of interest rates in the face of continued vigorous expansion, with federal funds rates at the beginning of June some 3 percentage points above the level of end-December 1983.

189. Second, high interest rates, capital inflows and a strong dollar have enhanced the transmission of United States expansion to other countries through trade, thus creating output, employment and savings in other countries. The high interest rates also attracted savings in other countries to investment in the United States. The behaviour and net impact of these movements varied. For example, the western European economies contributed importantly to the net flow of funds to the United States. The increase in United States imports from western Europe, however, amounted to only $1.5 billion in 1983; during the same period the rise in United States imports from countries in the Pacific Basin (including Canada and Mexico) amounted to $17.3 billion.[36]

190. There is mounting evidence that the highly expansionary stance of United States fiscal policy will pose increasing dangers and difficulties to both the United States and the world economy in the months ahead. With excess capacity declining rapidly and output expanding at an annual rate of 9.7 per cent in the first quarter of 1984, maintenance of the improved performance as regards price inflation required some slowing of the pace of advance. With fiscal policy pitched toward rapid expansion and set to remain there, restraint could be applied only through monetary policy, with the resulting increases in interest rates during 1984 mentioned above. The imbalance in the mix of fiscal and monetary policies that characterized 1981 and 1982 and has persisted in an attenuated form in 1983 is thus being intensified, with all the dangers that are entailed.

191. Yet it is in the interest of the United States itself to regain control over the budget deficit; and the longer this is postponed, the more difficult it will become. As the Council of Economic Advisors has observed, on present policies "the cumulative federal budget deficit would be more than $1,100 billion over the next six years. The annual interest on this extra debt alone would represent a permanent cost equivalent to between 10 per cent and 17 per cent of the personal and corporate tax revenue now projected for 1989".[37]

3. The prospects

192. The uneven pace of economic expansion of the developed market-economy countries in 1983 is likely to persist in 1984. On average, however, the growth of real output of the OECD countries as a whole is expected to accelerate further in 1984 before slackening in 1985.

193. While the unemployment situation may be expected to improve markedly in the United States in the coming months, unemployment rates may increase slightly for EEC as a whole, although some declines seem possible in the United Kingdom and the Federal Republic of Germany. Inflationary pressures are likely to become more pronounced in the United States, in the absence of the moderating influence of favourable factors such as low food prices following the recent unfavourable weather conditions; in contrast, inflation is likely to continue to lessen in western Europe in 1984.

194. The major feature in the movement of the current balance of payments of the OECD countries will probably be the further deterioration of the trade account of the United States in 1984, while Japan is expected to record substantial surpluses during the year.

195. Fiscal policy is expected to continue to be contractionary in general in the major OECD countries in 1984, in spite of an expected move toward expan-

[36] The implications of the United States expansion for the exports of developing countries were examined in detail in chapter II above.

[37] *Economic Report of the President to the Congress, 1984* (Washington, D.C., 1984), p. 37.

sion in the United States.

196. The conditions for rapid growth seem to be present in many countries. Yet, risks and uncertainties are likely to persist as strains, particularly in the financial markets, could intensify and the coming months may witness further interest rate rises. The dangers of accelerating price increases are also very much in evidence, especially in the United States, as already noted.

197. The recent fast growth of the United States economy, combined with a reduction of inflation and an improved employment situation, needs to be reviewed in the context of large excess capacity and high unemployment. Thus, as the margins of unutilized resources become smaller, it may be more and more difficult to maintain the fast pace of expansion without rekindling inflationary pressures. Furthermore, the fast growth of domestic demand has been met to a very large extent by increases in imports. The large trade deficit existed, therefore, side-by-side with the large deficit of the federal budget.

198. Economic conditions in the United States were very buoyant during the early months of 1984: unemployment continued to drop and industrial production continued to expand while orders were strong and retail sales were rising significantly. For the near future, however, the composition of output may be changing as the recovery matures. In particular, despite higher interest rates, business investment in plant and equipment may expand faster than other components of demand owing to good sales performance, rising capacity utilization and improved profits. But activity in some sectors particularly sensitive to interest rates that responded very early during the current recovery, in particular housebuilding, is expected to slow down, as is consumer spending generally. Thus, although real GNP in the United States is expected to expand fairly rapidly in 1984, economic activity as a whole may show increasing weakness towards the end of the year and the rate of growth of real GNP in 1985 is expected to be below that of 1984.

199. Good growth performance is also likely in the other major OECD countries in 1984. In Japan, domestic demand, in particular investment, is expected to continue to receive a strong stimulus from exports. Nevertheless, due to the restrictive stance of government policy, public capital formation may actually decline in 1984. On the other hand, business investment and inventory accumulation are expected to expand significantly as corporate earnings increase. The economic climate also improved in Canada, where the export sector is expected to remain quite strong, on average, in 1984.

200. It has also become apparent during recent months that conditions were becoming more auspicious for economic expansion in the developed market-economy countries of Europe. External demand had become stronger, especially during the second half of 1983, while domestic demand had already improved during the year in several countries. A more buoyant economic climate should thus contribute to stimulating investment, which may be the major factor underpinning economic recovery in 1984. As already pointed out, the resumption of investment, which has been declining during recent years in EEC, could be jeopardized by the behaviour of interest rates, which have continued to remain high in real terms.

201. On the positive side, the constraints imposed on some countries by the imbalances in the government budget and the external payments position also appear to have lessened during recent months. In general, the economic climate was particularly favourable in the countries which had recovered the earliest in 1983, notably the Federal Republic of Germany and the United Kingdom. On the one hand, the United Kingdom will probably experience a rate of expansion of real output well above the average for EEC as a whole. On the other hand, a sharp acceleration in growth is likely in the Federal Republic of Germany, where private consumption is expected to be strong due to an expected increase in labour income and the investment climate is also likely to improve, because of better sales expectations and rising capacity utilization. Further support can also be expected to be provided by fast export growth.

202. Only a modest improvement, however, is expected in France, where economic policy was aimed at consolidating the achievements in the elimination of the external imbalance and the

reduction of inflation. In consequence, the unemployment rate is expected to increase further in 1984.

203. The combined real output of the European OECD countries is expected to grow by 2 per cent in 1984 and by a somewhat higher rate in 1985.

B. Socialist countries of Eastern Europe

204. There is now evidence that a turnaround in economic activity took place during 1981-1982 in the socialist countries of Eastern Europe other than the Soviet Union, while in the latter country growth continued at a moderate pace.

205. The annual rate of growth of net material product (NMP) in the socialist countries of Eastern Europe other than the Soviet Union had been steadily declining from around 6 per cent in the mid-1970s up until 1981, when it turned negative. After a year of stagnation in 1982, NMP grew by 3.4 per cent in 1983. This increase is, in part, the result of growth in Poland after four years of decline (in spite of an increase of 4.5 per cent in 1983, Poland's NMP in that year was about 20 per cent lower than in 1978). However, a recovery is clearly perceptible in the other socialist countries of Eastern Europe also, although it started somewhat later. Annual growth of NMP in the Soviet Union, on the other hand, has been more stable, remaining within the 2-4 per cent range between 1979 and 1983. According to the annual plans for 1984, aggregate NMP of the socialist countries of Eastern Europe as a whole should grow in 1984 at a rate almost identical to that of 3.8 per cent achieved in 1983.

206. Activity in industry and agriculture in the socialist countries of Eastern Europe has broadly followed a similar pattern to that of NMP between 1977 and 1983, although the annual fluctuations were much larger in agriculture than in the industrial sector. Despite more or less unfavourable weather conditions in most of these countries, and particularly severe ones in the central and southern parts of the region, gross agricultural output increased by some 3.2 per cent in 1983. Aggregate gross industrial output increased by 4.1 per cent in 1983 - almost twice as fast as in 1981 and 1982 - although the slower growth in the labour supply continued to be an important constraint. In this respect, the implementation of economic policies to raise efficiency and encourage a shift towards a less capital-intensive pattern of industrial growth by placing greater emphasis on light industry, appears to be an important element in explaining last year's good performance, together with a reduced consumption of energy and raw materials per unit of output and with favourable developments in the foreign trade sector.

207. For most countries of the region separate data on output in 1983 of producer goods on the one hand and consumer goods on the other are not available, but from the evidence for 1981 and 1982 the movement has been in favour of consumer goods. In the case of the Soviet Union, for which more recent data are available, this trend was confirmed in 1983, as production of consumer goods increased by 4.3 per cent, while that of producer goods rose by only 3.9 per cent.

208. Similarly, and as already indicated in part I of the *Trade and Development Report, 1983*,[38] the current five-year plans (1981-1985) of the socialist countries of Eastern Europe call, in general, for a reduction in the ratio of investment to NMP in order to redress the imbalance which has developed between investment and consumer goods. According to the plans, investment should have declined in 1983 by 2 per cent in countries other than the Soviet Union and increased by 3 per cent in the latter. In fact, it rose by nearly 2 per cent for the former group of countries and by 5 per cent in the Soviet Union.

209. For the socialist countries of Eastern Europe as a whole, the salient feature of external trade in 1983, as compared to 1982, was the smaller increase in the value of exports from 6.9 per cent in 1982 to 4.9 per cent in 1983, and the faster rise in imports,

[38] UNCTAD/TDR/3/Rev.1 (United Nations publication, Sales No. E.83.II.D.13 and corrigendum), chapter II, section C.

from 0.9 per cent to 3.4 per cent. It should be stressed, however, that the faster import growth was a result of a reactivation of trade among the countries of the region (including the socialist countries of Asia), which increased by 8.7 per cent in 1983; imports from developed market-economy countries and from developing countries continued to decline, by 4.0 and 0.9 per cent, respectively. However, national experience was varied. In particular, in contrast to the USSR, the growth of exports of the other socialist countries of Eastern Europe accelerated in 1983 (from 4.0 per cent in 1982 to 4.6 per cent in 1983), while in the USSR it slowed down, from 9.5 per cent to 5.1 per cent (see annex table A.5).

210. The terms of trade of the socialist countries of Eastern Europe as a whole deteriorated slightly in 1983; there was a small improvement for the Soviet Union but a somewhat greater deterioration in the other countries. Nevertheless, the trade surplus of these latter countries increased, as it did also in the USSR. Furthermore, it seems that the balance of investment income improved somewhat during the past year. As a consequence, the positive balance on current accounts of the socialist countries of Eastern Europe rose from $5 billion in 1982 to $9 billion in 1983. The trade surplus of these countries with developing countries increased from $9.1 billion in 1982 to $9.8 billion in 1983 ($6 billion for the USSR and $3.8 billion for the other countries), as exports remained virtually stable (1.3 per cent in 1983 against +9.0 per cent in 1982), while imports declined by 0.9 per cent (against a decline of 4.4 per cent in 1982).

211. As in 1983 the generation of a surplus on current account allowed the socialist countries of Eastern Europe to improve markedly their external financial position, as can be seen by the variations in assets and liabilities at BIS reporting banks. During the first three quarters of 1983, the net liabilities of the group as a whole decreased by $3.1 billion. Except for the USSR, the net liabilities of each country decreased (as they did in 1982, with the sole exception of Bulgaria). In the Soviet Union, however, (where they had also decreased in 1982) net liabilities rose during the first three quarters of 1983. The combined net indebtedness of the socialist countries of Eastern Europe to the developed market-economy countries, which may by now stand at around $60 billion, decreased by some $7 billion in 1983. However, it should be stressed that, out of this amount, about $4 billion resulted from the appreciation of the United States dollar against the other currencies, in which a considerable portion of the debt of the socialist countries of Eastern Europe is denominated.

212. Although positive balances on current account in 1982 and 1983 have significantly improved the international financial position of the socialist countries of Eastern Europe, balance-of-payments constraints, which have obviously continued to play a key role in the external sector plans of most of these countries for 1984, are likely to remain a major concern for 1985. Although enlarged trade surpluses figure explicitly among the plan targets of a number of these countries for 1984, likely increases in import demand associated with economic recovery in the socialist countries of Eastern Europe, on the one hand, and possible slowdown in world demand for exports, on the other hand, may lead to a stabilization of the balance on current account around its present level.

Blank page

Page blanche

Part II

THE EVOLUTION OF THE TRADE AND PAYMENTS SYSTEM

Chapter I

INTRODUCTION: THE TREND TOWARDS INCREASED INTERNATIONAL ECONOMIC INTEGRATION

213. The economic performance reported in part I is in large part the direct result of past and present policy decisions and stances taken by the governments of developed and developing countries. But in an open economy, the interaction of national economies and of national policy decisions is of considerable importance in shaping the overall outcome of such decisions. Thus, the operation of the trade and payments system, which shapes this interaction, is of critical importance in determining the performance of national economics.

214. In order to explore the changing role of the trade and payments system, this part of the *Trade and Development Report, 1984* focuses on some of the main lines of evolution which the international monetary, financial and trading systems have undergone in the post-war period, in particular the dramatic changes that have occurred in the last decade. It begins in chapter II with an analysis of the arrangements instituted at the end of the Second World War, including their rationale and objectives and their strengths and their weaknesses. It then proceeds, in chapter III to analyze the evolution of the international trading system and the conflicting trends that are evident in that evolution. Chapter IV chronicles the explosive growth and the subsequent precipitous contraction of bank lending to developing countries and chapter V plots the evolution of multilateral financing. Chapter VI analyzes the character and impact of the floating of the major currencies.

215. Closely connected to the subject matter of chapters III and IV are, respectively, annex D ("The level, costs and effects of protectionist measures") and annex B ("Some aspects of the financing of international trade").

216. The historic transformation in the international monetary, financial and trading systems which are discussed below have been accompanied by other far-reaching and structural changes in the world economy - in levels of income, industrialization and technical sophistication; in the pattern and geographic distribution of production and consumption; in the mechanisms of income generation and resource allocation; in the volume and composition of flows of trade and finance, and so on. A full analysis of the broad changes that have occurred in the world economy is beyond the scope of this report, let alone this part. Nevertheless, in order to appreciate better the significance of the changes in the international monetary, financial and trading systems for the stability and growth of the world economy, and of the developing economies in particular, it is necessary to highlight one particular trend, that towards increased international economic integration (or "interpenetration").

217. Over the last three decades the ratio of exports to gross domestic product (GDP) has doubled, for the world, for the countries members of the Organisation for Economic Co-operation and Development (OECD), and for the developing countries, each taken as a whole; the ratio for the socialist countries of Eastern Europe has also risen significantly. The ratio for Japan has increased moderately, from a quite high initial level, while that for the United States has increased substantially, from an initially low level (see table 13). Thus, for all groups of countries, a much larger share of home output is now accounted for by foreign sales. Consequently, the importance of the influence of effective demand abroad on the level of home output and employment has increased, while that of home demand has decreased, as compared with conditions that prevailed in the

Table 13

Share of exports in GDP
(Percentage, based on data in current dollars)

Year	Developed market-economy countries				Socialist countries *a/*	Developing countries	World
	Total	OECD	USA	Japan			
1950	10.1	9.9	4.5	9.8	..	12.8	10.6
1960	11.7	11.5	5.1	10.8	5.3*b/*	15.6	11.1
1970	13.7	13.5	5.7	10.8	5.8	15.9	12.5
1975	17.6	17.4	8.5	12.8	8.0	24.2	16.9
1980	20.6	20.2	10.2	14.0	8.9	26.8	19.6

Source: Estimates by the UNCTAD secretariat, based on United Nations sources.

a/ Excluding China in 1960 and 1980.
b/ Ratio excludes countries with missing export or GDP data.

immediate post-war period. At the same time, the level of home demand now exerts a greater influence than previously on the level of output and employment abroad. Thus, the "income multiplier" has been increasingly internationalized, and the task of avoiding an excess or deficiency of aggregate demand has become increasingly a global one.

218. Secondly, the competitiveness of a country in foreign trade, its access to foreign markets and the access of others to its home market have become increasingly important influences on the level of home economic activity.

219. Thus, as countries have become more "open" via foreign trade, their chances of experiencing inflation or deflation in response to changes in the macro-economic policies of other countries, or to changes in exchange rates and in protectionism, have increased considerably. In other words, increased economic integration has heightened the potential for expansionary or contractionary impulses to be transmitted across the world economy. In this sense, the potential for instability has increased.

220. Another notable trend has been the decline in the share of the United States in world output, from around half of world GDP up to 1950 to less than a quarter in 1983. However, because, as noted, both the United States and the other major developed market-economy countries have become more "open", the sensitivity of the world economy to fluctuations in the United States has remained strong. Nevertheless, the reduction of the share of the United States in world output has meant that the overall level of world activity cannot be "managed" by a single set of policy makers to the same degree as previously. The chances of the world economy becoming overheated or depressed as a result of an unplanned convergence of the macro-economic policies of the major developed market-economy countries has therefore increased.

221. A third important trend has been the increase in the degree of financial openness of countries, as a result of the widespread dismantling of restrictions on financial flows by the major developed market-economy countries (as well as many other countries). National money and capital markets have increasingly become integrated into a world money and capital market. The money and capital markets of the United States are naturally the predominant force in this world market, not only because of their own depth, breadth and resilience, but also because of the special role of the dollar as a vehicle for international transactions, as a liquid reserve and as a unit of account. Consequently, United States monetary policies and the behaviour and psychology of the private

financial markets of that country have come to exert a stronger influence on other countries.

222. Thus, while the overall impact of United States policies has not lessened greatly in importance for the world as a whole, the significance of the mix of policies has increased perceptibly. Moreover, the consequences of the macro-economic policies of the major developed countries in relation to one another have become much more important.

223. The United States has itself become more exposed to international influences. Moreover, as the weight of the influence exercised by the United States via the financial markets has increased, the feedback effect of its own policies (via, for example, its foreign trade sector and investment income) has increased. The integration of money and financial markets has been accompanied by the internationalization of United States financial institutions, whose portfolios have come to contain an exceptionally high share of liabilities issued by residents of other countries. It has also been accompanied by the internationalization of production, in which the growth in the overseas activities of transnational corporations with their headquarters in the United States and other developed market-economy countries has been a principal component. The financial viability of debtors to United States banks and the pace of economic activity in the host countries of United States transnational corporations have thus come to exert an increasingly important, albeit indirect, influence on the United States economy.

224. More generally, real economic variables in the world economy have come increasingly under the influence of monetary and financial variables. The ability of the regimes governing international monetary, financial and trading relations to blunt the transmission of negative impulses and to propogate positive impulses has thus become a key feature in determining the degree of stability of the world economy and the rhythm of international trade and development.

Chapter II

THE ESTABLISHMENT OF THE POST-WAR SYSTEM

A. Introduction

225. The structure of international economic relations established at the end of the 1939-1945 world war was the outcome of a deliberate attempt to establish mutually supporting systems covering money and finance, international trade, commodity markets, post-war relief and reconstruction, and other major areas of the world economy. Such efforts were deemed indispensable to ensure high and stable levels of activity and employment and the participation of all countries in benefits from the growth of international trade. It was recognized that new institutions, rules and procedures would be needed for this purpose. The economic disruption resulting from the war followed the preceding breakdown of the framework of international economic relations during the depression of the 1930s. Indeed, it was the aim of those responsible for establishing the new systems to avoid a repetition of the inter-war experience of economic instability and depression, an experience widely attributed in part to failures of international co-operation.

B. The experience of the inter-war years

226. The interdependent character of the difficulties encountered in the inter-war period by the international systems of money and finance, trade, and commodity markets was clearly perceived by those who drew up the initial plans for a new post-war structure of international economic relations. The final collapse of the gold standard[39] at the beginning of the 1930s stemmed from destabilizing international capital movements and the effects of the spread of depression. The increases in tariffs in many countries from 1929 onwards were also a response to the depression[40] as well as a reaction to the Hawley-Smoot Tariff Act of the United States in 1930. Moreover, the widespread resort to discriminatory trade and payments arrangements during the 1930s and the use by some countries of competitive devaluation were another part of efforts by governments to insulate their economies from world depression and other adverse external shocks. These disorders accompanied a breakdown of the pattern of international lending of the 1920s, partly as a result of defaults by certain countries on their external debts.

227. Various aspects of the inter-war experience had especially severe effects on both developed and developing countries. For example, international competitiveness in the United Kingdom during much of the 1920s and in France during the first half of the 1930s suffered from overvaluation of the countries' exchange rates, and the consequences were substantial losses in terms of output and employment. Moreover, countries which exported primary commodities were adversely affected by several phenomena associ-

[39] The gold standard of the 1920s was only a vestigial version of that operative before 1914. As one writer has put it, "The cat had slowly faded away: only the gold standard grin remained". (K. W. Dam, *The Rules of the Game. Reform and Evolution in the International Monetary System* (Chicago and London: University of Chicago Press, 1982), p. 55.)

[40] This phenomenon was especially marked in agriculture. For example, as depression in this sector deepened from 1928 onwards, there were very large rises in import duties on wheat in a number of European countries, amounting in one case to more than 350 per cent between the beginning of 1928 and late 1930. (M. S. Gordon, *Barriers to World Trade. A Study of Recent Commercial Policy* (New York: Macmillan, 1941), pp. 22-23.)

ated with the depression and its aftermath. Falls in the prices of such commodities were accompanied by greater stability in the prices of manufactured goods, so that the terms of trade of the former deteriorated. The exporters of primary commodities also faced increased protectionism in the forms of higher tariffs, quotas, and discrimination of various kinds. At the same time as the debt-service capacity of such exporters was being thus undermined, financial flows to them from the major capital markets began to dwindle. Among the results of these countries' worsening position were increasing difficulties in the management of their external payments (leading to steps such as devaluation and the suspension of the gold standard) and the accumulation of abnormally large stocks of certain commodities in the early 1930s.

228. Depression and the accompanying disintegration of international economic relations led to dramatic falls in the value and volume of world trade, and even in 1937, a year of widespread economic recovery, the exports of major trading countries were still lower than in 1929.[41] The resort to discrimination in policies towards trade and external payments, which accompanied this decline, was associated with significant shifts in the pattern and size of trade balances among countries and regions. For example, the fall in world trade from $68.1 billion in 1928 to $46.5 billion in 1938 was associated with a reduction of total balances in the trade between six major regions of the global economy from $12.5 billion (or 18.4 per cent of world trade) to $7.3 billion (or 15.8 per cent of world trade). These figures indicate the significant increase in the importance of agreements designed to achieve balance in bilateral trade.[42]

229. Alongside this fragmentation of the trading system were analogous trends in the distribution of international lending. Thus, while total new bond issues in the capital markets of both France and the United Kingdom fell sharply between the early and the late 1930s, there were sharp rises in the share of such issues going to the governments of, and companies operating in, their colonies.[43]

230. By the end of the 1930s a widespread measure of economic recovery had been achieved. However, except in a few cases, the return to full employment had to await the large increases in expenditure and the economic mobilization resulting from global war. Although there were efforts in the late 1930s at greater international co-operation in the field of exchange rates,[44] discrimination and direct controls were continuing features of international economic relations up to and throughout the war. Moreover, while there was widespread recourse to unorthodox measures in internal as well as external economic policy during the 1930s, the management of aggregate demand was not yet well understood. In addition, traditional modes of thinking (which included in certain circles irrational fears about the likelihood of a resurgence of inflation) militated against a thorough analysis of the depression and resulted in tendencies

[41] See annex B.

[42] See the analysis of the League of Nations study, *The Network of Trade*, in W. Arthur Lewis, *Economic Survey 1919-1939* (London, Boston and Sidney: George Allen and Unwin, 1949), pp. 168-170.

[43] See, for example, D. Gisselquist, *The Political Economics of International Bank Lending* (New York: Praeger, 1981), table 3.6 (which is based on League of Nations sources). New foreign bond issues by France amounted to 4.6 billion French francs in 1933 (of which 1.5 billion French francs were for foreign governments and the remainder for the governments of, and companies in, its colonies) and to 1.1 billion French francs in 1937 (all of it accounted for by colonial borrowers). The fall in new foreign bond issues by the United Kingdom began earlier, their value being 106 million pounds sterling in 1930 (of which about 73.5 million pounds were accounted for by colonial borrowers) and 33 million pounds in 1937 (of which 26 million pounds were accounted for by colonial borrowers). Foreign bond issues by the United States fell to very low levels after 1931.

[44] This co-operation was the outcome of the Tripartite Monetary Agreement of September 1936, initially involving the United Kingdom, the United States and France but subsequently broadened to include some other European countries.

to treat its symptoms rather than its underlying causes. As a result of the inter-war experience, the aims of planning for the post-war structure of international economic relations included the achievement of high rates of employment of labour and other productive resources, the eventual dismantling of most of the apparatus of discrimination in trade and payments which had characterized the 1930s, and the establishment of a system of trade which would give broad scope to market forces. The achievement of these aims was to be underpinned by an international framework of rules, procedures and institutions which would be more comprehensive and more robust than the arrangements for international economic co-operation of the 1920s and the 1930s.

C. The post-war arrangements

231. Preliminary plans for the international economy after the war included the following: an international organization which would be concerned with exchange rates and external payments adjustment, and would provide short-term balance-of-payments financing; an international organization which would finance and promote long-term international investment; international agreement on the stabilization of the prices of primary commodities; measures for reducing trade barriers; the organization of relief and reconstruction; and policies to promote full employment. Initial proposals along these lines underwent much modification in the negotiations during and immediately after the 1939-1945 war. Some areas of the world economy were not covered by the framework of institutions and arrangements eventually negotiated. Nevertheless, the main results, namely the programmes of the United States economic assistance to war-damaged economies, the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), and the General Agreement on Tariffs and Trade (GATT) went a considerable distance towards meeting the original set of objectives.

1. International Monetary Fund

232. The objectives of IMF (as stated in its Articles of Agreement) are to promote international monetary co-operation; to facilitate the expansion and balanced growth of international trade and so to contribute to high levels of employment and resource utilization; to promote stability of exchange rates and to avoid competitive depreciation; to help to establish a multilateral system of payments for current transactions and to eliminate restrictions on external payments; to provide balance-of-payments financing to members in order to enable them to correct external deficits without resort to measures which would damage national or international prosperity; and to reduce the scale of external payments adjustment and shorten its duration.[45]

233. These purposes clearly reflect the determination to avoid a recurrence of the depression and closely associated disintegration of international economic relations of the 1930s. Under the monetary arrangements associated with IMF it was envisaged that exchange rates would be fixed but could be altered to correct "fundamental disequilibria" in the balance of payments. IMF credits were of a temporary nature, providing support to members in handling external deficits which could be reversed in a relatively short period of time. It was intended that exchange restrictions should eventually be removed for current transactions. However, controls on international capital movements were accepted as a normal part of economic policy. There was no mention of trade restrictions in the Articles of Agreement, since this subject was supposed to be covered by the proposed International Trade Organization.[46]

234. In short, the new monetary arrangements were designed to ensure that the international economy's system of money and finance functioned in an orderly manner and promoted high levels of employment and economic

[45] Article I of the Articles of Agreement of the International Monetary Fund.
[46] See section 3 below.

activity worldwide. To facilitate the achievement of these objectives IMF credit would be forthcoming in sufficient amounts and on appropriate terms, while private international financial transactions would be controlled to the extent necessary.

2. International Bank for Reconstruction and Development

235. It was expected that long-term international lending from private sources would revive as conditions in the world economy, especially in the major capital-exporting countries outside the United States, returned to normal. IBRD was established to help to bring about this revival and more generally to supplement private capital flows. Its main initial objective was to assist in the financing of post-war reconstruction. In the longer run its task was to promote investment in developing countries.

236. For these purposes it could make or guarantee loans at medium and long maturities. A major principle underlying IBRD was that of generalizing the risks associated with international investment. Four-fifths of its resources were in the form of capital callable from members to meet obligations for loans and loan guarantees but not directly available for lending. Thus, IBRD was dependent on funds raised from the main capital markets for a substantial part of its lending. This dependence was likely to limit the expansion of its operations until there was a relaxation of restrictions on international financial flows.

3. General Agreement on Tariffs and Trade

237. The framework of rules and procedures for the post-war trade regime were embodied in GATT. This agreement was the outcome of negotiations whose initial objectives were considerably more ambitious than the final results. At the first session of the Economic and Social Council, in February 1946, it was decided unanimously to convene a United Nations Conference on Trade and Employment with the purpose of drafting a charter for an international trade organization and also to pursue negotiations for reductions in tariffs. A Preparatory Committee was established to draft a charter for such an organization.

238. The Havana Charter of 1948 contained a wide range of commitments in the areas of employment, economic development and reconstruction, stabilization of commodity markets and restrictive business practices, in addition to commercial policy. It also provided for the establishment of an organization with extensive powers in all the areas falling within its competence and capable of taking initiatives on such issues. The Charter envisaged that certain disputes arising among Member States could be referred to the International Court of Justice. The International Trade Organization (ITO), however, did not come into being, since the major economic power at the time, the United States, failed to deposit its instrument of acceptance of the Havana Charter.[47] However, it was decided to apply the commercial policy chapter which had been drafted by the Preparatory Committee (the General Agreement on Tariffs and Trade) on a provisional basis. The other areas of the Havana Charter were addressed in other international organizations, notably UNCTAD, in the field of primary products and restrictive business practices. The international community's commitment to the principles of the Havana Charter was reaffirmed in certain recommendations of the Economic and Social Council, as well as in GATT article XXIX:1.

239. GATT was designed, primarily, for a market-oriented economic system under which the difference between international and domestic prices would be the main determinant of international trade flows. The tariff was to become the accepted device for regulating import competition. Quantitative restrictions were prohibited in principle but could be applied in strictly limited, carefully defined circumstances. Resort to other non-

[47] The activist nature of the proposed International Trade Organization, as provided in the Havana Charter, was one of the main reasons why the Charter failed to win approval from the United States Congress.

tariff measures was limited to the extent necessary to protect the value of tariff concessions. "National treatment", as defined in GATT article III, ensured that, once goods passed the frontier, they would not be subject to measures of a discriminatory nature *vis-a-vis* those domestically produced.

240. Tariff concessions were to be extended to all Contracting Parties on an unconditional most-favoured-nation (MFN) basis (article I) and were to be "bound" in the tariff schedules of concessions. These concessional tariff rates could be raised only after renegotiation with the principal supplying countries and with those holding the "initial negotiating rights". The General Agreement served to standardize and multilateralize the unconditional MFN clause as it had been applied in a number of bilateral trade agreements before the 1939-1945 war. It altered, however, the nature of tariff concessions in that such concessions became the collective right of the Contracting Parties. This was signalled by the provision that the principal supplying country acquired negotiating rights with respect to any modification in the concessions, regardless of which country had negotiated them.

241. As in the case of IMF, the principles underlying GATT reflected a determination to avoid a recurrence of the experience of the 1930s. Moreover, the trade regimes of earlier periods during which world trade had expanded, particularly the second half of the nineteenth century, were also taken into account. It was clearly the view of the drafters of the General Agreement that bilateral approaches to reciprocity, the "conditional" application of most-favoured-nation treatment, the resort to quantitative restrictions (especially when balanced on a bilateral basis) and the use of autonomous rather than concessional tariffs had all contributed to the failure of the international trading system of the 1920s and 1930s to resist the strains of the world economic crisis of the time.

242. It was not envisaged, however, that the tariff-bound GATT system would stand alone. Its operations were seen as complementing those of IMF and IBRD. In addition, it was to be supported by contractual obligations in the other major areas of economic relations included in the Havana Charter. A fundamental obligation envisaged in the Charter was that all Member States would attribute top priority to full employment in their economic policies, the achievement of which was considered to be a necessary pre-condition for the achievement of the Charter's objectives, including the expansion of international trade.

4. The absence of arrangements for stabilizing the prices of primary commodities

243. As noted above, the depression of the 1930s had particularly severe effects on producers of primary commodities. Indeed, the collapse of commodity prices not only was associated with widespread hardship in both developed and developing countries but also significantly contributed to international financial collapse owing to the unsustainable pressures put on the external payments position of countries depending heavily on commodity exports. As a result, the stabilization of commodity prices was an important part of initial planning for the post-war structure of international economic relations. Indeed, in 1942 Keynes put forward proposals for the creation of a new international commodity stabilization agency which through buying for, and selling from, stocks of commodities would smooth the price movements arising from fluctuations in world supply and demand.[48] Moreover, the failure to establish the ITO, which would have dealt with the stabilization of commodity prices, meant that the post-war arrangements for international economic relations contained no mechanisms for dealing with fluctuations in commodity prices as such.

[48] The different drafts of Keynes' proposals concerning primary commodities are given in D. Moggridge (ed), *Collected Writings of John Maynard Keynes*, Vol.XXVI - *Activities 1940-1946. Shaping the post-war World: Employment and Commodities* (London...: Macmillan, New York: Cambridge University Press, 1980), pp. 105-199. (The draft of 14 April 1942 was reprinted in *Journal of International Economics*, August 1974.)

5. Comments on the post-war framework of international economic relations

244. The framework for international economic relations which emerged from the process of planning and negotiations during and immediately after the 1939-1945 war contained a number of major weaknesses and omissions. Some of these were already obvious to observers at the time of its creation but others only became evident later.

245. One important shortcoming of the framework was that, despite the reference to full employment among the aims of IMF, there were no mechanisms to encourage countries to maintain high levels of economic activity or to discourage them from failing to do so. Closely related to this shortcoming was the lack of any means of inducing countries with persistent balance-of-payments surpluses to reduce them by reflation, appreciation of their currencies, or other means.[49] The resulting asymmetry in the pressures which might be brought to bear on deficit and surplus countries was a potential source of deflationary bias in the world economy.

246. Another shortcoming concerned the role of the dollar as the principal reserve currency. Under Keynes' plan for an International Clearing Union[50] countries would have settled balances in their international trade and payments either through the use of overdraft facilities provided by the Clearing Union or through transfers of gold. There would have been no place for official reserves of national currencies. However, under the post-war international financial system which actually emerged, the United States dollar became the principal reserve asset. Indeed, owing to the slow growth of the world's stock of monetary gold, a large part of additions to reserves were in the form of dollars. This role for the dollar had certain drawbacks. Since the growth of international reserves was closely associated with a deterioration of the net reserve position of the United States (that is to say, the difference between its external reserves and liquid liabilities), the international financial system became increasingly vulnerable to the disrupting effects of possible losses of confidence in the dollar.[51] Moreover, the system (the dollar-exchange standard) was based on a rigid link between the dollar and gold, so that it was impossible for the United States to alter its exchange rate without breaking that link. Thus, the adjustment of exchange rates required by changes in economic policy and levels of economic activity in the United States had to be undertaken by the rest of the world, and this proved difficult to achieve.

247. Further shortcomings of the new framework concerned provisions for the growth of world liquidity. In Keynes' plan this growth would have resulted from the use of the overdraft facilities of the Clearing Union (subject to conditions, and within limits, established by multilateral agreement) and from increases in the stock of monetary gold. The arrangements actually adopted gave less scope than Keynes' plan for increases in official reserves in response to demand. The total supply of credit available from IMF depended on the size of quotas and on periodic legislative decisions to increase them. These decisions were of a discretionary nature and linked less directly than in Keynes' plan to the size of world trade or payments.[52] The question of the conditions attached to the use of Fund credits was left unresolved and has been the subject of a series of subsequent decisions. In the event, much of the growth of world

---

[49] In principle, action might be taken against a country with a persistent surplus in its external payments under the "scarce currency" clause of IMF. Thus, under article VII, section 3, of IMF's Articles of Agreement, members can be authorized to impose exchange restrictions on operations in a currency declared scarce by the Fund. This clause was originally a response to fears concerning a post-war shortage of United States dollars and has never actually been used.

[50] *Proposals for an International Clearing Union*, Cmd. 6437 (London: H.M. Stationery Office, 1943).

[51] See also chapter IV below.

[52] Keynes' plan intended that the overdraft facilities of the International Clearing Union should be expanded in line with world trade.

liquidity has taken place outside the arrangements associated with IMF. In the early years after 1945 IMF was largely bypassed owing to such phenomena as the establishment of various temporary arrangements for international financing among certain western European countries. Later, increasing importance was assumed by finance from the private capital markets, which was an alternative to official liquidity and not subject to official control.[53]

248. Other major omissions of the post-war arrangements for international economic relations were due to the failure to adopt the agenda of the Havana Charter and in particular to give adequate consideration to the international actions required to assist economic and social progress in developing countries. Moreover, the arrangements did not include the socialist countries of Eastern Europe, which evolved parallel systems of their own for their mutual economic relations.

249. Attention has already been drawn to one consequence of these omissions, namely the absence of arrangements for the stabilization of the prices of primary commodities. Another consequence was that much of the framework of economic relations between developed and developing countries has had to be created on an *ad hoc* basis in response to particular problems as they arose. During this process there has for the most part been a failure to relate the overall functioning of the world economy to different aspects of development in developing countries and of the measures required to accelerate it.

[53] See chapter IV below.

Chapter III

THE EVOLUTION OF THE INTERNATIONAL TRADING SYSTEM

A. Introduction

250. The post-war regime for trade and payments was predicated on the belief that a monetary system based on convertible currencies at fixed exchange rates would provide a stable environment conducive to trade and investment, while providing disciplines to prevent countries from circumventing their trade obligations through actions such as the competitive devaluations which had caused so much havoc in the 1930s. Under the Bretton Woods agreements a new framework for international co-operation in the field of money and finance (described in the previous chapter) was established. This framework was intended to support the new regime for international trade which, under the aegis of the General Agreement on Tariffs and Trade (GATT), was to be based upon the tariff as the only legitimate trade policy measure. Other trade measures affecting quantities or the fixing of prices of imports were prohibited except in certain, clearly defined circumstances, including balance-of-payments difficulties (articles XII and XVIII of GATT). Trade negotiations were primarily to be addressed to exchange of tariff concessions, i.e., tariff reductions and "bindings" against tariff increases extended on a multilateral basis under the unconditional most-favoured-nation (MFN) clause.

251. During the early years of GATT a series of tariff negotiating rounds were held (Geneva, 1947; Annecy, 1949; Torquay, 1951), their principal result being the "binding" of a large number of tariff rates. The negotiating mechanism used during this period was essentially that of requests and offers being exchanged between principal suppliers of individual products and plurilateral negotiations which included "substantial" suppliers, which concluded when parties were generally satisfied that reciprocity had been achieved. The resulting tariff concessions were incorporated in the GATT schedules of the countries concerned (as an Annex to article II of GATT) and extended to all other Contracting Parties on the basis of article I, the unconditional most-favoured-nation clause. It should be borne in mind that the General Agreement did not require reciprocity to be a necessary condition for trade negotiations. The need for reciprocity resulted from domestic political considerations in particular countries.[54] The initial multilateral tariff negotiating rounds seem to have had little immediate economic impact. First, the tariff rates, although bound, were still very high. Moreover, in most European countries quantitative restrictions applied for balance-of-payments reasons provided additional protection, and these countries, devastated by war, were not in any position to supply many products to the unrestricted United States and Canadian markets. These early GATT rounds did, however, consolidate the tariff-based multilateral system.

---

[54] It is in the domestic context that there appears to be a tendency to return to the more narrow approach to reciprocity which threatens to erode what is perhaps the most positive attribute of the GATT system. Pressures exist to present reciprocity in terms of bilateral trade balances, and the "free ride" argument traditionally used by the opponents of the MFN principle is coming back into fashion. For a further discussion of this aspect, see William R. Cline: "Reciprocity, A New Approach to World Trade Policy?", in W.R. Cline (ed), *Trade Policy in the 1980s* (Washington, D.C., Institute for International Economics, 1983 - distributed by MIT Press/Cambridge, London).

252. The return to currency convertibility in Europe in the late 1950s led to the elimination of the quantitative restrictions which had been imposed after the war for balance-of-payments reasons (although a few residual "hard-core" exchange control restrictions remained much longer).

253. Tariff liberalization continued on a multilateral and regional basis during the later 1950s and early 1960s, developments in Europe (i.e., the formation of the European Free Trade Association (EFTA) and the European Economic Community (EEC)) greatly overshadowing the GATT "Dillon Round" of 1960-1961. In 1962, with the passage of the Trade Expansion Act in the United States, the "Kennedy Round" was begun. This Act reflected the concern of the United States to reduce the extent of tariff discrimination arising out of the liberalization within Europe. This round saw, for the first time, multilateral tariff reductions based on a "formula" for general tariff reduction, negotiations being confined essentially to the exceptions. Such negotiations were greatly facilitated by the participation of the European Economic Community (EEC) as a single negotiating unit, which reduced the number of active participants and facilitated "calculations" of reciprocity.

254. In the late 1960s (i.e., at the second session of UNCTAD, in 1968) developed countries agreed to introduce tariff preferences for developing countries. At that time, the main concern of the donor countries was not the effect of such preferences on trade flows, but the possibility that they might somehow be used as an argument to impede further tariff reductions on an MFN basis.

255. The "Smithsonian" agreements of 1972, which were designed to restore a measure of order to the international monetary system after the events of August 1971 (when the United States ended the link between the dollar and gold) also included provision for a new round of multilateral trade negotiations (MTNs). The Tokyo Round of 1973-1979 resulted in a further reduction of tariff rates, again through the application of a general formula. The post-Tokyo-Round average tariff rates for industrial products, on which most developed countries have agreed to advance implementation, are less than 7 per cent.[55]

256. As an overall assessment, it is clear that considerable progress has been made in the liberalization of tariff barriers to international trade through the series of multilateral negotiations under GATT. As a result of these negotiations, as well as some unilateral actions by individual developed countries, the average level of industrial tariffs has been reduced from about 40 per cent in the mid-1930s to under 7 per cent after the Tokyo Round. However, the result of these rounds of tariff reduction has varied greatly across sectors. On the one hand, tariff liberalization has been most complete in sectors characterized by a high degree of internationalization of production supporting the "horizontal" division of labour among the developed market-economy countries,[56] resulting in a growth of horizontal "intra-industry" trade which has outstripped the growth of inter-sectoral trade and which has come to dominate the trade among the industrialized countries. An interesting example of liberalization, based on industry initiatives, was that of civil aircraft, where all tariffs were removed as a result of a sectoral agreement reached in the Tokyo Round.[57] Tariff liberalization, however, was resisted in certain sectors, notably agriculture, textiles, clothing and footwear, and leather goods, partly because these products were excluded from the initial negotiating mandates, and also because developing countries, the principal

[55] Weighted for the tariffs of those countries which negotiated on the basis of the tariff-reduction formula.

[56] See S. Rossen: "Notes on Rules and Mechanisms Covering International Economic Relations", DERAP Publications, Bergen (Norway) 1981.

[57] Agreement on Trade in Civil Aircraft, (GATT, *Basic Instruments and Selected Documents, Twenty-sixth Supplement*(Sales No. GATT/1980-3).

suppliers of some of these products, had not participated in the tariff negotiations on a formula basis.

257. Again, tariffs were cut more heavily on manufactured goods (in accordance with the trading interest of the developed countries), with the effect of creating escalating tariff structures that provide effective protection to raw material processing facilities in the major industrial countries from competition from developing countries anxious to process their own raw materials. This has occurred despite the initiatives over several rounds by exporters, both developed and developing, to negotiate the removal of barriers within "vertical industries".[58] Nevertheless, some vertical intra-industry trade has been developed in certain sectors between developed and developing countries outside the GATT liberalization scenario, both at the initiative of governments and of private enterprise, involving such devices as international sub-contracting, industrial collaboration arrangements, etc., supported by the existence of value-added tariffs, such as exist in the European Economic Community (EEC) and the United States tariff provisions under items 806.30 and 807.00, as well as under the generalized system of preferences (GSP) itself.[59]

258. In a historical context it seems clear that several factors contributed towards providing a suitable environment for the negotiation of reductions in tariff barriers. First, economic conditions over most of the period extending from the mid-1950s to the early 1970s were generally favourable for liberalization efforts as both inflation and unemployment rates in the developed countries averaged about 4-5 per cent per annum. In such buoyant conditions expanding exports, in particular of manufactures, from traditional and new suppliers were accommodated and structural adjustment was facilitated without major adverse effects on the liberalization process. As noted, an important exception was the textile sector, where problems were evident in the mid-1950s. Secondly, there was a general consensus in the international community concerning the benefits associated with freer trade and this provided an important stimulus to liberalization efforts. Thirdly, the fixed exchange-rate regimes that generally prevailed among industrial countries also worked in favour of the tariff-cutting effort. With exchange rates fixed, participants in the multilateral trade negotiations could predict the full extent to which the competitive position of domestic industries would be affected by tariff cuts without having to be unduly concerned with other exogenous factors.

259. Thus, the combination of a favourable economic environment, the post-war consensus on economic policies and the multilateral institutions provided a favourable climate of certainty in which investment and trade could take place and expand. However, it needs to be added that, whereas considerable progress was achieved in respect of tariff liberalization, the same was not true of non-tariff barriers (NTBs), which became more important in both relative and absolute terms.[60] Indeed, there is no doubt that the existence of such barriers provided an additional screen or insurance which made it possible for governments to be more flexible in the various tariff-cutting rounds.

260. One reason for the lack of progress in liberalizing NTBs, or restraining their increased frequency of application, rests on the fact that the

[58] *The Tokyo Round of Multilateral Trade Negotiations: Supplementary Report by the Director-General of GATT*, January 1980.

[59] For a discussion see S. Laird, "Intra-industry trade and the expansion, diversification and integration of the trade of developing countries", *Trade and Development. An UNCTAD Review*, No. 3, Winter 1981 (United Nations publication, Sales No. E.82.II.D.3).

[60] See G. C. Hufbauer, "Subsidy Issues after the Tokyo Round" in W.R. Cline (ed) *Trade Policy in the 1980s, op. cit.*, where it is shown that there has been a general upward drift in the importance of subsidies since the early 1950s in the major developed countries.

approach through multilateral trade negotiations, which was used successfully for the reduction of tariffs, has generally not proved workable for these measures.[61] The lack of progress is partly due to the wide variety of non-tariff barriers applied, the difficulty in empirically assessing their trade effects or *ad valorem* incidence, and to the fact that centralized records on their application have not generally been available.[62] This contrasts with the situation concerning tariffs, whose *ad valorem* incidence is generally readily available or can be easily estimated in the case of specific (i.e., fixed-charge-per-unit) import duties.

261. Various other factors have also contributed to the changing nature of protection in developed countries. Especially important has been the use of barriers that both shield domestic producers from more efficient foreign suppliers and also insulate domestic markets from disequilibrating shocks that occur in external markets. For example, in the countries of western Europe (EEC, Sweden and Switzerland) variable import levies have a joint protection and domestic price stabilization effect, since these import charges are set at a level to afford an often sizeable margin of protection for domestic producers and are then allowed to fluctuate in a manner to offset any subsequent variations in international prices. However, it is clear that increases of other non-tariff barriers have been made by industrial countries in efforts to achieve a wide variety of national policy objectives.

262. Table 14 provides some summary statistics which document the proliferation of these non-tariff trade interventions and also illustrate their differing incidence on various exports. Using the UNCTAD Inventory on Non-tariff Measures as the data source, the table shows the share of selected developed market-economy countries' total 1980 imports subject to different forms of non-tariff measures.[63] Two key points emerge from these statistics. First, it is clear that these interventions play an important role in regulating international trade, since, for example, they are applied to approximately one-quarter of Switzerland's total imports and more than one-tenth of the imports of Japan, Norway and the European Economic Commu-

[61] The Tokyo Round resulted in codes relating to the use of subsidies and the imposition of countervailing charges, import licensing procedures, government procurement policies, and technical barriers to trade. For an analysis of the implications of these measures on the trade of developing countries, see the report by the Secretary-General of UNCTAD, *Assessment of the Results of the Multilateral Trade Negotiations*(TD/B/778/Rev.1), chapter II, section C, and "The influence of protectionism on trade in primary and processed commodities: the results of the multilateral trade negotiations and areas for further international co-operative action", Report by the UNCTAD secretariat (TD/B/C.1/207/Add.2).

[62] Work within the secretariat on the UNCTAD inventory of non-tariff barriers is specifically intended to fill this information gap, and to provide essential data for improving transparency in world trading conditions, as well as to service future efforts aimed at trade liberalization. Specifically, the inventory consists of computerized records which document the non-tariff measures currently applied by 45 developed and developing countries. For a description of the procedures employed in compiling this extensive inventory, as well as examples of potential applications, see "Non-tariff barriers affecting the trade of developing countries and transparency in world trading conditions: the inventory of non-tariff barriers", Report by the UNCTAD secretariat (TD/B/940).

[63] It should be noted that there is reason to believe that these trade coverage ratios may understate the actual importance of non-tariff measures. Specifically, the trade coverage index suffers from the fact that items which are subject to very restrictive trade barriers are automatically afforded zero or very low weights in the overall coverage index value.

Table 14

Share of selected developed market-economy countries' imports subject to non-tariff barriers: total imports by major groups of exporters *a/*

Importer \ Exporter	United States	Japan	EEC	Switzerland	Sweden	Norway	Austria
Developing America	7.3	18.5	27.7	36.3	32.2	21.7	37.7
Developing Africa	0.8	10.6	10.4	85.2	2.7	14.0	2.8
Developing Asia and Pacific	10.2	4.8	9.9	53.2	8.4	11.6	3.0
Socialist countries of Eastern Europe	10.4	16.4	34.1	75.9	3.7	40.0	4.2
Socialist countries of Asia	40.1	11.8	32.7	17.2	8.3	10.3	5.8
Developed market-economy countries	6.8	19.9	19.7	22.7	4.5	10.1	6.7
Total	6.9	11.4	17.3	27.4	5.9	11.0	6.7

a/ Estimates are based on: (1) 1983 tariff line information on total and conditional prohibitions, quotas, discretionary import authorizations, automatic licensing, minimum price systems, import price surveillance systems, anti-dumping and countervailing duty actions, Multifibre Arrangement (MFA) restrictions and restrictions on the application of MFN tariff rates (i.e., tariff quotas, seasonal increases in tariff rates, specific minima to *ad valorem* tariffs) from the UNCTAD Data Base on Trade Measures; and (2) tariff line import data for 1980 from GATT tariff tapes and the EEC Nimexe foreign trade tapes. In preparing the aggregates, estimates were made separately for each member State of EEC, with account taken of measures applied at both the Community and the national levels.

nity.[64] However, it is also clear that the incidence of these measures varies considerably among different groups of exporters. For example, non-tariff measures are applied to over 80 per cent of Swiss imports from African developing countries, yet only 22.7 per cent of the imports (by value) from other developed market-economy countries are subject to Swiss NTBs. Similarly, in Sweden less than 5 per cent of the imports from developed market-economy countries face non-tariff measures, yet almost one-third (32.2 per cent) of the exports of Latin American developing countries are subject to these measures.

263. The variations in the incidence of non-tariff measures reflected in table 14, as well as the overall level of their application, underline the important influence of these interventions on international trade. In examining the reasons for their proliferation, attention should be paid to the motives for their use and influence on trade in both agricultural and manufactured goods. Specifically, there is evidence that interventions in agri-

[64] The actual figures for trade coverage are without doubt higher than indicated in table 14, since there has been considerable difficulty in securing information on "voluntary" export restraints (VERs) for inclusion in the UNCTAD Inventory on Non-tariff Measures. This is primarily due to the fact that the inventory has been developed on the basis of official national or GATT documents as information sources, and VERs are generally not reported in these documents.

cultural trade are designed to provide both protection and domestic market stability, while many of the measures applied to manufactures are employed to offset secular losses in comparative advantage by the developed market-economy countries in some sectors, such as textiles and footwear.

B. The erosion of the GATT system

1. Conditionality and reciprocity

264. The principle of unconditional MFN treatment was an essential component of the tariff-based system. It ensured that negotiated tariff concessions constituted an obligation to the entire GATT membership, thus imparting a greater degree of security to the concessions. The obligation that all trade measures should be non-discriminatory ensured that the allocation of resources on the basis of comparative advantage would not be distorted to the benefit of some and not others. The concept of trade preferences in favour of developing countries constituted a variation of, but not a departure from, the basic theory underlying this approach.

265. The erosion of the unconditional MFN principle has been evident especially through the application of the concept of market disruption, which permitted discriminatory safeguard actions against certain countries. Although this form of discrimination has been "institutionalized" in GATT only in the textile and clothing sector, it has nevertheless permeated trade policies and attitudes toward trade. The pressures for acceptance of a selective safeguard clause, if successful, would extend this discriminatory regime to trade in general. In addition, the manner in which the Tokyo Round agreements were negotiated and applied resulted in the resurrection of the "conditional" MFN concept.

266. A fundamental difference between "unconditional" and "conditional" versions of the MFN clause is in the approach to reciprocity. Unconditional MFN treatment involves an overall approach to reciprocity which compares the totality of benefits received with the totality of concessions made. Conditional MFN treatment implies narrow bilateral or sectoral assessments, and intrinsically involves an element of discrimination as a result of differences in bargaining power. At one time, the concepts of reciprocity and non-discrimination were considered to be mutually exclusive, and the synthesis in GATT of the unconditional MFN clause with the idea of an overall balance of rights and obligations was a key innovation. Operated as intended, the system tended to place smaller countries in a situation of passivity in multilateral negotiations. They were able to benefit from the results while being required to make concessions only when they possessed a major supplying interest in a product. If the principal supplier did not wish to negotiate, it was unlikely that concessions would be made on products of interest to it.

267. The application of the reciprocity concept has been rather difficult when "East-West" or "North-South" trade has been involved. In the "East-West" context, differing conceptions as to what constitutes "reciprocity" or the "equivalence of concessions" have continually frustrated trade relations and the success of trade negotiations. At the heart of the problems connected with the accession to GATT of the socialist countries of Eastern Europe was the stand by many developed market-economy countries that the making of tariff concessions by the former countries did not constitute an appropriate form of reciprocity, since in their view a reduction in tariffs by countries maintaining a centrally-planned economy did not result in *de facto* improved market access. In the Tokyo Round, negotiations between participants of the socialist countries of Eastern Europe and their major trading partner, the European Economic Community, were largely unsuccessful because of the lack of a mutually-agreed interpretation of the application of the concept of reciprocity to such negotiations. In addition, separate conditions were included in certain of the agreements on non-tariff measures to deal with the "special situations" of centrally-planned economies.

268. Reciprocity, or rather "non-reciprocity", has also been a major issue in trade negotiations between the developed market-economy countries and the developing countries. The non-reciprocity principle was first accepted

in GATT in its Part IV (article XXXVI:8), which states that "The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties". This statement is accompanied by an interpretive note to the effect that the less developed contracting parties "should not be expected, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs, taking into consideration past trade developments". This language was reflected in the Tokyo declaration and in the Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (including the "Enabling Clause") which emerged from the Tokyo Round.

269. The non-reciprocity clause has also to be read in the light of the unconditional most-favoured-nation clause under which the developing countries benefit, as a matter of right, from tariff concessions exchanged among developed countries where developed countries are the principal and substantial suppliers. Only where a developing country is the principal or substantial supplier is the extent of reciprocity provided by the developing country modified in the light of the non-reciprocity principle. For many primary commodities, especially tropical products, there are a large number of developing country suppliers with a "substantial interest" (although none may be the principal supplier). During the Tokyo Round, this led to the paradoxical situation in which a large number of developing countries were requested to provide some form of reciprocal concessions in return for tariff reductions on one product by one developed country.

270. Attempts to restrict concessions to other countries which reciprocate and to shut out the extension of the benefits to developing countries under the MFN rule can be illustrated from the history of negotiations on textiles in the Tokyo Round. The entry into force in 1974 of the Multifibre Arrangement (MFA) was virtually a precondition for the Tokyo Round, since without this mechanism to enable the United States to restrict textile and clothing imports from developing countries, the United States textile lobby was not prepared to go along with the Trade Act of 1974. During the course of the negotiations, however, the lobby attempted to secure the passage of legislation prohibiting concessions in this sector, but the legislation was vetoed by President Carter on the grounds that this would lead to a breakdown in negotiations with EEC. The outcome was an agreement on substantial mutual tariff concessions in this sector between EEC and the United States. The implementation by the latter, however, was dependent upon the renewal of the MFA, i.e., the exclusion of developing countries from the main benefits.[65]

271. The most difficult problem in applying the non-reciprocity principle has arisen in the area of non-tariff measures, where negotiations have largely concentrated on drawing up more precise multilateral rules governing the use of these measures rather than bilateral bargaining on a product-by-product basis, the procedure in tariff negotiations. In negotiations on non-tariff measures the calculation of reciprocity becomes a highly subjective matter, and in the Tokyo Round reciprocity in the negotiation of the agreements on non-tariff measures seems to have involved (a) the extent of adherence to the new set of rules by the major trading partners, and (b) the extent to which, as a result of acceptance of these rules, trading partners satisfied the key negotiating objectives of each participant with respect to the policies of the other (e.g. elimination of protective customs valuation provisions, application of injury criteria in countervailing duty actions, etc.). Calculations of the extent of liberalization in terms of trade coverage and likely trade expansion could be made only very roughly, although considerable efforts were exerted to this end in the case of government procurement. The negotiating entities of the major participants in the Tokyo Round each presented their relevant legislatures or councils with an analysis of both the concessions and the benefits in the tariff and non-tariff areas, demonstrating in considerable detail that they had received an

[65] See Trade Agreements Act of 1979, section 504.

acceptable degree of reciprocity in the negotiations.

272. In relation to these new rules on non-tariff measures, the developed market-economy countries, which were responsible for devising the rules, were not prepared to extend the principle of non-reciprocity to developing countries, a situation that had applied in relation to tariff concessions. As a result, some of the agreements were applied on what has been termed a "conditional MFN" basis, implying that the GATT Contracting Parties (developed and developing) not accepting the agreements would not benefit from the higher level of commitments. In a limited number of cases, measures of a more punitive nature were applied against non-signatory developing countries to "encourage" them to accept the Agreements.

273. The "conditional" approach is having serious effects on the trade interests of non-signatory (i.e., developing) countries. Even more important than the significant trade effects of conditional application of the Agreements on Subsidies and Countervailing Measures and on Government Procurement is that conditionality seems to have been implicitly incorporated into the GATT system. In any case, no successful challenge has been made (and in fact only one serious challenge was attempted) to demonstrate the obvious incompatibility of the conditional approach with the fundamental GATT principle of unconditional and most-favoured-nation treatment. Although the Decision of the Contracting Parties of 28 November 1979 on the results of the Tokyo Round reaffirms the rights of GATT countries under article I in the application of the Agreements,[66] it is difficult to foresee *how* it *can* be effectively applied in the face of the "conditionality" provided in the implementing legislation of major trading countries.

2. The tendency toward managed trade

274. The movement towards greater management of trade began in the 1950s in specific sectors. The first and clearest example was the process in which trade in agricultural products was removed from the application of multilateral disciplines. Although it was recognized from the beginning in the General Agreement that quantitative restrictions might be necessary to maintain price support schemes, the imbalance in multilateral obligations accepted in the agricultural sector, on the one hand, and in the industrial sector on the other, has persisted ever since. Among the major reasons for this imbalance are the comprehensive, open-ended GATT waiver insisted on by the United States in 1955 (which still provides coverage for restrictions);[67] the "unbinding" of agricultural tariff concessions[68] in the schedules of certain Member States of EEC, which removed the legal impediments to the introduction of the mechanism of variable levies for the Community's agricultural imports; the generally small extent of bindings on agricultural tariffs emerging from the multilateral negotiating rounds; the maintenance of quantitative restrictions on imports of agricultural products in developed market-economy countries (e.g. Japan); the special provisions for agriculture in the Protocol for the Accession of Switzerland; and the differentiation between agricultural and "non-primary" products when rules on export subsidies were incorporated in GATT article XVI:2.

275. The results of the Tokyo Round had little effect on barriers to trade in agricultural products. While the Agreement on Technical Barriers to Trade provides its signatories with at least the potential means of attacking unnecessarily protective health and sanitary regulations, the Code on Subsidies and Countervailing Duties, the Arrangement Regarding Bovine Meat and

[66] GATT, *Basic Instruments and Selected Documents, Twenty-sixth Supplement* (Sales No. GATT/1980-3), p.201.
[67] This waiver was granted to the United States to cover actions under section 22 of the Agricultural Adjustment Act (see GATT, *Basic Instruments and Selected Documents, Third Supplement*, Geneva, June 1955, p. 32).
[68] This unbinding process is still continuing, e.g. in the case of manioc in EEC tariff in 1982.

the International Dairy Arrangement did not liberalize trade in agricultural products. In fact, the Arrangement Regarding Bovine Meat appears to have legitimized the use of "voluntary" export restraints and other "management" devices in that sector. Moreover, it must be recalled that agricultural products are, to an important extent, excluded from the generalized system of preferences. The significance of all this is not merely restricted trade but the emergence of a separate regime for trade in agricultural products reflecting principles and objectives drastically different from those of GATT.

276. The situation in agriculture arises from the greater priority given by government to domestic economic and social considerations than to the rules and principles of the trading system. It represents an attempt to manage trade for essentially protective purposes. In the case of textiles and clothing the mechanisms were also designed to discriminate against new entrants into the world market.

277. During the late 1950s, the United States and certain other developed market-economy countries which did not maintain residual quantitative restrictions in the textile and clothing sector decided that increased protection was necessary against textile imports from Japan, which had just acceded to GATT, as well as from a few developing countries which were becoming internationally competitive in textiles. Voluntary restraints were preferred to the renegotiation of tariff concessions or the application of the non-discriminatory GATT safeguards mechanism (article XIX) which would have affected major trading partners as well, and would have been likely to lead to retaliation or requests for compensation. As the only way to ensure the effective negotiation of these restraints was to have ultimate recourse to the possibility of imposing discriminatory restrictions against specific exporting countries, a device had to be found to reconcile such discrimination with the rules of GATT.

278. For this purpose, the concept of market disruption was invented in order to provide the conceptual base for the legitimization of departures from the MFN clause. The existence of a situation of market disruption required that the following conditions be present: (a) a sharp and substantial increase or potential increase of imports of particular products from particular sources; (b) these products be offered at prices substantially below those prevailing for similar goods of comparable quality in the market of the importing country; and (c) serious damage to domestic producers or threat thereof. It was recognized that the price differentials referred to in (b) above were the result neither of governmental intervention in the fixing or formation of prices nor of dumping practices.[69]

279. This concept thus justified discrimination against countries on the basis of their ability to offer goods at low prices. It was the first in a series of mechanisms directed against new entrants into the world market. Efforts were made to incorporate the market disruption concept into the General Agreement but, in the end, it was limited to certain textiles and clothing products under the short- and long-term arrangements on cotton textiles, and expanded in product coverage under the Multifibre Arrangement (MFA).

280. Under the MFA, the developed importing countries have negotiated a series of "comprehensive" bilateral agreements which restrain the entire range of textile and clothing exports from over 30 developing countries. As the network of restraint agreements against developing countries expanded, its product coverage was enhanced and its restrictive character tightened. Unrestricted imports from developed countries increased, as did their market shares. Moreover, various pressures are being exerted on other developing countries to bring them within the system of restraints.

281. The existence of the MFA has led to a situation in which trade in the textile sector is governed by a regime based on principles drastically

[69] GATT, *Basic Instruments and Selected Documents, Ninth Supplement*, Geneva, February 1961.

opposed to those underlying the multilateral system. Furthermore, there has been an erosion of the multilateral disciplines provided for in the Arrangement itself. The concept of "market disruption" has been transformed into the concept of "cumulative market disruption", and that of "low-cost imports" into "low-cost suppliers". These developments have led to a system based on the criterion of "acceptable levels of market penetration" from such "low-cost" suppliers (i.e., developing countries). Furthermore, the concepts and mechanisms embodied in the MFA have been embodied in the trade policies and legislation of the major trading countries, most notably in their widespread resort to "voluntary" export restraints and in the current pressures to permit the application of safeguards on a discriminatory (i.e., "selective") basis, as discussed below.

282. In the 1970s, major shifts occurred in the international competitiveness of steel production, due in large measure to the introduction of new technologies. Faced with major shifts in comparative advantage in a period of sharply falling demand in a major industry characterized by extreme capital intensity, certain developed countries were faced with the alternative of introducing either massive structural adjustment programmes or protective measures, including heavy subsidization, to maintain inefficient production. The major producing countries in the main chose the latter approach. In an effort to avoid recourse to GATT safeguard action or renegotiation procedures, both of which would require compensation or would have permitted retaliation, the major trading countries resorted to a variety of other mechanisms, including "voluntary" export restraints and price control schemes disguised as anti-dumping measures. The result has been a system of managed trade based on set import prices or established degrees of market penetration in these countries, and in respect of which the vast majority of trading partners, including the most competitive new entrants into the world steel market, have had virtually no say whatsoever.

283. More recently, there has been a trend towards establishing mechanisms which would permit the prices, quantities and sources of imports to be controlled on a discretionary basis. This has basically taken the form of (a) pressures for a "selective" safeguard clause and (b) mechanisms for inducing countries to apply voluntary export restraints which, with other actions, have contributed to the weakening of the position of new entrants and those without effective retaliatory power. (This is also reflected in the "resurrection" of the "conditional" MFN concept, the distortion of the multilateral reciprocity principle, and the pressures for the inclusion of non-trade issues within the trading system.) Moreover, all parties are effectively deprived of the economic advantages of a multilateral, market-oriented trade system.

284. In the 1973 Tokyo Declaration Ministers decided that the multilateral trade negotiations then launched should aim to "include an examination of the adequacy of the multilateral safeguard system, considering particularly the modalities of application of article XIX, with a view to furthering trade liberalization and preserving its results".[70] As the negotiations progressed, it became clear that discrimination, or so-called "selectivity", was being made the predominant issue. Certain developed countries expressed the view that GATT Contracting Parties should be permitted to apply safeguard measures only against imports from those countries apparently causing the "injury", arguing that only the "guilty" should be affected by safeguard actions. This proposal met with strong reactions basically from smaller trading countries, who presented a common front in opposing any form of "selectivity". One reason as far as developing countries were concerned was their experience in the 1977 negotiations (bilateral and multilateral) leading to the first renewal of the Multifibre Arrangement. They considered that acceptance of a "selective" safeguard clause would be roughly equivalent to extending the MFA on an across-the-board basis. Certain developed countries, as well as those socialist countries of Eastern Europe participating in the negotiations,

[70] Paragraph 3(d) of the declaration. See GATT, *Basic Instruments and Selected Documents, Twentieth Supplement* (Sales No. GATT/1974-1), p. 21.

also firmly opposed any breach of the most-favoured-nation principle in the application of safeguards under article XIX.

285. Smaller trading countries generally do not have open to them the avenue of retaliatory action to ensure enforcement of their rights. Consequently, they recognized that only through the maintenance of non-discrimination in the application of protective measures through the exercise of MFN treatment under article I would their interests and rights be protected. This firm position of the smaller trading countries, which remains unchanged to this date, led to the inconclusive results on this subject at the multilateral trade negotiations (MTNs) in July 1979. The decision of 28 November 1979[71] merely stressed the need for agreement on an improved multilateral safeguard system and set up a committee with the aim of elaborating supplementary rules and procedures in order to provide "greater uniformity and certainty" in the implementation of article XIX. Though the committee has met a number of times, work has not moved much beyond the stage of uncertainty reached in the MTNs. Prior to the GATT ministerial session of November 1982, there was intense activity on safeguards in the Preparatory Committee for that meeting, but agreement on an interpretative agreement was not reached. In their declaration, Ministers directed that a new "understanding" be prepared by the GATT Council for adoption by the Contracting Parties not later than their 1983 session.[72] It did not prove possible to meet this deadline, and at their November 1983 session the Contracting Parties decided that work should continue so as to reach an understanding by their 1984 session. As they now stand, the discussions in GATT on this very important issue may be moving further from an agreement on a multilateral safeguard clause and thus leading to a dead end on an issue which could have a negative impact on trade relations in general and frustrate the sustained recovery and development drive sought by all trading partners.

286. With the exception of the products and countries covered by the MFA and of settlements reached in anti-dumping and countervailing duty cases, voluntary restraints are not permitted by GATT, as they constitute discriminatory quantitative restrictions. Nevertheless, over recent years they have become a common means of controlling exports for an increasing range of products. They have become a frequent feature of the major trading countries' trade relations, and in some of them, such as the United States, are specifically permitted by legislation. Japan's willingness to enter into such agreements has greatly contributed to their proliferation against weaker trading countries.

287. The fact that an "illegal" measure has become one of the key trade policy measures obviously poses threats to the credibility of the system, which was further shaken when it proved impossible, at the GATT ministerial session of 1982, to obtain from Contracting Parties a firm commitment not to apply measures which "circumvented" the GATT rules.[73]

288. Voluntary export restraints often take the form of agreements between enterprises in the exporting and importing countries. Such market-sharing agreements are frequently contrary to the restrictive business practices legislation of the importing countries.

289. Full use has been made of existing legal mechanisms to facilitate the negotiation of such restraints. The Codes on Anti-Dumping and on Subsidies and Countervailing Duties provide that the investigation leading to the application of these duties may be suspended if the exporting country (or firm) concerned agrees to enter into certain "undertakings" to eliminate the injurious effects on the domestic industry of the importing country. The undertaking may require the revision of export prices, a quantitative restraint of exports, or restriction of the subsidy to industry. Exporters or governments of the exporting countries may reluctantly agree to give such undertakings in order to remove uncer-

---

[71] *Ibid., Twenty-sixth Supplement* (Sales No. GATT/1980-3), p. 202.

[72] *Ibid., Twenty-ninth Supplement* (Sales No. GATT/1983-1), pp. 12-13.

[73] See the note by the UNCTAD secretariat, "Recent developments in international trade relations" (TD/B/948).

tainty with regard to their trade. Irrespective of their legality, these undertakings in general create problems for the international trading system. The growing use of undertakings seems to indicate an increased emphasis on bilateralism, which inevitably leads to an erosion of confidence in the multilateral trading system. Where anti-dumping actions are used to force exporters to enter into voluntary export restraints, they contribute to an increase in the extent of the so-called "grey-area" measures subject to much debate in GATT. The danger for the developing countries is that the stronger trading partners may use such practices to carve up world markets and restrict market access for products from the developing countries.

290. In practice, this trend is evident in the number of applications for anti-dumping and countervailing duty procedures, which has shown a dramatic increase in recent years, confirming the move to flexible measures of protection. Such actions in the developed market-economy countries increased from 124 in 1979 to 405 in 1982.[74] While developed market-economy countries' producers were the main target of these actions, developing countries' exporters were involved in 17 per cent of actions in 1979, 37 per cent in 1981, and 26 per cent in 1982.

291. This substantial use of Anti-Dumping (AD) and Countervailing Duty (CVD) procedures against developing countries should be a matter of special concern. First, the use of export subsidies is essentially a transitional device in the absence of perfectly functioning capital markets to assist developing-country exporters in the process of development and to assist the transition from import substitution to more open trading regimes. They are, moreover, often used to offset the effect of other policies, so that there may in fact be no *net* subsidy effect. In other words, the industry may be no larger and exports no greater than they would be in a situation in which there was no government interference. Second, uncertainty regarding international trading conditions caused by external factors weighs more heavily on them as new entrants into the international market than on well-established exporters. Subsidies can, therefore, be seen as a means to offset special exogeneous factors. Third, the procedures often require the presentation of data not readily available in developing countries. Fourth, the expense of participation in investigations to obtain such data is in many cases very considerable. Fifth, developing countries' tenuous links with importers and consumers are vulnerable when anti-dumping or countervailing duty actions are initiated.

292. The application of such mechanisms has been facilitated by the absence of clear, internationally acceptable criteria for the determination of injury (in its many forms), or even a general consensus as to what constitutes a situation of injury (or "damage" or "market disruption").[75] The neglect of the "result", i.e., injury, has transferred the debate to the "cause" of the problem, such as increasing imports, low prices, dumping or subsidization, with little discipline over the determination of the effect. Such a tendency works, in particular, against the interests of developing countries, many of which may be "guilty" merely of being competitive but, given the trade volumes involved, are unlikely to be causing injury and also less able to defend their rights and interests in such cases. It also creates a situation conducive to the harassment of trade by protectionist interests through the massive submission of petitions for protective actions and reduces the efficiency of markets in the reallocation of resources along more economic lines.

3. Graduation

293. Lately, the theme of "graduation" has tended to dominate discussions in

[74] See the note by the UNCTAD secretariat, "Anti-dumping and countervailing duty practices" (TD/B/979 and Corr.1).

[75] It should be borne in mind that the United States does not apply an injury criterion in countervailing duties cases against those developing countries which have not signed the Tokyo Round Code or those developing-country signatories which have not accepted additional commitments to phase out export subsidies.

international trade forums and in domestic trade policy debates. The "graduation" concept is spelled out most clearly in the Tokyo Round decision on "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries". It maintains that "as their capacity to make contributions or negotiated concessions or take other mutually agreed action... would improve", so would their ability "to participate more fully in the framework of rights and obligations under the General Agreement". In practice, however, the graduation concept has been used to justify a variety of unilateral actions, including those in the areas of the GSP, export credits and World Bank loans. Graduation is being applied as a flexible restrictive measure as products can be removed from beneficiary treatment with respect to individual countries. It also appears that those developing countries that have been affected by graduation will be permitted to retain the benefits from which they are "graduating" (GSP), if they agree to make certain reciprocal concessions. Thus, graduation is becoming a tool for extracting concessions in negotiations.

C. Conclusions

294. In the post-war era there have been two parallel trends in trade relations. On the one hand, there has been a trend towards trade liberalization, essentially through the reduction of MFN tariffs in the course of various GATT rounds of multilateral trade negotiations. Further liberalization of tariffs has taken place in more limited contexts such as regional agreements, whether free trade areas or common markets, and the introduction of preferential tariffs for developing countries under the GSP negotiated in UNCTAD. If anything, the regional approach is becoming stronger, while the preferential approach is being eroded by the reduced level of MFN rates and the graduation of the fast-growing developing country exporters. The trend towards trade liberalization has taken place in the context of the basic GATT rules. It has also been fostered by the use of value-added tariffs and drawback of tariffs, which have encouraged the internationalization of production through a variety of means of an essentially market nature, including international sub-contracting. This tendency towards liberalization was supported by favourable economic conditions in the 1950s and 1960s, an apparent consensus in the international community on economic objectives and on freer trade as a means of attaining those objectives, and also by the stability in international exchange rates provided for in the Bretton Woods arrangements.

295. On the other hand, it is also clear that one of the elements which permitted this trend towards tariff liberalization was an incipient tendency to apply measures of a flexible nature (non-tariff measures) on an increasing scale, a tendency to manage trade in certain sensitive sectors, and a tendency to apply such trade-restrictive measures on a discriminatory basis. Clearly, the increased relative and absolute importance of flexible methods of protection goes against the basic objective of the GATT trading system that trade should be essentially regulated by tariffs. Moreover, whereas the intent of this system was that reciprocal trade concessions negotiated bilaterally should be made available to all GATT Contracting Parties by means of the unconditional MFN principle, this, too, has been eroded by the greater use of discriminatory measures (inside and outside the GATT set of rules) and by demands for reciprocity before the benefits of the newer GATT codes would be granted. Taking into account these developments and the increased resort to restrictive business practices, countertrade and industrial collaboration among GATT and non-GATT members, it is possible to discern that the overall tendency towards the greater management of trade has reached the point where only something of the order of 20 per cent of world trade is governed by the fundamental GATT instrument of unconditional MFN tariffs (zero or otherwise).

296. In effect, there has been a continuous process of erosion of the principles of the GATT trading system, brought on both by the success in the liberalization of tariffs and by the process of changes in the rules and in the degree of respect for the rules. The outcome has been an uneven distribution of the benefits of such liberalization as has taken place. As has been observed, liberalization has been more successful in some sectors than in oth-

ers and even from the earliest days of GATT there was a tendency towards management of trade in the areas of agriculture and textiles. In the last decade this tendency has spread to iron and steel and automobiles. It can also be discerned that greater progress has been made towards liberalization in areas where transnational corporations dominate. These areas are characterized by horizontal and vertical intra-industry trade which is growing much faster than inter-sectoral trade, thus permitting the internationalization of production. This element is not without its negative effects and the distribution of the net benefits of expansion along such lines has not always been completely equitable. The most insidious characteristic of the new protectionism has been the greater use of mechanisms such as the MFA and anti-dumping and countervailing duty procedures to take selective protective action to inhibit market access, in particular of new and fast-growing suppliers. This has come about by restricting and controlling prices, quantities and sources - in effect, the management of trade.

297. As noted earlier, the financial and monetary system established at Bretton Woods was seen essentially as supportive of the trade system, and the question arises to what extent these twin pillars of the post-war framework of international economic relations were in effect mutually supporting, and to what extent the breakdown of the fixed exchange rates from 1971 onwards contributed to the erosion of the GATT trading system. In fact, it is difficult to establish any direct causal links, as the systems and organizations charged with their stewardships operated quite independently of each other, except that IMF has contributed to the examination by the GATT Committee on Balance-of-Payments Import Restrictions of specific countries. However, it is certainly possible to note that, while the fixed exchange-rate system was in place and operating relatively smoothly, it coincided with the rapid post-war expansion of income and trade. It also coincided with the less well-documented rise in trade management and non-tariff barriers. Another coincidence of events to which attention is rarely drawn was that of the strain on fixed exchange rates (leading to their breakdown from 1971 onwards) and of the underlying pressures for structural adjustment in the industrialized economies, which were already beginning to be felt in the late 1960s. Finally, there is little doubt that the breakdown of the exchange-rate system also coincided with a substantial decrease in confidence in the GATT trading system and the increased use of "grey area" measures and flexible means of protection.

298. The importance of flexible means of protection, rather than the tariff, is clear under a regime of flexible exchange rates. In a simplistic theoretical model it is possible to imagine that tariffs could retain their relevance under a system of freely floating exchange rates. However, this would require the virtually impossible condition that such rates would adapt instantaneously to differing economic performance, e.g. differences in the rates of inflation, and that financial markets would have no significant effects. In practice, for the reasons mentioned elsewhere in this report,[76] the huge increase in the internationally-mobile funds at the disposal of the private sector has contributed to a period of considerable exchange-rate volatility over the last 13 years, rendering tariff rates a less effective means of protection. For example, average tariffs in the major industrialized countries in the entire 50-year period from the 1930s to the end of the Tokyo Round reductions in 1987 will have fallen from around 40 per cent to 6.9 per cent *ad valorem*, and in the course of the Tokyo Round itself the weighted average industrial tariff cut was from 10.3 per cent to 6.9 per cent, and even more in some cases.[77] On the other hand, during certain periods over the last decade, exchange rates of the currencies of major trading countries have fluctuated by as much as 20 per cent over a few months.

299. The lessening of the effectiveness of tariffs as a trade policy instrument has obvious implications for the GATT system under which tariffs were to constitute the only legitimate measure of protection, while measures

---

[76] See especially chapters IV and VI below.
[77] See *The Tokyo Round of Multilateral Trade Negotiations, Report by the Director-General of GATT* (Sales No. GATT/1979-3).

limiting quantities or fixing import prices would be eliminated. Exchange-rate volatility has thus contributed to the tendency toward the use of flexible or "contingent" measures of protection identified earlier. This is not to say that the pressure to move away from tariffs and toward more flexible "management" mechanisms can be entirely, or even primarily, attributed to the breakdown of the fixed-exchange rate system. Apart from the long-term trends towards intervention through the use of industrial policy instruments and non-tariff measures, and towards managed trade, particularly in certain sectors, a major contributory factor has been the inability of the trading system itself to adapt to changes in international competitiveness and the entry of new, efficient suppliers into the world market. The tariff levels of the major developed trading countries reflect the results of bargaining, essentially with each other in multilateral negotiations, with the concessions being extended to all other Contracting Parties. These rates did not serve to protect them against new, more efficient suppliers. The GATT mechanisms designed to deal with this situation, the application of temporary safeguards or the renegotiation of rates at a higher level, would have had to be applied on a non-discriminatory basis and could have entailed compensatory withdrawals of concessions (retaliation) from the affected parties. Such actions, if applied in anything but a very limited manner, risked unravelling the intricate balance of concessions among major trading partners. As a consequence, other restrictive measures of a discriminatory nature were relied upon in certain cases, such as the textiles sector, "legitimized" by multilateral agreement.

300. Contrary to the belief that floating exchange rates would lead to a system of continual adjustment in which currency values would rise and fall in response to variations in different countries' relative competitiveness, the monetary and financial systems since 1971 have been characterized not only by volatility in exchange rates, but also by the persistence of currency misalignment over prolonged periods.[78] There can be little doubt that such misalignments have created pressures not only for protectionist actions in individual sectors, but also for major changes in trade policies. It is obvious, for example, that an undervalued currency acts as an across-the-board tariff increase which can stimulate the establishment and expansion of otherwise uncompetitive industries, which will require protection when exchange rates adjust.

301. A greater threat to the trading system has come from overvalued currencies which, especially when prolonged, have undermined the competitive position of industries that otherwise would have been quite capable of competing with imports and in export markets. This situation has tended to increase pressures for protection among industries and interest groups which were not necessarily a part of the traditional protectionist lobby, while weakening political forces which traditionally resist protectionist initiatives. It has created unholy coalitions to provide the broad-based support required for the passage of protectionist legislation. Studies have illustrated this phenomenon in the United States, demonstrating the correlation between increases in protectionist initiatives and in the value of the dollar, even in cases where other factors usually contributing to such initiatives, such as unemployment, were not significant.[79]

302. The growth of protectionist barriers is also taking place at a time of unfavourable trends in the amount of, and the terms on, net financial flows to developing countries. Owing to the resulting pressures on their external payments, many developing countries are having to compress their imports, in some cases drastically, while also aggressively pursuing programmes of export expansion. These programmes may cover products that, in the absence of the domestic austerity policies necessitated by their deteriorating balance of payments, would have been purchased by domestic consumers. As is emphasized elsewhere in this report,[80] such policies may imply inefficient use of

---

[78] See chapter VI below.
[79] C. F. Bergsten and W. R. Cline, "Trade Policy in the 1980s: An Overview" in Cline (ed), *op. cit.*
[80] Part III, chapter II.

resources. Moreover, in addition to the deleterious effects on the economic and social development of the developing countries, the resulting increases in their exports may further accentuate protectionist pressures in developed ones.

303. This situation in many developing countries has been one of the contributing factors to the growth of countertrade. While the causes and effects of this phenomenon and its relation to multilateral obligations under the General Agreement are still under study by the international community, it is clear that increased countertrade is a further step away from the GATT trading system, and that one of its causes is the general disorder in the systems of money and finance.[81]

304. In conclusion, while it is impossible to calculate with any precision the extent to which a given trade measure is directly attributable to monetary or financial factors, it is obvious that the breakdown of the Bretton Woods arrangements has coincided with a corresponding movement of the trading system away from its original post-war rules and principles. Multilateral commitments and tariff bindings have lost much of their meaning, and new multilateral trade negotiations cannot be seriously envisaged in a situation where international trade is being disrupted by widespread depression throughout the world economy.

[81] See annex B below.

Chapter IV

THE GROWTH OF INTERNATIONAL BANK LENDING TO DEVELOPING COUNTRIES

A. Some overall changes in international financing since the 1950s

305. The period since the late 1950s has witnessed a marked rise in the relative importance of private institutions in international finance. The beginning of this rise can be traced to the widespread relaxation of restrictions on international payments by major developed market-economy countries in the late 1950s. In the early years after 1945 financial relations among these countries had been dominated by official arrangements such as the large programmes of economic assistance of the United States and a series of clearing systems for transactions in the currencies of certain western European countries, which were designed to facilitate mutual trade in the face of the payments restrictions then prevalent. As described in chapter V below, there was little recourse to IMF and the World Bank during this period. Developed market-economy countries largely bypassed these institutions owing to the arrangements mentioned above. Several developing countries were still colonies, and their economic policies, in particular those involving borrowing abroad and other aspects of external payments, were controlled to a considerable extent by the metropolitan powers. Moreover, thanks to favourable conditions in the markets for several primary commodities during various years of this period, many other developing countries had little need for balance-of-payments support. By far the most important category of private international financing at that time was foreign direct investment. International lending in the form of bank loans, bonds, and equity investment remained small, being inhibited by the restrictions on external payments and the aftermath of widespread defaults during the 1930s.

306. With the restoration of external convertibility in major developed market-economy countries from 1958 onwards there began the profound transformation of the international financial system which is sometimes described as its "privatization". The ensuing expansion of private international financial operations accompanied, and in many cases gave a fillip to, other far-reaching changes in economic relations, especially among the developed market-economy countries. These changes included the growing interdependence and interpenetration of these economies owing to trade flows and international investment, the expansion of international travel, the proliferation of financial instruments, and great improvements in the availability and quality of financial information and in communications.

307. From the late 1950s there was a revival of international portfolio investment and bank lending. An important form taken by the latter was Eurocurrency lending through offshore financial markets.[82] Demand for Eurocurrency loans to finance both foreign trade and other international transactions (for example, for the purpose of arbitrage) increased in response to the greater possibilities of financial transfers among national and offshore markets resulting from the relaxation of exchange controls. Moreover, Eurocurrency and other forms of international bank lending were greatly facilitated by sharp falls in the real cost of telecommunications, since much of this business is carried out by

[82] Eurocurrencies are currencies deposited with banks outside the countries where they are issued as legal tender. Offshore financial markets denote parts of the international banking system which are relatively free from national regulations. Although offshore markets are not identical to Eurocurrency markets, the two phenomena are in most cases closely associated.

telephone or teleprinter.[83] Indeed, since the beginning of the 1960s the links between national financial markets have been greatly increased, and in this process the use of offshore financial markets as a convenient vehicle for large international movements of funds has played a major part.

308. The growing importance of the private sector's participation in international finance accompanied only limited measures to expand the official role in this sphere. As early as the late 1950s concern began to be expressed about the functioning of the international financial system. Although such concern was eventually to take in a wide range of issues, initially attention was concentrated especially on the adequacy of international liquidity in relation to the requirements of world trade and on alternative forms of adjustment to imbalances in external payments. It was also pointed out that if an increasing share of international liquidity consisted of dollars generated by the balance-of-payments deficits of the United States, the international financial system was vulnerable to disruptions and possibly breakdown due to losses of confidence in that currency (an argument dramatized in the early 1960s by some large flows of funds out of the dollar into gold). Many of those taking part in the debate on international liquidity and the financial system at that time favoured bringing the process of liquidity creation under greater official control by reinforcing and expanding the role of multilateral financial institutions. However, their arguments were opposed by influential elements in both official and private circles. This opposition was based on various grounds, such as preferences for measures other than those of increasing international liquidity in the reform of the financial system. But it also often stemmed from resistance to measures which might strengthen multilateral financial institutions at the expense of the private capital markets.[84] In the event, the laborious efforts at reform during this period gave rise to only limited changes in the international financial system (such as the establishment of the General Arrangements to Borrow, increased IMF quotas, and the introduction of IMF special drawing rights). Multilateral financial institutions were thus left in a position where they could meet only a small part of the demand for financing associated with the large imbalances in external payments which arose subsequently.

309. By the beginning of the 1970s the liquid assets at the disposal of participants in the private international financial markets had increased to a figure much greater than official reserves.[85] The availability of these liquid assets facilitated the large international monetary movements which

---

[83] For example, the price of a transatlantic telephone call between London and New York in real terms fell by three-quarters during 1950-1970. See S. J. Prais, *The Evolution of Giant Firms in Britain. A Study of the Growth of Concentration in Manufacturing Industry 1909-1970* (Cambridge: Cambridge University Press, 1976), pp. 71 and 249.

[84] See, for example, the testimony of David Rockefeller at hearings on international financial reform in 1961 of the Subcommittee on International Exchange and Payments of the Joint Economic Committee of the United States Congress, reprinted as D. Rockefeller, "International monetary reform and the New York banking community", in H. G. Grubel (ed), *World Monetary Reform. Plans and Issues* (Stanford: Stanford University Press, 1963), especially pp. 156-159.

[85] According to estimates of the United States Tariff Commission the liquid assets at the disposal of participants in the international money markets in 1971 amounted to about $268 billion. A small part of this figure (at most $15-20 billion) consisted of official Eurocurrency deposits. Although there is some doubt as to how quickly some of the sums involved could be mobilized in practice, there can be no question that the internationally-mobile liquid assets of the private sector exceeded official reserves at this time by a large margin. (See United States Tariff Comission, *Implications of Multinational Firms for World Trade and Investment and for United States Trade and Labour*, Report to the Committee on Finance of the United States Senate and its Subcommittee on International Trade (Washington, D. C., 1973), pp. 534-543.)

became a feature of the financial system during the 1960s and were in turn associated with a series of crises in the exchange markets. These movements increasingly put pressure on the dollar, and in August 1971 forced the Government of the United States into a series of measures to protect its economy, which included an end to the link between the dollar and gold and effectively terminated the international financial regime established in 1945.[86]

B. Factors influencing the changing pattern of financial flows to developing countries until the early 1970s

310. From the late 1950s onwards there was a shift in the pattern of financial flows to developing countries. As in the earlier part of that decade, official loans and grants and private foreign direct investment continued to account for the largest share of net financial flows to developing countries (that of the former remaining above 50 per cent throughout the 1960s). However, at the same time there was a revival of export credits[87] and bilateral portfolio investment. The rise in the share of export credits in net flows was particularly marked - from well under 10 per cent in the early 1960s to almost 15 per cent at the beginning of the 1970s.[88] As discussed elsewhere in annex B below, this rise reflected the impact of changes in international trade and in financing techniques, especially the growth of export credits of longer-term maturities to finance developed market-economy countries' exports of equipment goods in increasingly competitive international markets. Together with export credits, short-term bank loans financed a large proportion of international trade during this period. However, medium- and longer-term international bank lending other than that associated with export credits accounted for only a very small part of the financial flows to developing countries during the 1960s. In the Eurocurrency markets a substantial proportion of lending and borrowing was between banks, in most cases as part of their use of interbank operations for the purpose of funding and asset management but also, on occasion, and with official encouragement, to help to finance the deficits of their home countries' external payments. Initially the most important non-bank borrowers from these markets were the overseas subsidiaries of United States transnational corporations. However, there was also some borrowing by public bodies, and by the end of the 1960s the Eurocurrency markets had become a significant source of finance for western European transnational corporations. The first substantial borrowing by developing countries in the form of medium-term Eurocurrency loans began only in the early 1970s, gross commitments to them amounting to about $1 billion in 1971 and about $3 billion in 1972.[89]

311. Although it is difficult to explain precisely why the growth of Eurocurrency lending to developing countries began at this time, several factors favoured such an expansion by the end of the 1960s. Such factors included the learning process associated with the growing internationalization of the operations of many banks in developed market-economy countries, the opportunities for profitable diversification by lending to developing countries, and aspects of the evolution of banking techniques which reduced some of the risks associated with international lending, thus encouraging its expansion to new kinds of bor-

---

[86] For a fuller account of the forces determining movements of exchange rates see chapter VI below.

[87] The export credits to which reference is made in available statistical sources include only those with an original maturity of at least one year received from an official source or insured by an export credit insurance agency (usually an official institution).

[88] UNCTAD, *Handbook of International Trade and Development Statistics, Supplement 1977* (United Nations publication, Sales No. E/F.78.II.D.1), table 5.3.

[89] *Ibid.* Some of the early borrowing in this form by developing countries such as Brazil and Mexico was used to accumulate reserves of foreign exchange for future needs, serving at the same time to establish closer relationships with major international banks.

rowers. Moreover, longer-term international bank loans also offered certain advantages to borrowers in comparison with alternative types of financing.

312. Since 1960 there has been a substantial expansion and reorganization of the international networks and operations of banks with headquarters in developed market-economy countries. For example, between 1960 and 1970 the foreign branches of United States banks increased more than fourfold, from 124 to over 530.[90] At the same time the former colonial banking networks of the United Kingdom and France were reorganized and, partly in response to the challenge from the United States, banks of these as well as of other western European countries and Japan increased their foreign presence. Several factors influenced the international strategies of banks in developed market-economy countries during this period. But one motive which applied widely derived from the growing financial requirements of transnational corporations. For example, the opportunities furnished by offshore markets for meeting these requirements constituted a powerful attraction for United States banks to establish entities abroad. The attraction was enhanced during the 1960s by measures taken by the United States Government to restrict capital outflows so that, as was mentioned earlier, the country's corporations financed a substantial part of their international operations with Eurocurrency borrowing.

313. As a result of the growing internationalization of their operations during the 1960s, banks were increasingly brought into contact with different aspects of the economies of developing countries. Indeed, by 1975 transnational banks were represented by approximately 1,500 entities[91] in those developing countries which were not financial centres. This contact contributed to a learning process on the part of banks concerning the lending opportunities in developing countries, thus paving the way for eventual diversification of their assets through such loans.

314. Three major categories of risk in banking, national and international, are lending or credit risk, interest-rate risk, and liquidity or funding risk.[92] Each of these categories of risk has been significantly affected by the evolution of practice in the Eurocurrency markets since the late 1950s.[93] As mentioned above, a large part of borrowing and lending in the Eurocurrency markets since their inception has been inter-bank. Both the value of, and the number of institutions participating in, this inter-bank business have increased with the growth of the Eurocurrency markets as a whole. As in the case of national financial systems, the existence of a large inter-bank market has helped the Eurocurrency markets to operate more smoothly by facilitating the adjustment of liquidity positions on the sides of both assets and liabilities and thus reducing funding risk.

315. The impact of lending risks in these markets was changed by the practice of syndication, and that of interest-rate risks by the introduction of "roll-over" credits. Syndication[94] made it possible to distribute the lending risks associated with a particular loan among the members of the syn-

---

[90] United Nations Centre on Transnational Corporations, *Transnational Banks: Operations, Strategies and their Effects in Developing Countries* (ST/CTC/16), United Nations publication, Sales No. E.81.II.A.7, para.90.

[91] Bank for International Settlements, *Forty-eighth Annual Report,* (Basle, June 1978, annex I, table I-2; *op. cit.*, table 3).

[92] See, for example, M. L. Stigum and R. O. Branch, *Managing Bank Assets and Liabilities. Strategies for Risk Control and Profit* (Homewood, Illinois: Dow Jones-Irwin, 1983), pp. 71-73.

[93] The effects of these changes in international banking practice have not necessarily been restricted to operations in the Eurocurrency and offshore markets. However, it is in these markets that their manifestations have been most widely noted.

[94] The practice of syndicating credits among groups of banks had already been a feature of financial markets in the United States, where its use resulted from *inter alia* the legal limitations on the loans of a single bank to any one customer.

dicate, thus limiting the potential loss of each participating bank to its share of the funds advanced. Moreover, since the leading banks in syndicates were large ones with substantial experience of international lending, syndication also enabled other banks to take advantage of their expertise. Both aspects of syndication increased the total resources available to the Eurocurrency markets, in particular making possible the participation of smaller, regional banks.[95]

316. The use of "roll-over" or variable-rate credits in the Eurocurrency markets became widespread at the end of the 1960s.[96] The interest rate on such credits is adjusted at three- or six-monthly intervals to reflect changes in the rates of interest on inter-bank lending. In this way banks eliminate risk arising out of possible divergences between the rates of interest on their borrowed funds and those on their loans. The variable-rate credit facilitated the lengthening of Eurocurrency loans' maturities, thus helping to bring about the great expansion of medium-term international bank lending which was such an important feature of the 1970s. However, it also had the consequence (whose significance is discussed further below) of transferring risk from lenders to borrowers, since unfavourable changes in the rate of interest on such loans might threaten the capacity of the latter to service their debts.

317. In addition to such factors as the learning process of banks and changing practices in the Eurocurrency markets, other advantages, involving convenience and flexibility to borrowers, also contributed to the rapid growth of medium-term international bank lending to developing countries during the 1970s. This growth resulted in an increase in the share of such lending in net longer-term financial flows to developing countries in comparison with that of export credits. Eurocurrency borrowing cannot be sharply distinguished from export credits, since much of it is for the purpose of financing international trade, for example, as a source of funds for buyers' credits. Nevertheless, such borrowing, especially in the form of medium-term syndicated loans, has many advantages of greater flexibility than export credits. For example, Eurocurrency loans are not necessarily tied to particular purchases and are normally unsecured. The schedules for drawings and repayments can be varied to suit the needs of particular borrowers and prepayment is often permitted, thus enabling borrowers to benefit from favourable changes in conditions in the capital markets. Loans are available in several different currencies, and it is often possible to change the currency denominations at each "roll-over" period. Moreover, syndicated medium-term Eurocurrency loans were especially attractive as a means of financing imbalances in external payments. Very large sums of money could be raised in this form,[97] and the loans were associated with fewer and less restrictive policy conditions than finance from multilateral financial institutions such as IMF. However, it should be emphasized that the bulk of Eurocurrency lending to developing countries was concentrated among a limited number of borrowers, and that the rates of interest on it were often higher as well as more unstable than those on export credits. Thus, it is not surprising that,

---

[95] Expanded participation in Eurocurrency lending was also facilitated by clauses in the loan agreements designed to ensure equal treatment for all creditors in the event of defaults. For example, "cross-default" clauses provide that a default by a borrower on any one loan is to be treated as a default on all its loans.

[96] Floating-rate loans became a widespread feature of banking practice during the 1960s in response to greater fluctuations in interest rates. The rapid increase in their use in the Eurocurrency markets is often attributed to the aftermath of the rise in Eurodollar interest rates due to restrictive monetary policy in the United States in 1969, since many banks in these markets had been financing medium-term lending at fixed rates of interest on the basis of short-term deposits.

[97] Borrowing large sums from the Eurocurrency markets was facilitated by the possibility of raising big individual loans, on occasion worth over $1 billion. Such sums were possible owing to the practice of syndication discussed earlier.

although the share of export credits in net medium- and long-term financial flows to non-oil-exporting developing countries declined from the level attained at the beginning of the 1970s, such credits still increased rapidly during much of the decade.

C. The growth of bank lending to developing countries after 1973 and its implications for the international financial system

318. The rise in international bank lending to developing countries accelerated after 1973. As a result, its share in the net flow of medium- and long-term finance to non-oil-exporting developing countries increased from less than 18 per cent in 1973 to about 30 per cent in 1979.[98] The factors considered above continued to be conducive to this growth of bank lending. However, various other influences were also important after 1973. There was a great rise in the demand for international financing during this period owing to the increases in imbalances in external payments and, as already mentioned, for many deficit countries bank lending was well suited to meeting much of their borrowing requirements. On the supply side of the capital markets higher lending was facilitated by the increased liquidity resulting from the deposits of oil-exporting countries.[99] Moreover, the initial experience of lending to developing countries had been favourable, and the borrowing prospects of the main recipients of funds continued to benefit from their relatively successful performance during much of the decade as regards economic variables such as the growth of GDP and exports.[100]

319. The growth of international bank lending during the period after 1973 was accompanied by a rapid increase in the number of participating banks. For example, on the basis of World Bank data it has been estimated that the number of named participants in publicized Eurocurrency credits almost tripled, from 133 to 386, between 1972 and 1980.[101] While the profitability of international bank lending was a major force behind these phenomena, the rates of expansion of both loans and participant institutions were also affected by changes in outlook and organization and by competition. Reference was made earlier to the effect of learning on the increase in international banking before 1973. This process was a continuing one, and as its influence became more widely felt, additional banks were attracted into international lending. Moreover, with greater experience banks integrated their international business more fully into their managerial and organizational frameworks. Among the results were increased willingness to expand both the types of their involvement in international financing and the categories of borrowers to whom they lent. The effects of banks' learning process about international operations were reinforced by the closely related considerations of fashion and the determination to match their closest competitors with respect to partic-

---

[98] UNCTAD, *Handbook of International Trade and Development Statistics, 1983* (United Nations publication, Sales No. E/F.83.II.D.2), table 5.3. (The share of international bank lending is approximately the same as that of bilateral portfolio investment.) The figures in this source exclude Mexico, which was a major recipient of international bank loans throughout this period and was widely classified as non-oil-exporting until the late 1970s.

[99] For example, the Eurocurrency deposits of a group of major oil exporters rose from $5 billion at the end of 1973 to almost $90 billion at the end of 1979. (*Bank of England Quarterly Bulletin*, June 1980, p. 158.)

[100] Banks' losses on their international loans (including those to developing countries) were low throughout the 1970s.

[101] Group of Thirty, *Risks in International Bank Lending* (New York, 1982), pp. 61-62. For the purpose of these estimates loan participants were consolidated into parent institutions. Such consolidation was possible only for named banks participating in the Eurocurrency credits covered by the World Bank data (which specify by name a maximum of ten participants, giving the number of additional, unnamed participants for loans where this figure is exceeded).

ipation in different kinds of business.[102]

320. The rate of growth of developing countries' bank debt was fastest in the first half of the 1970s. During the rest of the decade expansion continued at lower but still substantial rates (although there were sharply higher gross commitments in this form in 1978 and 1979). The slowdown in the rate of growth of developing countries' bank debt reflected the impact of factors involving both the supply of, and the demand for, funds. On the supply side banks' diversification of their assets through loans to developing countries was to some extent a once-for-all process. Subsequently, such loans would have tended to increase at a rate more in line with that of other kinds of lending. The fall in the growth of lending for this reason seems to have been partly, but not completely, offset by the entry of new banks into Eurocurrency lending.[103] The limits to this process of diversification were closely associated with banks' perceptions of the creditworthiness of different developing countries. These perceptions were reflected in the heavy concentration of international bank lending among a small number of such countries. For example, two borrowers accounted for more than one-third of Eurocurrency credits to developing countries in all but two of the years 1973-1979 and the five largest borrowers for more than 50 per cent of such credits in all but one of these years.[104] On the demand side, too, there were factors which would have tended eventually to restrain the increase of bank debt. For example, the loan demand of the major borrowers from banks was not unlimited, determined as it was by the interaction of their financing requirements and the prospects for variables affecting their capacity for servicing external debts.

321. The expanded share of international financing in the form of bank lending left the international financial system highly vulnerable to certain kinds of external shock. Reference was made above to various aspects of the evolution of international banking practices whose effects were to reduce important categories of

---

[102] The expansion of international bank lending may also have been affected by a widespread belief that, in the event of serious difficulties in the international capital markets owing to defaulting, additional liquidity would be provided from official sources. In support of such a belief attention was frequently drawn to a press communique of the governors of the central banks of the Group of Ten and Switzerland in September 1974 referring to an exchange of views on lender-of-last-resort facilities in the Eurocurrency markets, in which they "recognized that it would not be practical to lay down in advance detailed rules and procedures for the provision of temporary liquidity" but were satisfied that "means are available for that purpose and will be used if and when necessary". However, there must be doubt as to how far the existence of lenders of last resort influences banks' propensities to lend to different categories of borrowers. Large losses for banks frequently cause the officers responsible for the loans in question to lose their jobs, even if the ultimate stability of the financial system is assured by a lender of last resort. Nevertheless, it is reasonable to assume that the perceived security of deposits in the Eurocurrency markets was enhanced, and thus their supply of funds increased, by confidence that financial support for the international banking system would be forthcoming during periods of crisis.

[103] Easily available information suggests that there was only a slight fall in the rate of new entry of banks into Eurocurrency lending during 1973-1979. For example, World Bank data on 526 parent institutions participating in publicized Eurocurrency lending for the first time during 1973-1980 show a small fall in this rate until 1979. The rate would have decreased much more, if there had not been a rise in the rate of new entry on the part of banks from areas outside western Europe and North America, which, however, probably tended to be smaller than earlier entrants. The World Bank data are discussed in Group of Thirty, *op. cit.*, pp. 61-65.

[104] UNCTAD, *Handbook of International Trade and Development Statistics* and *Supplements*, table 5.12, various issues. In 1977 the share of the five largest borrowers in total Eurocurrency credits to developing countries was 49 per cent.

risk associated with borrowing and lending, especially in the Eurocurrency markets. However, no protection was provided against risk arising out of unfavourable changes affecting many borrowers simultaneously (sometimes designated systemic risk).

322. For example, the syndication of loans provides no protection against widespread falls in borrowers' ability to service their debts caused by the impact on their external-payments positions of unfavourable changes in the international markets for goods or funds (or both). In the case of variable-rate credits a global rise in interest rates is passed on to the borrower, with the result that reduced interest-rate risk for the lender is translated into increased credit risk.[105] Moreover, the inter-bank market, which facilitates the process of funding in normal conditions, becomes a potential source of heightened instability during periods of disturbance. By serving as a conduit for flows of funds among banks it is capable of transmitting widely throughout the capital markets the effects of local shocks originating anywhere in the international financial system. Disruptions of the inter-bank markets manifest themselves in such phenomena as restrictions on the access of certain banks to inter-bank deposits and the "tiering" of interest rates for certain borrowers (which increases their costs of funding).

323. A financial system cannot function smoothly without continuing flows of lending in all economic conditions. However, bank finance tends to be most easily available during periods when business is good. Indeed, it often adds to the impetus of booms. It becomes more difficult to obtain with the onset of recession or other factors adversely affecting borrowers' cash flows. Thus, there is a danger in such circumstances that the banks' own collective behaviour will put an additional squeeze on cash flows and in this way further undermine borrowers' creditworthiness.

324. In the international capital markets this danger has been enhanced by certain features of the expansion of lending in recent years. Especially important in this context are factors causing banks to behave as a herd. As mentioned above, during the 1970s fashion and emulation among banks helped to raise the growth of their international lending to developing countries and other borrowers. Moreover, as a result of the unequal distribution of knowledge among banks, owing, for example, to the key role accorded to a minority of them by syndication and the sheer size of the inter-bank market, which makes it difficult to determine ultimate sources and uses of funds, there were marked tendencies towards follow-the-leader behaviour in the international capital markets. In deteriorating world economic conditions the same forces are capable of hastening the contraction of international bank lending. Now leading banks may well wish to restrict or even to reduce their exposure to borrowers to whom previously they were eager to lend. Other banks, possessing inferior access to information, will surely follow. Thus, a wave of pessimism may be the sequel of the preceding wave of optimism, and there is a risk that the fall in lending will get out of control.[106]

D. The onset of the international financial crisis

325. Since the beginning of the 1980s the international financial system has been in the midst of a continuing crisis which has exemplified many aspects of its vulnerability to large external shocks. The period has been marked by fluctuating but generally higher international interest rates, sharp movements of major exchange rates, including an appreciation of the United States dollar, and depression in much of the world economy.

[105] Borrowing by developing countries in the form of international bonds at fixed rates of interest has remained limited since the beginning of the 1970s.

[106] Potential instability is increased by "cross-default" clauses, under which default on all the loans to a particular borrower can be triggered by a declaration of default concerning any one of them. (See footnote 95 above.)

326. The rise in international interest rates beginning in the second half of 1979 reflected a widespread shift in the policy stance of major developed market-economy countries in response to fears concerning inflationary pressures associated, *inter alia*, with the impact of increases in the price of oil. The shift in monetary policy was especially sharp in the United States, where it also served to stem a fall in the external value of the dollar. In the aftermath of this shift the three- and six-months deposit rates for Eurodollars increased by more than 50 per cent between September 1979 and March 1980. After a sharp fall in mid-1980 the rates rose to new peaks later in the year and, except for brief periods, until late 1982 remained at levels much higher than those of the first half of 1979. Such movements of interest rates resulted in greatly increased debt-service payments for developing countries. At the same time, the depression which began in 1979 led to a subsequent widespread erosion of creditworthiness, as both the volume and the unit value of world exports fell after 1980. For developing countries the effects of these trends in world markets were exacerbated by an intensification of protectionism against their exports, itself partly a consequence of the depression and, in the case of the United States, of the deterioration of domestic producers' competitive position due to the appreciation of the dollar following the shift to a tighter monetary policy.

327. The deterioration of the external payments positions of major borrowing countries which accompanied the rise in interest rates and declines of exports during this period led eventually to the outbreak of widespread debt-servicing difficulties, which first emerged in certain socialist countries of Eastern Europe in 1981. At the same time, there began a series of cases in which well-known private companies in developed market-economy countries failed or were forced into reorganizations of their debts. By 1982 there were signs that certain developing-country borrowers were facing serious liquidity difficulties in the management of their external debt and payments. Indeed, in some cases the outflow of funds to meet interest costs on loans from banks began to exceed total new monies borrowed from this source. It was becoming apparent that certain borrowers were having trouble in refinancing medium-term bank debts and were consequently having increasing recourse to short-term credit in excess of that required for their international trade.[107]

328. In the middle of 1982, after the suspension of debt-service payments by one of its largest private enterprises and substantial capital flight, Mexico found itself unable to meet payments due on its public external debt, and was forced to seek emergency financial assistance and a rescheduling of its obligations. Following these events, banks in Brazil, the other large Latin American borrower, began to have trouble in raising money in the inter-bank markets. Towards the end of the year, as a result of its liquidity difficulties, Brazil also found it necessary to seek various forms of emergency financial support. Earlier, Argentina had already started to experience restrictions on its access to medium-term bank credit, and during 1982 some other borrowing countries, principally in Latin America, faced a growing squeeze on their external cash flows owing to the reduced availability of bank finance. In 1983 similar problems spread to various countries in Africa and Asia. These liquidity shortages

[107] One way of measuring a country's short-term debt in excess of the normal financing requirements of its international trade is to take the amount of such debt in excess of the value of its imports during a six-month period. It has been shown that, for a sample of 11 countries, serious difficulties in servicing their external debts after 1981 were preceded by indications of increased excess short-term debt according to this measure in more than two-thirds of the cases. (See "International Debt. Banks and the LDCs", *Amex Bank Review*, Special Paper No. 12 (London: American Express International Banking Corporation, 1984)), pp. 17-18. A country's immediate liquidity difficulties may not be evident on the basis of this indicator, if it is able to draw on unused credit lines or to borrow at maturities slightly in excess of one year.

led to a proliferation of renegotiations of bank debt and a large rise in the sums rescheduled.[108]

329. The restrictions on their access to bank finance recently experienced by various developing countries are part of a larger slowdown in such lending since 1981. For example, gross commitments of medium- and long-term international bank loans to developing countries fell by about 30 per cent between 1981 and 1983,[109] and net flows of such financing have also decreased since 1981. Lower rates of lending have not only accentuated the financial difficulties of borrowing countries, thus forcing them to restrict imports and adding to global deflationary pressures, but have also been associated with types of behaviour on the part of banks faced with deteriorating economic conditions which were described earlier.

330. For example, since the onset of the financial crisis there has been widespread reluctance among banks to extend additional loans to developing countries.[110] In consequence, considerable official pressure has been necessary even to maintain bank lending at current, reduced levels. Here a crucial role has been played by IMF, which in a number of instances during the recent process of debt restructuring has made approval of its own stand-by arrangements conditional on undertakings by banks with respect to additional financing. Through such pressures IMF has helped to restrain tendencies among banks to curtail their involvement in lending to developing countries.[111] However, these continued flows of funds from banks have usually been obtained only at the cost of substantially higher spreads and commissions on the rescheduled commitments and new credits agreed as part of the debt renegotiations.[112] Moreover, such pressures have also been associated with a segmentation of banks' lending

---

[108] For example, the sums rescheduled in renegotiations of bank debt of developing-country members of the World Bank amounted to $56.5 billion in 1983, in comparison with figures of $4.5 billion in 1981 and $1.6 billion in 1982. (See *World Debt Tables. External Debt of Developing Countries, 1983-1984 Edition* (Washington, D. C.: World Bank, 1984), p. xviii.)

[109] OECD, "International capital markets - historical series", *Financial Market Trends,* No. 27, March 1984, table I.31.

[110] There has also been a slowdown of the flow of funds through the inter-bank markets. The slowdown has been attributed partly to publicity during debt renegotiations concerning certain features of banks' international lending. This publicity generated greater awareness among banks of such phenomena as the concentration of risks in the portfolios of, and the extent of maturity mismatching engaged in by, certain institutions as well as the use of short-term funds raised in the inter-bank markets by foreign branches and subsidiaries of banks with headquarters in some developing countries to finance medium-term lending at home.

[111] As the Managing Director of IMF put it in an address in December 1983, "The first thing to be said about the recent debt crises is that they did pose a very serious threat to the international financial and trading system. . . To support these adjustment efforts [of debtor countries], it has been essential to ensure that adequate financing flows be maintained. In this regard, a key objective has been to avert too sharp a reduction in net new lending by the commercial banks. . . As you know, the Fund has been instrumental in helping to put together financing arrangements in collaboration with governments, central banks, the Bank for International Settlements (BIS), and commercial banks". *IMF Survey,* Vol. 13, No. 1, 9 January 1984, p. 4.

[112] In discussion of the advantages to developing countries of Eurocurrency borrowing, attention is often drawn to the opportunities available for shopping around for better terms and thus taking advantage of competition among banks. However, during recent debt renegotiations borrowers have been faced with committees established to co-ordinate the actions of their creditor banks, and it is noteworthy that the terms arrived at for spreads and commissions have often been significantly more onerous than those on lending to the same borrowing countries in the period before the financial crisis. See, for example, Economic Commission for Latin America, "Adjustment policies and renegotiation of the external debt" (E/CEPAL/G.1299), table 15.

operations in this field, so that in a recent report the Bank for International Settlements referred to "the emergence of a split market, with no new spontaneous lending to Latin America in 1983" by banks in its reporting area.[113]

331. At the same time, finance from official sources and export credits have not increased to fill the gap left by lower bank lending. Indeed, both types of financing have tended to stagnate or decrease since 1980. Preliminary estimates indicate that in 1983 developing countries received new loans from all sources whose value was lower than their debt-service payments.[114]

332. This slowdown of financial flows is being accompanied by the spread of disorder and uncertainty throughout the international financial system. Pressures on borrowers are leading to a widespread breakdown of the normal channels of international payments, as witnessed by increases in arrears and in debt reschedulings and the proliferation of bilateral agreements between exporters and importers, private and official, for the purpose of countertrade.[115] Moreover, many aspects of the current financial crisis are now evolving outside of the control of the parties concerned. For developing-country borrowers effective management of external payments and debt is rendered increasingly difficult, if not impossible, by uncertainties over levels of interest rates and the availability of finance. At the same time, banks have lost control of the maturity structure of a significant part of their assets owing to the uncertain status of many of their international loans. Indeed, relations between lenders and borrowers in the international capital markets are now being forced to adjust to a situation in which it is widely recognized that the provisions in many current loan agreements have become fictitious.

---

[113] Bank for International Settlements, *International Banking Developments, Fourth quarter 1983* (Basle, April 1984), p. 9. ("Non-spontaneous" bank loans are those arranged in association with credits from IMF.)

[114] *World Debt Tables, op. cit.*, pp. ix-x (which indicates a negative net transfer for developing countries' medium- and long-term debt), and OECD, *External Debt of Developing Countries, 1983 Survey* (Paris, 1984), tables 9-10 and 13 (which indicate a negative net transfer for the total debt of non-OPEC, non-OECD developing countries).

[115] On the recent growth of countertrade, see annex B below.

Chapter V

THE EVOLUTION OF MULTILATERAL FINANCING

A. Growth of the multilateral system (1947-1973)

333. As it exists today, the multilateral system consists of a wide variety of financing mechanisms ranging from the World Bank Group and IMF to the regional and subregional development banks and the United Nations development agencies, the latter being also a particularly important source of technical and sector-specific assistance.[116] While recognizing the important role which this complex of institutions has played in providing assistance to developing countries, this chapter discusses primarily the Bretton Woods institutions, which were designed to play a key role in the post-war trade and payments system.[117]

334. In the years immediately following their establishment, the World Bank and IMF operated on a modest scale.[118] In the period 1947-1958, net annual use of IMF credit averaged $425 million, or 5 per cent of quotas, while the loan commitments of the World Bank maintained an annual level of around $200-400 million; but more than one-third of the commitments made by the Bank in the five years to 1952 was accounted for by reconstruction loans to four European countries.[119] On the other hand, bilateral flows to developing countries expanded vigorously, averaging close to $2 billion annually during 1950-1955, and rising to over $4 billion in 1958.[120]

335. A shift of emphasis towards multilateral financing began towards the end of the 1950s. This was partly due to changing perceptions of the efficiency of multilateral mechanisms compared with bilateral ones, but was mainly the result of important changes in the international situation: among them were the increased scope for burden-sharing by the industrialized countries once economic recovery was well under way (the bulk of development financing had previously been almost exclusively provided by the United States), and the growing influence of developing countries in international forums as a result of the decolonization process. The 1960s thus witnessed both qualitative and quantitative changes in the availability of financial flows.

336. IMF entered an expansionary phase in 1958 when quotas were doubled to $15 billion and were increased further to $29 billion by 1970. As a proportion of world imports, however, quotas fell

---

[116] These agencies have been playing an increasingly important role. In 1982, for instance, they accounted for one-third of all contributions by governments to the development activities of the United Nations system.

[117] The rationale of this system and the objectives of its institutions are discussed in chapter II above.

[118] This was partly for the reasons discussed in the preceding chapter, but in the case of IMF it is also attributable to the policy stance of the United States, particularly its emphasis on conditionality, as opposed to automaticity, of drawings, which led to a decline in requests for credit and, for a time, to a total halt in financial activity. See Sir Joseph Gold, "Some impressions of the early Fund", *Finance and Development*, March 1984, and A.D. Scott, "The role of the International Monetary Fund in economic development", in *Columbia Essays in International Affairs: The Deans Papers* (New York: Columbia University Press, 1967).

[119] E. S. Mason and R. E. Asher, *The World Bank since Bretton Woods*, (Washington, D.C., The Brookings Institution, 1973), p. 150.

[120] These figures represent financial flows from DAC member countries to developing countries and to multilateral agencies. (See *Partners in Development, Report of the Commission on International Development* (London: Pall Mall Press, 1969), pp. 137 and 378.)

from a peak of 13 per cent in 1959 to around 9 per cent in 1970. Partly in response to a suggestion made by the United Nations,[121] in 1963 IMF established the Compensatory Financing Facility (CFF) to provide compensatory finance to primary producing countries experiencing shortfalls in export receipts, and liberalized the Facility in 1966.[122] In 1969 the Buffer Stock Financing Facility (BSFF) was established in IMF to assist members who faced payments problems as a result of their participation in international buffer stock schemes. IMF made provision in 1962 to supplement its own resources with funds borrowed from countries members of the Group of Ten by creating the General Arrangements to Borrow. The expanded resource base of IMF did not, for reasons related mainly to the conditionality of purchases, to the relative scale of balance-of-payments deficits and to the existence of bilateral swap arrangements among the developed countries, give rise to a comparable use of its resources; between 1959 and 1973 the use of Fund credit averaged only 9.5 per cent of quotas.

337. As evidence accumulated that a relative shortage of world reserves was looming ahead, the IMF special drawing right scheme was instituted in 1969 after a long period of study and negotiation. While the allocation of SDRs on the basis of quotas did not acknowledge that developing countries had particularly inadequate reserves, the participation of these countries both in the negotiations in IMF leading to the introduction of SDRs and in the scheme itself satisfied the demand, voiced both within and outside[123] IMF at the time, that developing countries should be adequately represented in discussions leading to international monetary reform and in the operation of the new arrangements. Since then, developing countries have also participated in the work of the Committee on Reform of the International Monetary System and Related Issues (the Committee of Twenty) and of the Interim Committee.

338. The World Bank, too, became more active. Loan commitments rose sharply to over $700 million in 1958, a level which largely prevailed for a decade, and in 1969 its capital was raised to $25.3 billion. These years saw increasing Bank activity as a co-ordinator of assistance flows through consortia and consultative groups. Furthermore, by 1967 the Bank had virtually ceased to lend to developed countries. The increased recognition of the diversity of developing country needs, particularly for finance on concessional terms, also led during this period to the establishment of regional development banks for respectively Latin America, Africa and Asia, on the one hand, and, within the World Bank, of the International Development Association (IDA), on the other.

339. After 1968, World Bank Group lending accelerated rapidly, so that in the five years to 1973 annual commitments doubled, to $3.4 billion. The regional development banks also increased their lending, though to a lesser extent. Thus, by 1973 the multilateral institutions (World Bank Group, regional development banks, United Nations agencies and European regional funds) accounted for almost a third of total bilateral DAC and multilateral commitments, compared with some 17 per cent in 1968. This increased relative share was almost entirely attributable to the rapid growth in World Bank Group lending; the combined share of the three regional development banks remained at 24 per cent.[124]

---

[121] See United Nations Commission on International Commodity Trade, report on the tenth session (*Official Records of the Economic and Social Council, Thirty-fourth Session, Supplement No. 6*), para. 55.

[122] Both UNCTAD I (1964), in its recommendation A.IV.17, and the first UNCTAD Group of Experts (1965) identified measures for improving the Facility. For the report of the Group of Experts see *International Monetary Issues and the Developing Countries* (TD/B/32), United Nations publication, Sales No. 66.II.D.2, especially para. 56.

[123] See the report of the Group of Experts mentioned in the previous footnote and also General Assembly resolution 2208 (XXI) of 17 December 1966.

[124] M. E. Akins, *U.S. Control over World Bank Group Decision-making* (Ann Arbour, Michigan and London: University of Microfilms International, 1981), pp. 63-64 and 66.

340. These activities took place against the background of a significant overall growth of official or officially-supported financial flows. Official development assistance grew steadily in the 1950s and by 1963 amounted to nearly $6 billion. The pace of growth slowed thereafter, while private flows, particularly direct investment, assumed greater dimensions.[125] In 1964, the First session of UNCTAD adopted a target of 1 per cent of national income for flows of official and private capital from developed to developing countries (recommendation A.IV.2), and this target was later endorsed by members of the DAC. In 1969 the Pearson Commission proposed that donors increase commitments of ODA to the level necessary for net disbursements to reach 0.7 per cent of GNP,[126] and two years later this target was adopted as part of the International Development Strategy for the Second United Nations Development Decade.[127]

341. Though following different trends, official bilateral and multilateral sources together made a significant contribution to the development process during the 1950s and 1960s. Their combined share in the long-term financial flows received by developing countries reached 71 per cent in 1963; it then tended to decline, but still represented more than half of the total in 1971.[128]

342. A form of financing which took on increasing importance was export credits. The growing competition among exporters, particularly of capital goods, combined with the willingness of government-backed credit institutions to support them, tended to improve the terms of export credits, which thus became attractive to a wider spectrum of developing countries, especially for those whose access to other forms of finance was restricted for various reasons.[129] The share of export credits in financial flows to developing countries increased from well below 10 per cent in the 1950s and early 1960s to a peak of 15 per cent in 1971, equivalent to $2.4 billion.[130]

B. A faltering response to increased needs (1974-1979)

343. The international monetary and financial system was confronted with a major challenge by the sudden emergence in 1974-1975 of large payments imbalances of a mainly structural character. The new situation clearly called for larger amounts of official payments finance and on a conditional basis that reflected the character and external origin of the deficits. The multilateral institutions responded to a degree with a number of measures intended to assist deficit countries. IMF established the Oil Facilities (OF) and the Extended Financing Facility (EFF), designed to provide longer-term assistance than had been available under stand-by arrangements. Developing countries most seriously affected by the world crisis also benefitted from the Subsidy Account, which reduced the interest burden arising from drawings on the OF, while the Trust Fund (TF) provided highly concessional resources to lower-income members.[131] At the same time, the CFF was further liberalized. Finally, the Supplementary Financing Facility (SFF) was created, which increased members' access to high conditionality credit. In 1979

[125] *Partners in Development, op. cit.*, p. 137.

[126] *Ibid.*, p. 148.

[127] The Commission also recommended that donor countries should increase grants and capital subscriptions for multilateral development finance to a minimum of 20 per cent of the total flow of ODA. (*Ibid.*, p. 229.)

[128] UNCTAD, *Handbook of International Trade and Development Statistics, Supplement 1977* (United Nations publication, Sales. No. E/F.78.II.D.1), table 5.2.

[129] See annex B below.

[130] UNCTAD, *Handbook of International Trade and Development Statistics, Supplement 1977*, table 5.2. This source includes only official and officially-guaranteed private export credits until 1964 and estimates of the non-guaranteed part of the latter thereafter.

[131] Trust Fund loans carried an interest rate of 0.5 per cent per annum, had a final maturity of ten years from the date of disbursement, and were repayable in semi-annual instalments commencing five-and-a-half years after disbursement.

IMF entered into borrowing agreements with 13 member countries and Switzerland, for a total of SDR 7.8 billion, to finance the SFF.

344. These developments must, however, be viewed against the perspective provided by the magnitude of IMF's operations. First, its size: the proportion of quotas to world imports, already down to 9 per cent in 1970, fell to below 5 per cent after 1973. As for the actual recourse of members, the net use of Fund credit was markedly higher than in the previous period, both in absolute terms and in terms of quotas; except for two years, however, it did not exceed 30 per cent of quotas. Indeed, in 1978 and 1979 repurchases exceeded purchases, which meant that IMF was not in these years a net source of liquidity. Of the cumulative use of Fund credit of around SDR 7 billion between 1974 and 1979, non-oil-exporting developing countries accounted for SDR 4 billion; this represented just over 2 per cent of their combined current-account deficit during this period.[132]

345. The evidence suggests that the importance of IMF as a source of finance was small, in part due to its limited resources, but mainly because deficit developing countries were reluctant to make drawings involving a high degree of conditionality,[133] and at a time when plentiful financing could be obtained from other sources. Indeed, commercial credit on relatively attractive terms became increasingly available and those developing countries that could do so turned to that source of financing.[134] It appears that the countries approaching the Fund were mainly either lower-income countries which had no alternative sources of finance or countries seeking to use the Fund's seal of approval in order to obtain the confidence of private capital markets.

346. The SDR, too, fell short of expectations. Despite all the improvements in its usability,[135] it did not move towards becoming the principal reserve asset of the system, still less towards being linked to development finance. From 8 per cent in 1972, the share of SDRs in total non-gold reserves of IMF members fell to a low point of 3 per cent in 1978 and did not recover much beyond 5 per cent after the second allocation of 1979-1981. Cumulative allocations then stood at less than SDR 22 billion, of which developing countries had received SDR 6 billion.

347. The lending of the other multilateral financial institutions also grew in 1974-1979. The combined World Bank and IDA volumes of annual commitments and disbursements more than doubled, to \$10 billion and \$4.8 billion, respectively, in 1979. Cumulative loan commitments during the period totalled \$42.3 billion and disbursements \$21.6 billion.[136] In 1974 the Bank introduced the cofinancing technique and a year later the Intermediate Financing Facility (the so-called Third Window), to provide development assistance on terms between those on regular lending and those of IDA. Meanwhile, the three regional development banks all created or expanded concessional loan facilities and also engaged in various forms of cofinancing. Between 1974 and 1981 their combined loan commitments amounted to \$25.5 billion. In relation to the needs of their constituents, however, these flows were inadequate: thus, for example, the Inter-American Development Bank's \$2.5 billion loan commitments in

---

[132] UNCTAD, *Handbook of International Trade and Development Statistics*, various issues, table 5.3.

[133] This reluctance was by no means limited to developing countries. In 1974-1976, for instance, there were only 10 cases of drawings beyond the first credit tranche among the entire IMF membership. (See Sidney Dell, "On being grandmotherly: The evolution of IMF conditionality", *Princeton Essays in International Finance*, No. 144, October 1981, p. 24.)

[134] See the preceding chapter for the growth of international bank lending to developing countries. It should also be noted that by the end of the decade maturities had lengthened to as much as 10 years on some Eurocurrency loans. (See K.W. Dam, *The Rules of the Game* (Chicago and London: University of Chicago Press, 1982), p. 296.)

[135] *Ibid.*, pp. 275-279.

[136] These figures have not been adjusted for inflation, which was unusually high throughout the period.

1981 compared with an estimated deficit for the region of $34 billion.[137]

348. Again, the pattern of activity of multilateral institutions followed that of official flows generally. Like the multilateral institutions, ODA became a less important source of finance during the 1970s. The ratio of ODA to GNP for all DAC countries fell from over 0.50 per cent in the early 1960s to a nadir of 0.29 per cent in 1973 and averaged 0.32 per cent in the subsequent years to 1979.[138] Nevertheless, although it grew by less than the needs of the developing countries, ODA remained a crucially important source of finance for the low-income countries.

349. These trends were partly counterbalanced by the rapidly growing contribution of the OPEC member countries. It is estimated that during 1974-1979 these countries made available directly to non-oil-exporting developing countries some $39 billion as grants and soft loans.[139] Some OPEC countries also provided substantial resources to the Bretton Woods institutions, through loans for the OF, the SFF and the GAB, and through direct purchases of World Bank bonds. Moreover, a number of new financing mechanisms were established by OPEC countries, some of them bilateral and some, in particular the OPEC Special Fund, multilateral. Funds from such institutions were highly concessional and contained a significant share of programme loans and long-term balance-of-payments assistance.

350. An important new institution established during this period was the International Fund for Agricultural Development (IFAD). It is consciously based on an equitable partnership between developed donor countries, developing donor countries and developing recipient countries.

351. Though funds of OPEC origin accounted for a sizeable share of long-term financial flows between 1974 and 1979, private bank lending grew so fast that, notwithstanding the increase in OPEC flows, the share of total official bilateral and multilateral flows in the long-term finance received by non-oil-exporting developing countries experienced a further decline.

352. Officially-guaranteed export credits also grew rapidly up to 1976, after which they stabilized at around $4.5 billion in 1977-1979. However, their share in total flows to non-oil developing countries tended to fall below the level of around 15 per cent of the early 1970s.[140]

353. In sum, despite considerable innovation and rates of resource growth that compare favourably with those of the past, the multilateral institutions were not adapted by their members at the pace required by the rapidly changing world economic situation. Consequently, they became increasingly marginal to the functioning of the monetary and financial system.

C. Crisis management and the growing impact of financial stringency and conditionality (1979-1983)

354. After 1979 the combination of higher import prices, particularly for

---

[137] See the report by the UNCTAD secretariat, *Multilateral Development Finance Institutions of Developing Countries and the Promotion of Economic Co-operation and Integration* (TD/B/C.7/64), a forthcoming United Nations publication.

[138] UNCTAD, *Handbook of International Trade and Development Statistics, Supplement 1980* (United Nations publication, Sales No. E/F.80.II.D.10 and corrigendum), table 5.9B. These averages mask widely varying individual performances. While the major donors displayed signs of aid fatigue, Norway, Sweden, Denmark and the Netherlands have met, and even surpassed, the target on several occasions.

[139] See the report by the secretariat of UNCTAD, *UNCTAD, Financial Solidarity for Development. Development Assistance from OPEC Members and Institutions to Other Developing Countries, 1973-1981* (TD/B/C.3/187-TD/B/C.7/65), United Nations publication, Sales No. E.84.II.D.3, annex table 2.

[140] UNCTAD, *Handbook of International Trade and Development Statistics*, various issues, table 5.3.

energy, and reduced export earnings caused by recession and increasing protectionism in the developed countries, together with a sharp rise in interest rates and debt-service payments, had a severe impact on the current account of the majority of developing countries.[141] The resulting large financing gap of the developing countries was only partially covered by aid and export finance. The ODA/GNP ratio of DAC countries dropped further from its 1980 level of 0.36 per cent as bilateral ODA flows to developing countries were constant in nominal terms in 1980-1982. Flows from OPEC countries, which had risen fast until 1980, slowed thereafter as payments surpluses shrank. As for export finance, both the volume of official and officially-guaranteed DAC export credits and their share in net financial flows to developing countries fell after 1980, despite the slowdown in the growth of private bank credit. As needs multiplied and options narrowed, these countries turned increasingly to the multilateral institutions.

355. The net use of IMF credit by developing countries rose sharply in 1980 and again in 1981, reaching SDR 4.8 billion by the end of that year. This increase was facilitated by the enlargement of quotas which followed the Seventh General Review, the creation of a subsidy account to reduce the cost of SFF drawings for low-income members and the adoption in 1981 of the enlarged access policy, made possible by borrowed funds totalling SDR 9.3 billion, which raised the limits on drawings relative to quotas.[142] The rise reflected the large number of Fund members experiencing difficulties: 51 developing countries made net use of Fund resources in 1981 as compared with 26 in 1979.

356. The expansion of Fund activities in 1980 and 1981 was substantially different in character from that in 1974 and 1975. During the earlier period, it was believed that the sharp expansion in the external deficits of developing countries was either temporary in character or required, for various other reasons, to be financed for the time being at roughly their current levels, rather than sharply reduced.[143] Despite a number of important similarities with the earlier period, however, the Fund's assessment in 1980 and 1981 was that the external payments difficulties of developing countries had to be met with vigorous adjustment measures. Consequently, the use of Fund resources in these years entailed high conditionality.[144]

357. In recognition of the diverse character of the financing needs of developing countries, the World Bank introduced the programme of structural adjustment lending (SAL) during the same period, which was designed to assist countries in addressing structural problems that underlay external payments difficulties. SALs were not funded by any overall increase in Bank resources and were limited overall to 10 per cent of total Bank lending.

358. Both the size and the terms of financial flows to deficit developing countries were adversely affected by the debt crisis of 1982. As private banks sought to reduce their exposure,

---

[141] From $31 billion in 1978 the current-account deficit of non-oil-exporting developing countries had more than doubled by 1980 and reached a peak of $80 billion in 1981. (UNCTAD, *Handbook of International Trade and Development Statistics, 1983*, table 5.3.)

[142] In April 1984 IMF entered into additional borrowing agreements totalling SDR 6 billion.

[143] The principal consideration in this regard was the view that the deficits of non-oil-exporting developing countries were the counterpart of the surpluses of the oil-exporting countries. Since, in the aggregate, the deficits could not be reduced without reducing the counterpart surpluses, and since this could not be brought about in the short run by means other than lowering levels of activity, particularly in developed countries, it was deemed appropriate to finance the deficits.

[144] In the words of the Managing Director of IMF, "In the period following the first oil shock, approximately three-quarters of the resources provided . . . were made available on terms involving a low degree of conditionality. At present, by contrast, some three-quarters of our new lending commitments involve 'upper-credit tranche' programmes, that is to say, they require rigorous adjustment policies". *IMF Survey,* 9 February 1981, p. 35.

the rate of growth of international lending declined sharply in that year and fell further in 1983. Thus, the private capital markets now ceased to provide some measure of insulation to developing countries from external disturbances and themselves became a source of disturbance.[145]

359. Many developing countries, with high debt-service ratios and depleted reserves, in fact, had little option but to seek IMF credits. A record total of 63 such countries did so in 1983, and use of Fund credit doubled to SDR 10 billion in the process. The latter included substantial drawings by middle-income developing countries in connection with IMF-sponsored rescue packages.

360. The operations of the World Bank Group also expanded,[146] but here, too, replenishment problems were experienced in connection with IDA VI and VII, as well as with the Bank's proposed selective capital increase.[147] The prospect that net resource transfers from the Bank would begin to decline after 1985 became, and remains, very real. Furthermore, though the Bank has taken steps to increase the impact of its limited resources, notably via the new cofinancing instruments and the Special Assistance Programme (SAP) introduced in 1983, SALs, which are an important component of the SAP, remain restricted by the 10 per cent ceiling, are closely connected to IMF stand-bys and carry additional conditions of their own.

361. The intense crisis which erupted in late 1982 and which required *ad hoc* official action to mount extensive rescue packages for major debtor countries thrust IMF into a central role in the international financial system, where it has been pivotal in preventing a collapse of the system. The Fund has served as a focal point of policy action. It has influenced debtor countries in formulating domestic policy packages to be supported by its resources, and has intervened with the private banking system to influence the magnitude of funds forthcoming. Considerable attention has therefore naturally been focused on Fund policies and actions.

362. As regards adjustment policies, programmes endorsed by the Fund have frequently been associated with sharp drops in economic performance and sometimes with a severe contraction of output. In evaluating such a situation, it must be borne in mind that when sufficient balance-of-payments financing is unavailable, a sharp fall in external earnings and/or an abrupt drop in financial availabilities inevitably leads to severe disruptions of the domestic economy. Evidence to date suggests that attempts to cope with the massive shifts in external accounts and diminished confidence that have characterized recent years would have led to a sharp deterioration in growth even in the absence of any involvement by IMF.[148]

363. The central purpose of the Fund, however, is to allow countries to avoid the need for excessively rapid adaptation to changed external circumstances and therefore to avoid the need to tackle external disequilibria primarily by cutting back imports and growth. In the words of article 1 of its Articles of Agreement, the Fund should "give confidence to members by making

---

[145] A fuller account of developments in this area is given in the preceding chapter.

[146] Combined World Bank and IDA disbursements grew by a third in nominal terms between fiscal year 1981 and fiscal year 1983 to $9.4 billion in the latter year, but this was somewhat less than the 44 per cent of the previous biennium.

[147] The United States decision to stretch out over four years its original three-year commitment to IDA VI resulted in a substantial reduction in IDA's operations. The announced cut-back in the United States contribution to IDA VII has resulted in a $9 billion programme, a sharp decline in real terms compared with the $12 billion of IDA VI.

[148] Brazil, for example, implemented its own package of stabilization measures in late 1980, and pursued these adjustment measures throughout 1981 and 1982. Brazil's rate of growth was 7 per cent in 1979; 8 per cent in 1980; -2 per cent in 1981; and 1.5 per cent in 1982. Brazil entered into discussion with IMF in late 1982, and signed a Fund agreement in January 1983. Brazil's growth in 1983 was -3 per cent.

the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments *without resorting to measures destructive of national or international prosperity*" (emphasis added). Yet the small size of the Fund's resources relative to the monetary and payments needs of its members has placed it in a position in which it could not fulfil this objective, regardless of the policies it chose to follow. Meanwhile, the policies embodied in its conditionality are having an important bearing on the scope of action of governments in dealing with the present crisis, including domestic policies determining internal distribution of income and welfare losses, and strategies for the future.

364. Fund policies also impinge on creditors: in certain cases of commercial bank rescheduling, IMF, in concert with the major creditors, has taken the initiative to ensure that before its resources were committed, sufficient additional funds from both official and commercial sources were available adequately to support the adjustment efforts. IMF has thereby helped to "rein in" the "herd" of private lenders to prevent a self-destructing "stampede". This has been of benefit to the debtor countries; it has also been of great benefit to the banks.[149] Furthermore, the provision of fresh lending from bilateral sources, both concessional and non-concessional, has increasingly required as a precondition that the country should have an operative IMF stand-by agreement.[150] Acceptance of the policy advice given by the Bank has also become a criterion governing the allocation of bilateral ODA. The institutions established at Bretton Woods have thus recently increased their influence in the international financial system, more via their conditionality and its impact on market confidence than because of the size of their own resources.

---

[149] See also chapter IV above, section D.

[150] In all the agreements involving IMF members reached between 1981 and 1983 in the Paris Club, mention was made of the importance that creditor countries attached to the implementation of such an adjustment programme. In some cases, the continued validity of the agreement was made dependent on the country maintaining a satisfactory arrangement with IMF. See the report by the UNCTAD secretariat, "Review of the implementation of Trade and Development Board resolution 222 (XXI), section B" (TD/B/945), chapter III.

Chapter VI

THE FLOATING OF EXCHANGE RATES

365. Over the 1960s the par value system established at Bretton Woods came under increasing strain. In large part, these strains reflected two interacting rigidities in the exchange-rate system as it had evolved. First, the United States authorities regarded the maintenance of a fixed gold parity as essential in order to maintain the role of the dollar as a reserve currency. Hence, they could not resort to currency devaluation to curb the payments deficit (which had grown rapidly partly owing to increased military spending during the late 1960s). Second, surplus countries were reluctant to accept the loss of competitiveness that would ensue from appreciation, and were under little pressure to revalue since they could accumulate reserves instead. This quickened the pace at which foreign official holdings of dollars accumulated, and hence, that at which the net reserve position of the United States deteriorated. The inevitable crisis of confidence in the ability of the United States to convert its liquid liabilities into gold was therefore brought forward in time.[151] Moreover, the United States faced a growing conflict between its domestic policy objectives, in particular the maintenance of high employment, and its need to control its external deficit.

366. A variety of measures were taken, including co-operation among central banks, in order to prevent a breakdown of confidence in the parity structure and preserve the role of the dollar as a reserve currency. However, the stresses gathered increasing momentum at the end of the 1960s, confronting the United States with a double threat of large gold losses, if it maintained the convertibility of the dollar into gold, and the continued erosion of its competitive position, if the dollar did not depreciate *vis-a-vis* other currencies. In 1971 the United States authorities reacted by suspending convertibility and imposing a surcharge on imports.

367. The period that followed witnessed intense efforts to establish a new parity structure. However, the views of the major countries regarding both the appropriate patterns and system of exchange rates proved difficult to reconcile. At the same time, massive speculative pressures were exerted on currencies perceived by currency markets to be wrongly valued. The size of capital movements in response to exchange-rate expectations was such as to force the eventual abandonment of efforts to maintain fixed exchange rates. While floating had already been resorted to by some countries for limited periods, by 1973 it was generalized among the major currencies. The exchange-rate system has been characterized by floating since that date, notwithstanding the fact that most countries continue to peg their exchange rates to other currencies, and that countries which "float" do not eschew all intervention in the markets

[151] For a discussion of the inherent contradiction of the dollar-exchange standard see R. Triffin, *Gold and the Dollar Crisis* (New Haven: Yale University Press, 1960).

(so-called "dirty floating").[152]

368. The move to floating exchange rates in 1973 was initially thought to be a temporary measure, to be followed by a realignment of exchange rates at more realistic levels. Efforts to devise a new system, including a revised par value system, continued, most notably in the IMF Committee on Reform of the International Monetary System and Related Issues (Committee of Twenty). However, a growing body of opinion, including academics and policymakers, supported the continuation of floating exchange rates, on the grounds that an adjustable peg system would inevitably result in misaligned exchange rates and abrupt changes. It was argued that the adjustable peg system was faulty in that, on the one hand, it gave private markets relatively costless and risk-free opportunities for profitable speculation, and on the other hand, failed to tap the potential benefits from the free play of market forces. It was also said that since private markets consist of a multitude of individual profit-oriented decision-makers who have an incentive to utilize all the relevant information available efficiently, floating would result in exchange rates moving in the direction and at the speed necessary to align national price levels in such a way as to promote balance-of-payments equilibrium in the longer term. Finally, floating exchange rates were expected to give countries more policy autonomy, since movements of funds across the exchanges would no longer affect the volume of domestic money and credit.

369. The following sections attempt to assess how far these various expectations have been realized in practice.

A. Exchange-rate variability under floating

370. A comparison of the degree of month-to-month exchange-rate instability in the periods January 1966-August 1971 and April 1973-June 1979 carried out for UNDP/UNCTAD shows that the overwhelming majority of both developed and developing countries experienced substantial increases in instability in nominal effective exchange rates.[153] Moreover, instability in real effective exchange rates[154] registered an even more pronounced increase, particularly for developing countries.[155]

371. A recent study by the Research Department of IMF has come to similar conclusions. It finds that on almost any definition of exchange-rate variability, fluctuations in exchange rates have been greater in the decade, since floating was adopted than they were in the 1960s. Moreover, after examining whether a "learning process" making for reduced instability has been at work since floating began, it concludes that "there is . . . no convinc-

---

[152] Fourteen countries had floated their currencies in 1973, and of these six European countries operated a joint float. Of the 100 or so other members of IMF, most continued to peg their exchange rates to various single or composite currencies, e.g. the United States dollar, the French franc or the SDR. Nevertheless, abandonment of the adjustable peg system has affected almost all world trade. First, the countries which float account for a large share of world trade. Secondly, many countries which do not float independently declare parities with respect to single (or composite) currencies which are themselves floating; these countries can, therefore, be said to be floating *vis-a-vis* all currencies other than the one to which they are pegged (and other currencies similarly pegged). Finally, since 1973 a number of countries which peg their exchange rates now take advantage of wider margins with respect to their intervention currency.

[153] Nominal effective exchange rates are defined as an appropriately weighted average of the various bilateral exchange rates facing a country.

[154] Real effective exchange rates are nominal rates deflated by indices which take account of inflation differentials between countries.

[155] See G.K. Helleiner, "The impact of the current exchange-rate system on developing countries" (UNCTAD/MFD/TA/13, April 1981). See also D. Brodsky, G.K. Helleiner and G. Sampson, "The impact of the current exchange-rate system on developing countries", *Trade and Development. An UNCTAD Review*, Winter 1981 (United Nations publication, Sales No. E.82.II.D.3).

ing evidence of any trend towards greater or lesser variability over time".[156]

372. Increased volatility has been accompanied by a tendency for movements to be cumulative, that is to say, exchange-rate movements have often not been reversed within a short period, but have led to growing and persistent deviations from what may be termed a "fundamental equilibrium rate". The "fundamental equilibrium rate" may be thought of as the real exchange rate required to yield, over the cycle, a current-account surplus or deficit equal to the underlying capital flows.

373. The extent of deviations from the fundamental exchange rate are difficult to quantify exactly. For one thing, estimation of that rate requires judgement as to what level of capital flows is sustainable over the medium term, and information on the sensitivity of the current account to changes in the exchange rate. Moreover, the fundamental rate may change as a result of changes in the demand or supply of a country's traded goods, resulting from such factors as permanent shifts in a country's terms of trade or in domestic savings or investment opportunities, or as a result of the discovery of natural resources, etc. But while it may not be possible to agree about the exact degree of misalignment due to the reasons given above, there can be little doubt that such misalignments have occurred. The real effective exchange rates of the main currencies have often changed dramatically, sometimes within a period of two to three years, and it is difficult to justify such shifts on the basis of changes in economic conditions.[157] A recent estimate of the deviations from fundamental equilibrium exchange rates for the major industrial countries in 1976-1977 and 1983 shows that in both periods large differences existed between prevailing exchange rates and those needed to bring current accounts into line with underlying capital flows. Moreover, between the two periods the extent, and in some cases even the direction of misalignment, changed substantially.[158] Because it is the most important single currency, the degree of misalignment of the United States dollar is of special interest.[159]

B. Currency preferences, exchange rates, and the "fundamentals"

374. The observed tendency for exchange rates to be volatile in the short term and to be misaligned over more prolonged periods springs in an important degree from the very nature of the market in currencies; for when the relative prices of national currencies are left to be determined on the basis of preferences for currency holdings, expectations regarding the future values of those currencies become the ruling factor.

375. Under floating, exchange rates at any time are such as to "clear the market" for national monies. The market-clearing price, however, does not reflect only the balance of the current supply of, and demand for, currencies that stem from needs related to trade transactions and long-term financial flows (i.e., the basic balances of payments). A more important factor is the demand for (and supply of) currencies as capital assets, based on expectations as to what exchange rates will be on future dates as well as on the interest earned (or forgone) in the meantime. There is thus a major speculative demand for (or supply of) currencies, distinct from the transaction demand. The overwhelming weight of the speculative component of the demand for

[156] *Exchange Rate Volatility and World Trade* (Occasional Paper No. 28), Washington, D.C., July 1984, p.12.

[157] Thus, between 1977 and 1981 the pound sterling appreciated by more than 50 per cent in real terms; similarly, between mid-1978 and early 1980 the yen fell by almost 30 per cent, while between mid-1980 and early 1984 the United States dollar rose by nearly 50 per cent.

[158] For example, the United States dollar was undervalued by about 4 per cent in 1976-1977, while by 1983 it was overvalued by about 18 per cent. (See J. Williamson, *The Exchange Rate System* (Washington, D.C.: Institute for International Economics, 1983).)

[159] See C. F. Bergsten and J. Williamson, "Exchange rates and trade policy", in W.R. Cline (ed), *Trade Policy in the 1980s*, *op. cit.*, p.111.

different national monies[160] causes exchange markets to function primarily as asset markets in which the demand flow emerging from the balance of payments is subsidiary to the shifts in the stock demand emerging from expectations regarding future price changes. Currency markets are thus akin in many essential respects to equity or bond markets, where owners and managers of financial holdings continuously adjust the currency composition of their portfolios in response to their shifting views and perceptions regarding the chances of making capital gains or losses. Expectations regarding the future course of exchange rates, and the factors likely to affect such expectations in the future, have thus come to rule exchange-rate configurations.

376. Expectations regarding the future are formed on the basis of three broad types of information: first, information regarding the past, which is, in principle, "knowable" and generally (though not always) known with a considerable degree of accuracy; second, information regarding the present, which is for the most part "knowable" but often not yet fully known; and third, information regarding the future, which is in large part "unknowable" and to many relevant aspects of which it is in general impossible even to assign mathematical probabilities.[161]

377. Subjective factors consequently play a key role in the determination of exchange rates. They enter into the interpretation of such information as is known regarding the past, the present and the future, and into the making of judgements regarding both the significance that is to be attached to different types of information and to the reliability of different pieces of information. Subjective assessments also enter into the assignment of the relative weights that are given to information of differing degrees of knowability. And perhaps most importantly, they determine the view that is taken regarding the future course of events, and regarding the impact of past, present and future events.

378. Given the inherent difficulties in the way of forecasting exchange rates primarily on the basis of objective factors as well as the key role played by subjective factors in determining those values, the attention of much of the currency market naturally tends to be directed at predicting the mood of the market itself. Large profits may be made and losses avoided by anticipating the next move of the market as a whole, even if the direction of that movement is not judged to be correct from a longer-term standpoint. This, in turn, tends to enlarge the speculative component of the market, and to heighten the volatility and unpredictability of market sentiment itself.

379. Thus, even if individual market operators were to utilize all available information efficiently and rationally in forming their own expectations, it would not follow that the currency market as a whole could be depended on to behave in a stable or predictable manner over short or long periods, owing to uncertainty concerning the future and the prevalence of speculative behaviour.

380. The preceding considerations go a long way towards explaining some of the observed characteristics of market behaviour. For example, currency markets are often very "nervous", especially during periods of widespread abnormal conditions. Thus, they tend to react in an unpredictable fashion to "news", sometimes disregarding bad and relevant news (such as figures on current-account positions) and sometimes reacting to such news in a highly exaggerated manner. They also tend to attach extraordinarily large (or small) significance to unanticipated events and to rumour. The same considerations also help to explain the tendency of markets sometimes to focus on long-term prospects and at other times

---

[160] It is estimated that some 90 per cent of daily exchange dealings are for reasons other than the making of current-trade transactions. (Williamson, *op. cit.*)

[161] For a discussion of the difficulty of assigning mathematical probabilities in situations where future outcomes cannot be predicted and the way in which they are generated is not fully understood see, for example, N. Georgescu-Roegen, *Analytical Economics. Issues and Problems* (Cambridge, Mass.: Harvard University Press, 1966), pp. 204-207 and 263-269.

to pay attention only to recent or current trends. They also help to account for the frequency and strength of so-called "band-wagons" whereby a small initial rise (or fall) in the exchange rate of a country triggers secondary and tertiary rounds of speculation, thereby generating a cumulative and exaggerated movement of the currency upwards or downwards.[162]

381. The characterization of currency market behaviour advanced above also helps to explain why exchange markets have at times served to push the exchange rate in the direction of (or to keep it in) the range required for fundamental equilibrium - so-called "stabilizing speculation" - and at other times to push the rate away from (or keep it away from) such a range - so-called "destabilizing speculation". It helps, moreover, to explain the tendency of exchange-rate movements that are in the required direction to go too far, followed either by a period of misalignment or by a correction, perhaps to an equally exaggerated degree in the opposite direction.

382. Two broad conclusions on the floating exchange-rate system may, therefore, be drawn. First, while at any moment exchange rates are at market-clearing levels, their movements over extended periods of time may not be related, even loosely, to those required by the fundamentals. The factors influencing the portfolio choices of money-holders include variables of a transitory or purely monetary character, such as temporary differentials in short-term interest rates. Exchange-rate determination by financial markets with short-term perspectives is, therefore, apt to lead to misalignment.

383. Second, exchange rates tend to be unpredictable over a very wide (though not infinitely large) range. Changes in "mood" and "psychology" alter the significance attached to different factors, making it difficult, if not impossible, for either participants in the market or other observers to forecast the future course of exchange rates with any degree of precision by utilizing a single and stable set of explanatory variables.

384. These conclusions do not mean that the volatility, unpredictability and misalignment of exchange rates that have occurred in practice have been entirely due to the behaviour of private markets. For one thing, certain governments have from time to time intervened heavily in the exchange markets to sustain over-valued or under-valued exchange rates. For another, the domestic monetary and other policies of certain countries have themselves served to enlarge the influence of short-term monetary and financial factors, such as interest rates, on the currency markets. Such factors have been specially important since 1979, when United States monetary policy was tightened abruptly and shifted towards targeting the money supply, leaving the rate of interest to find its own level in financial markets. With monetary targeting, interest rates, and hence exchange rates, may be expected to continue to be volatile and to diverge from the level warranted by long-term considerations.

385. Yet another important source of instability has been, and is likely to continue to be, uncertainties regarding the relative prices of internationally traded goods, such as primary commodities and energy. These have tended to change abruptly and unexpectedly owing in part to government policy in consuming or producing countries (or both).

386. Exchange markets are also likely to be affected by uncertainty regarding the degree to which governments are likely to seek to change the external value of their currency, by means of intervention in currency markets or through domestic monetary and fiscal policies. One particular (but nevertheless noteworthy) example regards policies in the United States. On the one hand, the authorities may in future be indifferent, as they appear currently to be, to the adverse impact of a strong dollar on the export and import-competing industries of the United States, and continue with tight monetary policies in order to curtail

---

[162] For evidence on band-wagon effects, as well as a discussion of other issues including the efficiency of exchange markets see, United States Treasury, *Report of the Working Group on Exchange Market Intervention* (Washington, D.C., 1983).

inflationary pressures. On the other hand, they may (as in 1971 and in 1977-1978)[163] seek to lower the external value of the dollar in the context of expansionary economic policies, in order to reduce unemployment and revive the export industries.

C. Exchange-rate variability and real economic variables

1. Uncertainty and investment

387. The prevalence of uncertainty in currency markets as to the course of exchange rates has generated the expectation among traders and investors that exchange rates will move in an unpredictable and possibly erratic manner in both the short and the longer term. This, in turn, has tended to affect adversely many types of economic activity, particularly those that require forward planning and involve decisions that are only reversible, if at all, at high cost.

388. A noteworthy example of decisions that are inevitably made much more difficult when exchange rates are thought likely to move in ways that cannot be forecast with accuracy are those regarding long-term investment in production for a specific foreign market, particularly when the production process utilizes imports from third countries. This may be illustrated by taking the not untypical case of an investment project in a production unit in a developing country whose output would be sold in, say, the United States market for United States dollars, and which would utilize plant and equipment purchased from the Federal Republic of Germany to be bought partly on credit denominated in deutsche mark, intermediate goods from Japan denominated in yen, and domestic labour denominated in the domestic currency. The estimated rate of return on such a project may well be highly sensitive to how the domestic currency, the dollar, the deutsche mark and the yen are expected to be aligned over the whole life of the project. The greater the range of variation possible regarding the rates of exchange of the currencies, the less willing will the investor be to carry a mismatch between the currency composition of his cash outlays (in the example chosen, domestic currency, deutsche mark and the yen) and of his receipts (United States dollars). Moreover, the chance of making large gains due to an especially favourable configuration of exchange rates is likely to be more than outweighed by the risks of being bankrupted by an especially unfavourable configuration. Such asymmetries are of crucial significance to business decisions. Consequently, the investor faced with exchange-rate uncertainties may opt for an investment that is smaller or of shorter life (or both), or postpone an investment until conditions in exchange markets settle down. Moreover, he may prefer to produce goods that are potentially switchable from one market to another. Alternatively, the uncertainty may deter him from investing in production altogether and induce him to use the funds and borrowing power at his disposal in financial and speculative activities instead.

389. The costs to an enterprise of fluctuations in exchange rates and the impact on its investment decisions will depend on such factors as its size and financial strength and the diversification of its operations with respect to products and regions. Various methods are available for reducing the risk resulting from movements of exchange rates. These include variations in the timing of receipts and payments, price adjustments, invoicing practices, borrowing policies and the general management of assets and liabilities in different currencies, and covering in the markets for forward exchange.[164] However, it is not easy to achieve complete protection against exchange risks through the use of such methods. Forward cover entails costs which increase as fluctuations in exchange rates widen. Moreover, forward cover cannot be obtained for periods far ahead and thus cannot be used to reduce the foreign-exchange risks associated with long-term investments.

---

[163] See, for example, Michael Moffit, *The World's Money* (New York: Simon and Shuster, 1983), chapter 5.

[164] For a fuller account see B. Kettell, *The Finance of International Business* (London: Graham and Trotman, 1979), chapters 8-9.

390. The availability of different methods for managing foreign-exchange exposure will in general be greater for large firms, especially transnational corporations with highly diversified operations. For example, such corporations are frequently in a position to manipulate payments between their constituent business entities for purposes such as the reduction of foreign-exchange risk.[165] Moreover, the geographical diversification of their activities will itself tend to provide a measure of protection against such risk.

391. By contrast, smaller enterprises and those with less diversified activities will usually be more vulnerable to fluctuations in exchange rates. In consequence, such fluctuations are often especially severely felt by indigenous enterprises in developing countries, which are less likely to be able to take advantage of the various methods of reducing foreign-exchange risks. Moreover, owing to the underdeveloped state of capital markets in most developing countries, firms producing for export are often under-capitalized and especially dependent on borrowed funds. They may also face further disadvantages resulting from inadequate access to information concerning foreign-exchange markets and from the lack of forward markets in their own currencies.[166]

392. A recent study[167] undertaken at the Federal Reserve Bank of New York of the impact of exchange-rate variability on trade and which, unlike most other examinations of this question (but like the analysis contained in this chapter), focuses on the role of uncertainty on entrepreneurial behaviour, has concluded that trade has, indeed, been adversely affected in the period 1974-1982 for both the United States and the Federal Republic of Germany. The study found, for example, that, had exchange-rate variability never exceeded the lowest two-quarter average value, the trade of the United States in manufactures would have been 3-4 per cent higher and that of the Federal Republic of Germany 7-12 per cent higher. The more pronounced impact on the trade of the Federal Republic of Germany reflects the higher degree of openness of its economy. The study also makes the point that the degree of variability in exchange rates observed *ex post* will tend to understate the degree of uncertainty existing *ex ante* in the minds of investors as regards the timing and size of exchange-rate changes. "Many widely used structural models do not forecast exchange rates any better than a random walk. In fact, the existing empirical models as well as so-called structure-free empirical analysis (which combines various 'fundamentals' such as prices, money stocks, current accounts, etc., from different structural models) fail to explain exchange-rate movements adequately over the last ten years or so. Perhaps more importantly, virtually all exchange-rate forecasts - model-based or otherwise - exhibit large prediction errors outside the observed sample period. All of these points about the performance of empirical models and forecasts are well documented in many recent studies."[168]

2. Impact on developing countries

393. Fluctuating exchange rates also make the conduct of government policy in developing countries, particularly debt and reserve management, more difficult. Central bankers need to manage the currency composition of the country's portfolio of reserves in order to avoid losses due to exchange-rate realignments. In the case of debt, on the other hand, there are often only limited possibilities for changing the currency composition, so that uncertainty over the real burden of debt-service

[165] On the methods of transferring funds between constituent business entities which can be manipulated in the interests of a transnational corporation as a whole see, for example, M. Z. Brooke and H. L. Remmers, *The Strategy of Multinational Enterprise. Organization and Finance* (London: Longman, 1970), part II.

[166] Helleiner, *op. cit.*

[167] M.A. Akhtar and P. Spence Hilton, "Effects of exchange rate uncertainty on German and US trade", *Federal Reserve Bank of New York Quarterly Review*, Spring 1984, Vol. 9, No. 1, pp. 7-16.

[168] *Ibid.*, p. 8.

payments may make government planning difficult.

394. The loss of a stable unit of account has also served to make exchange-rate management difficult. It is generally accepted that independent floating is not a feasible option for developing countries, given the thinness of markets for their currency and the underdeveloped nature of domestic capital markets. On the other hand, pegging to a single currency, say, the United States dollar, implies that a country's exchange rate with the rest of the world is determined by movements in the exchange rate of the United States dollar and may be unrelated to its own balance-of-payments needs. In the face of large and persistent misalignments of the major currencies, developing countries have been increasingly reluctant to opt for the single-currency peg.[169] Many countries are using various composite currencies (including SDRs) as a standard to which to peg, while some others are maintaining relatively wide margins and revising their exchange rates at relatively frequent intervals on the basis of various indicators.

395. While the increasing use of a basket of currencies to which to peg and greater flexibility help to mitigate the effects of fluctuations and misalignments among major currencies, they do not provide complete insulation from the effects of floating. In particular, short-run uncertainty tends to increase as all bilateral exchange rates are made subject to fluctuations, whereas under a single currency peg at least the rate with respect to one currency is free from the risk of fluctuations. Normally, trade-weighted baskets are used for currency pegs. Such baskets reduce currency fluctuations for the country as a whole, but unless the geographical distribution of trade is identical for all traders, the risk for individual traders or industries may not fall, and may even rise.[170] Proliferation of the number of units of account in use makes prediction of exchange rates and international accounting more difficult.[171]

3. Macro-economic impact

396. Besides adversely affecting firms' investment decisions and the economies of developing countries, fluctuations in the exchange rates of the major currencies can generate or accentuate macro-economic imbalances and instability in the world economy.

397. Determination of exchange rates according to currency preferences means not only that nominal and real rates are not determined mainly by the fundamentals, such as relative rates of inflation or differences in productivity and thrift, but also that exchange rates are apt to move in ways which serve to destabilize the fundamentals themselves. For example, if expectations regarding future exchange rates are especially sensitive to recent trends in the trade balance, an initial worsening of that balance may trigger a cumulative and excessive depreciation. This is because the initial impact of a devaluation is generally to worsen the trade balance on account of the time lag before the positive volume effects are felt, whereas the negative

[169] In June 1975, for example, 81 countries out of 122 IMF members were pegged to a single currency, including 54 to the United States dollar. In March 1983, 56 countries out of 148 IMF members had a single currency peg, with 38 countries pegged to the United States dollar.

[170] For a discussion of currency pegs, see J. Williamson, "A survey of the literature on the optimal peg", *Journal of Development Economics*, Vol. 11, No. 1, August 1982.

[171] Thus, if an exporter in, say, the United Republic of Tanzania, is assessing the local currency value of a contract from Sweden (both countries being pegged to individually constructed basket pegs), he has to make a judgement about the possible value of the krona in terms of, say, the United States dollar, which depends on various bilateral rates, as well as the possible value of the Tanzanian shilling, whose rate in terms of, say, the United States dollar, is similarly subject to variations in different bilateral rates. See also A. D. Crockett, and S. M. Nsouli, "Exchange rate policies for developing countries", *Journal of Development Studies*, January 1977.

terms-of-trade effects are felt immediately.[172] In due course, the trade balance may improve sufficiently to trigger an appreciation of the currency and then the upward movement of the currency may also go too far. Such movements may be costly, since they may trigger wasteful reallocations of real resources into or out of the traded-goods sector which may subsequently need to be reversed.[173] The behaviour of currency markets may also affect the evolution of the balance on long-term capital account. For example, if currency-holders judge the current level of external borrowing to be excessive, the depreciation they bring about as a result may, in turn, weaken the willingness of long-term lenders and investors to commit funds to the country.

398. On the other hand, sensitivity of the exchange rate to rates of return on financial assets will tend to cause countries' competitiveness to swing in response to short-term differentials in money-market rates. In such circumstances, purely cyclical movements originating in the financial sector would be exerting a powerful influence on the pace and pattern of trade, on rates of economic activity, and on the distribution of investment, thus affecting the long-term economic situation of countries.

399. Upward or downward movements in the exchange rate tend to have important effects on the level of economic activity and on the price level. An over-valuation will tend to depress activity by lowering foreign demand for exports and home demand for the import-competing industries. It will, moreover, tend to lower investment in those industries, which will have long-term consequences. Even if the misalignment is subsequently corrected, the country's competitive strength will have been impaired. An under-valuation, on the other hand, will tend to raise prices. The price increases then tend to get worked into the cost-price structure of the economy and are difficult to reverse without lowering output while the under-valuation is corrected. Much investment undertaken during the period of under-valuation may subsequently be rendered obsolete. Furthermore, unless there is a systematic tendency for countries with over-valued exchange rates to stimulate demand, the overall level of world demand will tend to be adversely affected. This, in turn, will tend to depress levels of trade, in particular the export earnings of developing countries, and generate payments imbalances, adjustment to which may produce further rounds of price inflation and reduced activity.

400. Finally, fluctuating and misaligned exchange rates may lead to excessive speculative activity in markets other than currency markets. In particular, commodity markets, which function in an analogous manner, may be affected.[174]

401. When exchange rates are not dominated by the fundamentals, and are sensitive to short-term monetary influences, they act as a belt for the transmission of monetary disturbances internationally rather than as a mechanism to adjust the external sector without inflating or deflating the economy.[175] While floating allows the quantity of domestic money and credit to be protected automatically from the ebbs and flows of finance across the exchanges in response to interest rate differentials, it does so by increasing the exposure of the foreign trade sector to monetary disturbances. This is especially the case for the United States, whose exchange rate is highly sensitive to purely monetary influ-

---

[172] For a discussion of lags in the adjustment process and the so-called "inverted J-curve", see J. Artus and J. H. Young, "Fixed and flexible exchange rates: a renewal of the debate", *IMF Staff Papers*, December 1979.

[173] IMF has found that movements of resources into and out of the traded-goods sector has increased significantly since the advent of floating. The study concludes, *inter alia*, that while a number of factors may have been at work "it is probably not unreasonable to suggest that exchange-rate shifts were a contributing factor at least to some extent". (IMF, Occasional Paper, No. 28 (*op. cit.*), p.24.)

[174] See annex B below.

[175] As shown in chapter IV above, the existence of a large stock of external debt at variable interest rates serves as another transmission belt for fluctuations in interest rates.

ences owing to the widespread use of the dollar in international financial transactions. The vulnerability of trade is thereby increased when, as has recently been the case, interest rates are themselves volatile.[176] Under floating, variations in United States interest rates exert a strong influence on other countries' trade flows and price levels. They also affect the distribution of world income between rentiers and debtors.

402. It is thus doubtful whether floating allows any country to insulate itself from foreign monetary disturbances, and to conduct its domestic policies independently. Governments have not, in practice, remained indifferent to the consequences of exchange-rate movements, and some have felt obliged to set their monetary and fiscal policies to offset or avoid exchange-rate movements. Floating has altered the channel through which disturbances are transmitted rather than diminished the extent of these such transmissions. In particular, it has tended to cause the stance of policies to converge as governments have sought to avoid sharp changes in the degree of competitiveness or in the strength of inflationary pressures that result from exchange-rate changes (or both).

403. Moreover, part of the official response to the impact of exchange-rate changes on the industries involved in foreign trade has taken the form of yielding to the protectionist pressures generated by such changes. Import-competing industries that are hurt by a strengthening of the domestic currency in the exchange markets are often able, either on their own or in combination with other sectors seeking protection from foreign competition for other reasons, to bring about the imposition of import barriers. While the increased resort to non-tariff barriers over the past decade cannot be entirely ascribed to floating,[177] there would seem to be a close connection between the strength of protectionist sentiment and that of the external value of the currency.[178]

404. For all of the above reasons freedom of capital movements in a regime of floating exchange rates may not ensure an efficient allocation of resources in the world economy as a whole. While freedom of capital movements may ensure that savings flow among countries over the medium term in a way that reflects the relative return to capital in each economy, investment decisions within national economies, involving domestic as well as foreign savings, are distorted as a result of the exchange-rate fluctuations and misalignments permitted by such a regime. There can thus no longer be a presumption that unfettered international capital flows serve unambiguously to raise the level of world output.

[176] The theoretical arguments for floating exchange rates and monetary targeting are both based on the assumption that monetary factors do not affect the real variables in the long run.

[177] See chapter III above and annex D below.

[178] C. F. Bergsten and William R. Cline, "Trade policy in the 1980s: an overview", in Cline (ed), *op. cit.*

Blank page

Page blanche

Part III

TOWARD REFORM OF THE SYSTEM

Chapter I

INTRODUCTION

405. The past decade has been characterized by a general slowing of the pace of economic advance throughout the world economy, and by greater instability in output. It has been a period of significant change in national economies, and one in which all countries - developed and developing alike - have had to make far-reaching adaptations in their economies and reorient their policies.

406. Such changes are an integral part of a growing world economy, which requires national economies to adapt continuously to spontaneous developments at home and to new realities in their external environment. Economic growth inevitably invokes continuing, and often rapid and discontinuous, changes in technology, labour supply, investment, tastes, prices, competitiveness, institutions, etc.

407. However, the external environment of any given country is also generally subject to temporary disturbances that do not warrant changes at the national level; and many of those that are warranted may need to be phased over time in order to ensure that they take the form of progressive mutations rather than severe disruption to economic activity.

408. The extent, speed and character of the adaptations and adjustment made at the national level can themselves act as a major influence on the size and frequency of the shifts in the external environment faced by national economies as a whole. Both undue delays in adjustment and excessive or over-rapid changes can be a source of disturbance in the world economy as a whole.

409. An efficient system of trade and payments must, therefore, succeed in imposing disciplines on countries to undertake necessary changes without forcing them to respond to changing external conditions unnecessarily, excessively or too rapidly, and without generating further disturbances at the international level. The latter requirement is of great importance; without it the adjustment processes, far from taking the world economy towards stability and balanced, vigorous growth, may set in motion forces that will tend to move it further away from such an equilibrium.

410. The adequacy of any system of trade and payments needs in particular to be assessed from the standpoint of growth. Two basic questions arise here: how far does the system help to foster the husbanding of scarce resources and their deployment to maximum advantage?; and how far does it help ensure that resources are fully utilized at each point in time? Both these questions arise also in judging the adequacy of any given system of trade and payments from the standpoint of the trade and development of developing countries. A system that prevents countries from reaping (or which discourages them from seeking to reap) the potential gains from specialization, or which fails to channel savings to countries that can most effectively use them for productive investment, will be both irrational from the micro-economic standpoint and biased against developing countries. Moreover, a trade and payments system that tends to generate periods of deflation will tend most especially to obstruct growth in the developing countries, for whose development buoyant external markets are especially important.

411. Part II of the report has examined the main lines of evolution followed by certain selected parts of the system of trade and payments, namely, the trading system, exchange rates, bank lending, and multilateral financial institutions. In the following chapters an attempt is made to analyze how disciplines incurred by the system

as a whole have affected growth, and to examine the mutual consistency and overall thrust of the various market and other adjustment processes at work in international trade and finance. Chapter II focuses, in its first sections, on the resource-allocation dimension of the question, and in its final section on the mechanisms involved in the circular flow of world income, in particular the characteristics of the monetary, financial and trade regimes that cause macro-economic imbalances to be transmitted and amplified by the way in which those regimes are currently structured. These characteristics are, of course, not the product of nature, but of historical processes, many of which have been discussed in Part II. Chapter III, therefore, goes on to address the main structural weakness of the present system, and to discuss the essential requirements of a system that would be sufficiently supportive of employment and development.

Chapter II

SYSTEMS PERFORMANCE AND GROWTH

A. Introduction

412. Different aspects of the functioning of the world economy can be classified under various systems, such as money and finance, trade and the markets for primary commodities. Each of these systems has a separate and distinctive identity and certain "rules of the game" that are followed to a greater or lesser extent. Moreover, each system is endowed with one or more international organizations which are central to its operation, and is the responsibility of specific parts of national bureaucracies, which are not necessarily co-ordinated. Each of the systems has specific and well-defined tasks to fulfil, and the adequacy of its functioning can be judged, at least in part, within its own framework. Evaluations of the performance of such systems in terms of their assigned tasks have been undertaken in UNCTAD on a number of occasions. For example, the issue of the adequacy of official payments finance and its relation to the balance-of-payments adjustment process has been examined;[179] as have the performance of the private banking system in financial intermediation[180] and the level, costs and effects of international protectionism.[181]

413. In addition, however, there are a substantial number of important linkages between the systems which affect the efficiency with which they operate, and policy decisions taken within the context of one of the systems will often have implications for the functioning of the others. One example of such interlinkages, which has recently attracted wide attention, is the role that trade restrictions can play in impeding the servicing of external debt. Thus, evaluation of the functioning of systems should take account of the way in which policies in, or other features of, one system influence the capacity of the others to fulfil their assigned tasks.

414. A further consideration, which has taken on critical importance, is how the operations of the three systems, considered individually and as a whole with all their interlinkages, support the process of growth in national economies. The relationship between growth of national economies and the functioning of the systems of money, finance and trade has a number of circular elements. The operation of the systems can transmit and reinforce positive growth impulses in the world economy or mute negative factors (or both), thereby enhancing long-term growth. At the same time, rapid growth of national economies normally facilitates the proper functioning of the systems of money and finance, trade and commodities, although it by no means assures it.

415. The events of recent years have put the trade and payments system under increasing, and at times intense, strain. Throughout this period, the systems have demonstrated considerable resilience and a capacity to adapt to changing circumstances, often with the assistance of direct action taken by the governments of major countries. But at the same time there has been

---

[179] See the report by the UNCTAD secretariat, "International financial and monetary issues" (TD/275), reproduced in *Proceedings of the United Nations Conference on Trade and Development, Sixth Session*, Vol. I - *Basic Documents* (United Nations publication, Sales No. E.83.II.D.8), chapter IV.

[180] *Ibid.*, chapter VII.

[181] See the report by the UNCTAD secretariat, "Protectionism and structural adjustment in the world economy", Part I - "Analysis of major issues and policy requirements" (TD/B/981(Part I and Corr.1-2)), chapter II.

ample evidence of a deterioration of the systems, so that they are no longer properly fulfilling the tasks assigned to them. For example, the growth of protectionism, and more recently the progressive breakdown of trade financing, is leading to the proliferation of discrimination in international economic relations which impedes the efficient allocation of resources in the world economy. The erosion of official influence over the international financial system, which has accompanied its progressive "privatization", is complicating the tasks of finding solutions to the current debt crisis and impeding the flows of capital to debtor countries required to support domestic policies designed to bring about adjustment and restore growth. A disproportionate share of the burden of adjustment in the world economy, and in particular of measures in developed market-economy countries to combat inflation, is being borne by its weaker members, the developing countries, through factors such as higher interest rates and depressed commodity prices. Thus, the deterioration of the systems has now become a major impediment to measures at national and international levels to restore world economic growth and achieve an equitable distribution of its benefits.

416. The remainder of this chapter takes up briefly some of the salient features of the interaction of systems that need attention in the context of this deterioration. The following section addresses important aspects of the interaction of systems that would have an important bearing on growth of national economies even if domestic resources were being fully utilized. The subsequent section then addresses some of the more important issues regarding the way in which the performance of the systems helps or impedes governments in their efforts to secure the full utilization of resources and the full exploitation of growth potential.

B. The interaction of systems: selected issues

417. Throughout the post-war period policy measures taken within the various systems of the world economy have been subject to thorough analyses. For example, the impact of the rounds of tariff reduction since 1945 on the magnitude and composition of trade has been examined in great detail; the role that exchange-rate changes play in the process of balance-of-payments adjustment has been a recurrent topic of investigation; and more recently the consequences of a regime of flexible exchange rates for the demand for international liquidity have been explored.

418. However, it has also increasingly been recognized in recent years that policy measures or other changes occurring within the context of one of the spheres can have important implications for the functioning of the others. Indeed, this interdependence among systems was explored in some detail in UNCTAD during the early 1970s.[182] The paragraphs that follow single out six areas in which recent policy decisions or stances in one system have led directly to the diminished effectiveness of one of the others.

1. The availability of payments financing and the use of trade restrictions for balance-of-payments purposes

419. Countries faced with the need to reduce external deficits can exercise a number of options. One of the more rapid and immediate means of attacking the external deficit is through measures designed to control directly levels of imports through quantitative restrictions. It has been recognized throughout the post-1945 era that, however efficient such measures may be,

[182] See the reports by the Secretary-General of UNCTAD on the "Interdependence of problems of trade, development finance and the international monetary system" (TD/B/459 and TD/B/495) and also his report, "The interdependence of money, trade and finance: the balance-of-payments adjustment process in the current world economic situation", *Official Records of the Trade and Development Board, Fifteenth Session, Annexes*, agenda item 4, document TD/B/571 and Add.1).

they pose a considerable danger to the trading system and in particular to the process of trade liberalization which has characterized most of the period. In international economic relations it has, therefore, been generally presumed that measures restricting trade would not normally be invoked for balance-of-payments reasons. Moreover, mechanisms were established to provide temporary balance-of-payments financing to allow countries to eschew to the greatest extent possible the use of such measures and to address external imbalances through broader macro-economic policies, although in general these policies achieve their objectives more slowly than direct controls on trade and external payments.

420. Thus, IMF makes available payments finance to its members, "providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity".[183] Such direct restrictions on trade and payments as are maintained or introduced by IMF members for balance-of-payments reasons are supposed to be of a transitional nature, and the Fund is obliged to report annually on such restrictions that remain in force.[184]

421. In view of the close relationship between the availability of balance-of-payments finance and trade restrictions, it is not surprising that recent years, which have been characterized by growing stringency in the supply of such finance to developing countries, have also witnessed increasing recourse to trade restrictions in developing countries encountering payments problems.[185] Policies in the system of money and finance have thus led to a reduced play of market forces and lower levels of efficiency in the trading system. Moreover, policies that result in stringency in the availability of official payments finance must be seen as inconsistent with calls for trade liberalization by deficit countries.

2. Exchange rates and the efficiency of the trade regime

422. The advent of a general regime of flexible exchange rates among the major currencies has altered significantly the evolution of policies in those markets designed to provide protection to domestic producers. The imposition of tariffs provides a measurable differential between the cost of production in the domestic economy and the world market price of traded goods. Under a fixed exchange-rate system, the domestic-currency price of foreign goods changes only very slowly, as productivity and costs of foreign producers evolve. In these circumstances, the price differential provided by tariffs has fairly predictable consequences for domestic producers.

423. Under a regime of flexible exchange rates, however, the prices in domestic currency of imported goods are unpredictable, and the consequences for the competitiveness of domestic industries of a tariff of a given magnitude could be substantially altered by movements in the exchange rate. For example, the effect of a 10 per cent *ad valorem* tariff will be partly or wholly offset by a 10-per-cent appreciation of the exchange rate. Faced with these developments, governments have tended to have recourse to instruments that regulate directly the quantities, prices, and origin of traded goods; i.e., instruments whose impact is not affected by changes in exchange rates. Thus, non-tariff barriers to trade, especially quantitative restrictions on imports, have come to play a more central role in protectionism.[186]

424. As compared with tariffs, quantitative restrictions represent a greater interference with the operation of markets and their function of allocating resources efficiently. Thus, the advantages that are judged to result from a regime of flexible exchange rates would need to be set against the

---

[183] Article I(v) of the Articles of Agreement of IMF.

[184] Article XIV.

[185] For a survey of quantitative restrictions on imports imposed in developing countries in 1982, mainly in response to external payments difficulties, see IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions, 1983* (Washington, D.C., 1983), part one, section III.

[186] This topic is explored in detail in annex D below.

reduced efficiency of the trading regime that has been one of its results.

3. Trade restrictions and the efficacy of exchange-rate changes as an instrument for balance-of-payments adjustment

425. Not only has the regime of flexible exchange rates pushed the trading system in a direction that reduces its efficiency but also trade restrictions, in turn, have reduced the efficacy of policies to adjust external payments. An essential part of balance-of-payments adjustment is the ability to alter trade flows by changing relative prices. Trade practices which obstruct such changes necessarily reduce the effectiveness of adjustment mechanisms. Thus, import restrictions affecting the exports of developing countries not only impede the adjustment process in developed countries by reducing competition in their markets but also make it more difficult for developing countries to secure external balance: for example, currency devaluation in a developing country cannot lead to increased export earnings from export goods subject to strict quota restrictions. In developed countries, a greater share of the burden of adjustment must be borne by parts of the economy which do not benefit from the import restrictions. In developing countries, resources must be shifted to a greater extent than warranted to alternative export sectors and import-competing activities, where their productivity will normally be lower. Since such restrictions reduce the responsiveness to price changes of the trade flows concerned, they work to increase the magnitude of exchange-rate adjustments required to correct an imbalance of any given size.

426. Because of these interrelationships, there is an inherent contradiction between actions taken to encourage developing countries to make more extensive use of devaluation to reduce external deficits and actions taken to increase non-tariff barriers to their exports.

4. Financial intermediation, debt service and the trade regime

427. The distribution of savings throughout the world economy takes place in large part through the process of international lending. This lending gives rise to debt and to debt service. While debt service is effected through supplies of foreign exchange from all sources, export earnings are of particular importance in this context; accordingly, a situation in which the growth of debt service exceeds that of export earnings is one which cannot be sustained for long. Thus, when trade barriers and fluctuations in commodity prices have a significant impact on the growth of export earnings, they also influence the whole process of international financial intermediation. Trade barriers, therefore, have implications not only for the efficient allocation of resources within domestic economies; they also influence the efficiency with which savings are distributed within the world economy as a whole.

5. Commodity markets, fluctuations in export earnings and payments finance

428. Throughout the period since 1945 commodity markets have been characterized by substantial fluctuations in the prices and earnings received by producers. This has had a number of consequences, of which one of the more important has been sharp shifts in the external payments situation of countries that depend to a great extent on commodity exports. It has been recognized for a number of years that fluctuations in export earnings that can confidently be expected to reverse themselves within a reasonable period of time should be dealt with through financing without measures of domestic adjustment. Indeed, the reorientation of domestic policy and policy objectives to meet a situation which can be expected to disappear would give rise to a considerable loss of efficiency and misallocation of resources.[187] Accordingly, failure to provide ade-

---

[187] This issue is taken up in greater detail in annex C below.

quate unconditional liquidity to finance payments swings resulting from price fluctuations in the commodity markets increases the likelihood of an inefficient use of domestic resources in commodity-exporting countries.

6. Trade finance and trading arrangements

429. An efficient trading regime requires that purchasers be able to secure the goods and services they need at the lowest available cost. Where trade financing is a normal part of the transaction, efficiency is thus attained only if financing is available in amounts and on terms which allow trade flows to be determined by the competitiveness of different suppliers. Because of the fungibility of financial instruments denominated in convertible currencies, optimal trading arrangements among countries with market economies involve the exchange of goods or services against convertible currencies, usually in the form of credit instruments. When trade finance becomes difficult to secure or its cost is deemed exhorbitant, trading arrangements will take other forms, including countertrade and barter.[188] While these techniques have their place in international trading that is governed by central planning rather than market forces, they represent a diminution in the efficiency with which trade is carried out between market-economy countries. A dearth of trade finance thus leads to practices which undermine the efficiency of the trade regime itself.

7. Summary

430. The six areas sketched out above in which policy measures or other changes in one system influence the working of others are meant to be illustrative rather than exhaustive. All of the above are examples of instances in which recent developments or policy actions taken in one system have reduced the capacity of other systems to fulfil effectively their assigned tasks. By influencing trade efficiency, the location of activity and the distribution of savings, all of these negative interactions have affected, and will continue to affect, the long-term growth path in the world economy and in particular the capacity of developing countries to transform their economies and accelerate development. They would thus be of great significance for the operation of the system even if they were accompanied by the full use of capital and labour in the world economy. However, other aspects of the system, relating to the way in which shifts in aggregate demand are transmitted at the global level, have worked to constrain levels of activity even below those permitted by existing productive capacities. The following section takes up this issue.

C. Trade, payments and levels of activity

431. Changes in macro-economic performance are usually a basic characteristic of national economies. The business cycle has characterized the growth of developed market-economy countries for more than a century. Individual economies are also subject to periods of price inflation and rapid spurts of growth. A crucial characteristic of any set of trade and payments arrangements is the extent to which they reinforce stability and growth throughout the world economy, while protecting individual countries from the full force of imported inflation or deflation.

432. The experience of recent years has revealed marked changes in this respect, particularly as regards the transmission of changes in output and prices between developed and developing countries. The following para-

[188] For a fuller discussion of the growth of practices such as countertrade in response to widespread disruptions of arrangements for trade finance, see annex B below. These practices have also been stimulated by factors other than the availability of trade finance, such as the collapse of traditional markets for the products in question. The interaction between the evolution of the systems and levels of demand and growth are taken up in section C below.

graphs review salient features of experience during the recent recession in the developed market-economy countries, with a view to examining the shortcomings that have been revealed in the functioning of the systems.

1. The amplification of disturbances by the commodity and financial markets

433. A major feature of recent years was the recourse to deflationary macro-economic policies in developed market-economy countries at the end of the 1970s in an effort to bring down inflation. In the ensuing period the systems of money and finance, trade and commodity markets have served to amplify the resulting deflationary pressures on developing countries.

434. Had the impact of the recession in developed countries on the developing countries been confined mainly to unfavourable effects on export volumes, its consequences would have been serious enough. However, there have been four factors at work that have amplified its impact on the balance of payments of developing countries. First, for most countries exporting primary commodities, the outcome was sharply lower export revenues, decreases in prices being accompanied by proportionately smaller rises, or even falls, in volume. Such price flexibility, which reflects the interaction of the short-term inelasticity in demand and supply widely characteristic of markets for primary commodities, aggravates the impact of world deflation. Second, the sharp escalation of interest rates has directly increased the debt-service payments of developing countries, owing to the large amount of outstanding debt contracted at floating rates.[189] Third, lending by banks to developing countries has declined sharply, largely because the rise in interest costs and the decline in export earnings (from both commodities and manufactures) have caused lenders to reassess unfavourably the creditworthiness of borrowers.[190] Fourth, the exchange rate of the United States dollar has risen, thereby increasing the cost to some countries of interest and amortization payments on their external debt.[191]

435. It is important to bear in mind that this enlargement of the impact of the policies of developed market-economy countries has occurred because of the particular ways in which the commodity and financial markets are structured. It is also important to recognize that the degree of amplification is dependent on the particular policy mix adopted to bring about disinflation. Disinflationary policies of the same force, but involving tighter fiscal policies and less tight monetary policies, would have entailed lower interest rates, a less unfavourable impact on the creditworthiness of developing countries, a smaller reduction of bank lending, and hence, less serious consequences for developing countries. Amplification has thus been the joint product of the policy mix in developed countries and the characteristics of the different systems.

436. The greater flexibility of the prices of primary commodities than manufactures reflects inability to control supplies reaching the market. Regulation of the production of primary commodities (and hence, of their prices) is still the exception rather than the rule, particularly for agricultural commodities exported by developing countries. Moreover, stocking decisions often do not help to stabilize prices but actually serve to accentuate price movements. Revenues

[189] See part II, chapter IV. OECD estimates of the gross floating-rate debt of non-OPEC, non-OECD developing countries indicate that the cost of a 1 per cent rise in the interest rate on such debt would have been about $2 billion at the end of 1980 and about $3 billion at the end of 1983. However, developing countries had substantial external assets as well as external liabilities at floating rates of interest. The cost of a 1 per cent rise in the interest rate on the net floating-rate debt of non-OPEC, non-OECD developing countries would have been about $1 billion at the end of 1980 and about $2 billion at the end of 1983. (See OECD, *External Debt of Developing Countries, 1983 Survey* (Paris, 1984), tables 13-14 and pp. 37-38.)

[190] See part II, chapter IV.

[191] *Ibid.*

thus tend to fall steeply in response to falls in demand because of the conditions under which commodity production and trade take place. Indeed, between 1980 and 1982 the prices of primary commodities exported by developing countries dropped by 30 per cent, and the earnings of developing countries from the export of these commodities fell by $16 billion.[192]

437. International bank lending, which has emerged as a major source of finance for a number of developing countries, has also led to instability. In making medium- and long-term loans to developing countries, banks have passed on the interest-rate risks to borrowers through the technique of floating interest rates. Moreover, individual banks have sought to protect themselves against the risks and uncertainties involved in lending to developing countries by lending substantial amounts only when other banks have also been willing to do so. This behaviour has resulted, in "market segmentation" whereby some countries have been able to borrow large sums, while others have been able to borrow little or nothing. It has also led to abrupt revisions in the perceived creditworthiness of individual borrowers in response to changes in their external payments positions due to variations in interest rates, exchange rates and export revenues. Changes in perceived creditworthiness have resulted in wide swings in the willingness to extend new loans and in the margins above inter-bank interest rates charged to different borrowers. In short, the so-called "herd" instinct of banks is based not only on subjective factors but also on the organization of the private financial markets.[193]

438. It is thus not surprising that bank lending has recently behaved in a pro-cyclical manner, contracting as balance-of-payments positions have worsened: borrowings by non-oil-exporting developing countries from private creditors, which amounted to some $70 billion in 1981, reached only about $25 billion in 1983. Nor is it accidental that the private international financial markets have tended to widen and deepen the repercussions of disturbances in capital and goods markets. Such repercussions have been evident in the experience of many countries, including certain oil-exporting countries, which were able to increase their external borrowing at rapid rates before the onset of weak oil markets and high interest rates but which now face difficulties in the servicing and management of their external debts.

439. The shocks emanating from the policies of developed countries and transmitted via the systems of money and finance, trade, and primary commodity markets have varied considerably in their incidence. The effects of lower commodity prices have been felt by their exporters and not by the exporters of manufactures (except indirectly). Similarly, the effects of movements of interest and exchange rates have been especially serious for countries that are heavy borrowers; many of these are exporters of manufactures and fuel. Most vulnerable have been countries which are both exporters of primary commodities and heavy borrowers, and poorer developing countries generally, whose economies are least able to withstand adverse external pressures.

2. The liquidity squeeze and the international monetary system

440. Adequate financing has not been forthcoming to cover the large external deficit of developing countries resulting from the stance and mix of macro-economic policies in developed countries and amplified by the reactions of the systems of money and finance, trade, and primary commodity markets. Previously, it was believed that countries with access to private capital markets could borrow for the purpose of expanding official reserves, so that the level of world liquidity was "demand-determined", that is, would expand to any level collectively desired by countries. This view, which took no account of the reserves needs of countries without access to private capital markets, also failed to foresee the consequences of a

---

[192] For a quantitative analysis of the impact of recession on commodity prices and earnings in recent years, see annex C below.

[193] For a fuller discussion of the factors underlying the "herd" behaviour of banks, see part II, chapter IV.

situation in which there was widespread difficulty with external payments and debt. In such circumstances, the downward pressure on the external liquidity of deficit countries is two-fold: reserves are lost as they are spent; and the underlying credit arrangements that generated the reserves come under pressure as banks attempt to reduce their own exposure to risk.

441. Under such circumstances, the role of IMF in providing official payments finance comes to the fore. However, the existing resources of IMF have proved too small to deal with the large actual and potential demand for Fund credit,[194] despite steps that have recently been taken to augment the Fund's lending capacity. This, together with a restricted view by some of its larger members regarding the appropriate duration of IMF assistance to a member country, has meant that the payments support needed to overcome underlying payments problems while sustaining growth has not been available. Consequently, policies have had to be more narrowly focused on the task of bringing about rapidly a substantial improvement in the trade balance. This, in turn, has tended to encourage or even enforce national policy responses, which in some cases may be counter-productive and in others may contribute further to the propagation of deflation in the world economy, and particularly in developing countries.

3. Exports of primary commodities

442. Developing countries as a group can raise their export earnings from any commodity by means of increased volume only when the demand that they face is price elastic. However, for the great majority of the primary products exported by developing countries demand is price-inelastic.[195] Therefore, attempts by countries acting individually to earn more abroad by increasing export volume are likely to result in a decline in prices and in an increase of the collective deficit of the developing countries.

443. For most commodities, the earnings of developing countries as a whole can be increased only if volumes are controlled. This result cannot be brought about by market forces alone. Indeed, if producers respond positively to price incentives, and if governments rely on currency devaluation to clear the market for foreign exchange, there is a danger that the resulting expansion of output will so reduce the price of commodity exports that imbalances in external payments will actually be increased.[196] However, volume control requires collective action by producers. In its absence unco-ordinated attempts by exporters of primary commodities to balance their external payments through programmes entailing devaluations may well worsen over-supply in many commodity markets and exacerbate rather than reduce developing countries' deficits on current account.[197]

444. The information presently available regarding the response of commodity-producing countries to their acute payments problems is incomplete. The evidence that is available does not suggest that policies followed by these countries have as yet increased the relative profitability of commodity production, although some actions along these lines have occured.[198] However, pressures to deal with payments problems through measures to expand exports, including substantial currency devaluation, abound. Thus, the potential for individual actions that would result in an unco-ordinated expansion of total supply continues to exist.

---

[194] The process through which this has occurred is discussed in part II, chapter V.

[195] See annex C below.

[196] The effect of devaluation on incentives to producers may be nullified by an increase in general inflation. Indeed, this appears to have been the outcome for many developing countries in recent years (see annex C below).

[197] There are, of course, cases where this conclusion does not hold. One example is oil where the market is managed and production decisions are insensitive to movements of exchange rates. Such exceptions are important ones, for under present circumstances they tend to make the world economy more stable. But they are not the general rule.

[198] See annex C below, section C.

4. Import volume and exports of manufactured products

445. To the extent that earnings from primary commodities cannot be enlarged, adjustment of the trade balance has to come about through cuts in imports or increases in exports of manufactured products (or both).

446. For most semi-industrialized developing countries, the bulk of imports of manufactures consists of inputs into the production process rather than articles of final consumption. The totals for the latter thus tend to be small compared to the size of the improvements sought in the trade balance.[199] Consequently, import compression involves cut-backs either in investment goods such as plant and machinery, necessitating a decline in investment, or in "maintenance" goods such as raw materials and spare parts, which necessitates a curtailment of output, or a combination of the two. It is not possible to avoid these consequences by greater saving, since consuming less can improve the balance of payments only by causing output, employment, and the rate of capacity utilization to fall, if imports of consumer goods are not an important element of the import bill.

447. Increased exports of manufactures can, in principle, provide a means of limiting the cut in imports and its attendant consequences. For some developing countries this is an important option. But in practice the scope for most developing countries to enlarge their earnings from manufactured exports in the short term, (i.e., without adding to their capital stock) is narrow.

448. For one thing, many developing countries have little industrial production. For another, it is usually difficult to sell goods attuned to domestic markets consisting largely of consumers with low incomes to countries where disposable incomes are higher and tastes different. Thus, as a result of such disparities in income levels, reducing domestic consumption in a poor country with an external deficit will not necessarily release an increased supply of goods that are exportable to the developed countries but is likely to lead, instead, to more unemployment (and hence, to a widening of international disparities in income levels).

449. It is true that many developing countries have developed supply capabilities in certain specialized lines of production for which there is potentially ample demand in the developed countries; but the possible expansion of such exports in the short term will also tend to be limited. First, there may be little or no scope for increasing output of such goods in the short run because of capacity limitations. The increase in exports in the medium term will thus depend on the amount of new capacity "in the pipeline", i.e., on investment decisions already taken, and on the amount of new investment that will be forthcoming in the future. In such cases reductions in domestic expenditure make possible additional exports only when the home market is a significant source of demand for the products in question.[200]

450. Second, the country may be able to supply more of the goods in question but be impeded from selling them in foreign markets by protectionist barriers of various kinds. This is the situation that many developing countries have faced in trying to increase exports of a wide variety of goods, such as processed primary products, textiles, clothing, footwear, and more recently steel.[201]

451. Some of the more industrialized developing countries have developed a substantial capability to manufacture capital goods and intermediate pro-

---

[199] There remain countries where a proportion of imports consists of consumption goods purchased mainly by the urban population. However, such proportions have been reduced since the onset of the current international financial crisis, in many cases by substantial amounts.

[200] The reductions in expenditure should be achieved by measures such as specific taxes which apply as closely as possible only to the categories of goods which are to be made available for increased exports. As is noted below, if the goods in question are investment goods, increased exports will be achieved at a cost to the country's future productive capacity.

[201] For details, see annex D below.

ducts, generally in the course of import-substitution policies of industrialization. If there is little scope for increasing the output of such goods owing to capacity limitations, the analysis above is applicable and increased exports are possible only by diverting supplies from the domestic market, which, in this case, can be accomplished only by constraining investment and the country's future productive capacity. If there are no limitations to expanding output, then increased export sales are likely to require price subsidies or devaluation. Price subsidies will usually be difficult to finance in the context of a programme of external payments adjustment, which in general entails restrictions on government expenditure and will, in any case, be resisted by importing countries. As a result, the only practical alternative is likely to be devaluation. However, in depressed world markets devaluation may not produce results rapidly while its negative consequences, in terms of increased inflationary pressures, increased cost of debt service in domestic currency, etc., are felt immediately.

452. One general conclusion of this analysis is that for most developing countries there will be only limited scope for expanding the supply of exports through reducing domestic expenditure.[202] For a few countries, in particular the more industrially advanced among the developing countries, the scope for improvement of the trade balance via this route is greater. However, unless productive capacity is rising rapidly owing to previous investment, the export of capital goods, intermediate goods or raw materials will entail a cost to present or future output. On the side of the demand for imports the reductions in expenditure required to achieve substantial improvement in the balance of payments will in general lead to higher unemployment, lower levels of capacity utilization and reduced investment. Such efforts will also usually have long-run harmful implications for development. Indeed, external payments adjustment should not be focused only on short-run improvements in the trade balance but should also be directed towards strengthening the capacity to produce goods formerly imported and goods in which the country has a long-term cost advantage. For this purpose increased investment is indispensable. However, increased investment cannot be achieved through higher domestic savings when current consumption does not consist, or only marginally consists, of goods that are exported or imported by the country.

453. The analysis also raises the question how far or how long developing countries would be left free in the course of a recession to compete with producers in developed countries in industries that are sensitive to downturns in economic activity (such as those producing capital or intermediate goods).[203] Efforts by the more industrialized developing countries to penetrate developed countries' markets for such products may thus be impeded by protectionist forces in the latter. These forces tend to become more insistent during periods of recession or depression. They are thus strengthened by the same deflationary monetary and fiscal policies in the developed coun-

---

[202] A possibility not covered by the discussion so far is improving the trade balance by reducing food consumption, since food products are often exportable. Such cuts will tend to affect most severely lower-income groups and may result in increases in social tensions and pressures on the political system, taking such forms as riots.

[203] A concrete example of this and of the mechanisms described in the preceding paragraph may be found in the recent behaviour of trade between Mexico and the United States in iron and steel products. In 1980 and 1981 the United States made net exports to Mexico of these products amounting to more than $0.5 billion annually. Following Mexico's debt crisis, the resulting severe cut-backs in aggregate demand in that country and pressures to improve the trade balance, Mexico's exports of iron and steel products to the United States rose four-fold in 1983, while United States exports to Mexico were slashed to about 20 per cent of their former level. This was accompanied by a reduction of investment in Mexico. It also contributed to protectionist pressures which, in July 1984, led the United States International Trade Commission to propose higher protection for the United States steel industry.

tries that are contributing to external payments problems in developing ones.

454. Such strains in the trading system stemming from global macro-economic conditions are not, of course, confined to capital and intermediate goods. They are evident across a wide spectrum of other manufactured goods and primary commodities. Moreover, the increase in protectionism stemming from recession, payments imbalances and misaligned exchange rates is superimposed on secular difficulties in the trading system resulting from longer-term structural adjustment in the face of changing patterns of international competitiveness.

455. In brief, the trading system is being overloaded by the combined strains imposed on it by the recession in developed countries and the financial distress of developing countries. Both the sources of the increased problems of the trading system and the solutions to them lie to a considerable degree outside the system itself. Indeed, it is doubtful whether the escalation of protectionism can be held back if levels of activity are not increased and external payments imbalances are not corrected by means that depend less on demand deflation. Moreover, it is unrealistic to suggest that trade liberalization can take place alongside a continued policy of disinflation. However, higher levels of activity, reduced external imbalances, and more appropriate exchange rates will not suffice to reverse protectionism involving particular sectors whose difficulties are to a significant extent the consequences of long-term factors. Thus, there would still remain a substantial agenda for reform in the trading system proper.

5. Trade among developing countries

456. Another shortcoming of the way in which external payments adjustment operates in the world economy is that the corrective action of individual deficit countries tends to enlarge the deficits of other countries. As already noted, effects of this kind may result from attempts by developing countries to correct external imbalances through increasing exports of primary commodities. In addition, part of the impact of import reductions by developing countries will be on those countries' mutual trade. This argument applies to non-essential as well as essential imports. For example, a reduction of coffee imports by one deficit country may help it to correct its external imbalance or maintain essential imports from other markets. But it does not improve the trade balance or import availabilities of developing countries taken as a whole. Indeed, it increases the trade deficit or triggers cuts in imports of coffee-exporting developing countries.

457. Mutual trade among developing countries has been adversely affected during the sharp slowdown of world trade since 1980, and preliminary indications suggest that in some cases the slowdown has been especially severe. For example, there were sharp falls during 1981-1982 in the exports of both parties in the trade between Africa and Latin America and in the share of such mutual exports in the total exports of both areas.[204] The relationship between the slowdown in total world trade and that in developing countries' mutual trade is not yet well understood. However, it is widely believed that inadequate financing and clearing arrangements played a significant part.

6. The impact on developed countries

458. An improvement in the balance of payments of developing countries brought about by either a decrease in imports or an increase in exports (or a combination of the two) will work to reduce employment in developed countries. The consequences of import cuts by developing countries have not gone unobserved. It has frequently been noted that the associated drop in export orders has caused a reduction in activity levels in developed countries, first in the export sectors themselves and subsequently in other industries, through the workings of the

[204] GATT, *International Trade 1982/83,* (Sales No. GATT/1983-3), table A.23.

"multiplier".[205] Much the same thing also takes place to the extent that the adjustment in the trade balance takes place through an expansion of developing countries' exports unmatched by an expansion of demand in developed countries, though with the difference that here the initial impact is on the import-competing industries of developed countries.

459. In this context it is interesting to consider the order of magnitude of the effect on the GDP of the OECD area of a one-year improvement of $25 billion[206] in developing countries' overall trade balance with developed market-economy countries. If the one-year international multiplier for the effect on GDP in OECD countries of an exogenous change in expenditure is taken as 2 and the two-year multiplier as 3,[207] then the fall in GDP in OECD countries resulting from the improvement in developing countries' trade balance would be $50 billion after the first year and $75 billion after the second. Thus, unless aggregate demand from other sources increases, adjustment by developing countries has a depressing overall effect on income and employment in developed countries, similar to, say, a decline in business investment, whether it takes place through reduced imports of developing countries or an increase in their exports. Although adjustment through export expansion is preferable to adjustment through import contraction for the deficit country concerned, the consequences for its trading partners are roughly equivalent. If intensified deflation in the economies of its partners is to be avoided, offsetting measures to stimulate demand will be required.

460. The negative feedback from the developing countries will generally be a multiple of the initial impact of deflationary policies in developed countries on the demand for imports from developing countries. This is because, as already discussed, the systems of money and finance and of commodity markets tend to amplify the impact on the balance of payments of developing countries. Thus, in a situation such as that described in the preceding paragraphs, the workings of the systems of money and finance and of trade not only disrupt the development process in developing countries by, *inter alia*, forcing a substantial part of external payments adjustment to take place via investment cuts, but also push up rates of unemployment (and hence, tend to reduce business investment) in developed countries. This adjustment entails lower supply in developing countries (as a result of reduced imports) and lower demand in developed market-economy countries (as a result of this changed balance of trade). World income and employment are consequently depressed by factors operating on both supply and demand. Protectionism in developed countries serves to shift the deflationary impact on developed countries from some industries to others but not to reduce it overall. However, it accentuates the depressive impact of external payments adjustment on developing countries.

461. Thus, when external imbalances

---

[205] See, for example, *North-South: A Programme for Survival. The Report of the Independent Commission on International Development Issues under the Chairmanship of Willy Brandt* (London and Sydney: Pan Books, 1980), pp. 66-67 and 238-240; and *Common Crisis North-South: Co-operation for World Recovery. The Brandt Commission 1983* (London and Sydney: Pan Books, 1983), pp. 25-27.

[206] The figure of $25 billion is chosen for illustrative purposes only. However, it is of the same order of magnitude as the improvement during 1983 in the balance on current account of both developing countries as a whole and the non-oil-exporting members of the group.

[207] These multipliers are approximately those of OECD's international linkage model, which takes account of feedback effects associated with the linkages among OECD economies ("The OECD international linkage model", *OECD Economic Outlook, Occasional Studies*, January 1979, pp. 19-24). Strictly speaking, the international multipliers of this model should not be applied to improvements in the trade balance of developing with developed market-economy countries, since they were estimated on the basis of a particular assumed distribution among OECD economies of an exogenous change in expenditure. Nevertheless, this qualification is probably of limited importance for an approximate calculation such as that in the text.

reflect macro-economic imbalances, adjustment of payments deficits through severe demand contraction serves to depress employment, output and development in the world as a whole.

462. These adverse effects could be avoided if the balance-of-payments deficits of developing countries were to be addressed by a different route, that is to say, by measures that would include a decline in interest rates, a stimulus to demand in developed countries (which would help to improve commodity prices), and an increase in net capital flows to developing countries. In this way the burden of external payments adjustment would be shared by surplus and deficit countries and take place in a context of expansion rather than contraction. However, the present systems of money and finance, trade, and commodity markets are not designed to bring about such a result. On the contrary, during periods of generalized recession they have placed the burden of adjustment on the deficit countries, and thus amplified the initial effect on world income of deflation in developed market-economy countries. This asymmetry in the balance-of-payments adjustment process tends to be disregarded during periods of rapid growth in the world economy but becomes all too evident when, as in the recent past, recessionary tendencies are strong.

7. Debt

463. A salient feature of the recent operation of the systems of money and finance, trade, and commodity markets has been the sharp rise in international indebtedness relative to world trade and economic activity, and the widespread inability of many debtor developing countries to meet debt payments as originally scheduled.

464. The rapid and accelerating pace of external indebtedness is, in large part, directly related to the characteristics of the system of money and finance. As is described elsewhere in this report,[208] the shortcomings in the mechanisms for liquidity creation and the relatively slow growth of bilateral and multilateral flows of official financing induced many developing countries to have recourse to private banks to meet their financial needs. The banks, in turn, expanded their lending in response to these demands, but most of their credits were extended at variable rates of interest (intended to eliminate their interest-rate risk).

465. So long as interest rates fluctuate within the bounds of historical experience, such features of the system of money and finance need not lead to widespread problems. Policy makers in borrowing countries are able to assess the consequences of swings in interest rates and to manage their external indebtedness accordingly. Acute problems arise, however, when interest rates rise far above the range of historical experience in the context of levels of external debt incurred on assumptions about the costs of debt service, export earnings, etc., which no longer hold. In such circumstances the sharply higher interest payments become an important source of deterioration in debtors' current-account balances and thus are themselves a cause of rapid increases in indebtedness which, should it continue, could quickly reduce the debt-servicing capacity and creditworthiness of the debtor country.

466. Developing countries' difficulties with their external debts are not attributable to the functioning of the system of money and finance alone. They are the joint product of the response of this system and of the systems of trade and commodity markets to the mix and stance of macro-economic policies in developed market-economy countries, and of policies in debtor countries themselves (policies which were often shaped to a significant extent by systemic deficiencies).

8. Recovery and developing countries

467. The analysis in the preceding paragraphs has concentrated almost exclusively on the ways in which the system has operated to propagate deflation in the world economy: these have been the features of the system most in

[208] Part II, chapters IV and V.

evidence in recent years. It should be emphasized, however, that two very real dangers leading to a severe intensification of deflation have so far successfully been averted: governments have avoided the sharp increases in protectionism that contributed so importantly to the destruction of prosperity in the 1930s; they have also, with IMF, prevented a collapse of bank lending that would have had severe consequences for the world economy.

468. The trade and payments system has undergone transformations that make it difficult to assess the way in which it will propagate positive, expansionary tendencies in the world economy.[209] There is some reason to believe, however, that the behaviour of the system during the recent recession, in particular its tendency to accentuate the accumulation of debt, has significantly affected the way in which, and the extent to which, cyclical upswings are transmitted from developed to developing countries. The contraction of the economies, and the deterioration of the external financial position of many developing countries, have combined to weaken the capacity of the systems to transmit fully and promptly to them the benefits of any generalized recovery in the developed market-economy countries.

469. With regard to the trading system, the spread of protectionist measures, which was intensified by the period of recession, will diminish the extent to which increased demand in the developed market-economy countries spills over into demand for exports from developing countries. Moreover, the overhang of indebtedness of a number of developing countries will require behaviour on their part that works to weaken further the link between growth in developed market-economy countries and that in developing countries. For example, during the period immediately ahead the efforts of many developing countries are likely to be largely directed towards further reductions of external imbalances, the elimination of debt arrears, the restoration of official reserves and inventories to more normal levels, increased expenditure on maintenance postponed as a result of financial crisis, etc. Such activities will absorb a large part of any increases in the availability of foreign exchange but are likely to be associated with only limited rises in output. Thus, the interaction of the past accumulation of debt and continuing high interest rates appears likely to result in behaviour throughout the current cycle which impedes a return to higher growth in developing countries. For developing countries, the systems of money and finance, trade and commodity markets have operated during the period of downturn by amplifying the negative forces emanating from the economic performance of the developed countries, and will have operated during the upturn, at least initially, by dampening the positive effects of recovery in the developed market-economy countries.

[209] For a discussion of this process during 1983, see part I above, chapter II.

Chapter III

TOWARD REFORM OF THE TRADE AND PAYMENTS SYSTEM

470. The recent performance of national economies has been the weakest of the post-war period. The developed market-economy countries have experienced their most severe recession in output and employment. The development of the developing countries has been disrupted to the point that many of these countries, now under the weight of severe external pressures, declines in output, financial disorder and sharply diminished prospects for growth in future years, face the prospect of economic and social disintegration. The socialist countries of Eastern Europe have not escaped the consequences of the broader disorder in the world economy.

471. These results have had a number of causes. Factors of a national character have been important. Changes in national economies relating to demographic and technological shifts, thrift and productivity have played a role in slowing growth and increasing unemployment. Policy choices have also exerted a significant influence on performance, in particular in as much as they have allowed national economies to take advantage of the opportunities presented by the international trade and financial system and to skirt their dangers. Nevertheless, the characteristics and the operation of the international trade and payments system have had a decisive influence on the outcome, including the results obtained from efforts and policies pursued at the national level.

472. The trade and payments system can affect national economic performance through three principal routes. First, it can influence the efficiency with which resources - both labour and capital - are allocated to alternative uses. Second, it can affect policies by encouraging certain types of behaviour and discouraging others. Third, it can affect the way positive impulses and negative disturbances are transmitted from country to country, and the size and distribution of the consequences of such transmissions.

473. The present system has serious drawbacks in all three areas. For one thing, the erosion of the post-war trading system has reduced the efficiency of resource allocation and limited the system's capacity to deal with changes in competitive capabilities among countries, especially those that give rise to new entrants in international markets.

474. For another, the signals and incentives provided to decision-makers in both the private and the public sectors have been made more confusing, for the system has not yielded the minimum degree of predictability required for rational decisions, both micro-economic and macro-economic. Erratic exchange-rate movements have made long-term investment in "tradeable" production extremely risky. By the same token, volatility in the international environment as a whole, including the terms of trade and the cost and availability of external finance, have deprived national policy makers of a reliable yardstick with which to judge the degree to which their economies are properly adjusted to the international environment. Yet, adapting an economy to shifts in the international environment that are apt to be reversed is very costly and wasteful. This is evident at the present time, when deficit developing countries are being obliged to adjust to an environment characterized by mounting fiscal deficits in the United States, unprecedented high real interest rates and unusually low growth in the European economies - none of which can be assumed to be sustainable in the long term.

475. Third, the system has contributed to cyclical instability in the world economy. Macro-economic disequilibria such as inflation, and more particularly deflation, are made to shift from one country to another in a way that tends to amplify, rather than diminish, them. The lack of an adequate contracyclical mechanism capable of counteracting contractionary movements of output and growth is clearly in evidence at the present time.

476. These deficiencies have imposed heavy costs on all countries. The direct costs to developing countries

have been particularly high. Fluctuations in terms of trade, interest rates, lending levels and exchange rates, combined with inadequate facilities for payments financing, have had a strongly negative impact on their economic performance. The slow growth of official, and in particular multilateral, financing, and increasing dependence on volatile sources of funds, has been a second major problem for them. Finally, the developing countries have also been victims of the erosion of the multilateral trading system through its effects on producers of agricultural products, labour-intensive manufactures, and in general, new entrants into traditional markets.

477. The damage inflicted upon the development process by the malfunctioning of the trade and payments system has in turn damaged employment and growth in developed countries. For example, the "adjustment" of the trade balance of developing countries currently under way serves both to reduce levels of activity in developing countries and to restrain the recovery of output and employment in developed countries. Similarly, the debt crisis, apart from disrupting the economies of debtor countries, is also putting in jeopardy the international financial system and hence, the whole process of income-generation in developed market-economy countries.

478. The increasing importance of the trade and payments system as a factor determining growth performance may be explained in terms of three broad factors. First, as the major economies, in particular, have become more open through trade and financial flows, the potential for the transmission of cyclical and secular impulses has increased, and thus has given a more prominent role to the monetary, financial and trade regimes in the processes of income-generation and growth in the world economy.

479. Second, abnormal demands have been made of the system of trade and payments by various shocks. These have included, in particular, periodic shifts in the overall stance and mix of macro-economic policies of the major developed countries and large and abrupt changes in energy prices. Taken together, these have served to disturb levels of demand, overall prices, terms of trade, interest rates, lending levels and payments balances.

480. Third, the trade and payments system has undergone changes that have further reduced its ability to absorb shocks and bring about needed long-term adjustment. The financing of payments imbalances and of capital development, the creation of international reserves and the determination of exchange rates have been assigned almost entirely to processes that are outside significant official influence, and which are inherently fragile and subject to rapid shifts of direction.

481. The recent evolution of the system and the recent performance of economies point to the substantial dangers that lie in store for the world economy both now and in the years immediately ahead. The cumulative impact of past stresses, including the overhang of accumulated debt, has seriously eroded the capacity of the system and national economies to cope with new strains. Although economic expansion is proceeding vigorously in North America and can be expected to improve in other developed market-economy countries, serious doubts remain regarding the durability of expansion in North America and the vigour of expansion in Europe. The possibility of another downturn in economic activity taking place during the next one or two years is a real one, and there is a danger that it will trigger an overt and irreversible rupture in the fabric of international economic relations.

482. Prudent policy planning calls for urgent examination of how the trade and payments system may be re-ordered and re-structured so as to avoid these dangers and facilitate the achievement of high rates of employment in developed countries, on the one hand, and of development in developing countries, on the other.

483. Appropriate economic policies in developed countries, designed to ensure high levels of demand together with lower interest rates and to avoid a revival of cost-push inflation, remain essential to both these objectives. At the same time, a vigorous development process in developing countries is increasingly a factor required for the proper functioning of the economies of developed countries. In a national economy in the throes of recession, reduced consumption expenditure by unemployed wage earners serves

to aggravate unemployment, and reduced profits serve to worsen the balance sheets of financiers and institutions and to lower the price of capital assets. Likewise, adjustment by developing countries through demand contraction of an external deficit originating in a world recession results in an aggravation of that recession, while the worsening of their cash flow position tends to lower the quality of the portfolios of international banks. The increased interdependence of the world economy has made a global macro-economic perspective increasingly necessary.

484. Thus, a viable system needs not only to reaffirm the emphasis on employment and growth that underlay the design of the post-war systems, but also to complete that commitment by establishing mechanisms to ensure adequate growth opportunities for all members of the system. The establishment - as one of the guiding principles of the system - of a development consensus which would recognize that rapid development in developing countries is an imperative both for the developing countries and for the proper functioning of the world economy as a whole would be the logical extension of the original rationale of the Bretton Woods arrangement.

485. In the present climate of hesitant growth and financial disorder, the solution to problems inevitably raises certain conflicts of interests. For example, the exigencies of international financiers and the international monetary and financial agencies, which exert pressure on developing countries to redress external imbalances by means of export growth, come into conflict with the demands of industrialists and workers in developed countries for protection against foreign competition. Moreover, in response, in part, to the interests of the export industries of the developed countries, developing countries are increasingly being urged to reduce their own import barriers, notwithstanding the fact that they are at the same time obliged to cut their imports.

486. Despite these various conflicts of interest, there are also a number of areas where the interests of the different parties are convergent. Both the export industries and the import-competing industries in the developed countries have an interest in seeing that the import capacity of developing countries is not harmed by such factors as low commodity prices and lending levels and by high interest rates, and that adequate liquidity is made available to avoid excessive or over-rapid adjustment. The export industries in developed countries and financiers also have a common interest with the developing countries in seeing the latter's exports grow over the long term, and hence, in improving the access to foreign markets of developing countries. Finally - and perhaps most important - profit and wage earners in developed countries have, in common with developing countries, an interest in ensuring that aggregate demand is not deficient and that interest rates are not excessive. There thus exist objective bases on which to build a "development consensus".

487. The necessary consideration of the need for reform of the trade and payments system is unlikely to occur in the present arrangements for international economic discussions, which separate from one another the ever more closely connected problems of development, employment, debt, trade and payments balances. One major failing that results is that decisions on the international monetary and financial system, although having a deep impact on the real sectors in both developed and developing countries, are circumscribed by the perspectives of narrow monetary and financial considerations. At the same time, the agenda of international monetary negotiations is being shaped in restricted groups in which developing countries are not represented.

488. What is required is an alternative approach which would seek to reform the trade and payments system on the basis of the interdependence of the problems in these fields and of the mutual dependence of employment and development.

489. Efforts to implement such an approach would necessarily require governments to grapple with a number of very basic and fundamental issues. Among the more important of these are the following:

(a) How and to what extent is it possible for countries that are large enough for their policies to have important consequences for other countries to take into account the needs of the system in designing their policies? What mechanisms are likely to be required to achieve such results and to what extent would they need to embody a set of incentives and disciplines? Would it also be necessary to equip the system with new or strengthened mechanisms to offset the international impact of domestic policies of major countries, such as fluctuations in interest rates?;

(b) What are the mechanisms available to remove the bias of the system against full employment and development? Can features be designed for the system that would encourage national policies contributing to growth and stability?;

(c) How can the system be made better able to resist the generation of cyclical fluctuations? In the area of payments this raises the question of whether a more symmetrical balance-of-payments adjustment process might be devised in which the distribution of the burden of adjustment between surplus and deficit countries would be arrived at in the light of the overall cyclical situation in the world economy. In the area of trade this raises the question of how the commodity regime can be made more resistant to cyclically-induced swings in prices.;

(d) What is the proper domain of the system as regards its membership? Some socialist countries of Eastern Europe are associated with the mechanisms governing trade and payments among developed market-economy countries as well as with those governing exchanges among socialist countries. Is it possible to devise a common framework that would have equal validity for both groups of countries?;

(e) What is the proper domain of governmental intervention with regard to international transactions? This issue has a number of dimensions. One of the more important is whether international financial transactions should systematically be treated differently from the exchange of goods and services. At present, financial transactions encounter little, if any, governmental constraint in most major countries; and where constraints do exist, the trend is toward reducing or eliminating them. Trade, on the other hand, is subject to considerable and growing governmental interference, some of which is directly or indirectly the result of exchange-rate misalignments made possible by freedom of capital movements. Is there a rationale for such divergent trends? Is there a case for a more balanced approach in which governments would attempt to reach a rough equivalence between policies that impede trade in financial assets and those that impede trade in goods and services?;

(f) What is the proper domain of the trade regime? How are governments to formulate a common framework of rules that would meet trading needs in manufactures, agricultural products and services? How can this regime provide an adequate framework for intra-firm transactions and take account of the various trading sub-systems?;

(g) How can the international system be endowed with mechanisms that allow necessary adjustments in policies and in national economies to go forward in the context of growth and development? In the sphere of payments, this entails devising mechanisms to support a balance-of-payments adjustment process that is compatible with growth. In the sphere of trade, it entails divising mechanisms to allow countries to accommodate changes in the competitive capabilities of their trading partners, particularly those newly entering world markets. What is the role of deliberate structural adjustment policies in such a process? Can governments devise safeguard arrangements that are adequate from an international standpoint? How can the trading system be made to meet the needs of weaker trading partners - that is, the developing countries?;

(h) In the monetary sphere, what is the feasible scope of official action? In the past, it was assumed that governments could have a collective policy as regards the creation of international liquidity and the character of the exchange-rate regime. Is the present scope of government influence in these areas sufficient? If not, how can governments secure its enlargement while ensuring consistency in national policies?;

(i) How can a reasonably predictable and growing flow of development finance consistent with development needs be secured? Can such flows be made a more integral part of the payments system?;

(j) What institutional arrangements need to be put in place to ensure through time coherence and consistency in the formulation of policies relating to trade and those relating to payments so that they may promote full employment and development?

490. Although these fundamental, underlying issues form the core of any agenda for reform, there are a number of immediate and urgent issues that will need to be given special attention. Foremost among these is the question of debt.

491. A multitude of proposals presently exist with regard to the way in which current debt problems might be alleviated. One of the more important issues in this regard, however, is the way in which the resolution of present difficulties can be made compatible with high and rising financial flows to debtor countries in future years, which is an issue that can only be adequately addressed in the context of a broader discussion of the evolution of the financial system in the years to come. The debt problem is also closely related to the conduct of monetary policies in developed market-economy countries, the growth of activity in those economies, and the access of developing countries to foreign markets.

492. Thus, the debt question can only be satisfactorily resolved in the context of reform of the system of trade and payments. At the same time, the system itself will inevitably be affected, and its long-term evolution heavily influenced, by decisions regarding debt in the immediate future.

Blank page

Page blanche

ANNEXES

Annex A

SUPPLEMENTARY STATISTICS

Contents

Table *Page*

Annex table A.1

World output *a/* summary: annual rates of change in volume, 1975-1985
(Percentage)

A. By main regions

Region	Actual 1975-1980	1981	1982	1983*	Forecast *b/* 1984	1985
World	3.8	1.6	0.0	1.9	3.5	3.1
Developed market-economy countries	3.5	1.7	-0.2	2.3	3.9	2.9
North America	3.6	2.7	-2.1	3.4	5.5	3.1
Canada	3.3	4.0	-4.2	3.0	4.8	3.4
United States	3.7	2.6	-1.9	3.4	5.6	3.1
Western Europe	3.0	0.0	0.3	1.1	2.1	2.3
France	3.3	0.3	1.8	0.5	0.7	1.5
Germany, Fed. Rep. of	3.5	0.0	-1.1	1.2	3.0	3.3
Italy	3.9	0.1	-0.3	-1.5	2.2	2.4
United Kingdom	1.7	-2.0	1.5	3.1	2.5	2.0
Japan	5.1	4.0	3.0	3.0	4.5	3.5
Others	2.5	4.2	-0.3	0.9	2.2	2.6
Developing countries	5.1	1.2	0.9	-1.3	2.1	3.7
Western Hemisphere	5.1	0.0	-1.2	-2.8	0.9	3.0
North Africa	7.5	-0.9	2.6	3.0	3.1	4.1
Other Africa	2.8	0.4	-0.5	-0.7	2.2	2.2
Excluding Nigeria	2.3	2.1	0.5	0.5	2.7	3.3
West Asia	5.6	-2.0	2.1	-4.6	1.2	3.8
South Asia	4.0	5.4	3.3	5.2	5.2	5.2
East Asia	8.2	6.8	3.6	4.7	5.6	6.2
China *c/*	4.9	3.0	7.4	9.0	6.6	6.3
Socialist countries of Eastern Europe *d/*	4.1	2.0	3.1	3.8	3.7	3.9
Memo item: Unemployment rates in OECD countries e/						
Canada	..	7.6	11.0	12.0	11.0	10.5
France	..	7.8	8.0	8.3	9.5	10.0
Germany, Fed. Rep. of	..	4.8	7.0	8.5	9.3	9.1
Italy	..	8.5	9.1	10.0	10.1	10.2
Japan	..	2.2	2.4	2.7	2.7	2.7
United Kingdom	..	10.6	11.0	11.5	11.5	11.5
United States	..	7.6	9.7	9.5	7.6	7.2

For sources and notes, see end of table.

Table A.1 (cont'd)

World output *a/* summary: annual rates of change in volume, 1975-1985
(Percentage)

B. Developing countries by major analytical groups

Region	Actual				Forecast *b/*	
	1975-1980	1981	1982	1983*	1984	1985
Major oil exporters	5.1	0.7	0.7	-3.2	1.8	3.2
Oil sector	1.3	-17.3	-3.3	-8.9	0.5	3.1
Non-oil sector	6.9	5.2	1.2	-0.8	2.4	3.2
Other oil exporters	5.7	5.6	2.8	0.1	3.5	4.9
Net oil-importing countries	5.0	1.3	1.0	2.1	3.2	4.4
Exporters of manufactures	5.9	-1.5	0.3	0.6	2.3	4.4
Least developed countries	3.4	3.3	2.0	3.0	3.9	3.7

Source: UNCTAD secretariat calculations, based on official national and international sources.

Note: Major oil-exporting developing countries are Algeria, Angola, Bahrain, Brunei, Congo, Ecuador, Gabon, Indonesia, Iran (Islamic Republic of), Iraq, Kuwait, Libyan Arab Jamahiriya, Mexico, Nigeria, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Trinidad and Tobago, United Arab Emirates and Venezuela.

Other oil-exporting developing countries are Bolivia, Egypt, Malaysia, Peru and Tunisia.

Net oil-importing developing countries are all developing countries, excluding the major oil exporters and other oil exporters.

Exporters of manufactures are Argentina, Brazil, Hong Kong, Republic of Korea, Singapore, and Taiwan Province of China.

a/ Gross domestic product/gross national product.

b/ The forecasts have been prepared by the UNCTAD secretariat on the basis of recent forecasts of Project LINK and the econometric models covering 60 developing countries, and of consultations with experts. For a brief description of Project LINK and the econometric models, see TD/B/C.3/134/Add.1, sect. II. The UNCTAD secretariat contributes to the LINK econometric modelling system with regional models of developing countries and price forecasts for their principal export commodities.

c/ National income.

d/ Net material product.

e/ Total is weighted average of standardized unemployment rates in 15 OECD countries.

* Estimated.

Annex table A.2

World trade summary: annual rates of change in volume and prices, 1975-1985
(Percentage)

A. Developed market-economy countries by main regions

Country, region or group	Actual 1975-1980	1981	1982	1983*	Forecast 1984	1985
World exports						
Volume	6.0	-0.8	-2.5	1.1	5.0	5.5
Unit value	11.5	-2.3	-5.0	-4.0	2.0	4.4
Developed market-economy countries						
Export volume	6.5	1.5	-1.0	1.0	5.0	5.2
Terms of trade	-2.1	-0.1	2.0	1.0	0.0	0.0
Purchasing power of exports	4.4	1.4	-1.0	2.0	5.0	5.2
Import volume	5.7	-3.0	0.0	2.1	5.8	5.0
North America						
Export volume	6.7	-2.2	-7.0	-3.3	3.0	4.5
Terms of trade	-3.2	2.4	2.0	4.8	1.1	-0.5
Purchasing power of exports	3.5	0.2	-5.1	1.3	4.1	4.0
Import volume	5.7	1.5	-6.9	8.5	11.5	7.0
Western Europe						
Export volume	6.2	1.5	1.0	1.9	5.0	5.0
Terms of trade	-1.0	3.2	3.1	1.0	0.0	0.0
Purchasing power of exports	5.2	4.7	4.1	2.9	5.0	5.0
Import volume	6.0	-4.5	3.2	0.0	3.5	4.0
Japan						
Export volume	9.3	10.7	-2.3	8.3	7.5	7.0
Terms of trade	-5.2	4.0	0.0	3.8	3.5	0.0
Purchasing power of exports	4.1	14.7	-2.3	12.4	11.3	7.0
Import volume	4.5	-2.2	0.0	0.8	6.0	5.5
Others						
Export volume	6.0	-5.4	10.5	1.0	7.0	7.5
Terms of trade	-2.5	4.3	-3.7	-2.0	0.0	1.0
Purchasing power of exports	3.5	-1.1	6.4	-1.0	7.0	8.5
Import volume	2.7	10.6	11.6	-12.0	1.5	5.5

For sources and notes, see end of table.

Annex table A.2 (cont'd)

World trade summary: annual rates of change in volume and prices, 1975-1985
(Percentage)

B. Developing countries by main regions

Country, region or group	Actual				Forecast	
	1975-1980	1981	1982	1983*	1984	1985
All developing countries						
Export volume	2.1	-6.0	-6.4	1.1	4.2	6.1
Terms of trade	4.8	7.0	-3.7	-4.9	0.0	0.0
Purchasing power of exports	7.0	1.0	-9.9	-3.9	4.2	6.1
Import volume	5.1	10.0	0.0	-5.5	2.4	3.7
Western Hemisphere						
Export volume	5.9	5.0	-2.0	4.9	4.7	4.2
Terms of trade	-1.3	-2.0	-5.1	-1.2	0.6	-1.0
Purchasing power of exports	4.5	2.9	-7.0	3.5	5.3	3.1
Import volume	2.1	2.0	-16.7	-19.1	6.1	2.5
North Africa						
Export volume	1.0	-31.9	-1.0	-5.0	0.8	2.5
Terms of trade	8.7	13.0	-5.3	-8.4	-2.5	1.0
Purchasing power of exports	9.8	-21.9	-6.3	-13.0	-1.7	3.5
Import volume	0.0	26.0	4.8	-6.8	-2.8	-2.4
Other Africa						
Export volume	0.8	-19.0	-4.9	-11.7	5.3	3.0
Terms of trade	5.4	1.0	-5.0	-4.2	-0.9	0.0
Purchasing power of exports	6.2	-18.2	-9.7	-15.5	4.3	3.1
Import volume	3.3	8.0	-9.3	-24.5	-1.8	-7.2
West Asia						
Export volume	-2.6	-12.0	-21.6	-4.4	1.9	1.2
Terms of trade	11.1	19.0	1.0	-11.7	-4.4	0.1
Purchasing power of exports	8.2	4.7	-20.8	-15.6	-2.6	1.3
Import volume	10.8	22.0	15.6	-10.6	-4.9	-8.1
South Asia						
Export volume	7.6	-1.7	10.4	-3.2	6.0	5.5
Terms of trade	-6.9	-3.0	-3.6	6.2	3.0	0.3
Purchasing power of exports	0.2	-4.7	6.4	2.8	9.2	5.8
Import volume	2.4	-5.5	7.9	-4.3	4.7	4.6
East Asia						
Export volume	11.8	5.4	10.2	9.5	6.9	7.7
Terms of trade	-6.9	-4.7	-3.0	1.3	0.3	-0.1
Purchasing power of exports	4.1	0.5	6.8	10.9	7.2	7.6
Import volume	7.8	8.7	8.4	5.5	5.5	5.8

For sources and notes, see end of table.

Annex table A.2 (cont'd)

World trade summary: annual rates of change in volume and prices, 1975-1985
(Percentage)

C. Developing countries by major analytical groups *a/*

Country, region or group	Actual				Forecast	
	1975-1980	1981	1982	1983*	1984	1985
Major oil exporters						
Export volume	-0.6	-14.0	-14.0	-4.1	2.5	1.4
Terms of trade	10.8	17.0	-1.9	-10.4	-4.2	0.0
Purchasing power of exports	10.1	0.6	-14.8	-14.1	-1.8	1.4
Import volume	9.3	24.0	4.8	-13.9	-1.3	-6.1
Other oil exporters						
Export volume	9.3	-4.2	8.8	7.0	7.2	7.1
Terms of trade	1.7	-4.2	-6.0	0.2	1.7	1.8
Purchasing power of exports	11.2	-8.2	2.3	7.2	9.0	9.1
Import volume	3.7	25.3	8.4	0.8	4.3	5.7
Net oil-importing countries						
Export volume	11.4	10.9	4.0	2.8	6.6	6.1
Terms of trade	-6.1	-8.8	-4.4	5.2	1.3	-0.6
Purchasing power of exports	4.6	1.1	-0.5	8.1	8.0	5.5
Import volume	3.1	-0.4	-4.4	1.1	4.9	2.3
Exporters of manufactures						
Export volume	18.4	20.0	-0.6	10.1	7.8	7.4
Terms of trade	-8.6	-9.0	-0.1	5.6	0.5	-0.7
Purchasing power of exports	8.2	9.2	-0.7	16.3	8.4	6.7
Import volume	4.8	4.0	-5.8	5.1	6.7	6.4
Least developed countries						
Export volume	5.4	1.0	-3.0	-3.1	5.2	2.1
Terms of trade	-1.2	-7.0	-1.0	3.3	3.1	-0.2
Purchasing power of exports	4.1	-6.1	-4.0	0.1	8.4	1.9
Import volume	6.2	2.0	-3.0	-3.1	5.2	3.7

Source: UNCTAD secretariat calculations, based on official national and international sources.

Note: The terms-of-trade calculations for groups of developing countries have been made by the UNCTAD secretariat using a methodology briefly described in the UNCTAD *Handbook of International Trade and Development Statistics, Supplement 1981* (United Nations publication, Sales No. E/F.82.II.D.11), p. 456.

a/ For definition of country groupings and description of forecasting techniques, see notes to table A.1.

* Estimated.

Annex Table A.3

Annual rates of change of consumer prices, by main regions, 1975-1985
(Percentage)

Region	Actual				Forecast	
	1975-1980	1981	1982	1983*	1984	1985
Developed market-economy countries a/	10.6	9.7	7.3	5.5	5.5	6.0
North America	8.9	8.8	6.2	4.2	4.4	5.4
Western Europe	13.0	11.9	10.1	8.3	7.1	7.3
Japan	6.5	4.5	2.9	1.5	1.5	2.5
Others	11.2	9.9	14.1	9.9	9.4	9.8
Developing countries b/	18.8	40.5	55.6	131.8	...	...
Western Hemisphere	33.3	67.2	91.9	185.7	...	...
North Africa	12.0	13.7	12.8	10.2	...	...
Other Africa	17.6	27.5	13.4	57.4	...	...
West Asia	16.9	21.9	20.1	17.8	...	...
South Asia	5.3	12.6	7.7	10.8	...	...
East Asia	11.6	14.7	7.5	6.6	...	...

Source: UNCTAD secretariat calculations, based on official national and international sources.

a/ GDP private consumption deflator.
b/ Index of consumer prices.

* Estimated.

ANNEX TABLE A.4

BALANCE OF PAYMENTS SUMMARY OF DEVELOPING COUNTRIES, 1982-1985
(Billions of current dollars)

A. By main regions

Item / Region	Exports (f.o.b.)	Imports (f.o.b.)	Trade balance	Balance on non-factor services and private transfers	Investment income (net)	Current-account balance	Total capital flows (net)	Changes in reserves (minus equals increase)
Total								
1982	490.6	475.7	15.0	-59.6	-43.6	-88.3	56.9	31.4
1983	458.2	433.1	25.1	-53.3	-41.6	-69.8	68.5	1.3
1984	481.2	446.6	34.6	-48.4	-49.7	-63.6	69.3	-5.8
1985	521.9	472.5	49.3	-48.6	-57.0	-56.2	60.3	-4.0
Western Hemisphere								
1982	108.8	101.6	7.2	-8.9	-37.9	-39.7	26.6	13.1
1983	107.7	78.6	29.1	-7.6	-33.8	-12.3	12.0	0.2
1984	114.3	84.1	30.2	-7.0	-38.1	-14.8	20.6	-5.8
1985	123.4	90.3	33.1	-6.7	-39.0	-12.6	15.7	-3.1
North Africa								
1982	35.1	37.0	-1.9	-2.5	-3.5	-8.0	4.9	3.0
1983	31.7	34.9	-3.1	-1.6	-4.1	-8.8	6.0	2.7
1984	31.4	34.2	-2.8	-0.9	-4.7	-8.4	6.6	1.8
1985	33.7	34.6	-0.9	-0.5	-5.3	-6.7	5.7	1.1
Other Africa								
1982	38.3	37.9	0.3	-12.1	-4.6	-16.4	12.9	3.4
1983	33.1	33.1	0.0	-10.4	-5.3	-15.7	15.0	0.7
1984	35.0	33.1	1.9	-10.0	-5.9	-14.1	15.2	-1.1
1985	37.4	36.8	0.6	-10.4	-6.5	-16.3	16.4	-0.1
West Asia								
1982	152.0	120.8	31.2	-51.3	18.1	-2.0	-10.3	12.3
1983	122.5	110.8	11.6	-50.6	18.0	-20.9	15.8	5.2
1984	122.0	107.3	14.7	-47.8	16.9	-16.2	15.1	1.1
1985	127.8	103.8	24.0	-48.4	13.9	-10.5	10.4	0.1
South Asia								
1982	14.7	25.1	-10.4	5.2	-0.7	-5.8	5.5	0.3
1983	14.4	22.9	-8.5	6.1	-0.7	-3.1	5.2	-2.1
1984	15.8	24.1	-8.3	6.6	-0.6	-2.3	1.2	1.1
1985	17.3	26.1	-8.8	6.9	-0.7	-2.7	2.5	0.2
East Asia								
1982	131.6	141.0	-9.5	6.7	-13.3	-16.0	15.9	0.1
1983	138.8	141.5	-2.7	7.6	-14.0	-9.0	14.3	-5.2
1984	151.3	151.7	-0.4	7.7	-15.5	-8.2	10.6	-2.4
1985	169.7	167.3	2.4	7.7	-17.5	-7.4	9.3	-1.9

For sources and notes, see end of table.

ANNEX TABLE A.4 (cont'd)

BALANCE OF PAYMENTS SUMMARY OF DEVELOPING COUNTRIES, 1982-1985
(Billions of current dollars)

B. By major analytical groups a/

Item / Region	Exports (f.o.b.)	Imports (f.o.b.)	Trade balance	Balance on non-factor services and private transfers	Investment income (net)	Current-account balance	Total capital flows (net)	Changes in reserves (minus equals increase)
Major oil exporters								
1982	257.5	195.5	62.0	-77.2	-2.0	-17.2	-5.3	22.5
1983	218.0	166.2	51.8	-72.5	-0.8	-21.4	18.3	3.2
1984	220.0	165.3	54.7	-70.0	-4.7	-20.0	19.8	0.2
1985	234.4	167.6	66.8	-71.5	-8.6	-13.3	14.2	-0.9
Other oil exporters								
1982	21.7	27.5	-5.8	0.9	-3.2	-8.2	8.1	0.1
1983	22.6	26.7	-4.1	1.1	-4.0	-7.1	6.4	0.7
1984	24.7	28.1	-3.4	1.3	-4.6	-6.7	6.0	0.7
1985	27.7	30.8	-3.1	1.5	-5.3	-6.9	7.0	-0.1
Net oil-importing countries								
1982	211.5	252.6	-41.1	16.7	-38.4	-62.9	54.2	8.8
1983	217.7	240.2	-22.5	18.1	-36.9	-41.3	43.9	-2.6
1984	236.4	253.2	-16.7	20.3	-40.4	-36.9	43.5	-6.6
1985	259.8	274.1	-14.3	21.5	-43.1	-36.0	39.0	-3.1
Exporters of manufactures								
1982	110.7	115.7	-5.0	7.2	-23.9	-21.8	19.4	2.4
1983	119.7	111.7	8.0	8.4	-21.6	-5.2	8.4	-3.2
1984	131.8	121.1	10.7	8.7	-23.6	-4.2	9.7	-5.5
1985	146.8	134.4	12.4	9.1	-25.0	-3.5	4.1	-0.6
Least developed countries								
1982	6.3	14.9	-8.6	1.2	-0.6	-8.0	7.4	0.6
1983	6.2	14.0	-7.8	1.6	-0.7	-6.9	6.9	0.0
1984	6.6	14.8	-8.2	1.7	-0.8	-7.3	7.3	0.0
1985	7.0	15.9	-8.9	1.6	-0.8	-8.1	8.1	0.0
Other countries								
1982	94.5	122.0	-27.5	8.3	-13.9	-33.1	27.3	5.8
1983	91.8	114.5	-22.7	8.1	-14.6	-29.2	28.5	0.7
1984	98.0	117.3	-19.3	9.9	-16.0	-25.4	26.5	-1.1
1985	106.0	123.9	-17.8	10.8	-17.3	-24.4	26.8	-2.5

Source: UNCTAD secretariat calculations, based on IMF balance-of-payments tapes and official national and international sources. 1983 figures are preliminary; 1984-1985 figures are forecasts.

a/ For definition of country groupings, see notes to table A.1.

Annex table A.5

Socialist countries of Eastern Europe: growth rates of exports and imports (f.o.b.) by major areas of destination and origin, 1982 and 1983
(Percentage increase over previous year, based on values in dollars)

Country	Exports 1982	Exports 1983	Imports 1982	Imports 1983
Bulgaria				
World	7.0	6.1	6.8	5.4
Developed market-economy countries	-9.6	-2.1	-11.0	-13.2
Developing countries	4.5	-17.6	20.3	8.3
Socialist countries *a/*	11.1	14.4	10.4	9.3
Czechoslovakia				
World	4.9	5.8	5.4	5.9
Developed market-economy countries	-4.9	-2.6	-9.8	-6.5
Developing countries	1.5	9.6	5.7	-1.9
Socialist countries *a/*	8.6	7.2	10.2	10.3
German Democratic Republic				
World	9.5	8.5	0.1	9.2
Developed market-economy countries	15.6	7.1	-7.5	13.2
Developing countries	13.0	8.0	11.3	7.5
Socialist countries *a/*	0.3	9.3	2.4	7.7
Hungary b/				
World	1.4	-0.9	-3.3	-3.5
Developed market-economy countries	1.3	8.8	-12.3	-8.7
Developing countries	9.8	-1.8	12.4	14.7
Socialist countries *a/*	-0.9	-6.2	0.3	-4.9
Poland c/				
World	6.0	2.9	-14.9	2.5
Developed market-economy countries	-6.3	2.5	-29.2	-5.5
Developing countries	3.8	-3.3	-32.6	23.5
Socialist countries *a/*	16.7	5.3	-1.2	3.6
Romania				
World	-9.5	-0.4	-24.2	-8.8
Developed market-economy countries	-13.2	-7.0	-46.2	-42.0
Developing countries	-12.9	-0.5	-17.1	-12.9
Socialist countries *a/*	-2.6	5.6	-10.8	12.7
USSR				
World	9.5	5.1	6.2	3.3
Developed market-economy countries	8.2	1.9	3.3	-3.1
Developing countries	14.6	2.7	-4.1	-2.4
Socialist countries *a/*	7.8	8.5	14.4	10.8
Total b/				
World	6.9	4.9	0.9	3.4
Developed market-economy countries	4.2	2.0	-7.4	-4.0
Developing countries	9.0	1.3	-4.4	-0.9
Socialist countries *a/*	7.5	7.8	8.0	8.7

Source: Data provided by the secretariat of the United Nations Economic Commission for Europe and estimates by the UNCTAD secretariat.

a/ Socialist countries of Eastern Europe and Asia.
b/ Imports c.i.f. for Hungary only.
c/ In 1982, the use of "zloty dewizawy" as an accounting unit was abandoned and accounts maintained in (ordinary) zlotych. In order to provide consistent data, 1981 external trade in dollar terms was re-estimated, using the new system, with exchange rates as at 1 January 1982.

Annex B

SOME ASPECTS OF THE FINANCING OF INTERNATIONAL TRADE

Contents

Tables

I. INTRODUCTION

1. The relationship between financing and international trade is inevitably close, and has long been evident in various forms. Among the many historical examples of this relationship are the association of certain types of financing with transactions in foreign exchange[1] and the foundation of many banks as offshoots or associates of enterprises in international trade and the provision of related services such as shipping.[2] Yet although the connection between financing and trade is a commonplace of descriptions of international transactions, it has been subjected to surprisingly little systematic analysis, in particular to much less than that between domestic economic activity and credit.

2. Disruptions of the international banking and financial systems usually inflict serious damage on trade. The most notable peace-time example of such a disruption in this century took place during the depression of the 1930s. For example, the average volume of world trade in 1931-1935 was 18 per cent lower than in 1930.[3] The fall in the value of trade at current prices was even sharper. Thus, in 1937, a year of widespread economic recovery, the value of the exports of certain major industrial countries was still about 25 per cent below its level of 1929.[4] There were also large reductions in the value of the exports of several developing countries during this period. For example, in the case of eight African and Asian countries or territories seven experienced falls in the value of their exports and only one a rise. For four of them the fall exceeded 30 per cent.[5]

3. There is probably no way of assessing the magnitude of the contribution of financial disruption to the collapse of world trade in relation to that of other factors such as falling incomes and increases in tariffs.[6] However, this contribution was undoubtedly large. For example, the decline in the exports of the United States from $5.1 billion in 1928 to $2.6 billion in 1932 (which was associated with a decline in exports of machinery and transport equipment from $1.1 billion to $209 million) was widely attributed to a shortage of dollars among other coun-

---

[1] See, for example, the succinct account of the historical evolution of exchange arrangements in P. Einzig, *A Textbook of Foreign Exchange,* 2nd edition (London, etc.: Macmillan, 1969), chapter 20.

[2] See, for example, K. E. Born, *International Banking in the 19th and 20th Centuries,* translated from the German by V. R. Berghahn (Leamington Spa, Warwickshire: Berg Publishers, 1983), pp. 23-24 and 28. It is noteworthy that the founder of the first of the banks associated with the Rothschild family had earlier been a trader in various commodities, a dealer in bills of exchange, and court factor at the Court of the Landgrave of Hesse-Kassel. (*Ibid.*, pp. 25 and 52-58.)

[3] W. W. Rostow, *The World Economy. History and Prospect* (Austin and London: University of Texas Press, 1978), table B.3, p. 669.

[4] A. Maizels, *Industrial Growth and World Trade: An Empirical Study of Trends in Production, Consumption and Trade in Manufactures from 1899-1959 with a Discussion of Probable Future Trends* (Cambridge: Cambridge University Press, 1963), table A1, pp. 426-427. The industrial countries or territories in question were Belgium/Luxembourg, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, the United Kingdom and the United States.

[5] If the value of exports is taken as 100 in 1929 (or 1929/1930 for Siam), then the corresponding indices for 1937 (or 1936/1937 for Siam) were 97 for British Malaya, 73 for Ceylon, 53 for China, 66 for Dutch East Indies, 63 for India, 109 for Nigeria, 92 for Philippines, and 67 for Siam. The figures for the value of exports are taken from A. J. H. Latham, *The Depression and the Developing World, 1914-1939* (London: Croom Helm, Totowa, New Jersey: Barnes and Noble Books, 1981), appendix 11 (which is based on League of Nations sources).

[6] See also section III, below.

tries.[7] Moreover, financial breakdown was followed by a proliferation of bilateral trade and clearing arrangements.[8] It was the desire to avoid a repetition of the unhappy experience of the 1930s as regards international trade, payments, and finance which was a major part of the motivation of the various plans for post-war reform of the structure of international economic relations.[9]

4. The recent international financial crisis has led to revived fears of a financial crash which would disrupt trade on a scale similar to that of the 1930s. World trade has already been tending to contract since 1981, but in general values have fallen less than during the 1930s. However, signs of financial strain such as the proliferation of debt reschedulings, large payments arrears, and increasing recourse to barter arrangements for international trade have become widespread. The sections which follow trace various features of the evolution of the financing of international trade since the 1950s.

II. OVERALL TRENDS IN THE FINANCING OF INTERNATIONAL TRADE SINCE THE 1950S, WITH SPECIAL REFERENCE TO DEVELOPING COUNTRIES' IMPORTS

5. During the early years after 1945 a large share of international financing was in the form of official loans and grants. Indeed, such grants and loans accounted for 52 per cent of an estimated $33.1 billion of world financial flows during 1950-1954, and foreign direct investment accounted for 35 per cent.[10] For a group of countries consisting principally of developing countries and socialist countries of Eastern Europe the share of government grants and loans in net financial inflows was still higher, at 63 per cent, while that of foreign direct investment was 28 per cent.[11] These were years when financial relations among the developed market-economy countries of western Europe were still dominated by large-scale programmes of assistance from the United States and the establishment of a series of clearing systems for transactions in certain western European currencies (culminating in the European Payments Union), which were designed to facilitate mutual trade in the face of the payments restrictions then prevalent. Many developing countries were still colonies, and their policies with respect to borrowing abroad and other aspects of external payments were controlled to a considerable extent by the metropolitan powers. Others, which had been the beneficiaries of the booms in primary commodity prices during World War II and the Korean war, had little need for external borrowing.

6. As payments restrictions began to be relaxed and the gradual ending of severe goods shortages led to a return to more normal conditions in international markets, patterns of international financing also changed. In particular, there was a revival of

---

[7] See, for example, R. E. Feinberg, *Subsidizing Success. The Export-Import Bank in the United States Economy* (Cambridge: Cambridge University Press, 1982), pp. 10-11. This belief was a stimulus to the establishment of the Export-Import Bank of the United States.

[8] According to the United States Treasury (in *The Bretton Woods Proposals* (Washington D.C., 1945), p. 3, cited in D. Gisselquist, *The Political Economics of International Bank Lending* (New York: Praeger, 1981), p. 72), the number of bilateral trade agreements which had been signed by Germany, France, Italy, USSR, and the United Kingdom was nine in 1932 but had risen to 88 by 1938.

[9] See also part II, chapter II.

[10] W. P. Michael, *Measuring International Capital Movements*, National Bureau of Economic Research, Occasional Paper No. 114 (New York and London: Columbia University Press, 1971), table 1, pp. 6-13. Michael's estimate of $40.3 billion for world financial flows during this period has been reduced by the amount of changes in reserves, since such changes reflect, *inter alia*, the impact of other flows.

[11] *Ibid.* None of the foreign direct investment in countries belonging to this group went to socialist countries of Eastern Europe, the recipients being mainly developing countries.

export credits[12] and bilateral portfolio investment.[13] Official grants and loans continued throughout the 1950s and 1960s to account for much the largest share of net financial flows to developing countries, a share which reached its peak in the early 1960s.[14] However, during the same period the shares of export credits and bilateral portfolio investment tended to increase, that of the former rising from less than 10 per cent in the late 1950s and early 1960s to almost 15 per cent at the beginning of the 1970s.[15]

7. The relaxation of restrictions on external payments among the major developed market-economy countries from the late 1950s onwards had far-reaching consequences for private financing other than export credits.[16] Among these consequences (discussed in more detail below) was an increase in international bank lending, of which an outstanding manifestation was the growth of lending through the offshore and Eurocurrency markets.[17] A marked shift in international borrowing and lending patterns in favour of the private capital markets began in the early 1970s following the large increase in the imbalances of the external payments in different regions (fluctuations in which, for a group consisting mainly of non-oil-exporting developing countries, are shown in table B.1).[18] The Eurocurrency markets played a particularly important part in the enhanced role of private international financial intermediation during this period, and became an important source for borrowing by developing countries. For example, for the group of developing countries just mentioned, borrowing from this source, which had been negligible at the beginning of the decade, amounted to about $7 billion in 1971-1973 and rose to well over $35 billion during the next four years.[19]

---

[12] An export credit is a loan directly tied to the purchase of exports. Its maturity may be short, medium or long, but available statistics are restricted to official and officially-guaranteed export credits with a maturity of at least a year. For a more detailed account of terms and various other features of export credits see A. C. Cizauskas, *The Changing Nature of Export Finance and its Implications for Developing Countries* (World Bank Staff Working Paper No. 409, Washington, D.C., 1980), annex 1.

[13] Underlying the distinction between bilateral portfolio and foreign direct investment is the degree of control over the recipient entity which is aimed at by the investor. Only in the case of foreign direct investment does the investor's purpose include an effective voice in management. However, this distinction between the two kinds of investment is not sharp, so that the relative magnitude of series for them may be affected by variations in reporting practices.

[14] The share of official flows in total net financial flows to developing countries rose to more than 70 per cent in 1963 and has tended to decline thereafter. (See UNCTAD, *Handbook of International Trade and Development Statistics, Supplement 1977* (United Nations publication, Sales No. E/F.78.II.D.1), table 5.3.)

[15] *Ibid.* The coverage of the series for export credits in this source varies, including as it does estimates of the non-guaranteed part of officially-guaranteed export credits only from 1965 onwards.

[16] This tendency towards more liberal regimes for external payments from the late 1950s was not continuous, subject as it was to several reversals in the case of countries facing unfavourable trends in their balance of payments. For example, during the 1960s the United States Government resorted to various means of controlling capital outflows.

[17] For definitions of Eurocurrency deposits and offshore markets see part II above, footnote 82.

[18] The balance on current account of OECD countries recorded a surplus of $12.8 billion in 1973. During the rest of the decade it fluctuated within the range of a surplus of $12.5 billion (in 1978) and a deficit of $28.5 billion (in 1979). (See OECD, *Economic Outlook*, No. 34, December 1983, technical annex, table R13.)

[19] The figures (which refer to gross commitments of Eurocurrency credits) were taken from UNCTAD, *Handbook of International Trade and Development Statistics, 1979* (United Nations publication, Sales No. E/F.79.II.D.2), table 5.12.

8. Greater borrowing from banks was largely responsible for the increase in the share of funds raised from the private capital markets in the financing of the external payments of developing countries during the 1970s. For example, the share of private export credits, bank lending and international bonds[20] in the total long-term financing of the deficits on current account of non-oil-exporting developing countries rose from 23 per cent in 1970 to 42 per cent in 1979. Within these figures the share of export credits fell from about 17.5 per cent to about 8 per cent, while that of international bank lending rose from about 4 per cent to about 31 per cent. Since 1980 there has been a reversal of the rising trend in the share of private sources in the financing of developing countries' deficits on current account; both export credits and international bank lending to such countries have tended to fall.

9. Table B.1 illustrates various facets of the growth of the Eurocurrency market and its relationship to world imports and the imports and current-account deficits of developing countries which are relevant to the discussion below of the connections between bank lending, the financing of trade and the international financial system generally. World imports, the imports of the group of mainly non-oil-exporting developing countries, and the size of the Eurocurrency market all show rapid growth during the period covered by this table (though in the case of world imports expansion comes to an abrupt halt in 1981).[21] However, it is noteworthy that the growth of the Eurocurrency market far outstrips that of the different series for imports. Moreover, its growth has also been much greater than that of such variables at constant prices as the volume of world imports and world GDP.[22] This reflects the fact that, although Eurocurrency credits are a major vehicle for the financing of international trade, they are also used for a wide variety of other transactions. Thus, as is discussed further in section III below, trade financing has become increasingly dependent on a form of lending of which both the terms and amounts reflect the impact of changes in conditions in several different regions, sectors, and activities of the international economy.

III. TYPES OF TRADE FINANCING AND THEIR ROLE IN THE EXPANSION OF INTERNATIONAL TRADE

10. The contribution of financing to the expansion of international trade is not easy to measure. Although the majority of transactions in international trade involve the use of credit, no systematic information is available concerning a large part of this financing. Thus, although rapid growth of international trade is in general accompanied by a corresponding expansion of trade credit, it is not possible to disentangle the two variables in such a way as to measure precisely the contribution of increases in the latter variable to those of the former. In consequence, analysis in this area is limited to documenting qualitative changes in the techniques of trade financing and comparing these changes and movements in the series for rele-

---

[20] These three categories cover total private medium- and long-term financial flows other than those due to foreign direct investment.

[21] Row 2 in table B.1 includes as well as imports f.o.b. net payments for various services, interest and direct investment income (which are typically an important source of net outflows in the balance of payments of developing countries).

[22] For developed market-economy countries the average annual rate of growth of import volume was about 5 1/2 per cent during 1967-1981. The corresponding rate of growth for developing countries as a whole was 8.1 per cent, and for non-oil-exporting developing countries 5.3 per cent. (UNCTAD, *Handbook of International Trade and Development Statistics, 1983*, United Nations publication, Sales No. E/F.83.II.D.2, table 2.2.) Average annual rates of GDP growth during 1960-1970 and 1970-1980 were 4.8 per cent and 3.3 per cent for developed market-economy countries, 5.5 per cent and 6 per cent for developing countries as a whole, and 4.9 per cent and 5.5 per cent for non-oil-exporting developing countries. (*Ibid.*, table 6.2.)

TABLE B.1

IMPORTS AND CURRENT-ACCOUNT DEFICITS OF SELECTED DEVELOPING COUNTRIES, a/
WORLD IMPORTS, AND ESTIMATED SIZE OF THE EUROCURRENCY MARKET IN 1960 AND 1967-1982

	1960	1967	1968	1969	1970	1971	1972	1973	1974
Selected developing countries a/									
(1) Imports c.i.f. ($ million)	23796 (12.9)	33897 (1.8)	36506 (7.7)	39994 (9.6)	45314 (13.3)	50224 (10.8)	55233 (10.0)	76319 (38.3)	126070 (65.0)
(2) Imports f.o.b. and payments for certain services b/c/ ($ million)	23279 (13.0)	34664 (2.6)	38012 (9.7)	41421 (9.0)	58483 ..d/	64663 (10.6)	71249 (10.2)	99139 (39.1)	152909 (54.2)
(3) Current-account deficit ($ million)	6394e/	7522e/	8880e/	8082e/	10738e/	14031	10821	10896	30229
(4) = (3)/(1)	0.27	0.22	0.24	0.20	0.24	0.28	0.20	0.14	0.24
(5) = (3)/(2) c/	0.27	0.22	0.23	0.20	0.18	0.22	0.15	0.11	0.20
(6) Estimated gross size of Eurocurrency market f/ ($ billion)	.. ..	36 (24.1)	50 (38.8)	85 (70.0)	110 (29.4)	150 (36.4)	210 (40.0)	315 (50.0)	395 (25.4)
(7) Estimated net size of Eurocurrency market f/ ($ billion)	.. ..	25 (19.0)	34 (36.0)	50 (47.1)	65 (30.0)	85 (30.8)	110 (29.4)	160 (45.5)	220 (37.5)
World									
(8) Imports c.i.f. ($ million)	135200 (11.7)	227000 (5.1)	252000 (11.0)	286400 (13.7)	328600 (14.7)	365300 (11.2)	429500 (17.6)	591400 (37.7)	855300 (44.6)

Note: Figures in parentheses are annual percentage rates of growth.

TABLE B.1 (cont'd)

IMPORTS AND CURRENT-ACCOUNT DEFICITS OF SELECTED DEVELOPING COUNTRIES, a/ WORLD IMPORTS, AND ESTIMATED SIZE OF THE EUROCURRENCY MARKET IN 1960 AND 1967-1982

	1975	1976	1977	1978	1979	1980	1981	1982	Annual percentage rate of growth 1970-1981
Selected developing countries a/									
(1) Imports c.i.f. ($ million)	134955 (7.0)	141189 (4.6)	163219 (15.6)	192534 (18.0)	244824 (27.1)	320268 (30.8)	339713 (6.1)	303597 (-10.6)	20.0
(2) Imports f.o.b. and payments for certain services b/c/ ($ million)	164388 (7.5)	176384 (7.3)	204414 (15.9)	245402 (20.1)	320562 (30.6)	419836 (31.0)	463959 (10.5)	411376 (-11.3)	20.7
(3) Current-account deficit ($ million)	38915	27527	26573	35073	53475	78515	96152	80138	22.1
(4) = (3)/(1)	0.20	0.19	0.16	0.18	0.22	0.25	0.28	0.26	-
(5) = (3)/(2) c/	0.24	0.16	0.13	0.14	0.17	0.19	0.21	0.19	-
(6) Estimated gross size of Eurocurrency market f/ ($ billion)	485 (22.8)	595 (22.7)	740 (24.4)	950 (28.4)	1235 (30.0)	1525 (23.5)	1860 (22.0)	2060 (10.7)	29.3
(7) Estimated net size of Eurocurrency market f/ ($ billion)	255 (15.9)	320 (25.5)	390 (21.9)	495 (26.9)	590 (19.2)	730 (23.7)	890 (21.9)	960 (7.9)	27.0
World									
(8) Imports c.i.f. ($ million)	908900 (6.3)	1017900 (12.0)	1167200 (14.7)	1352200 (15.8)	1695700 (25.4)	2070800 (22.1)	2043500 (-1.3)	1937200 (-5.2)	18.1

TABLE B.1 (cont'd)

IMPORTS AND CURRENT-ACCOUNT DEFICITS OF SELECTED DEVELOPING COUNTRIES, a/ WORLD IMPORTS, AND ESTIMATED SIZE OF THE EUROCURRENCY MARKET IN 1960 AND 1967-1982

Sources:

Imports c.i.f. (rows (1) and (8)) and current-account deficit (row (3)): estimates of UNCTAD secretariat *adjusted from country* figures of IMF.

Imports f.o.b. and payments for certain services (row (2)): 1970-1982: estimates by the UNCTAD secretariat; 1960, 1967-1969: estimates by the UNCTAD secretariat based on IMF data.

Estimated gross and net size of Eurocurrency market (rows (6) and (7)): 1970-1981: Morgan Guaranty Trust Company of New York, **World Financial Markets**, various issues; 1966-1969: estimates of Morgan Guaranty Trust Company cited in G. Dufey and I. H. Giddy, **The International Money Market** (Englewood Cliffs, New Jersey: Prentice-Hall, 1978), p. 22.

a/ Developing countries, excluding the major petroleum exporters listed in annex table A.1 other than Congo, Mexico and Syrian Arab Republic.

b/ Imports of goods f.o.b. plus services debit from balance-of-payments summaries.

c/ Owing to a discontinuity in the series, the figures for 1970 onwards are not comparable with those for earlier years.

d/ The annual rate of growth for 1970 is not included owing to the discontinuity in the series in row (3).

e/ The country coverage of the figures for current-account deficits is less complete for years up to 1970 than for subsequent years.

f/ These estimates omit certain offshore banking centres and their coverage is subject to some variation.

vant types of international lending, for which data are available, with figures for the growth and evolving structure of international trade. Much of the analysis in the present annex is of this kind.

11. While it is possible for fast growth of trade credit to accompany a rapid expansion of mutually-balanced international trade, it is of special interest to examine the relationship of financing to imbalances in trade and payments. It is generally accepted that economic development often accompanies deficits on external trade or on the entire current account (or both). As a result, North-South trade has historically been associated with financial transfers, a large proportion of which are the outcome of deliberate policy decisions. The importance of such transfers to developing countries' trade can be indicated by the relative sizes of their current-account deficits and of their imports, since such deficits are in general closely linked to financing (although they may also be partly covered by changes in official reserves).

12. The ratio of these two variables for a group of mainly non-oil-exporting developing countries in selected years is given in row 4 of table B.1 and is typically in the range of 20-25 per cent.[23] Although there are considerable year-to-year fluctuations in this ratio, no marked trend in its value is evident since the beginning of the 1960s. Data for developing countries' deficits on current account are highly incomplete for the 1950s. However, an analogous measure of the importance of the financial transfer associated with developing countries' trade, namely the ratio of trade deficits to imports,[24] has tended to be substantially higher during the period since 1960 than in the 1950s for the same group of developing countries as in table B.1. As can be seen from table B.2, this group of countries actually had surpluses in their external trade in a number of years during 1950-1956, and only from the late 1950s onwards does the ratio tend towards a level of about 20 per cent.

13. The rise in the financial transfers to developing countries after the mid-1950s, which is reflected by such figures, accompanied shifts in the relative importance of different forms of financing. A feature of financial flows to developing countries during the early 1950s, which was noted above, was the high share of foreign direct investment. Indeed, the share during 1950-1954 of foreign direct investment in net private financial inflows[25] for the group of developing countries and socialist countries of Eastern Europe mentioned earlier[26] was 69 per cent, while that of net portfolio investment was 7 per cent, that of short-term (primarily trade) credits 21 per cent, and that of private loans (principally of banks and enterprises at medium-term maturities) 3 per cent. These figures indicate the still very limited role of international financing from private sources other than direct investors. The revival of portfolio investment was inhibited by the prevalence of restrictions on external payments affecting the major financial centres of western Europe and by the aftermath of widespread defaults in the inter-war

[23] It may be argued that a superior measure of this financial transfer would be the sum of the current-account deficits of the deficit members of a group of countries. However, it is doubtful if the use of this alternative would have made much difference to the overall impression given for the developing countries covered in table B.1 owing to the prevalence among them of deficits on current account. For a fuller discussion of measures of this kind, see V. L. Kelkar, "Reflections on the post-war growth in world trade in manufactures" (New Delhi, 1982, mimeo.), pp. 14-16.

[24] As in the case of current-account deficits, it would have been preferable to base the measure on the trade balances of those countries in the group with trade deficits, but here, too, the use of this alternative would probably have made little difference.

[25] Michael, *op. cit.*, table 1. Net private inflows are net flows under the headings in this table of portfolio investment issues less portfolio redemptions and trading (i.e., net portfolio investment), direct investment, private loans (net), repatriations, and short-term credit.

[26] See footnote 10 above.

Table B.2

Ratio of trade deficit *a/* **to imports of selected developing countries,** *b/* **1950-1982**
(Percentage)

1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
-3.8	5.3	18.8	7.1	10.0	-11.5	-12.0	20.8	19.9	14.4	19.9
1961	**1962**	**1963**	**1964**	**1965**	**1966**	**1967**	**1968**	**1969**	**1970**	**1971**
22.0	22.9	20.2	18.6	17.7	19.8	21.1	20.5	17.3	18.3	24.5
1972	**1973**	**1974**	**1975**	**1976**	**1977**	**1978**	**1979**	**1980**	**1981**	**1982**
17.7	13.3	25.1	30.9	20.3	18.3	21.2	19.8	22.9	24.2	18.7

a/ Exports f.o.b. minus imports c.i.f. Negative figures denote trade surpluses.
b/ The countries defined in note *a/* to Table B.1.

period. Gross flows of private loans[27] from banks and enterprises were to a considerable extent offset by repayments, so that the net figures represented only a small part of the net private financial flow to developing countries. A substantial proportion of such loans was associated with the purchase of materials and equipment, in some cases by transnational corporations operating in developing countries. A more important form of trade financing during this period consisted of short-term credits, net inflows in this form being concentrated principally on certain relatively advanced developing countries in Europe and Latin America.[28]

14. However, from the mid-1950s onwards there was a revival of private international financing other than direct investment, which included both bilateral portfolio investment and export credits. Only a small number of developing countries were recipients of bilateral portfolio investment.[29] Borrowing in the form of officially-insured export credits was

[27] Approximately two-thirds of global flows in the form of private loans were made to governments or were guaranteed by the government of the borrower. (Michael, *op. cit.*, pp. 54-55.) Michael does not indicate whether the same proportion applied to private loans to developing countries.

[28] *Ibid.*, pp. 57-58.

[29] According to the Pearson Commission, *Partners in Development. Report of the Commission on International Development* (London: Pall Mall Press, 1969), table 15, p. 378 (which is based on OECD sources), among the net financial flows from DAC member countries to a group of countries classified by OECD as less developed and to multilateral agencies the sum of bilateral and multilateral portfolio investment rose from $190 million in 1956 to figures in the range of $600-700 million in 1957-1960. Multilateral portfolio investment consisted mainly of bond flotations by multilateral financial institutions in the capital markets of DAC member countries and only from 1960 is it distinguished in the figures from bilateral portfolio investment.

more widespread. Net commitments of such credits from DAC member countries to a group consisting mainly of developing countries were running at a rate of almost $500 million in 1956-1957, and after a brief setback in 1958-1959 their share in net financial flows to developing countries began the rise mentioned above.[30]

15. This rise reflected the interaction of demands associated with expanding international trade and of the evolution in financing techniques. An outstanding feature of international trade between the mid-1950s and the mid-1960s was the rise in the share of engineering goods (a rise according to GATT figures from 19 per cent in 1955 to 31 per cent in 1960 and 58 per cent in 1966). Exports of engineering goods to developing countries increased from $6 billion in 1955 to $13 billion in 1966.[31] The growth of these exports was accompanied by increasing competition among suppliers in developed market-economy countries, one aspect of which[32] was an expansion of the share in total export credits to developing countries of those with maturities greater than five years from 44 per cent in 1956-1957 to 74 per cent in 1967-1968.[33] Indeed, OECD data on the goods coverage of export credits with such maturities during the 1960s indicate that they were used mainly for purchases of equipment goods.[34]

16. At the same time the growing requirements for export credits, in particular of longer maturities, led to various changes in the techniques of such financing. For example, from the late 1950s export credit agencies in some developed market-economy countries began to offer guarantees on loans made directly by financial institutions to foreign buyers of capital equipment (buyers' credits), thereby enabling exporters to be paid in cash on delivery and thus reducing their financing costs.[35] Other policy

---

[30] "The use of commercial credits by developing countries for financing imports of capital goods", *IMF Staff Papers*, Vol. XVII, No. 1, March 1970, p. 37. The same source also contains data for commitments of official export credits to developing countries with maturities exceeding five years by member countries of the OECD Group on Export Credits and Credit Guarantees. These rose from $80 million in 1957 to $1,046 million in 1961. Commitments then fluctuated in 1962-1966 between $335 million and $532 million before reaching levels of $1,080 million in 1967 (an amount affected by exceptionally high exports of aircraft) and $760 million in 1968. These figures presumably refer to gross flows commitments.

[31] The figures are taken from GATT, *International Trade, 1967* (Geneva, 1968), as quoted in "The use of commercial credits . . .", *op. cit.*, p. 48.

[32] There seem to have been few attempts to estimate the impact of variations in rates of interest and maturities on the transaction prices of goods sold with export credits during the 1950s and 1960s. However, in "The effect of trade credit on price and price level comparisons", *Review of Economics and Statistics,* Vol. LXII, No. 4, November 1981, C. R. Hekman gives calculations illustrating the effects of differing average maturities and interest rates in December 1978 and July 1980 on the ratios of various countries' transaction prices for an export good sold on credit to the price in the United States. The ratios were in the range of 96-109 per cent. For particular goods differences in the maturities of export credits will often deviate from the average, and in such cases variations in ratios of transaction prices would exceed those estimated by Hekman.

[33] "The use of commercial credits . . ." (*op. cit.*), p. 37.

[34] According to an analysis of the OECD Group on Export Credits and Credit Guarantees (cited in *ibid.,* p. 51), various categories of equipment goods accounted for a minimum of 82-96 per cent of annual figures for commercial credits with maturities of more than five years extended to developing countries during 1963-1968.

[35] *Ibid.,* p. 53, and J. Pearce, "Subsidized Export Credit", (*Chatham House Paper No. 8* (London: Royal Institute of International Affairs, 1980)), pp. 3-4.

responses to growing competition in this field included the extension of official insurance to credits with maturities greater than five years[36] and an expansion of official financial support to enable exporters to offer more favourable terms on longer-term credits.[37] Indeed, many of the policy measures affecting export credits during this period can be characterized as an attempt substantially to insulate the terms on such financing from fluctuations in conditions in domestic credit markets.

17. Together with export credits short-term bank credit continued to finance a large proportion of increasing international trade during the 1950s and 1960s. Mention has already been made of the small share in net financial flows to developing countries of bank loans of intermediate maturities during the early 1950s. A similar pattern continued to prevail until the beginning of the 1970s, and official statistics of this period for medium- and long-term financial flows to developing countries do not separately specify international bank lending. However, in the late 1950s there began the revival of the role of the private capital markets in medium- and long-term international financing which was to have a major impact on the pattern of developing countries' external borrowing in the 1970s and early 1980s.[38]

18. As already noted, an outstanding feature of this revival was the rise of Eurocurrency lending. From an early stage such lending was used for trade financing. An important fillip to its use for this purpose was provided by the restrictions on financing foreign trade with sterling which accompanied the external payments crisis of the United Kingdom in 1957. Moreover, demand for Eurocurrency credits for both foreign trade and other international transactions was increased after 1958 by the relaxation of exchange controls and the widespread return to external convertibility in western Europe, since these measures greatly expanded the possibilities of making financial transfers among national and offshore money markets. Much of the early use of Eurocurrency loans for trade financing was in the form of short-term credit; but increasingly such loans were also made at medium-term maturities, an expansion which was facilitated by the introduction of "roll-over" credits on which the interest rate was adjusted at three- or six-month intervals to reflect variations in the rate of interest on inter-bank lending in the Eurocurrency markets.

19. The evolution of these markets during the 1960s was closely associated with the trends towards the internationalization of both banking and production. In particular, they were a major source of financing for the exports, imports and investment of transnational corporations, especially those of the United States. Indeed, the opportunities furnished by the Eurocurrency markets for meeting the financing needs of such corporations contributed substantially to the expansion in the number of overseas entities of United States banks and their growing participation in Eurocurrency

---

[36] From the late 1950s there were increasingly frequent violations of the 1953 Understanding of the Berne Union that export insurance agencies would not provide guarantees for export credits with maturities greater than five years on sales of heavy capital goods. (See C. Prout, "Finance for developing countries" in A. Shonfield (ed), *International Economic Relations of the Western World, 1959-1971* (London: Oxford University Press for the Royal Institute of International Affairs, 1976), Vol. 2, pp. 379-382.

[37] "The use of commercial credits . . ." (*op. cit.*), pp. 55-57.

[38] See also part II, chapter IV.

operations.[39] Eurocurrency lending to developing countries on a large scale started at the beginning of the 1970s, gross commitments amounting to about $1 billion in 1971 and about $3 billion in 1972 before the more rapid expansion from 1973 onwards.[40] It is not entirely clear why this expansion of Eurocurrency lending to developing countries began when it did; but as is discussed in part II of this report (chapter IV, section B), by the end of the 1960s various circumstances were propitious to such an expansion.

20. Available information is scarce concerning financing and payments arrangements in international trade except those involving medium-term bank loans and export credits, so that changes in the amounts and terms of much of the trade credit extended to developing countries are mostly difficult to document.[41] For example, until recently there were no data covering short-term financing.[42] Moreover, little information is available concerning private export credits not carrying official insurance, although it is believed that a significant amount of trade, principally between transnational corporations and their constituent entities, takes place on the basis of uninsured loans.[43]

21. Nevertheless, it is possible to compare recent trends in some of the forms of lending used to finance inter-

[39] The 1960s and 1970s witnessed a rapid expansion of the foreign networks of United States banks. For example, their foreign branches increased from 124 in 1960 to 532 in 1970 and 761 in 1978. (See United Nations Centre on Transnational Corporations, *Transnational Banks: Operations, Strategies and their Effects in Developing Countries* (ST/CTC/16), United Nations publication, Sales No. E.81.II.A.7, para. 90.) Among the factors contributing to this expansion was the recognition by United States banks that certain requirements of their major corporate customers could be met only through foreign entities. The need for such entities was enhanced by the measures of the United States Government during the 1960s to restrict capital outflows, since the country's corporations now found it necessary to finance a substantial part of their foreign operations from the Eurocurrency markets. The participation in the Eurocurrency markets of the foreign branches of United States banks was facilitated in February 1967 by the exemption of their loans with maturities of more than one year from the provisions of the Interest Equalization Tax (which increased the cost of raising dollars from the capital markets and financial institutions of the United States for designated foreign borrowers). Previously only loans with a maturity of less than one year had been exempt.

[40] UNCTAD, *Handbook of International Trade and Development Statistics, 1979* (United Nations publication Sales No. E/F.79.II.D.2), table 5.12.

[41] There have been investigations into practices with respect to trade and payments for particular countries. See, for example, the account of various recent investigations on this subject for Sweden in S. Grassman, *Exchange Reserves and the Financial Structure of Foreign Trade* (Westmead, England, and Lexington, Mass.: D. C. Heath, 1973), especially chapters 2 and 3.

[42] The Bank for International Settlements and OECD have recently begun to publish figures of reporting countries' bank and non-bank external short- and long-term claims which are associated with trade financing and covered by official insurance. See, for example, *Statistics on External Indebtedness: Bank and Trade-Related Non-Bank External Claims on Individual Borrowing Countries and Territories at End-December 1982 and End-June 1983* (Paris and Basle: BIS/OECD, 1984).

[43] See, for example, "The use of commercial credits . . ." (*op. cit.*), p. 36. In such cases (especially when the trade involves different constituent entities of a single multinational enterprise) the risk of non-payment tends to be greatly reduced, and much use is made of transactions on open account (where the exporter loses control of the goods to the importer at the time of their dispatch and has no way of enforcing payment at the agreed date). B. Kettel, *The Finance of International Business* (London: Graham and Trotman, 1979), p. 127.

national trade in the statistics for medium- and long-term financial flows to developing countries.[44] For example, such a comparison shows the much more rapid rate of expansion of international bank lending than of officially-insured export credits. This feature is generally attributed to various advantages to borrowers and lenders which are associated with international bank loans, especially of Eurocurrencies, although such loans cannot be sharply distinguished from export credits. As mentioned earlier, much Eurocurrency lending is for the purpose of financing international trade. Indeed, the Eurocurrency markets are an important source of funds for buyers' credits.[45] However, a large part of the expansion of international bank lending has been in the form of syndicated Eurocurrrency loans, which in general are not closely related to particular transactions in international trade.

22. For lenders such credits have advantages due to reductions in various forms of risk which resulted from changes in international banking from the late 1950s onwards.[46] For borrowers such credits were more flexible than export credits. The absence of a link between syndicated Eurocurrency credits and particular purchases is one example of such flexibility. These credits are also normally unsecured (although the loan agreements cover many aspects of the current situation and future conduct of borrowers). Moreover, the schedules for drawings and repayments can be varied to meet different requirements.[47] The loan agreements frequently allow prepayment of the full amount at relatively short notice, thus enabling borrowers to take advantage of changes in their favour of conditions in the capital markets. Loans are available in several currencies, and it is often possible for borrowers to change the currency of their loans at each roll-over period. Finally, very large amounts of money have been available in the form of syndicated Eurocurrency credits,[48] so that such loans were particularly useful for financing the greatly increased payments imbalances on current account

---

[44] The figures for medium- and long-term financial flows to developing countries also show lending to them in the form of international bonds, part of which would have been closely related to trade transactions. However, such lending was small in comparison to that by banks and limited to relatively few developing countries.

[45] Since the late 1970s several developed market-economy countries have ceased to make official insurance available only for export credits denominated in their own currencies, so that, for example, Eurocurrency buyer credits are now widely eligible (Cizauskas, *op. cit.*, pp. 11-13). For the purposes of official statistics on financing flows to developing countries officially-insured buyer credits financed with Eurocurrencies are classified under export credits and not under bank lending. See, for example, Bank for International Settlements, *Manual on Statistics Compiled by International Organizations on Countries' External Indebtedness* (Basle, 1979), pp. 27 and 64.

[46] See part II, chapter IV, section B, where there is a discussion of the effect on different forms of banking risk of such features of the Eurocurrency markets as the growth of the inter-bank markets, "roll-over" or variable-rate credits and loan syndication. From the point of view of lenders, many of the advantages of Eurocurrency lending would have applied equally to forms other than syndicated credits. However, the coincidence of benefits to lenders and developing-country borrowers was greatest in the case of such credits.

[47] See M. S. Mendelsohn, *Money on the Move. The Modern International Capital Market* (New York: McGraw-Hill Book Company, 1980), pp. 76-78. Since the 1950s there have been changes in the technique of export-credit financing designed to make it more flexible. For example, lines of credit are sometimes made available in certain developed market-economy countries to be used by a supplier for a number of export contracts. ("The use of commercial credits . . ." (*op. cit.*), pp. 54-55.)

[48] Individual Eurocurrency loans can be very big, thus facilitating the raising of large sums in this form. To finance the export of products such as aircraft or nuclear power plants there have on occasion been buyer credits amounting to several hundred million United States dollars, but even larger amounts are sometimes advanced in the form of Eurocurrency loans.

widely experienced by the major developing country borrowers during this period.

23. However, Eurocurrency loans have the major drawback that their rate of interest is floating and unpredictable. It was the interaction of rising interest rates on such loans with such features as depressed export markets and fluctuations in exchange rates which was eventually to lead to the debt crisis discussed further below. Yet, even before this crisis the rates of interest on Eurocurrency loans were frequently higher, as well as more unstable, than those on insured export credits. Thus, export credits would in many cases have been the more advantageous form of financing, and it is noteworthy that, although their share of private long-term financial flows to non-oil-exporting developing countries declined, such credits expanded rapidly during much of the 1970s.

IV. SOME IMPLICATIONS OF THE INCREASE IN THE DEPENDENCE OF TRADE FINANCING ON INTERNATIONAL CAPITAL MARKETS

24. Owing to the trends discussed in previous sections of this annex, the financing of international trade has become highly dependent on international bank loans. As already noted, such loans, especially syndicated Eurocurrency credits, have many advantages for borrowers owing to their flexibility. However, funds from this source are used for several purposes other than the financing of international trade. Indeed, their use is closely linked to a substantial part of international movements of funds of both a precautionary and a speculative character among assets, such as financing instruments in different capital markets, international bonds, currencies, gold, and various other commodities. Thus, as a result of increased dependence on the global network of capital markets, both the supply and the terms of trade financing have become more sensitive to the impact of unfavourable changes in international financing generally.

25. As is discussed in part II, chapter IV, international bank lending is subject to marked upward and downward fluctuations. Moreover, its downward movements tend to take place during periods when borrowers' cash flows are under pressure resulting from unfavourable business conditions, so that their financial positions are further worsened by difficulties over raising loans. Thus, as has been graphically illustrated during the current financial crisis, the expanded use of international bank loans for trade financing has increased the mutual vulnerability of the systems of money and finance and of trade.

26. During this crisis the international capital markets have served to transmit throughout much of the world economy many of the effects of the shifts in economic policy in developed market-economy countries since 1979 and of the depression which began in that year. One of the consequences has been disruption, and in some cases breakdown, of normal arrangements for financing and payments in developing countries' international trade. Higher debt-service costs resulting from the rise in international interest rates after 1979 coincided with a slowdown in the growth of world exports, and led to a widespread erosion of creditworthiness among developing countries and other borrowers from the international capital markets. At the same time, the rapid rise in international bank lending to developing countries of the 1970s came to an end; the level of gross Eurocurrency lending to such countries, for example, fell substantially in 1980.[49] The decline in the growth of developing countries' borrowing from the international capital markets accompanied various indications of a deterioration in their liquidity position, such as falls in their official reserves in 1981-1982 and increased recourse to short-term borrowing as a result of difficulties over the refinancing of longer-term debt.

27. Such lending behaviour on the part of banks was a response to the erosion of developing countries' creditworthiness already mentioned, an important

[49] See, for example, UNCTAD, *Handbook of International Trade and Development Statistics, 1983*, table 5.12.

part of which was due to unfavourable movements in world trade. However, by adding to the pressures on developing countries' external payments positions, such behaviour also constituted a threat to trade on its own account. Indeed, during the present financial crisis there has been a continuing danger that decreases in bank lending would so damage borrowers' capacity to service their debts and meet other international payments that a cumulative downward movement would ensue in which trade and financing each helped to pull down the other. As already noted, it is difficult to disentangle the effects on international trade of adverse shifts in the availability of financing. Nevertheless, while cumulative downward movements of the two variables have so far been avoided, many signs are now evident of the strains which the current crisis has placed on the mechanisms of financing and payments in the international trade of developing countries.

V. SOME RECENT MANIFESTATIONS OF THE EFFECTS OF FINANCIAL CRISIS ON INTERNATIONAL TRADE AND PAYMENTS

28. During the period since 1982 major types of lending to developing countries have continued to contract, and there has been a proliferation of payments arrears and debt reschedulings. Moreover, the widespread breakdown of normal financing arrangements appears to be leading to an increase in bilateral trade agreements between exporters and importers.

29. The reduction in new borrowing by developing countries in the form of medium-term syndicated Eurocurrency credits which began in the second half of 1982 continued in 1983, the fall in their value amounting to 20 per cent in comparison with 1982. Moreover, almost half of the 1983 figure for such borrowing consisted of loans arranged as part of debt reschedulings and programmes of adjustment agreed with IMF.[50] After rising in 1980, export credits tended to fall in 1981-1982. There are various indications that, with the exception of some special operations of the United States Export-Import Bank in support of certain Latin American countries, the trend has been similar in 1983.[51] Indeed, in a number of recent instances insurance agencies in developed market-economy countries have withdrawn or restricted cover for developing-country borrowers.[52] Furthermore, many developing countries have recently found it more difficult to obtain short-term trade credits.

30. The contraction of lending since 1982 has been closely associated with substantial increases in payments arrears. Accurate figures for the magnitude of developing countries' arrears are difficult to obtain, and they may vary as a function of such things as the degree of pressure on certain major borrowers' external payments and the stage reached in on-going debt reschedulings. However, available data suggest that at least $15 billion (or approximately one-quarter) of repayments of principal due from developing countries in 1983 either had to be refinanced or were added to arrears.[53] Moreover, there have also recently been arrears on interest payments in a number of cases. The rise in arrears has accompanied a large increase in the amount of developing countries' external debt rescheduled and in the number of borrowers affected by this process. For example, the sums restructured in renegotiations of

---

[50] Morgan Guaranty Trust Company of New York, *World Financial Markets*, January 1984, p. 2.

[51] These operations included facilities for Brazil and Mexico, through which $1.5 billion of loan guarantees and insurance were made available to the former country and $500 million to the latter.

[52] The debt crisis has accompanied a rise in the claims on international credit insurance agencies in developed market-economy countries. For example, early in 1983 it was already estimated that eight of a group of 13 such agencies were paying out more in claims than they were receiving in premium income. (C. Tyler, "When losing money can be good for business", *Financial Times*, 26 April 1983.)

[53] *World Debt Tables. External Debt of Developing Countries, 1983-1984 edition* (Washington, D. C.: World Bank, 1984), p. xi.

official and bank debt of developing country members of the World Bank amounted to more than $67 billion in 1983, compared with about $6 billion in 1981 and about $2 billion in 1982.[54]

31. The different manifestations of the debt crisis point to a widespread breakdown of the normal channels for financing international trade. At the beginning of this annex attention was drawn to the proliferation of bilateral trade agreements which followed the disruption of the international financial system in the early 1930s. It is noteworthy that in their turn recent difficulties are also proving a stimulus to bilateral trading arrangements between exporters and importers, private and official, for the purpose of countertrade. The current extent of countertrade is the subject of extensive debate. Recent estimates range from as low as 1 per cent of world trade to more than 30 per cent.[55] Much of the variation in these estimates is probably due to differences of definition. Countertrade comprises barter, compensation deals and counterpurchase, and buy-back arrangements.[56] Such transactions are especially common in East-West trade (amounting to perhaps as much as 30 per cent), but are thought to be much less prevalent in trade among other groups of countries. However, the definition of countertrade is sometimes extended to include trade covered by various bilateral intergovernmental agreements, as well as industrial co-operation arrangements and certain forms of joint venture involving transnational corporations and developing countries and socialist countries of Eastern Europe.[57] Thus, according to which of the more inclusive definitions is used, countertrade's share in world trade is likely to be in the range of 15-30 per cent.[58] Moreover, it is widely believed to account for a rising

---

[54] *Ibid.*, p. xviii.

[55] IMF (*Annual Report on Exchange Arrangements and Exchange Restrictions, 1983* (Washington, D.C., 1983, p. 46), gives an estimate of about 1 per cent for the share of countertrade in world trade. References to the subject elsewhere usually put this share much higher.

[56] The terminology of countertrade is not completely uniform. However, barter usually signifies the exchange of goods for goods without the medium of cash payments; compensation deals and counterpurchase both refer to agreements relating to linked purchases, but under the first the goods involved frequently come from the same industry and delivery and counter-delivery are covered by a single contract, while under the second the goods are typically less closely related and there are two self-contained contracts; and buy-back arrangements involve payment for sales of capital goods with a proportion of their output. See, for example, C. Raemy-Dirks, "Countertrade: linked purchases in international trade", pp. 17-19, in C. J. Gmur (co-ordinator), *Trade Financing* (London: Euromoney Publications, 1981).

[57] Various data are available concerning the importance of transnational corporations in world trade. See, for example, United Nations Centre on Transnational Corporations, *Transnational Corporations in World Development. Third Survey* (ST/CTC/46), United Nations publication, Sales No. E.83.II.A.14, of which table V.7 shows that in 1980 the proportions of a wide range of food commodities and agricultural raw materials marketed by transnational corporations were in most cases at least three-quarters, and of which annex table IV.9 shows that transnational corporations generated very high proportions of both the exports and the imports of the United States in 1977. In the case of manufactured goods estimates of the UNCTAD secretariat indicate that approximately one-third of trade is accounted for by intra-firm transactions alone. (See the study by the UNCTAD secretariat, *Dominant Positions of Market Power of Transnational Corporations: Use of the Transfer Pricing Mechanism* (TD/B/C.2/167), United Nations publication, Sales No. E.78.II.D.9.)

[58] G. Banks (in "The economics and policies of countertrade", *The World Economy*, Vol. 6, No. 2, June 1983, pp. 162-164) estimates that a maximum of 5 per cent of world trade consists of countertrade according to a restrictive definition. To this he would add a figure of at most 10 per cent for the proportion of world trade covered by bilateral intergovernmental agreements. However, he does not discuss the possible consequences for his estimates of using a broader definition which would include more of the arrangements to be found in trade involving transnational corporations.

share of developing countries' trade.

32. Several different categories of goods are covered by countertrade involving developing countries,[59] and of the possible reasons for engaging in such arrangements not all result from shortages of foreign exchange or difficulties in raising trade finance. Nevertheless, past instances of similar practices indicate that they were frequently a response to such shortages.[60] This response is more likely in circumstances where producers, especially those with large overhead costs, are actively seeking outlets for export sales in the face of generally depressed levels of demand for their output, as has recently been the case in many industries producing capital goods in the developed market-economy countries. Moreover, in countries where foreign exchange is in short supply, there will often be a strong incentive to link purchases of imports to offsetting transactions of a value equivalent to some proportion of their cost. Countertrade has many disadvantages in comparison with more conventional methods of carrying out international trade. Nevertheless, it is likely to become increasingly important in the absence of improved availability of international finance, greater recourse to more efficient multilateral payments and clearing mechanisms, or both. Such measures are discussed further in the following section.

VI. SOME BROADER ASPECTS OF THE BREAKDOWN OF INTERNATIONAL FINANCING

33. The breakdown of the financing of many developing countries' international trade is part of the broader disruption of the system of money and finance as a whole. There is a close connection between this disruption and many aspects of the current situation in developing countries. For example, the very low rates of capacity utilization now widespread in several developing countries are frequently due to constraints resulting from difficulties in financing imported inputs. Moreover, the severe deflationary policies now in force in many developing countries are usually a response to the financial pressures caused by the interaction of imbalances in their external payments and restrictions on their international borrowing. These policies have in many cases had severe effects on the living standards of broad segments of the population in developing countries, on occasion leading to major social and political unrest.[61] They have also been widely associated with sharp falls in investment, which are likely not only to compromise developing countries' capacity for servicing their external debts in the longer term but also to harm their prospects for overall social and economic progress.[62]

34. The debt crisis in developing countries has also had adverse effects on the exports of developed market-economy countries. For example, the balance on goods trade of developed market-economy countries with Latin America (an area containing many of the developing countries which have

[59] Available information suggests that, as a result of the recent slump in prices, developing countries have increased their recourse to countertrade as a means of finding markets for exports of primary commodities. See, for example, "Going under the counter", *Far Eastern Economic Review*, 27 January 1983.

[60] For example, in the late 1940s and the 1950s Austria resorted extensively to countertrade, owing to shortages of foreign exchange, and several of the financial institutions specializing in countertrade are located in Vienna. (J. Dizard, "Is countertrade worth the effort?", *Institutional Investor*, January 1982.)

[61] In a number of developing countries for which relatively reliable data are available (especially in Latin America) there have recently been rises in rates of urban unemployment to levels without recent precedent.

[62] These falls in investment followed a period during which there had been increases in many developing countries to rates significantly higher than those of the 1960s.

recently had to reschedule large amounts of external debt) fell from a surplus of $3.2 billion in 1981 to a deficit of $8.5 billion in 1982.[63] Analogous data for the first nine months of 1983 indicate an additional sharp deterioration of this balance.[64] North America alone suffered a decline of more than $7 billion in its balance on goods trade with Latin America between 1981 and 1982,[65] and a recent study indicates that the reduction of employment in the United States due to the fall in its exports to this area in 1982 was almost one-quarter of a million people.[66]

35. Forecasts of future improvements of world economic conditions remain highly uncertain. Even on optimistic assumptions there will be a period in which the debt situation of many developing countries is likely to remain critical. Moreover, the recovery in such countries will be to rates lower than those which prevailed during most of the 1970s.[67] Thus, even on these assumptions there will be a continuing risk of exacerbated conflict between creditors and developing countries over the servicing of debts. If the out-turn were to prove less favourable, as might be the case, for example, if there were a weakening of recovery in developed market-economy countries or a return to higher interest rates, then this risk would be increased.

36. As was noted above, the next few years will probably witness a further expansion of bilateral trading agreements and countertrade. Moreover, prolongation of widespread shortages of foreign exchange and finance for imports among developing countries may prove a stimulus to the introduction of new clearing systems for their mutual trade and the strengthening of existing arrangements of this kind.[68] This would be a constructive response on the part of developing countries to continuing financial pressures, and might lead to further co-operation in the fields of trade and finance.

37. However, initiatives of this kind can help to solve only some of the financial difficulties of developing countries, since a much larger part of their trade continues to be with the developed market-economy countries. As mentioned above, there have already been shifts in the structure of financial flows to developing countries, and it seems unlikely that during the next

---

[63] GATT, *International Trade 1982/1983* (Sales No. GATT/1982-3), table A23. The exports (f.o.b.) of the developed market-economy countries to Latin America fell from $78.5 billion in 1981 to $61.8 billion in 1982.

[64] See the figures for the first three quarters of 1983 for industrial countries' exports (f.o.b.) to, and imports (c.i.f.) from, the Western Hemisphere in IMF, *Direction of Trade Statistics*, February 1984, which show a deficit of more than $17.5 billion.

[65] Gatt, *op. cit.*

[66] The estimate is from a study carried out for the United States Department of Commerce, cited in S. Dhar, "U. S. trade with Latin America: consequences of financing constraints", *Federal Reserve Bank of New York Quarterly Review*, Autumn 1983, p. 17.

[67] For example, in a relatively optimistic analysis of the likely future evolution of the situation of a number of major debtor developing countries (in *International Debt and the Stability of the World Economy* (Washington, D.C.: Institute for International Economics, 1983), pp. 112-113), W. R. Cline postulates an annual rate of GDP growth for developing countries as a whole which rises from 2 1/2 per cent in 1983 to 4 1/2 per cent in 1986. These figures can be compared with an average rate of 6 per cent for developing countries as a whole during 1970-1980 and one of 5.5 per cent for the non-oil-exporting members of the group. (UNCTAD, *Handbook of International Trade and Development Statistics, 1983*, table 6.2.)

[68] Membership of such clearing unions need not be limited to developing countries. For example, it has been suggested that the Asian Clearing Union would be strengthened by the inclusion not only of other developing countries of South and South-East Asia but also of Japan. (P. M. Manely, "Liquidity: a possible solution", *Far Eastern Economic Review*, 29 December 1983.)

few years syndicated Eurocurrency credits will again account for as large a share as in the late 1970s.[69] There remain various questions concerning appropriate forms of, and terms for, a new pattern of financial flows to developing countries which cannot be fully discussed here. Nevertheless, in this context it is instructive to compare certain aspects of the present debt situation with that which prevailed before 1914. Arthur Lewis has pointed out that developing countries' ratios of foreign debt to exports during the 1970s were not exceptionally high in comparison with those of the earlier period. For example, in 1913 the ratio of foreign debt and foreign direct and equity investment to exports was 8.6 for Canada, 6.3 for South Africa, 5.2 for Latin America, more than 4.5 for the rest of Africa, Australasia and Russia, and more than 2 for China, India and Japan.[70] Even the 1982 ratios of net debt (including that at short-term maturities) to exports were less than 4 for various countries which had to reschedule large amounts of external debt in that year.[71] Economic development has historically tended to be associated with high levels of borrowing, and such a comparison suggests that the causes of the current crisis should be sought less in the amounts of debt incurred than in its terms.[72]

38. During the 1970s the external financing of developing countries came to depend excessively on medium- and long-term lending at variable rates of interest, which left borrowers dangerously vulnerable to unfavourable changes in the capital markets, exchange rates and their trade balances. By contrast, a much higher proportion of external financing before 1914 consisted of bonds, on which rates of interest were fixed, and of private foreign direct and equity investment, which did not involve an obligation for recipients to meet a schedule of payments of interest and principal regardless of domestic and international economic conditions. At most, a limited shift in the pattern of financial flows to developing countries in favour of foreign direct and equity investment could reasonably be envisaged at present, owing to developing countries' unwillingness to compromise national autonomy in key sectors of their economies, on the one hand, and the impact of prevailing uncertainties on long-term investment commitments, on the other. Nevertheless, it is to be hoped that the current crisis will give rise to efforts to achieve a more sustainable relationship between the debt-service obligations of developing countries and movements in their balance of payments on current account. Such a relation-

---

[69] There are indications that banks themselves are now less favourably disposed towards expanding their syndicated Eurocurrency lending but anticipate greater involvement in the provision of credits directly related to foreign trade. See, for example, S. Andrews, "The bold new look in trade finance", *Institutional Investor*, January 1984.

[70] W. Arthur Lewis, *Growth and Fluctuations 1870-1913* (London: George Allen and Unwin, 1978), table 7.7, p. 177. For the implications of such ratios and their relationship to the more recent evolution of developing countries' debt, see *ibid.*, pp. 237-239, and (by the same author) *The Evolution of the International Economic Order* (Princeton: Princeton University Press, 1978), chapter 9.

[71] Cline, *International Debt . . . op. cit.*, appendix B, table B-1. These ratios (but not presumably those cited by Arthur Lewis) include short-term debt. However, they exclude foreign direct and equity investment. Addition of the value of the stock of private foreign direct investment to the numerator of the ratios cited by Cline would not greatly affect their order of magnitude in relation to the 1913 figures in the text. See, for example, United Nations Centre on Transnational Corporations, *Salient Features and Trends in Foreign Direct Investment* (ST/CTC/14), United Nations publication, Sales No. E.83.II.A.8, table 20.

[72] The pre-1914 ratios of foreign debt and foreign direct and equity investment to exports cited in the text were associated with a pattern of financial flows which reflected contemporary political and economic realities, including the colonial status of many borrowing countries and the lower rates of inflation presumably anticipated by investors. The comparison with recent ratios nevertheless still helps to bring out certain features of the current debt crisis.

ship should clearly be an aim of debt reschedulings; but it might also usefully be given a place in the terms on at least part of future official lending to developing countries, for example, by linking the schedules of debt-service obligations more closely to different aspects of the evolution of borrowers' current accounts.[73]

[73] Suggestions as to ways of linking debt-service obligations on developing countries' outstanding external debt to the evolution of various factors affecting their balance of payments on current account were made in the report by the UNCTAD secretariat, "International financial and monetary issues" (TD/275), reproduced in *Proceedings of the United Nations Conference on Trade and Development, Sixth session*, vol. III - *Basic Documents* (United Nations publication, Sales No. E.83.II.D.8), paras. 40-41. A classic instance of the inclusion in an official loan of a clause permitting the waiver of interest payments in the face of an unfavourable change in the borrower's external payments position is to be found in clause 5 of the Financial Agreement between the Government of the United States and the United Kingdom of December 1945.

Annex C

COMMODITY MARKETS AND THE MONETARY AND FINANCIAL SYSTEMS

Contents

Appendices

Tables

Chart

I. INTRODUCTION

1. There has always been a close interconnection between movements in prices of the main internationally-traded primary commodities and monetary and financial factors. Since the breakdown of the Bretton Woods system in the early 1970s, the interconnections have become more marked and have contributed materially to the instability of the international economic system.

2. The collapse of commodity prices from 1980 to the latter part of 1982, itself essentially a manifestation of the economic recession in the developed market-economy countries exacerbated by restrictive monetary policies, resulted in severe balance-of-payments difficulties for the great majority of developing countries. At the same time, however, the fall in commodity prices contributed substantially to the success of developed countries in reducing their rates of domestic inflation. In a well-functioning system, the reduction in inflation to moderate levels, combined with the existence of substantial unused resources in these countries, would have resulted in a relaxation in monetary restriction, in expanding economic activity, and consequently in a recovery in commodity prices to somewhere near their pre-recession levels.

3. However, in the existing international economic system there is no automatic mechanism linking monetary policy with the movement of commodity prices and, as shown elsewhere in this report, monetary policy in all the developed market-economy countries has remained severely restrictive, both in the period of high inflation and, since mid-1982, when inflation rates had been substantially reduced. Consequently, virtually the entire burden of adjustment to the commodity price collapse has had to be borne by the commodity-exporting countries - mainly developing countries - with the support, albeit limited, of the international financial institutions.

4. The present section focuses on the period from 1980 to 1982, during which commodity prices collapsed to their lowest level in real terms since the Great Depression of the early 1930s, and traces the impact on the export earnings and balance-of-payments position of developing countries, as a background to a consideration of their national policy responses and of those of the international financial institutions. More recent changes in 1983 and the early months of 1984 are referred to where appropriate.

II. THE IMPACT OF THE RECESSION ON COMMODITY PRICES

5. Commodity prices, measured in terms of United States dollars, were on a definitely upward trend over the whole of the decade of the 1970s, reflecting the underlying inflationary forces in the world economy. However, a dramatic shift in the trend of nominal prices of commodities began in 1980. By the end of 1982, the UNCTAD index of market prices of the principal commodity exports of developing countries had fallen by one-third from the 1980 level, in terms of dollars, while "real" prices (i.e., in terms of prices of manufactured goods) had declined by one-quarter. Though a recovery set in during the course of 1983, by the first quarter of 1984 the commodity market price index was still some 20 per cent below the 1980 average level (see table C.1).

6. A substantial part of the decline recorded in commodity prices reflects the appreciation of the United States dollar since 1980. However, even in terms of special drawing rights (SDRs), the price fall was appreciable, amounting to 17 per cent between 1980 and 1982 (as against 29 per cent in dollar terms). Prices of manufactures have also been falling since the end of 1980, reflecting the lessening of the rate of inflation in industrialized countries, and this has reduced somewhat the adverse effect of the commodity price decline on the terms of trade of developing countries; but, as can be seen from table C.1, the fall in the "real" prices of commodities has still been severe over the recent recessionary period.

Table C.1

Industrial production in developed market-economy countries and prices of commodity exports of developing countries, 1980-1984

	Industrial production		Prices of commodities			
					Deflated *b/*	
	Weighted by output	Weighted by imports *a/*	Dollars	SDRs	Dollars	SDRs
	(Percentage change from corresponding period of previous year)					
1980	- 1.0	0.0	+14.8	+14.5	+ 3.3	+ 3.0
1981	0.0	0.0	-15.6	- 8.2	-10.8	- 3.5
1982	- 3.0	- 3.0	-16.1	- 9.8	-14.5	- 7.3
1983	+ 3.0	+ 2.0	+ 5.8	+ 9.9	+11.3	+14.5
1984 1st quarter	..	..	+14.7	+20.0	+16.9	+23.7
	(Percentage change)					
1980-1982	- 3.0	- 3.0	-29.3	-17.2	-23.7	-10.6
1980-1984 1st quarter	..	..	-19.9	- 0.8	-12.6	+ 9.3

Source: OECD, *Main Economic Indicators* (various issues); United Nations, *Monthly Bulletin of Statistics*; UNCTAD, *Monthly Commodity Price Bulletin, Supplement 1960-1982* and *March 1984.*

a/ Industrial production indices for the United States, the European Economic Community, Japan and other developed market-economy countries, weighted by the value of their respective imports of primary commodities (other than fuels) from developing countries in 1980.

b/ Deflated by the unit value of exports of manufactures from developed market-economy countries.

7. By far the most important cause of the price collapse of 1980-1982 was the continuing recession in the developed market-economy countries. Real output in these countries (GDP at constant prices) rose in aggregate by only 1 per cent in 1981, followed by a marginal decline in 1982, whereas over the period 1970-1980 the average rate of growth had been 2.5 per cent. Industrial production showed no increase over the two years 1980 and 1981, and fell by 3 per cent in 1982. The more recent recovery is indicated by a rise of industrial output in developed market-economy countries in 1983 back to the 1981 level, but if national indices are weighted by relative importance as import markets for primary commodities produced in developing countries, the 1983 index was still below the 1981 level[1] (see table C.1).

8. The stagnation and subsequent decline in industrial production in the main industrial countries was particularly marked in the capital goods sector, resulting in a substantial contraction in the demand for industrial raw materials. In addition, abnormally high interest rates, particularly in 1981, greatly increased the cost of holding commodity stocks, resulting in a large decumulation of

[1] The relative importance of the United States, which led the recent recovery, is considerably smaller in total imports of developed market-economy countries than it is in their total gross output.

inventories in consuming countries which further reduced the demand for a wide range of primary commodities, both agricultural and mineral. Moreover, the squeeze on international liquidity in 1981 and 1982 seems to have adversely affected demand for a number of commodities as stores of value because of its tendency to cause redistribution of investment towards more liquid assets.

9. There were, in addition, a number of supply-side factors which accentuated the price decline. World cereal production rose by 6 per cent in 1981, and by a further 1 1/2 per cent in 1982, at a time when cereal stocks were at a record high level. Production of both cocoa and coffee rose substantially in 1981, and though there were declines in the subsequent season (a result, in the case of coffee, of frost damage in Brazil), over-supply conditions prevailed for both. For sugar, there was an exceptionally large expansion in output, by 14 per cent in 1981, mainly as a reaction to high prices in the preceding season. Stocks of primary commodities in consuming countries have been generally depleted since 1980, while stocks in producer countries have perforce been augmented as a result of the time lag between price declines and a readjustment of commodity output.

10. The general correspondence between industrial production in developed market-economy countries (taken as a proxy for demand for primary commodities) and commodity prices was even closer during the previous industrial cycle (of 1973-1977) than in the current one (see chart C.1). However, the experience of commodity prices was very different in the two cycles. The earlier recession was sharp but short-lived, the price nadir being reached in five quarters following the peak in mid-1974. In the current cycle, the downward phase of commodity prices was twice as long (the nadir being nine quarters after the peak), as well as substantially more severe. Moreover, commodity prices are still far lower in relation to the level of industrial production in the current phase of recovery (at the beginning of 1984) than they were at the corresponding phase of the previous cycle.

11. A full analysis of the causes of the recent commodity price collapse would need to take account of longer-term structural factors operating in the economies of commodity-importing countries, in addition to the short-term factors - the effects of the recession, including stock decumulation, and unusually good harvests of certain crops - which were mentioned earlier. An analysis of some of these longer-term factors which was presented in an earlier *Trade and Development Report*[2] showed that, as regards the food, beverages and tobacco sector, the volume of imports into developed market-economy countries was severely constrained over the past decade by continuing import substitution resulting from income-support for domestic farmers, by a secular shift in the pattern of food consumption[3] and by a retardation in the rate of growth of total food consumption. As regards industrial raw materials, the substitution of natural materials by synthetics has continued on a substantial scale in spite of the increases in the relative price of petrochemicals.[4]

12. The emergence of the world economy from a very severe recession is likely to increase the relative impact of these longer-term influences which have, over the past decade, constituted a major constraint on the growth of world demand for primary commodities. To the extent that these secular factors continue to operate, the trend in commodity prices, in terms of manufactures, is likely to remain relatively depressed over the medium-term future.

---

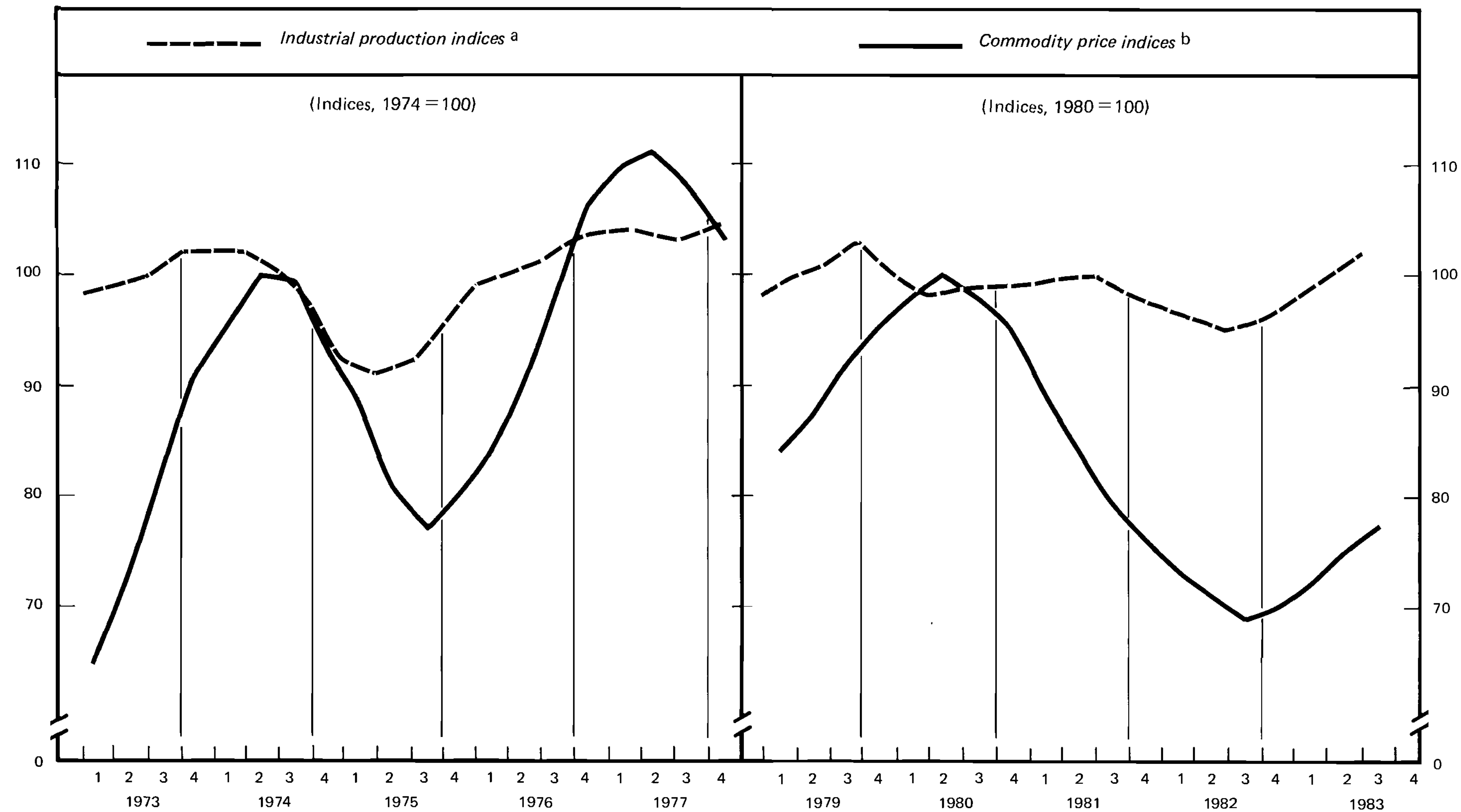
[2] See *Trade and Development Report, 1982* (United Nations publication, Sales No. E.82.II.D.12), part III, chapter 3.

[3] This shift in pattern reflects mainly a stagnant or declining secular trend in consumption of cocoa, tea and sugar, and relatively slow growth in coffee consumption. (*Ibid.*, paras. 274-277.)

[4] *Trade and Development Report, 1982*, *op. cit.*

Chart C.1

Industrial production in developed market-economy countries and commodity prices in two recent cycles



a Weighted by value of primary commodity imports from developing countries.

b 4 – quaterly moving average.

III. THE IMPACT ON EXPORT EARNINGS

13. The decline in prices since 1980 affected virtually the entire range of commodities exported by developing countries, reflecting the contraction in demand by developed countries as the predominant causal factor. Between 1980 and 1982, the price decline was exceptionally large for sugar (-71 per cent) and cocoa (-33 per cent) among foods, and for rubber (-41 per cent) and various vegetable oilseeds and oils among raw materials.

14. However, export unit values generally fell by smaller proportions than market prices, partly because a significant volume of trade is carried on at contract prices, which lag behind the trend in market prices, and partly, also, because there is a lag between market sales and actual shipments. None the less, the decline in the unit value of commodity exports from developing countries between 1980 and 1982 was very substantial (some 27 per cent) and wholly accounted for the contraction over that period in the commodity export earnings of these countries. While complete data for 1982 are not yet available, a calculation covering 35 major commodities,[5] accounting for over two-thirds of the total value of non-oil commodity exports (see table C.2), indicates that the decline in unit value was associated with only a marginal increase in volume (2 per cent over the two years), and that export earnings declined by some 25 per cent (or by $16.5 billion).

15. Though a decline in export earnings occurred in all the major commodity groups between 1980 and 1982, the food group was exceptional, in as much as export values rose for a number of individual commodities (maize, meat, bananas and soyabean cake) as a result of greater quantities traded, the latter circumstance being a factor in the falls in market prices for these commodities. For all the other commodity groups, export values declined for almost every individual commodity.

A. Terms-of-trade losses and import contraction

16. The prices of developing countries' imports of manufactures also declined after 1980 in terms of United States dollars, though the decline was relatively small (some 5 per cent on average from 1980 to 1982) and was approximately offset in its impact by a rise in the dollar prices of petroleum imports (by 7 per cent). Consequently, the terms of trade of non-oil-exporting developing countries deteriorated sharply, reflecting essentially the collapse in their commodity export prices. Detailed information for this group of countries is not yet fully available, but for some 70 such countries the net effect of the fall in export prices can be approximately estimated (see table C.3). It appears that almost the entire loss of export earnings of this group of countries attributable to price changes (about $24 billion) arose in the commodity export sector (some $22.5 billion), the relative loss on this account being greatest for the large group of "other" non-oil-exporting countries. The fall in export earnings for each of the three country sub-groups was, however, mitigated by an expansion in the volume of exports.

17. The relationship between changes in the purchasing power of exports and in import volume from 1980 to 1982 is summarized in table C.4 for 63 countries for which the relevant estimates can be made. Only for 12 of these was there any increase over the two years in the purchasing power of exports; for over half the countries, the purchasing power of exports fell by up to 25 per cent, while for the remaining 14 countries (most of which are in Africa), the decline exceeded that proportion. This table also indicates the prevalence of a general relationship between export experience and import volume.[6] The majority of the 50 countries which

---

[5] These are the commodities included in the UNCTAD commodity price index (see UNCTAD, *Monthly Commodity Price Bulletin*, annex).

[6] This relationship is statistically significant at the 1 per cent level (X^2 = 22.37; d.f. = 9).

Table C.2

Unit value, volume and value of major commodity exports of developing countries, 1980-1982

	Unit value	Volume	Value	Value		
	Change from 1980 to 1982			1980	1982	Change
	(Per cent per annum)			*($ billion)*		
Food and beverages:	-14.7	5.0	-10.5	34.50	27.61	-6.89
Food	-13.6	7.3	- 7.5	18.66	15.97	-2.69
Tropical beverages	-16.0	2.2	-14.3	15.84	11.64	-4.20
Vegetable oilseeds and oils	- 9.4	-1.4	-11.3	5.45	4.29	-1.16
Agricultural raw materials	-11.0	-4.4	-15.1	15.41	11.10	-4.31
Minerals, ores and metals	-10.6	-1.8	-12.5	17.61	13.48	-4.13
Total	-12.5	+1.0	-12.0	72.97	56.48	-16.49

Source: FAO, *Trade Yearbook, 1982,* Rome, 1983; national trade statistics.

suffered a deterioration in the purchasing power of exports also cut back the volume of imports while, at the other extreme, the majority of the 13 countries which experienced an expansion in the purchasing power of exports were also able to effect a growth in import volume.

B. Exports in the balance-of-payments crisis

18. The generally sharp deterioration in the purchasing power of exports (i.e., the value of exports adjusted for changes in import prices) over the two years 1980-1982 was reinforced in its adverse impact on the economies of non-oil-exporting developing countries by the simultaneous increases in interest payments on foreign loans and by a shrinkage in the volume of capital inflows. Though the deterioration in the export situation was thus only one element in the rapidly worsening external payments balance, taking this group of countries as a whole there was none the less a relatively large number of developing countries for which the collapse in the world prices of their traditional commodity exports dominated the picture, and necessitated - among other remedial measures - drastic cuts in the volume of their imports.

19. For the large group of countries (other than the least developed) whose exports consist wholly or mainly of primary commodities, the fall in export earnings from 1980 to 1982 amounted to $13.8 billion, while interest payments on foreign debt increased by $6.4 billion, though these declines were partly offset by an increase in the inflow of long-term capital. Imports were perforce treated as a residual, being cut by over $15 billion (see table C.5). To have maintained imports in 1982 at the same volume as in 1980, capital inflows in the later year would have had to rise to some $68 billion, as against the actual total of $43 billion of long-term capital received (before allowing for amortization).

20. The balance-of-payments experience of commodity-exporting countries in the current recession is in marked contrast to that in the previous recession. While export earnings of these countries fell by $1.5 billion (3 per cent) from 1974 to 1975 - only the second annual decline in value terms in the post-war period - this was more than offset by an increase in the net

Table C.3

Effects of price and volume changes on export earnings of non-oil-exporting developing countries, 1980-1982

	Major exporters of manufactures	Least developed countries	Other non-oil-exporting countries	Total
	(billions of dollars)			
Commodity exports				
1980	26.2	6.2	45.1	77.5
1982	25.1	5.2	32.0	62.3
Change	- 1.1	- 1.0	-13.1	-15.2
Total exports				
1980	104.6	7.7	100.1	151.2
1982	112.4	6.5	88.4	141.6
Change	+ 7.8	- 1.2	-11.7	- 9.4

Source: UNCTAD, *Handbook of International Trade and Development Statistics, Supplement 1984* (United Nations publication, Sales No. E/F.84.II.D.12), table 2.3.

inflow of long-term capital. Consequently, imports could be maintained in 1975 at about the 1974 level, the rise of $4.8 billion in value resulting from higher import prices.

21. Continuing difficulties in export markets for commodities in 1983, combined with a sharp contraction in the volume of commercial loans and continuing high interest payments, forced many countries into further import cuts. In Latin America, where this process was most intense, import volume in 1983 was cut by 29 per cent from the 1982 level to about 40 per cent lower than in 1980.[7] One mechanism of government policy used widely, often as part of an IMF "package" of short-term financial assistance, was the devaluation of the currency. Indeed, a number of developing countries were forced into a series of successive devaluations, which inevitably had adverse effects on domestic price stability as well as on the profitability of commodity production for export.

IV. NATIONAL POLICY RESPONSES AND THE IMPACT OF CURRENCY DEVALUATION

22. The appropriate policy response to a deterioration in the external payments position of a country depends on whether the origin of the deterioration is mainly domestic or external, and on whether or not it is judged to be of a temporary, self-reversing character. A payments deficit which appears to have arisen, or worsened, as a result of essentially temporary factors can best be met by additional borrowing or by running down monetary reserves (or both), thus safeguarding existing development programmes. Where a payments deficit arises as a result of domestic inflation, which has raised production costs of a country's primary commodity exports to uncompetitive levels at the existing rate of exchange, then a currency devaluation to restore the competitive position would be an appropriate policy

[7] "Economic Survey of Latin America, 1983. Summary" (E/1984/71). For the non-oil-exporting countries of Latin America, the corresponding import cuts were 11 and 32 per cent, respectively.

Table C.4

Changes in the purchasing power of exports and in import volume of non-oil-exporting developing countries, 1980-1982

Import volume in 1982 (1980 = 100)	Purchasing power of exports in 1982 (1980 = 100)				
	Under 75	75-100	100-125	Over 125	Total
	(No. of countries)				
Under 75	6	7	-	-	13
75-100	6	19	4	-	29
100-125	2	8	7	-	17
Over 125	-	2	1	1	4
Total	14	36	12	1	63
of which:					
Africa	11	14	7	-	32
Asia	-	7	3	1	11
Latin America and Caribbean	3	15	2	-	20

Source: UNCTAD, *Handbook of International Trade and Development Statistics, 1983* (United Nations publication, Sales No. E/F.83.II.D.2), table 7.2 and UNCTAD secretariat estimates for 1982.

response.

23. However, it is abundantly clear that the balance-of-payments crisis now confronting the great majority of developing countries has its origins in external factors, of which the severe economic recession in developed market-economy countries has been the central element, though no doubt inappropriate domestic policies have aggravated the situation in a number of these countries. Moreover, it cannot be assumed that the factors which led to adverse shifts in the international economy will reverse themselves in the near future, since the purely recessionary effects of reduced aggregate demand appear to have been superimposed on structural changes of a longer-term character - such as those mentioned in section I above - which are likely to persist in the future, and which will necessitate appropriate structural adjustment policies in both developed and developing countries.

24. The magnitude of the external shock to the payments balances of developing countries, and the speed with which it developed, left little choice to the governments of these countries but to make further cuts in imports, even where previous payments difficulties had already resulted in a drastic pruning of imports to a bare level of essentials. To be sure, a certain number of developing countries were able to raise loans on the commercial markets in 1982, but the possibility of large defaults on existing debt after mid-1982 resulted in a sharp contraction of loans on offer thereafter. Some of the poorer developing countries, too, were able to cover a growing export deficit by increased receipts of concessionary finance. But the majority of developing countries, faced with an immediate and often overwhelming payments crisis, were forced to take immediate corrective measures to cut imports, rather than to consider the longer-term need for structural adjustment to meet the changed conditions of the world market.

25. A variety of mechanisms has been adopted to achieve the required import cuts. In many developing countries, imports were already subject to some form of licensing or exchange control, so that the existing administrative

Table C.5

Balance of payments of commodity-exporting developing countries:*a/* 1974-1975 and 1980-1982

	Previous recession			Current recession		
	1974	1975	Change	1980	1982	Change
	(billions of dollars)					
Exports	51.4	49.9	- 1.5	123.2	109.4	-13.8
Debt service:						
Interest	- 2.3	- 2.7	- 0.4	- 8.2	-14.6	- 6.4
Amortization	- 7.9	- 5.8	+ 2.1	-14.4	-14.6	- 0.2
Long-term capital (net)*b/*	15.4	20.4	+ 5.0	38.0	43.2	+ 5.2
Total	56.6	61.8	+ 5.2	138.6	123.4	-15.2
Other items	3.2	1.7	- 1.5	13.5	11.0	- 2.5
Imports	-59.9	-64.7	- 4.8	-160.7	-145.5	+15.2
Basic balance	0.3	- 0.7	- 1.0	- 8.6	-11.1	- 2.5

Source: International Monetary Fund.

a/ Excluding major oil exporters, major exporters of manufactures and the least developed countries.
b/ Excluding amortization of debt.

machinery could be quickly deployed to restrict imports still further. Other forms of direct impact on imports, such as requiring advance deposits at the Central Bank of a proportion of the value of imports, have also been used in some countries. However, the most commonly adopted mechanism has been the devaluation of the currency,[8] either as an "open" devaluation covering all traded items, or as a partly "concealed" devaluation, in which multiple exchange rates discriminate against different categories of imports.

26. A currency devaluation can be expected to work on both sides of the balance-of-payments accounts. Its primary effects are to raise import prices in terms of domestic currency, thus causing a reduction in the demand for imports, and to reduce export prices in terms of foreign currency, thus stimulating demand for exports. However, there are also important secondary effects, which in some circumstances can largely frustrate the objectives of the original devaluation, as well as having undesirable depressing effects on the standard of living of the population.

27. One important secondary effect arises where the resulting fall in imports impinges on the availability of intermediate products and spare parts for domestic production, including production for export. An increasing scarcity of such imports has indeed adversely affected the potential for expanding exportable supplies in many developing countries and, in some, even resulted in an absolute contraction in export volumes. Apart from this adverse impact on the export effort, a country forced to cut back imports of goods essential for its productive activities would also be unable to take effective measures to promote struc-

[8] The term devaluation is used in this chapter to include both devaluation to a fixed rate and a depreciation of a floating rate.

tural adaptation.

28. Another important secondary effect of currency devaluation - particularly if it forms part of a wider package of measures which include reducing food subsidies - can arise to the extent that it accentuates existing inflationary pressures. To this extent, the price incentives to correct an external payments imbalance can be wholly or partly eroded, since the resulting domestic inflation may prevent the real exchange rate from depreciating. The recent experience of developing countries in this respect reveals a wide variation in the ratio of the rate of currency devaluation to the rate of domestic inflation, the latter rate depending on many other factors also including, particularly, the success of the monetary authorities in controlling the growth of the money supply. For 30 developing countries which are important exporters of non-fuel primary commodities,[9] all of which experienced currency devaluations between 1980 and 1983, the rate of devaluation exceeded the rate of domestic inflation in 18 countries, equalled its inflation in two countries, but was below it in 10 countries. Thus, difficulties in controlling domestic inflationary pressures were widespread, particularly for countries having to make severe cuts in imports.

29. As regards export earnings, the effect of a currency devaluation on export earnings will depend essentially on whether the relative profitability of export production is indeed increased thereby, whether the short-term response of producers to increased profitability is positive, and whether, and to what extent, a country's exports are large enough to influence the price on the world market.

30. As regards producer response, it has sometimes been argued that peasant producers of export crops, in so far as they aim to gain a minimum level of real income, will expand production when prices fall, and reduce production when prices rise. However, empirical studies do not bear this out. They invariably show that commodity producers in both developed and developing countries, whether peasant producers or large estates or mines, react positively to changes in relative output prices,[10] so that it can be assumed that devaluation, when associated with an increase in relative profitability of production, will result in greater output.

31. As regards the impact of greater commodity output and exports on the world price it is convenient, to begin with, to consider the simplest case, *viz.*, where a country's exports represent so small a proportion of world supply that variations in such exports have no impact on the world price. For such a country, faced with a decline in the world price of its commodity exports, a devaluation will improve its export earnings only if there results a greater rate of expansion in export volume than the rate of decline in the world price. In the short run, this export volume response is likely to be related to the level of economic development and the structure and organization of the commodity export sector. The small and least developed countries, particularly those exporting mainly tree crops, are unlikely to make a quick response, though countries specializing in mineral exports or in perennial agricultural crops may well be able to do so.

32. For a number of primary commodities, however, the exports of one, or a few, developing countries are large enough to influence the world price. In such cases, the beneficial effects of a currency depreciation will be greater, other things being equal, the greater the price elasticity of external demand for the commodity in question.

33. It is this last condition which can cause acute problems for developing countries exporting primary commodities, since the external price elasticities of demand are typically very

[9] These are the countries included in appendix I.

[10] For a recent study of agricultural supply responses, see Marian E. Bond, "Agricultural responses to prices in sub-Saharan African countries", *IMF Staff Papers,* Vol. 30, No. 4, December 1983; see also F. G. Adams and J. R. Behrman, *Commodity Exports and Economic Development* (Lexington, Mass.: Lexington Books, D. C. Heath, 1982) for a summary of the available supply elasticity estimates.

low, being in the range of -0.1 to -0.4 for a large number of such commodities.[11] Thus, if a devaluation, by increasing the profitability of production of export commodities in a situation of persistent over-supply in the world market, results in an addition to world supply, a further fall in the world price will result over and above the price fall which was the original cause of the external payments deficit. In such a situation the devaluation, far from promoting a movement towards external equilibrium, will have the perverse effect of exacerbating the original commodity market imbalance and of further reducing the export earnings side of the balance-of-payments account of the producing country.

34. It is not easy to determine whether this kind of perverse result has, in fact, occurred in the current recession and, if so, its relative importance. There is little doubt that recent devaluations, including floating depreciations, have considerably raised the domestic prices of primary commodity exports in the majority of developing countries, but it must be borne in mind that the increase in import prices (in domestic currency) resulting from devaluation has tended to increase costs of production, so that the rise in commodity prices does not necessarily indicate any increase in the relative profitability of commodity production.

35. An approximate indication of the impact of recent devaluations on the incentive to produce export commodities can, however, be obtained by deflating the rise in the domestic prices of commodity exports by changes in the appropriate indices of consumer prices. Since, however, one of the consequences of devaluation is to reduce real wages, which constitute a major cost in the production of most commodities, the probability is that wage costs and input costs generally will rise less than the cost-of-living index, particularly where devaluation is accompanied by a reduction in food subsidies. Thus, deflating commodity prices by indices of consumer prices is likely to give a downward bias to the resultant indicators of profitability.

36. An analysis on these lines for 19 commodities (other than petroleum) of importance in the exports of developing countries is summarized in table C.6 for the period 1980-1983 (see appendix I for details). For each commodity, separate indices for the change in the world price, the exchange rate, the implied change in the domestic price, and the latter deflated by the change in consumer prices, were computed for the principal exporting countries. In all, the table covers 57 commodity/country situations, for each of which a currency depreciation was associated with a concurrent fall in the world price. Of these, the deflated commodity price fell over this period by more than 25 per cent in 17 cases (30 per cent), fell by up to 25 per cent in a further 25 cases (over 40 per cent), and rose in the remaining 15 cases (over 25 per cent). For about one-half of the cases in which the deflated commodity price rose between 1980 and 1983, the rise was less than 20 per cent; for the other half, the mean (unweighted) increase was as high as 60 per cent. Thus, the analysis reveals that where currency devaluation is substantial, a perverse incentive for producers to increase output in a period of excess supply may well be generated.

37. An analysis based on adjusting the movement in world prices by changes in exchange rates is indicative of the "potential" for perverse supply reactions rather than the "actual" extent of such reactions where they exist. This is because in many developing countries marketing boards, *caisses de stabilisation* or other mechanisms insulate the producer, to a greater or lesser extent, from price fluctuations on the world market. This is generally achieved by ensuring that the producer price rises, in terms of foreign currency, by less than the world price in a boom period, and falls, in terms of foreign currency, by less than the world price in a recession. But the movement in producer prices in terms of domestic currency will depend heavily, also, on the extent of the devaluation of the currency.

---

[11] See, for example, the summary of estimates of price elasticities for a variety of primary commodities in F. G. Adams and J. R. Behrman, *op. cit.*, table 2-1.

Table C.6

Changes in "real" commodity prices in domestic currencies for selected developing countries, 1980-1983

	Commodity price index for 1983 (1980=100)				
	Under 75	75-100	Over 100	Total	Unweighted mean index for 1983
	(No. of countries)				(1980=100)
Cereals *a/*	3	-	2	5	108
Tropical beverages *b/*	2	4	3	9	84
Sugar	1	2	-	3	71
Vegetable oilseeds and oils *c/*	-	4	5	9	123
Agricultural raw materials *d/*	7	7	4	18	85
Minerals, ores and metals *e/*	4	8	1	13	84
Total	17	25	15	57	92

Source: See appendix I.

a/ Wheat, maize and rice.
b/ Cocoa and coffee.
c/ Soyabeans, coconut oil and palm oil.
d/ Cotton, jute, sisal, rubber and tropical timber.
e/ Bauxite/aluminium, copper, tin, iron ore and phosphate rock.

38. Relevant data for producer prices over the 1980-1983 period are available only for certain commodities. For coffee, for example, prices paid to growers, deflated by the consumer price index, fell between December 1980 and December 1983 by 17 per cent in Brazil, and by 23 per cent in Colombia - the two major producers. They also fell in 22 other producing countries, but rose in 11 countries. For cocoa, deflated prices paid to growers in 1983 in the five major producing countries ranged from 79 per cent to 96 per cent of the 1980 level. For sugar, deflated prices received by growers in the crop year 1983/1984 were some 20 per cent below the 1980/1981 level, but for both Brazil and Argentina the corresponding prices had risen significantly. For jute, deflated domestic prices in 1983 were some 20 per cent down from the 1980 level in Thailand, were approximately unchanged in India, but in Bangladesh, the main producing country, the deflated price was higher by over 30 per cent.[12]

39. As regards non-fuel minerals exported by developing countries, mines, smelting and refining plants are mainly State-owned or controlled in many countries and, especially where they provide the major part of a country's export earnings, these mines or plants are likely to be subsidized from government funds. Mine production of both copper and iron ore in developing countries, to take the two most important examples, was maintained during the price collapse of 1980-1982, major producers of each (State-owned corporations in Chile for copper, and in Brazil for iron ore) proceeding with capacity expansion programmes.

40. It would appear from this review that the substantial declines in world prices of major commodity exports of developing countries in the period 1980-1982 were generally associated with currency devaluations as part of

[12] See appendix II.

the policy responses of governments to the external payments crisis. The resultant increases in commodity prices in domestic currencies were, however, concurrent with general inflationary processes, and the profitability of commodity production appears to have declined over this period in the majority of cases investigated. However, there was a wide dispersion in the movement of deflated prices among different producing countries, and in some cases relative profitability appears to have increased as a result of currency devaluation combined with efforts to limit the rate of domestic inflation.

41. Since the purpose of a currency devaluation is to increase the price of exportables (in relation to importables), to the extent that a given devaluation is effective, the potential for a perverse commodity supply reaction clearly exists. Such a reaction is also likely to have operated in practice for a number of commodity-producing countries over the recent period of commodity price declines. In any event, it is clear that no automatic mechanism exists which would constrain the volume of commodity production in a period of over-supply on the world market when domestic prices are significantly influenced by monetary factors in addition to reflecting the supply/demand balance on the world market.

V. INTERNATIONAL POLICY RESPONSES

42. For commodities in persistent over-supply on the world market, the predominant need is for international co-operation to regulate the flow of supplies so as to inject a better balance in the market. National adjustment projects would clearly have a part to play, but in themselves cannot be regarded as substitutes for an internationally co-ordinated programme which would, in appropriate circumstances, include harmonization of diversification programmes to ensure that resources moving out of production of one commodity in persistent surplus are not used to create, or accentuate, a surplus elsewhere.

43. That some form of supply regulation is an appropriate policy response to the development of substantial excess capacity has generally been recognized by developed countries in dealing with over-supply problems in their domestic primary producing sectors. The subsidies paid to farmers in the United States for not planting crops,[13] and the quotas recently agreed by the European Economic Community for milk production in each member country, are but two examples of this recognition.[14] By the same token, a series of international commodity agreements - had they been in operation - could have greatly attenuated the price collapse that afflicted the markets for the principal commodity exports of developing countries in the period from 1980 to the end of 1982.

44. The experience of recent years has revealed several ways in which the international financial system interacts with, and powerfully influences, the movement of primary commodity prices. The overriding factor in this period has been the influence of the restrictive monetary policies of the larger developed market-economy countries which, while successfully reducing the rate of inflation in these countries, have also intensified the economic recession and thereby put additional downward pressure on commodity prices. At the same time, the commodity price decline has been the predominant factor in the sharp deterioration that occurred from 1980 to 1983 in the external payments position of a large number of developing countries, many of which have had serious difficulties in servicing their foreign debts. These difficulties, together with the continuing danger of default by sovereign borrowers, have created major problems for the international banking system.

45. The sharp contraction in commodity export earnings of developing coun-

---

[13] Subsidies to farmers in the United States rose to a record level of $20 billion in 1983.

[14] Supply regulation has also played a prominent role in efforts by developed countries to deal with persistent excess capacity for industrial products (EEC steel quotas being only one example).

tries in 1981 and 1982 was offset only to a limited extent by additional credits and loans from the international financial institutions, while in 1983 commercial bank loan availability was very substantially curtailed. Over this period, therefore, the international financial system was operating to magnify, rather than to mitigate, the adverse effects of the economic recession on the commodity sector. Moreover, the conditionality terms of IMF assistance were likely, if anything, to have accentuated the problems of certain commodities in persistent over-supply, in so far as they provided for obligatory currency devaluation (see section III above).

46. There are several main lessons to be drawn from this experience. First, an effective international commodity strategy - such as that already set out in the Integrated Programme for Commodities - now needs urgently to be put into operation to safeguard the interests of producing countries against a price collapse arising from factors outside their control and to evolve longer-term policies designed to promote structural adjustment in the interests of both producing and consuming countries. Second, the volume of international credit made available to offset unexpected shortfalls in commodity export earnings needs to be very substantially increased. Third, conditionality terms on such credits should not necessarily include a mandatory currency devaluation; alternative policies should also be considered for meeting external payments deficits in the light of the current and prospective situation in the world market for a country's primary commodity exports.

47. A corollary of the argument that conditionality terms for loans to commodity-exporting developing countries should be related to the problems of the actual producing sector suffering from a price fall on the world market is that there would appear to be a need, in addition to the IMF Compensatory Financing Facility, for a new international facility able to furnish commodity-specific compensatory finance, with a view to remedying not only a shortfall in export earnings resulting from an unforeseen price decline, but also those causes of commodity market instability which are *amenable to mitigation at a national* level.[15]

48. More generally, the experience of the 1980s so far has revealed also a major lack of coherence between international financial policies and the efforts of the international community to evolve a viable international commodity policy. Closer interaction between the international institutions concerned with these problems, particularly at the intergovernmental level, would go some way to resolve the difficulties which otherwise are likely to persist.

[15] Pursuant to Conference resolution 157 (VI), an expert group has been set up in UNCTAD, after consultation with interested governments, to consider the need for such an additional facility, its possible sources of finance, modalities and relationship to existing facilities. The group is expected to complete its work in November 1984.

Appendix I

Changes in commodity prices and exchange rates in selected developing countries, 1980-1983

Commodity/ Exporting country *a/*	Percent-age of world exports, 1980	Commodity prices (dollars)	Exchange rate *b/*	In domestic currency: Commodity prices	In domestic currency: Consumer prices	In domestic currency: "Real" commodity prices *c/*
			(Indices for 1983, 1980=100)			
Wheat						
Argentina	10.2	68	5700	2876	2403	161
Maize						
Argentina	6.4	77	5700	4389	2403	183
Thailand	5.4		112	86	123	70
Rice						
Pakistan	16.3	64	132	84	127	67
Thailand	14.6		112	72	123	59
Cocoa						
Ivory Coast	27.5		181	146	125	117
Ghana	24.5		125	102	574 *d/*	18
Brazil	10.1	81	1095	887	985	90
Nigeria	8.4		133	108	150 *e/*	72
Cameroon	7.3		181	146	142 *e/*	103
Coffee						
Brazil	19.9	68	1095	745	985	76
Colombia	18.9	79	167	132	190	69
Indonesia	5.3	84	145	122	137	89
Ivory Coast	5.2	84	181	152	125	122
Sugar						
Brazil	9.0	43 *f/*	1095	471	985	48
Philippines	4.3	83 *f/*	148	123	139	88
Argentina	2.2	33 *f/*	5700	1881	2403	78
Soyabeans						
Argentina	8.5	95	5700	5415	2403	225
Brazil	5.5		1095	1040	985	106
Palm oil						
Malaysia	56.8		107	92	120	77
Indonesia	12.5	86	145	125	137	91
Ivory Coast	2.8		181	156	125	125
Palmkernel oil						
Malaysia	56.4		107	105	120	88
Nigeria	13.0	98	133	130	150 *e/*	87
Ivory Coast	3.6		181	177	125	142
Linseed oil						
Argentina	61.5	70	5700	3990	2403	166

For sources and notes see end of table.

Appendix I (cont'd)

Changes in commodity prices and exchange rates in selected developing countries, 1980-1983

Commodity/ Exporting country *a/*	Percent-age of world exports, 1980	Commodity prices (dollars)	Exchange rate *b/*	In domestic currency: Commodity prices	In domestic currency: Consumer prices	In domestic currency: "Real" commodity prices *c/*
			(Indices for 1983, 1980=100)			
Cotton						
Pakistan	4.3	) (	132	119	127	94
Turkey	4.1	) 90 (	297	267	230	116
Mexico	4.1	) (	523	471	410	115
Sudan	3.0	69	260	179	183 *g/*	98
Jute						
Bangladesh	75.7	) (	159	151	134	113
Nepal	5.4	) 95 (	121	115	139 *d/*	83
Burma	5.3	) (	122	116	111 *h/*	104
Sisal						
Brazil	43.3	74	1095	810	985	82
United Republic of						54
Tanzania	22.2	) 82 (	137	112	206	54
Kenya	17.4	) (	179	147	150	98
Madagascar	4.6	74	204	151	204 *e/*	74
Natural rubber						
Malaysia	48.4	) (	107	79	120	66
Indonesia	26.9	) 74 (	145	107	137	78
Thailand	13.8	) (	112	83	123	67
Sri Lanka	3.6	) (	142	105	149	70
Tropical timber						
Malaysia	17.8	) 70 (	107	75	120	63
Indonesia	16.5	) (	145	102	137	74
Philippines	4.3	83	148	123	139	88
Iron ore						
Brazil	22.2	) (	1095	975	985	99
India	5.1	) 89 (	128	114	136	84
Chile	2.2	) (	202	180	167	108
Copper i/						
Chile	44.8	) (	202	147	167	88
Zaire	26.1	) 73 (	294	215	269	80
Zambia	14.3	) (	157	115	153 *d/*	75
Peru	12.4	) (	563	411	609	67
Tin i/						
Malaysia	42.4	) (	107	85	120	71
Thailand	20.4	) 79 (	112	88	123	72
Indonesia	15.6	) (	145	115	137	84
Phosphate rock						
Morocco	34.5	) (	181	129	130	99
Jordan	7.3	) 71 (	122	87	122	71
Togo	6.2	) (	180	128	146	88

For sources and notes see end of table.

Appendix I (cont'd)

Changes in commodity prices and exchange rates in selected developing countries, 1980-1983

Sources: FAO, *Trade Yearbook, 1982* (Rome, 1983); IMF, *International Financial Statistics* (various issues); national trade statistics.

a/ Countries listed in order of export value in 1980.
b/ National currency units per United States dollar.
c/ Commodity price index in domestic currency deflated by consumer price index.
d/ 11 months.
e/ 9 months.
f/ Export unit value.
g/ 6 months.
h/ 10 months.
i/ Ore and metal.

Appendix II

Changes in prices received by producers of selected agricultural crops in developing countries, 1980-1983
(Index numbers, 1980=100)

	Price in domestic currency			Deflated by consumer price index		
	1981	1982	1983	1981	1982	1983
Cocoa						
Ivory Coast	100	100	113	92	86	91
Ghana	133	300	450	62	113	77
Cameroon	103	108	123	93	86	99
Brazil	153	223	949	75	55	96
Nigeria	107	107	113	88	83	75
Coffee a/						
Brazil	165	366	909	82	90	83
Colombia	113	132	155	100	103	77
El Salvador	139*b/*	135	142	125	106	94
Indonesia	83	99	121	77	84	90
Ivory Coast	100	100	117	94	89	95
Sugar c/						
Brazil *d/*	..	..	453-540	..	..	108-129
Philippines	..	..	97	..	..	79
Argentina	..	..	914	..	..	117
Jute c/ e/						
Bangladesh	124	138	202	110	114	157
India	111	121	134	100	103	114
Nepal	122	164	202	110	130	146
Thailand	97	101	97	89	89	83

Sources: Cocoa: International Cocoa Organization; Gill and Duffus, Ltd., London; Coffee: *Quarterly Statistical Bulletin*, Oct.-Dec. 1983 (Preliminary), International Coffee Organization; Sugar: International Sugar Organization; Jute: FAO, *Jute, Kenaf and Allied Fibres, Quarterly Statistics*, March 1984; IMF, *International Financial Statistics* (various issues),

a/ Indices relate to December of each year.
b/ November price.
c/ Crop years beginning 1 July of year stated.
d/ Lower price relates to North and North-Eastern states, higher price to other states.
e/ Indices for 1983 relate to January-June.

Blank page

Page blanche

Annex D

THE LEVEL, COSTS AND EFFECTS OF PROTECTIONIST MEASURES

Contents

Tables

I. INTRODUCTION

1. While chapter III of part II of this report examined the reasons for, and changing nature of, the trade intervention measures employed to shield domestic industry from more efficient foreign producers (or to insulate both producers and consumers from the destabilizing effects of external supply or price changes), supplementary information is needed on the level, costs and effects of these barriers in order to obtain a proper perspective on these developments. In this connection, the findings and conclusions of a growing number of investigations which attempt to quantify the influence of current protectionist policies are especially useful, as they all basically reach common conclusions: that existing protectionist policies involve major international costs and welfare losses; that they influence the international location of manufacturing activity and agricultural production; and in particular, that they pose major constraints to the achievement of the trade and industrialization objectives of developing countries.

2. As an indication of the nature and magnitude of the costs associated with protectionist practices, table D.1 provides a summary of the main conclusions of a number of representative studies which provide empirical evidence on these points. As indicated, one of the important findings is that consumers in the protected markets often bear major costs as a result of existing trade restrictions. For example, the 1980 study by the Canadian North-South Institute estimated that the annual costs borne by Canadian consumers due to trade restrictions on clothing were in excess of $Can. 0.5 billion per year. Similarly, the United States Federal Trade Commission concluded that protection against imports of footwear, clothing and sugar cost national consumers approximately $7.7 billion over the period 1975-1979, while the Australian Industries Assistance Commission estimated that the total annual cost of protection in the clothing sector was $A 235 per household.

3. With regard to the influence of protectionist measures on foreign producers, table D.1 shows that major losses are also borne by exporters because of the imposition of trade restrictions. Furthermore, many of the investigations also conclude that the effects of the protectionist measures fall especially severely on developing country exporters. As an illustration, the International Food Policy Research Institute study estimated that a 50 per cent reduction in trade barriers facing these countries' major agricultural exports would lead to a $3 billion annual increase in exports, while a related study by the World Bank indicated that a removal of the trade barriers imposed by industrial countries on eight processed agricultural products would increase developing country export revenues by more than the GSP had done. In addition, several of the investigations have also concluded that a major aspect of the effects of trade barriers in industrial markets is their influence on processing activity in developing countries and other raw material exporters. Specifically, the fact that tariffs and other forms of trade barriers have been found generally to increase or "escalate" with fabrication has been interpreted to constitute a bias against the importation of semi-finished or manufactured goods.[1]

---

[1] Concerning this point, the UNCTAD secretariat has argued that traditional procedures for assessing the influence of tariff escalation may considerably understate the importance of these phenomena from the standpoint of developing countries. This is due to the fact that processed commodities generally have higher import demand elasticities than raw materials and, as such, are far more sensitive to a given cut in tariffs. The implications of this point are that a given (say, 10 per cent) tariff on all stages of a processing chain will have a greater trade-restrictive effect on imports of processed goods than on raw materials. For a further discussion see the report by the UNCTAD secretariat, "Protectionism and structural adjustment in the world economy, Part I - Analysis of major issues and policy requirements" (TD/B/981(Part I) and Corr.1-2), paras. 74-79.

Table D.1

Commentaries on and basic findings of studies and analyses relative to the discussion in this annex

A. GENERAL STUDIES

1. *World Bank (1979)*

Protectionist measures imposed by the United States between 1975 and 1977 on goods imported from Asia and Latin America resulted in a loss to consumers of $1,200 million for footwear, $60 million for sugar, $400-$800 million for meat and $500 million for television sets or over $4 billion for these five items (Robert McNamara, "The high cost of protectionism", *Institutional Investor*, September 1979).

2. *United States Federal Trade Commission (1980)*

Estimated that the cost of protection against imports from all foreign exporters of footwear, clothing and sugar was approximately $7.7 billion over the period 1975-1979 (M.E. Morkre and D.G. Tarr, *Effects of Restrictions on United States Imports: Five Case Studies and Theory*, Staff Report of the Bureau of Economics to the Federal Trade Commission, June 1980.)

3. *UNCTAD (1968)*

Demonstrated that tariffs in industrial countries had a consistent tendency to increase or escalate with the degree of product processing. Further demonstrated that escalating tariffs and other forms of trade barriers are a major constraint to the export of fabricated goods from developing countries *(The Kennedy Round Estimated Effects on Tariff Barriers* (TD/6/Rev.1), United Nations publication, Sales No. E.68. II.D.12).

4. *United Nations Economic Commission for Asia and the Far East (1972)*

Estimated nominal and effective rates of protection for a selection of developing countries and demonstrated that in almost all cases a major need for rationalization existed. High tariffs and other trade restrictions on production inputs were found to have an important adverse effect on a number of potential export industries (*Intra-regional Trade Projections, Effective Protection and Income Distribution*, Vol.II - *Effective Protection* (United Nations publication, Sales No. E.73.II.F.12)).

B. STUDIES RELATING TO MANUFACTURES

1. *United Kingdom Consumers Association (1978)*

Concluded that the Multifibre Arrangement had increased prices of 60 per cent of all British clothing imports by between 15 and 40 per cent and had created shortages of many lower-priced items. (A similar investigation for the European Communities estimated that the MFA raised clothing prices by some 30-40 per cent.) (As cited in Commonwealth Secretariat, *Protectionism: Threat to International Order: The Impact on Developing Countries* (London, 1982), p. 84.)

Table D.1 (cont'd)

Commentaries on and basic findings of studies and analyses relative to the discussion in this annex

2. *North-South Institute (1980), Canada*

Placed the annual cost to consumers of bilateral quotas on clothing instituted in 1979 at $Can 198 million, while the costs of tariffs and quotas was put at $Can 467 million. The study estimated that only 6,000 man/years employment was created by this protectionist policy, at an annual cost to the Canadian consumer of $Can 33,000 per job (Glenn P. Jenkins, *Costs and Consequences of the New Protectionism: The Case of Canada's Clothing Sector*, North-South Institute (Montreal: July 1980)).

3. *Australian Industries Assistance Commission (1980)*

Estimated that the total annual cost of protection in the clothing sector was $A 235 per household. At the retail level it was estimated that consumers pay $A 1.1 billion more per year for clothing, drapery and footwear than they would if all assistance to industries was withdrawn (Australian Industries Assistance Commission, *Report on Textiles, Clothing and Footwear* (Canberra, 1980)).

C. STUDIES RELATING TO AGRICULTURE

1. *Food and Agriculture Organization of the United Nations (1979)*

The subsidizing of domestic production and higher prices due to international trade barriers for three products (wheat, sugar and dairy products) were estimated to have cost European Community consumers some $27 billion in 1978. In Japan the extra costs for consumers of rice alone was estimated at over $10 billion, while in the United States consumers of sugar and dairy products were paying nearly $4 billion in excess of world prices (FAO, *Commodity Review and Outlook: 1979-1980* (Rome, 1979)).

2. *International Food Policy Research Institute (1980)*

Estimated that the agricultural exports of 56 developing countries would increase by $3 billion annually if the OECD countries would lower agricultural trade barriers by 50 per cent. The largest sectoral gains were projected for sugar ($1.1 billion), oilseeds and products ($378 million) and meat ($336 million) (A. Valdes and J. Zietz, *Agricultural Protection in OECD Countries: Its Cost to Less Developed Countries* (Washington, D.C.: International Food Policy Research Institute, December 1980)).

3. *UNCTAD (1972)*

Estimated that a comprehensive liberalization of trade barriers for ten major agricultural products (wheat, rice, coarse grains, sugar, vegetable oils, beef and veal, lamb, pork, poultry and milk) would: (i) raise the annual net foreign exchange earnings of developed and developing country exporters by $8 billion; (ii) raise international prices for these commodities by about 30 per cent on average, and thus

Table D.1 (cont'd)

Commentaries on and basic findings of studies and analyses relative to the discussion in this annex

reverse the decline in their terms of trade; and (iii) raise the gross domestic product for developing countries by about 6 per cent, once all linkage effects were accounted for ("Agricultural protection and the food economy", UNCTAD Research Memorandum No. 46 (Geneva, 1972)).

4. *World Bank (1981)*

Conducted an analysis of the effects of international trade restraints facing eight processed agricultural products and concluded that their removal could increase total value added in developing country processing activity by 20 per cent or more, and would also increase developing country export revenues by more than the GSP had done. (*World Development Report, 1982* (New York: Oxford University Press, for the World Bank, 1981).)

5. *Food and Agriculture Organization of the United Nations (1980)*

In a sectoral study for beef trade, estimated that if rates of protection had been reduced by 25 per cent, exports would have been 22 per cent higher than their actual 1977-1979 level, and that average prices would have been 7 per cent higher. Furthermore, the study indicated that 1977-1979 exports of Latin America and Oceania would have been $3.8 billion, as opposed to an actual figure of $2.8 billion over this three-year period. If a 50 per cent liberalization had been effected, the exports of these regions would have been $2 billion above actual 1977-1979 levels ("Protectionism in the livestock sector" (CCP: ME 80/4), Rome, October 1980).

6. *Food and Agriculture Organization of the United Nations (1981)*

Estimated that if OECD countries were to reduce protection for oilseeds and (related) products by 50 per cent, the potential increase in export revenues of developing countries would be about $400 million, a rise by some 7-10 per cent, and that world trade in these products would increase by about $1 billion (in 1977 prices) ("Protectionism in the oilseeds, oils and oilmeals sector" (CCP: OF 81/2), Rome, January 1981).

7. *Commonwealth Secretariat (1982)*

Estimated that removal of European and Japanese trade barriers facing five agricultural products (wheat, maize, barley, sugar and beef) would raise imports of these items by approximately 60-70 per cent with even greater increases expected for beef. Much of the benefit of such increased exports were expected to accrue to developing countries in the case of sugar and maize (Commonwealth Secretariat, *Protectionism: Threat to International Order: The Impact on Developing Countries* (London, Commonwealth Secretariat, 1982), p. 74)).

Source: TD/B/981(Part I), *op.cit.*, table 16.

4. While the problems and economic losses for developing countries arising from such protectionist practices have always been viewed as a matter of major international concern, the dimensions of the problem have been steadily increasing, given the direct link that exists between trade and international debt issues. For example, a recent report by the UNCTAD secretariat revealed that, on average, the annual debt-service ratio of ten of the most heavily indebted countries amounted to 37 per cent of these countries' annual exports of goods and services.[2] The report recognized the extent to which trade expansion could make a contribution towards relieving the debt burden of these countries and also showed the major extent to which existing tariff and non-tariff measures in industrial countries prevented such an expansion. As an illustration, nearly one-fifth of these countries' exports (by value) to the European Economic Community, Japan and the United States were found to face direct import controls such as quotas and variable import levies, while the average post-Tokyo Round tariffs on these products amounted to almost 10 per cent in the case of the Republic of Korea.

5. In view of the importance of the findings of these various investigations, a key issue centres on the reasons why governments have adopted (and continue to adopt) such measures, given the magnitude of the costs involved. A closely related and equally important issue is whether or not the national objectives which governments seek to achieve through the use of these protectionist practices could be achieved by alternative policy instruments that would have less onerous effects on the international community. Some insights into these questions can be had from a more detailed analysis of the rationale for, and the nature of, the protectionist measures which have been adopted.

II. THE SITUATION IN AGRICULTURAL AND COMMODITY MARKETS

6. It is by now generally conceded that monetary and other institutional factors have contributed toward an amplification of the level of instability in international markets for many goods, and that this effect has been particularly important for agricultural products and other basic commodities. An essential part of the problem is that these goods are generally traded in international markets with prices denominated in a single major currency (generally United States dollars, but sometimes pounds sterling).[3] As such, the expenditure required to purchase these commodities in terms of the currencies of other major importing countries (i.e., Japanese yen, French francs, Swedish kronor, etc.) has the potential to be adversely affected (i.e., destabilized) by both changes in the dollar price in terms of those currencies and by exchange-rate changes of other currencies against the dollar.

7. Considerable evidence exists that this disequilibrating exchange-rate factor has recently been a far greater source of instability for some agricultural and commodity-importing countries than the degree of variation in dollar prices. Specifically, two considerations are relevant for importers in calculating their level of expenditure for these goods: the percentage change in the dollar-denominated price of the commodity on international markets, and the corresponding change in the importer's exchange rate against the dollar. These elements can be analyzed in a common framework to show their joint effect on the percentage change in national currency required to

---

[2] The ten developing countries which were the focus of this analysis were Brazil, Mexico, Argentina, Republic of Korea, India, Indonesia, Turkey, Egypt, Philippines and Algeria. (*Ibid.*, paras. 80-86.)

[3] Where there are major commodity markets trading in terms of sterling, like the London Metal Exchange, it should be noted that parallel markets for these same products exist in terms of United States dollars. As arbitrage would prevent any significant divergence in the dollar and pound prices, this point should be borne in mind when evaluating the statistics presented in table D.2.

purchase a given quantity of a commodity.[4]

8. Table D.2 shows the results when this expenditure variation index was calculated for six major industrial countries and 35 primary commodities or agricultural goods. Shown here are the expenditure changes for each country (measured in national currency units) required to purchase a given quantity of each commodity when the 1977-1982 effects of both price and exchange-rate changes are accounted for (i.e., the results from equation (1)).[5] In addition, the table also indicates (the extreme right column in the table) the commodity's 1977-1982 price change. To assist in interpreting these figures, a measure (the price-exchange rate ratio) of relative change in exchange rates and commodity prices has also been computed.[6] This index will take values above unity when the exchange-rate influence on the required expenditure of domestic currencies exceeds that of the dollar denominated price term. Values of less than unity indicate the price term has been the dominant factor.

9. When viewed in terms of these expenditure and price-exchange rate relatives, perhaps the most striking feature to emerge from table D.2 relates to the markedly different experiences of the individual developed countries. In Japan, whose currency appreciated by about 10 per cent against the dollar over this period, the price term is clearly the predominant influence on required yen expenditures as the price-exchange rate relative exceeds unity for only eight of the 35 commodities. This situation is in marked contrast with the Italian and Swedish experience, where the exchange-rate term is of greater importance in every instance. In the case of France, the price term was relatively more important for only one commodity (beef), while prices were the dominant influence on Belgium's expenditures for only two commodities (wheat and beef).[7] The Federal Republic of Germany had a more balanced experience, with the price influence being of primary importance for 15 of the 35 commodities. However, the key point that emerges from these data is that the degree of price and exchange-rate-induced instability has had a major impact on expenditure variation in all the developed countries.

10. As previously noted, some government-imposed trade measures have the objective of insulating domestic markets from such international instability as well as of providing a level of protection for domestic producers. However, many of these non-tariff interventions increase the

---

[4] Specifically, over a given time period the percentage change in national currency expenditure required to purchase a fixed quantity of such a commodity is: (1) $(E_t - E_o)/E_o = ((p_t/p_o)(r_{ik,t}/r_{ik,o})) - 1.0$, where p is the dollar-denominated price of the commodity, r_{ik} is the exchange rate between the importer's currency and the dollar, while E represents units of the importer's currency. Equation (1) can be derived directly by noting that it is directly equivalent to (2) $(E_t - E_o)/E_o = (p_t q_o r_{ik,t} - p_o q_o r_{ik,o})/(p_o q_o r_{ik,o})$; where q_o represents a fixed quantity of imports.

[5] It should be noted that there is a potentially important interaction effect between exchange rates and prices, since a currency appreciation against the dollar would cut import demand. Another point to note is that the influence of exchange-rate changes on import demand can be a cause of commodity price instability.

[6] This measure is defined as:

$$(3) \quad R_c = \frac{[(r_{ik,t}/r_{ik,o}) - 1.0]}{[(p_t/p_o) - 1.0]}$$

$$(0 < R_c < \infty)$$

[7] According to IMF statistics, recent inflation rates are not markedly different between these currencies. Annual rates for Belgium, the Federal Republic of Germany, Japan and Sweden are in the 5-8 per cent range, while the corresponding figures for France are about 10-12 per cent.

TABLE D.2

THE RELATIVE INFLUENCE OF 1977-1982 PRICE AND EXCHANGE-RATE CHANGES
ON THE EXPENDITURE REQUIRED TO PURCHASE A CONSTANT VOLUME OF COMMODITY IMPORTS
(Measured in terms of the percentage change in domestic currencies)

Commodity	Belgium (francs)		France (francs)		Federal Republic of Germany (deutsche mark)	
	Expenditure variation	Price-exchange ratio	Expenditure variation	Price-exchange ratio	Expenditure variation	Price-exchange ratio
Wheat, U.S. No. 2	135.3	0.95	140.1	1.01	90.3	0.42
Maize, U.S. No. 3	80.2	2.82	83.9	2.89	45.7	1.24
Rice	67.8	5.10	71.1	5.41	35.7	2.25
Sugar*	65.0	6.12	68.4	6.49	33.4	2.71
Beef	139.1	0.91	144.0	0.96	93.3	0.40
Bananas	113.5	1.29	117.9	1.37	72.6	0.57
Pepper, Black Malabar	4.7	1.40	-2.7	1.48	-22.9	0.62
Soybean meal	44.8	10.85	47.7	11.50	17.1	4.79
Fish meal	16.7	2.24	19.0	2.37	-5.7	0.99
Coffee, Arabicas*	-5.7	1.37	3.8	1.45	-23.7	0.61
Coffee, Robustas*	-26.6	1.01	-25.1	1.07	-40.6	0.44
Cocoa*	-28.9	0.98	-27.4	1.04	-42.5	0.43
Tea*	8.0	1.80	10.2	1.90	-12.7	0.79
Soybeans, U.S. No. 2	34.2	4.42	36.9	4.68	8.4	1.95
Soybean oil	20.9	2.54	23.3	2.69	-2.2	1.12
Sunflower oil	28.8	3.41	31.4	3.61	4.1	1.50
Groundnuts	13.2	2.04	15.5	2.16	-8.5	0.90
Groundnut oil	9.5	1.86	11.7	1.97	-11.5	0.82
Copra	20.6	2.52	23.0	2.68	-2.5	1.12
Coconut oil	24.4	2.86	27.0	3.03	0.6	1.26
Palm kernels	25.0	2.93	27.6	3.10	1.1	1.29
Palm kernel oil	14.7	2.10	17.0	2.23	-7.3	0.92
Palm oil	32.0	3.94	34.7	4.18	6.8	1.74
Olive oil	98.6	1.70	102.7	1.80	60.6	0.75
Linseed oil	76.4	3.26	80.0	3.45	42.6	1.44
Cotton, extra long*	24.0	2.83	26.5	3.00	23.3	1.25
Cotton, U.S. medium*	59.4	10.85	62.6	11.50	28.9	4.79
Wool	106.0	1.46	110.2	1.55	66.7	0.65
Jute*	38.0	5.60	40.8	5.94	11.6	2.47
Sisal*	73.4	3.72	76.9	3.98	40.2	1.64
Cattle hides	27.9	3.27	30.5	3.70	3.4	1.45
Rubber*	57.7	14.08	60.9	14.91	27.6	6.21
Phosphate rock	94.4	1.87	98.3	1.99	57.2	0.83
Manganese ore	84.4	2.50	88.2	2.65	48.0	1.11
Iron ore	83.1	2.44	86.9	2.59	48.1	1.08

* Designated by the UNCTAD secretariat as a "core commodity" for buffer stock management.

TABLE D.2 (cont'd)

THE RELATIVE INFLUENCE OF 1977-1982 PRICE AND EXCHANGE-RATE CHANGES ON THE EXPENDITURE REQUIRED TO PURCHASE A CONSTANT VOLUME OF COMMODITY IMPORTS (Measured in terms of the percentage change in domestic currencies)

Commodity	Japan (yen)		Italy (lira)		Sweden (kronor)		1977-1982
	Expenditure variation	Price-exchange ratio	Expenditure variation	Price-exchange ratio	Expenditure variation	Price-exchange ratio	Percentage price change
Wheat, U.S. No. 2	34.7	0.24	163.6	1.28	149.8	1.12	54.7
Maize, U.S. No. 3	2.7	0.72	101.9	3.80	91.3	3.32	18.5
Rice	-4.4	1.30	87.9	6.90	78.1	6.03	10.3
Sugar*	-5.9	1.56	85.0	8.28	75.3	7.23	8.5
Beef	36.2	0.23	167.9	1.23	153.9	1.08	57.2
Bananas	21.7	0.33	139.2	1.74	126.7	1.52	40.4
Pepper, Black Malabar	-45.3	0.36	6.8	1.88	1.2	1.65	-37.3
Soybean meal	-17.5	2.77	62.2	14.67	53.7	12.81	-4.8
Fish meal	-33.5	0.57	30.7	3.02	23.9	2.64	-23.3
Coffee, Arabicas*	-46.3	0.35	5.6	1.85	0.1	1.62	-38.0
Coffee, Robustas*	-58.1	0.26	-17.7	1.36	-22.0	1.19	-51.8
Cocoa*	-59.5	0.25	-20.3	1.32	-24.4	1.15	-53.3
Tea*	-38.4	0.46	21.0	2.42	14.7	2.12	-29.0
Soybeans, U.S. No. 2	-23.5	1.13	50.3	5.97	42.4	5.22	-11.8
Soybean oil	-31.1	0.65	35.5	3.43	28.4	3.00	-20.5
Sunflower oil	-26.6	0.87	44.3	4.60	36.8	4.02	-15.3
Groundnuts	-35.5	0.52	26.8	2.75	20.2	2.40	-25.6
Groundnut oil	-37.6	0.48	22.7	2.51	16.3	2.20	-28.0
Copra	-31.3	0.64	35.1	3.42	28.1	2.98	-20.6
Coconut oil	-29.1	0.73	39.4	3.87	32.1	3.38	-18.2
Palm kernels	-28.8	0.75	40.1	3.96	32.8	3.46	-17.8
Palm kernel oil	-34.7	0.54	28.5	2.85	21.8	2.49	-24.7
Palm oil	-24.8	1.01	47.9	5.33	40.2	4.66	-13.2
Olive oil	13.2	0.43	122.5	2.31	110.9	2.01	30.6
Linseed oil	0.5	0.83	97.7	4.40	87.3	3.84	16.0
Cotton, extra long*	-29.3	0.72	38.9	3.83	31.6	3.34	-18.4
Cotton, U.S. medium*	-9.1	12.77	78.6	14.66	69.3	12.81	4.8
Wool	17.4	0.37	130.9	1.98	118.8	1.73	35.6
Jute*	-21.4	1.43	54.6	7.57	46.5	6.61	-9.3
Sisal*	-1.2	0.95	94.3	5.02	84.1	4.39	14.0
Cattle hides	-27.1	0.84	43.3	4.42	35.8	3.87	-15.9
Rubber*	-10.1	3.59	76.7	19.02	67.5	16.62	3.7
Phosphate rock	10.8	0.48	117.8	2.53	106.4	2.21	27.8
Manganese ore	5.1	0.64	106.7	3.38	95.9	2.96	16.3
Iron ore	4.4	0.62	105.2	3.30	94.4	2.89	21.3

* Designated by the UNCTAD secretariat as a "core commodity" for buffer stock management.

instability developing countries and other agricultural exporters face in world markets. For example, a recent OECD report demonstrates that variable levies and quotas have a greater destabilizing influence on world prices than either nominal or specific tariffs.[8] In addition, there is considerable evidence that these interventions have had a far greater restrictive effect on trade than tariffs, and that they are being applied with increasing frequency. As an illustration, table D.3 shows the importance of EEC's and Sweden's variable levies and tariff for products falling in SITC 0 (food and live animals) and SITC 4 (animal and vegetable oils). Perhaps the most striking feature to emerge from the table concerns the relative height of the average tariff and *ad valorem* equivalent of the levies. Within SITC 0, for example, a nominal EEC tariff of 18 per cent couples with levies whose average rate is approximately three times higher. Much the same picture concerning the relative importance of these variable import charges and tariffs can be observed in SITC 4 (animal and vegetable oils), where average tariffs of approximately 8 per cent combine with levies of 24 per cent. Only in SITC 06 (sugar and honey preparations) is the incidence of the EEC levies less than that of tariffs, due primarily to pre-Tokyo import duties that averaged over 50 per cent.[9]

11. For Sweden, much the same picture emerges concerning the relative importance of tariffs and levies. There, variable levies are applied with high frequency in the meat sector, where 95 per cent of imports, measured by value, and approximately 80 per cent of the tariff line items are covered by these import charges. However, product coverage is highest in SITC 02 (dairy products and eggs), where all the tariff line products encounter levies. The relative height of the average tariff and nominal equivalent of the levies also confirms the importance of the latter as trade barriers. In SITC 0, for example, an average tariff of 3.6 per cent is coupled with a levy of more than ten times this figure, while in SITC 4 tariffs are negligible, but levies average close to 80 per cent in nominal terms.

12. While table D.3 illustrates the importance or incidence of these non-tariff barriers (i.e., the variable levies) at a given point in time, table D.4 shows *ad valorem* equivalents for some of the major products covered by EEC's levies over two-year periods starting in 1975 and also indicates the application of other non-tariff measures or tariffs. The key points which emerge from this table relate to the level of the *ad valorem* equivalents for these non-tariff measures as well as their variability. For example, over the 1975-1976 period the average *ad valorem* equivalent for wheat levies was 41.3 per cent, but had ranged from a high of 101 per cent to a low of 22 per cent. In this same period, the nominal equivalent for the maize levies ranged from 63 to 17 per cent, while the range for the barley levies was from 43 per cent and 7 per cent. However, the highest nominal equivalents in the table, and also those with the greatest degree of fluctuation, are for sugar. In this case the levies had an *ad valorem* equivalent of almost 200 per cent on

[8] See *Problems of Agricultural Trade* (Paris: OECD, 1982), p. 140.

[9] These figures are offered as examples of the level of non-tariff protection afforded agricultural products in EEC and Sweden, and are not meant to imply that they are higher in these markets than elsewhere. In fact, Gulbrandsen and Lindbeck estimate that the levels of agricultural protection in Switzerland, Norway and Finland are higher than in EEC. Also, FAO estimates for Japan suggest that levels of protection for many major agricultural products are at least as high as in EEC. See Odd Gulbrandsen and Assar Lindbeck, *The Economics of the Agricultural Sector* (Stockholm: Almquist and Wicksell, 1973), p. 38, and FAO, *FAO Commodity Review and Outlook, 1979-1980* (Rome, 1979), pp. 112-114.

TABLE D.3

PRE-TOKYO ROUND NOMINAL PROTECTION FOR EEC AND SWEDISH AGRICULTURAL PRODUCTS

		European Economic Community					Sweden				
		Coverage by levies a/		Nominal protection (%)			Coverage by levies a/		Nominal protection (%)		
SITC	Product description	% of tariff lines	Value of imports ($000)	Tariffs	Levies	Total	% of tariff lines	Value of imports ($000)	Tariffs	Levies	Total
0	**Food and live animals**										
00	Food and live animals	33.4	1828	11.8	18.2	30.0	12.2	505	4.2	10.1	14.3
01	Meat and meat preparations	39.5	188887	18.1	30.4	48.5	79.4	43646	-	62.0	62.0
02	Dairy products and eggs	29.4	892	18.4	152.9	171.3	100.0	15471	-	77.3	77.3
03	Fish and fish preparations	-	-	12.8	.	12.8	4.1	60	3.7	12.0	15.7
04	Cereals and preparations	41.9	355330	15.2	52.1	67.3	48.0	16025	6.3	65.9	72.2
05	Fruits and vegetables	8.2	91936	16.4	37.1	53.8	4.0	170	7.1	6.6	13.7
06	Sugar and honey preparations	38.5	97075	53.1	12.0	65.1	59.3	13175	8.7	105.8	114.5
07	Coffee, tea, cocoa and spices	6.9	-	10.8	51.0	61.8	-	-	6.4	-	6.4
08	Feeding stuffs for animals	8.4	11	5.4	56.0	61.4	2.5	53	2.1	-	2.1
09	Miscellaneous food preparations	13.4	8	19.2	47.3	66.5	35.8	6432	4.1	20.2	24.3
1	**Beverages and tobacco**										
11	Beverages	-	-	27.0	.	27.0	-	-	25.1	-	25.1
12	Tobacco manufactures	-	-	61.4	.	61.4	-	-	40.2	-	40.2
4	**Animal and vegetable oils**										
41	Animal oils and fats	9.6	14	3.5	31.8	35.3	44.5	482.6	-	116.2	116.2
42	Fixed vegetable oils and fats	15.8	16640	11.4	39.2	50.6	77.3	20597.0	0.1	77.7	77.8
43	Processed animal oils and fats	11.2	-	7.5	1.1	8.6	..	..	..	..	...

Source: Adapted from Alexander J. Yeats, Trade Barriers Facing Developing Countries: Commercial Policy Measures and Shipping (London: Macmillan Press, 1979, p. 132), and Gary Sampson and Alexander Yeats, "Do import levies matter? The case of Sweden", **Journal of Political Economy** (Vol. 84, No.4), p. 883.

a/ Due to the fact that the table was compiled from two different data sources, 1970 trade data are shown for Sweden and 1974 data for the European Economic Community.

Table D.4

Estimated ad valorem equivalents of EEC variable import levies, tariffs and other non-tariff measures facing selected agricultural products

Product	Average MFN tariff (per cent)	Other NTBs *a/*	Period	*Ad valorem* equivalent of variable import levies *b/* (%)		
					Range	
				Average	High	Low
Wheat	20.0	L, VL	1975-76	41.3	101.0	22.1
			1977-78	116.3	143.5	96.7
			1979-80	69.9	103.0	39.3
			1981-82	46.0	36.9	51.0
Oats	13.0	L, VL	1975-76	24.6	48.4	10.8
			1977-78	91.0	125.4	45.9
			1979-80	77.1	150.8	19.6
			1981-82	15.5	29.2	3.7
Durum wheat	20.0	L, VL	1975-76	45.4	139.8	5.0
			1977-78	130.8	163.7	103.0
			1979-80	69.8	130.0	29.8
			1981-82	55.5	74.3	27.9
Maize	9.0	CT, VL	1975-76	31.5	62.6	17.0
			1977-78	98.2	120.7	57.1
			1979-80	84.1	107.0	53.2
			1981-82	53.3	83.0	41.6
Barley	13.0	L, VL	1975-76	23.2	43.1	6.6
			1977-78	100.6	141.2	42.1
			1979-80	75.0	152.2	27.7
			1981-82	40.7	54.3	18.7
Rye	16.0	L, VL	1975-76	46.6	64.7	28.3
			1977-78	94.6	116.3	71.6
			1979-80	66.9	118.0	25.5
			1981-82	17.1	23.7	11.5
Raw sugar *c/*	80.0	L, VL	1977-78	195.5	217.2	173.8
			1979-80	75.9	182.0	-
			1981-82	38.1	79.5	0.2

Source: UNCTAD secretariat estimates.

a/ L = import licensing; VL = variable import levy; and CT = countervailing taxes.

b/ Estimates based on quarterly averages of the *ad valorem* incidence of the variable import levies.

c/ Published data on the sugar levies are not available before the third quarter of 1977.

average in the 1977-1978 period and then fell to a low of zero two years later.[10] Two additional points to note from the table concern the relative unimportance of tariff protection for these products as opposed to levies and that other forms of NTBs may also be applied to regulate imports.

13. It is essential to bear in mind that the previous estimates refer to the degree of protection afforded by only one form of non-tariff intervention (i.e., variable import levies), and that a wide variety of different forms of trade measures are applied in the agricultural sector. In addition, it has also been documented that specific products may be subject to the multiple application of different non-tariff measures. In these latter cases, which are referred to as the "stacking" of non-tariff measures, as many as five different types of NTBs can be applied to the same product. As an illustration, cheese exports to Japan have been subject to discretionary licensing arrangements, global quotas, tariff quotas, special labelling requirements and special health requirements. Similarly, meat exports to EEC face variable import levies as well as a discretionary licensing system, prohibitions on imports from specific countries, health standards and selective price control measures.[11] In such cases, levies may not be the primary source of protection, in spite of the imposing estimates of their nominal equivalents (see tables D.3 and D.4).

14. While empirical evidence (i.e., *ad valorem* equivalents) concerning the restrictive effects of alternative forms of protection for agricultural products is not always available, some indication as to the potential importance of the trade interventions can be had from table C.5.[12] The table shows the total 1980 values of agricultural

---

[10] While the systems of European agricultural price support were established prior to the period of exchange-rate instability, there is evidence that recent monetary fluctuations have placed major new burdens on these stabilization systems. For example, prices have differed more in recent years than in the pre-EEC phase on some markets. While in the spirit of a customs union, the Common Agricultural Policy (CAP) sets uniform prices within the EEC, expressed in terms of "European Currency Units" (ECUs), this does not mean that agricultural prices are uniform among members of the Community. The "green" currency exchange rates for agriculture ensure this result. Thus, the price of wheat converted from ECUs to United States dollars at official exchange rates was $180/ton in France and $213/ton in the Federal Republic of Germany, the price of sugar was $390/ton in the United Kingdom and $511/ton in the Federal Republic of Germany. The intent of the "green" rate is to compensate producers from member countries differently. In order to ensure that intra-EEC trade will occur at a common price, despite the apparent differences in producer prices, a system of "monetary compensatory amounts" (MCAs), approximately equal to the difference between the official and "green" exchange rate for each country, are administered. Thus, a member country with a strong currency receives a positive MCA for each unit of agricultural output which it exports, and a member country with a weak currency incurs a negative MCA for its agricultural exports. Agricultural imports within EEC are affected the same way.

[11] For a detailed analysis of the application, incidence and effects of non-tariff interventions in international markets for agricultural products, see the report by the UNCTAD secretariat, "Protectionism and Structural Adjustment in Agriculture" (TD/B/939). For evidence of the stacking of non-tariff measures on specific agricultural products, see Alexander J. Yeats, "Agricultural protectionism: an analysis of its international economic effects and options for institutional reform", *Trade and Development*, Winter 1981 (United Nations publication, Sales No. E.82.II.D.3), p.12.

[12] With regard to the continuing efforts to quantify the effects of trade barriers in the major markets for agricultural products, the continuing monitoring effort by the FAO is especially important, since it both provides estimates of trends in agricultural protection for major products and also yields producer and consumer subsidy equivalents for the systems of protection. For a description of this approach, see FAO, *Agricultural protection and stabilization policies: a framework of measurement in the context of agricultural adjustment* (C 75/LIM/2), Rome, October 1975.

products exported by developed and developing countries to the United States, Japan, nine EEC countries, Switzerland, Sweden, Norway and Austria, as well as the share of these exports that are subject to seven different forms of non-tariff barriers: voluntary restraints, tariff quotas, import authorizations, other quantitative restrictions, variable duties (including variable import levies), anti-dumping duties and other price control measures. The application of these measures is shown separately for exports of developed countries and of developing countries.

15. As shown in the table, variable import levies are applied to over 20 per cent of the agricultural imports of Belgium-Luxembourg, Netherlands and the United Kingdom from other developed market-economy countries, while over 40 per cent of the other developed market-economy countries' exports face quantitative restrictions in these two markets. In Japan, over 36 per cent of developing country exports are subject to quantitative restrictions (over 70 per cent for exports from developing countries), with an additional 6 per cent of this trade being subject to tariff quotas. In the United States, primary use is made of quantitative restrictions (i.e., voluntary restraints, tariff quotas, authorizations, and quantitative restrictions (QRs)) to control imports, as these non-tariff measures are applied to over 9 per cent of agricultural imports from developed countries. Other price control measures (column 7) are also applied to about 2 per cent. As a result of the different forms of interventions, approximately three-quarters of developing country agricultural exports to the Benelux countries, Japan, the Netherlands and Italy face NTBs, while more than 40 per cent of these countries' exports to Denmark, the United Kingdom and the Federal Republic of Germany encounter one or more forms of these restraints.

16. Previous empirical studies have established the fact that these extensive systems of agricultural protection involve major trade losses for developing countries and more efficient developed market-economy country exporters of agricultural products.[13] In addition, it has also been documented that the existing systems of support often entail major losses for consumers in the highly protected markets, due to the inflated prices for foodstuffs and other agricultural products. Hence, there is a common interest in attempting to reform the existing protectionist policies to better serve the needs of both agricultural exporters and consumers. In this respect, the UNCTAD secretariat has proposed a special, immediate reduction of barriers to trade in agricultural and processed commodities in favour of developing countries, as an interim measure, pending a more universal and longer-term solution for agricultural trade in the multilateral trading system that is being examined in GATT.[14]

17. With regard to the longer-term approaches, the UNCTAD secretariat has suggested that one option which governments might wish to pursue could be the formulation of multilaterally-agreed principles for international trade in agriculture. Such principles might constitute some of the elements for liberalization efforts to be pursued through GATT. They could also be put in the form of a code which would provide a framework for the adaption of national policies over the medium to long term to reduce costly protection of the agricultural sector and improve international economic efficiency. Such a code could also provide a benchmark for the development of policy and could also, at a minimum, assist governments to resist domestic pressures harmful to international trade on the grounds that policy changes need to be consistent with the internationally-agreed principles.[15]

---

[13] See UNCTAD, *op. cit.* (TD/B/939), for documentary evidence.

[14] See its report, "Commodity issues: a review and proposals for further action" (TD/273 and Corr.1-2), reproduced in *Proceedings of the United Nations Conference on Trade and Development, Sixth Session*, vol. III - *Basic Documents* (United Nations publication, Sales No. E.83.II.D.8), chapter III.

[15] For a detailed elaboration on the possible elements and effects of such a code, see UNCTAD, *op. cit.* (TD/B/939), particularly chapter V, "International co-operative action in production and trade in agriculture".

TABLE D.5

SHARE OF SELECTED DEVELOPED MARKET-ECONOMY COUNTRIES' 1980 IMPORTS OF AGRICULTURAL PRODUCTS SUBJECT TO DIFFERENT NON-TARIFF BARRIERS

	NTB category														1980 value of imports ($ million)	
	Voluntary restraints		Tariff quota		Automatic authorizations		Other QRs		Variable duties		Anti-dumping duties		Other price control measures			
Importer	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
USA	-	-	2.1	-	-	-	7.3	2.0	-	-	-	0.2	0.8	1.0	7832.2	11348.1
Japan	-	-	6.3	1.5	-	-	35.5	71.3	-	-	-	-	-	-	11419.2	4203.1
EEC, of which:																
Denmark	0.7	0.3	9.5	0.1	-	-	18.7	36.5	4.2	6.9	-	-	10.7	0.3	645.0	420.4
Ireland	0.2	0.8	3.7	3.1	-	0.1	22.5	29.3	5.7	7.6	-	-	9.4	0.3	138.0	171.0
France	0.1	1.1	1.5	1.1	15.3	5.2	16.3	11.5	4.0	3.2	-	-	20.3	5.0	2666.3	4111.3
United Kingdom	8.0	-	12.2	2.3	0.4	0.3	41.5	37.6	22.7	3.3	-	-	12.8	2.7	4797.7	3747.3
Italy	0.2	0.4	2.5	3.1	0.1	4.5	28.3	50.2	18.7	4.5	-	-	3.0	5.0	2347.9	2428.2
Germany, Fed. Rep. of	0.3	3.9	3.4	3.1	1.0	0.6	18.4	37.8	7.8	5.1	-	-	11.0	2.8	4725.2	5530.6
Netherlands	0.1	11.3	1.0	1.8	0.9	0.1	32.7	39.9	9.1	14.9	-	-	6.3	3.2	2988.6	3311.2
Belgium/Luxembourg	0.3	6.4	1.6	1.6	0.2	-	40.4	50.7	27.3	14.6	-	-	11.2	1.4	1304.2	979.8
Switzerland	-	-	-	-	25.5	62.9	43.9	11.8	5.3	-	-	-	-	-	2385.0	602.9
Sweden	-	-	-	-	-	-	8.4	60.7	10.1	39.2	-	-	1.7	-	1809.9	652.1
Norway	-	-	-	-	0.5	0.1	26.4	10.8	-	-	-	-	7.5	5.2	1012.8	305.2
Austria	-	-	1.2	0.3	-	-	15.5	46.1	27.8	1.3	-	-	1.4	0.2	1050.0	389.9

Source: See note a/ to table 14 in the main text.

(a) = application of measures on the exports of developed countries.
(b) = application of measures on exports from developing countries.

III. PROTECTIONISM FOR MANUFACTURED GOODS

18. Although a wide variety of other factors also play a role, there is little doubt that monetary and exchange-rate factors are important in generating pressures for increased protection in importing markets. For example, a currency realignment that is due primarily to factors other than changes in comparative costs can have a major impact on the competitive position of domestic versus foreign producers. Thus, if the domestic currency of an importing country strongly appreciated against that of foreign suppliers due (say) to interest rate differentials, this could produce important domestic pressures for protection. However, the available evidence does not permit estimation of the quantitative importance of the influence of such monetary-induced protectionist pressures as opposed to other factors, such as the longer-term competitive decline in industries in which foreign countries are becoming relatively more efficient.

19. As an indication of the extent of the application of non-tariff measures in the international trade in manufactured goods, table D.6 shows the share of 13 developed market-economy countries' imports from developing countries of various categories of products that face non-tariff trade barriers. For the purpose of comparison, information on non-tariff measures facing four broad classes of agricultural goods (CCCN sections I-IV) have also been included in the table: live animals and animal products, vegetable products, fats and oils, and prepared foods. The two key points that emerge from these statistics concern the variation in the application of the restraints among products and countries. For example, in Japan less than 6 per cent of total imports face non-tariff measures, while the corresponding share in Switzerland is almost 50 per cent. Even among the countries comprising EEC considerable variation is evident in the incidence of these measures: 28 per cent of Danish imports are subject to NTBs, while the corresponding shares for France, Italy and the Federal Republic of Germany range from 7 to 13.8 per cent.

20. As far as the individual product sectors are concerned, there is a clear tendency for labour-intensive industrial products to encounter the highest application of non-tariff barriers, with textiles and footwear standing out as among the most heavily protected manufactures in all of the industrial markets. Over 80 per cent, for example, of imports of footwear products into Denmark and the Netherlands are subject to non-tariff measures, while over 85 per cent of the imports of textiles into Denmark and the Federal Republic of Germany face trade restraints. Apart from these products, exports of wood and cork manufactures (CCCN section IX) experience a relatively high application of non-tariff measures in some industrial country markets (33 per cent of these exports to France face such restraints) while 60 per cent of French imports of base metal products (CCCN section XV) also encounter non-tariff measures.

21. While table D.6 indicates that non-tariff barriers have a high frequency of application for many manufactured goods, supplementary evidence is needed as to the associated levels of protection afforded by these restrictions. Some indication on this score can be derived from international comparisons of prices for the affected items. While it is recognized that comparisons of the effects of trade restraints are complicated by the fact that the barriers take different, and not easily comparable, forms, a GATT panel of experts headed by Gottfried Haberler suggested that their incidence or "the degree of protection can be very roughly judged by the extent to which the price paid to the producer exceeds the world price for importers".[16] While it is acknowledged that there are difficulties of interpretation associated with differences in supply-demand elasticities, the effects of subsidies, differences in national tax schemes, etc., several investigations which attempted to quantify the effects of NTBs have found the GATT approach useful.

[16] See GATT, *Trends in International Trade. Report by a Panel of Experts* (Geneva, 1958).

TABLE D.6

SHARE OF SELECTED DEVELOPED MARKET-ECONOMY COUNTRIES' IMPORTS FROM DEVELOPING COUNTRIES SUBJECT TO NON-TARIFF BARRIERS

CCCN section	Japan	European Economic Community								Norway	Sweden	Austria	Switzerland
		Denmark	Ireland	France	UK	Italy	Fed. Rep. Germany	Netherlands	Belgium/ Luxembourg				
I Live animals	94.4	20.0	12.1	53.9	63.9	56.0	48.7	47.5	31.2	7.6	1.9	18.2	80.5
II Vegetable products	59.5	61.4	12.4	14.4	32.4	72.3	62.1	70.1	77.9	9.0	73.4	62.7	82.0
III Animal and vegetable fats and oils	3.3	-	-	17.5	-	47.4	-	-	-	9.6	-	-	98.4
IV Prepared foodstuffs	61.2	18.0	44.0	25.8	50.1	25.5	7.9	21.5	23.0	19.3	11.9	6.2	49.3
V Mineral products	2.0	-	-	-	-	-	-	11.7	7.0	11.2	-	-	76.6
VI Chemical products	8.7	0.3	14.1	4.5	0.8	8.8	4.0	0.5	3.8	-	0.1	1.4	18.3
VII Artificial resins and plastics	0.1	-	0.2	-	-	1.4	-	-	-	12.0	-	1.3	1.0
VIII Raw hides and skins	1.4	-	-	-	-	-	-	-	-	1.8	-	-	-
IX Wood and wood articles	-	18.9	18.5	32.9	31.6	0.7	3.8	15.1	16.6	-	-	-	-
X Paper and paperboard	-	-	-	5.9	-	0.1	-	-	-	-	-	-	-
XI Textiles and textile articles	16.2	86.8	72.0	70.3	81.3	56.4	84.6	87.3	61.5	39.1	78.4	21.4	42.2
XII Footwear, headgear, umbrellas, etc.	16.7	86.7	80.3	78.6	80.4	76.2	72.8	84.5	58.8	37.5	18.1	28.6	-
XIII Articles of stone or plaster	-	-	-	39.7	8.3	58.1	16.4	-	-	7.3	-	18.5	-
XIV Pearls and precious stones	-	-	-	-	-	-	-	47.5	79.8	-	-	-	-
XV Articles of base metal	0.7	49.5	1.1	59.7	6.3	14.5	10.3	5.5	2.3	2.1	-	-	6.6
XVI Machinery and appliances	-	-	0.2	10.1	1.7	14.1	-	-	-	25.7	-	1.8	2.2
XVII Vehicles and aircraft	-	-	-	34.2	-	-	-	-	-	99.3	-	1.1	0.1
XVIII Optical goods	-	-	0.3	42.5	0.3	0.1	-	12.0	5.8	13.2	-	-	0.1
XIX Arms and ammunition	100.0	-	-	-	-	-	-	-	-	-	-	6.0	99.3
XX Miscellaneous articles	0.3	-	-	0.7	-	-	-	-	-	-	-	-	-
XXI All items	8.3	-	-	-	-	-	-	-	-	-	-	-	-
Total	5.9	27.7	10.9	7.5	16.2	7.3	13.8	20.0	17.0	14.7	12.5	8.0	48.1

Source: See note a/ to table 14 of the main text.

22. While most previous studies have relied on general import statistics for comparisons of domestic and world prices, these data sources suffer from the well-known deficiency that it is impossible to determine accurately the portion of the observed differential which should be attributed to quality and other non-price factors. However, in a study initiated by the UNCTAD secretariat an attempt was made to minimize this problem by employing international price statistics compiled by the international consulting firm Business International.[17] Since this source provided cross-country price information for close to 90 processed agricultural products and basic manufactures, whose characteristics were clearly specified before drawing the price sample from 15 developed countries, it is unlikely that observed price differences could be strongly influenced by product variation.

23. The basic approach that was followed for the approximation of the effects of non-tariff measures is patterned after the methodologies developed in earlier analyses that have employed price differentials. First, a base or reference price for each of the standardized commodities was established. In general, this reference price was the lowest observed price in the 15 industrial countries, although where evidence existed of direct government subsidies an alternative price was employed. Next, a gross price differential for each of the 15 industrial countries in the sample was computed by taking the ratio of its domestic price for the standardized product to the reference price. Third, the portion of the gross price differential accounted for by tariffs, excise or other general taxes was computed and removed. This procedure produced a residual element (the NTB price relative) which has been used as a quantitative measure of the influence of non-tariff restrictions in the importing country.[18]

24. Table D.7 summarizes the results for four major industrial countries, namely, France, Japan, Sweden and the United States. It shows the average NTB measures for each of 26 different two-digit CCCN groups as well as the average MFN tariffs that were applied in each group. The two major points that emerge from these data relate to the general height of the non-tariff barrier measures relative to tariffs, and also to the absolute levels of protection connected with NTBs for some of the product groups. For example, the table shows that the NTB measure exceeds the MFN tariff average for over three-quarters of the entries in the table, and in some cases the differences may be as large as 50 percentage points or more. Thus, the table supports the previously cited propositions concerning the relative decline in importance of tariffs as opposed to NTBs as protective measures.

25. Regarding absolute magnitudes, in a number of cases rates of over 100 per cent are recorded for the NTB price relatives, yet in practically all of these instances the results are supported by findings of other studies.

[17] While the data are compiled annually by Business International in order to compute international price and living cost differentials, the mid-1970 period was specifically selected for the NTB analysis in order to minimize the difficulties connected with price comparisons in the face of rapidly changing exchange rates which occurred in the late 1970s and 1980s.

[18] For illustrations of previous analyses that have employed this or a closely related procedure for the quantification of NTBs, see Frederic L. Pryor, "Trade barriers of capitalist and communist nations against foodstuffs exported by tropical underdeveloped nations", *Review of Economics and Statistics*, November 1966, William Cline, *et. al.*, *Trade Negotiations in the Tokyo Round: A Quantitative Assessment* (Washington, D.C., Brookings Institution, 1978), p. 167; Carl Hamilton, "Agricultural protection in Sweden, 1970-1980", *Seminar Paper No. 214* (Stockholm: Institute for International Economic Studies, 1982); and Eric Saxon and Kym Anderson, *Japanese Agricultural Protection in a Historical Perspective* (Canberra: Australia-Japan Research Centre, July 1982). Two qualifications are generally made regarding the interpretation of results, the first being that international transport costs can influence the NTB price residuals although the influence is generally thought to be small. Second, the differentials may, in some cases, reflect importing countries' ignorance of the lowest cost supplier(s) or institutional factors that limit imports from these sources.

TABLE D.7

NOMINAL TARIFFS AND THE ESTIMATED AD VALOREM EQUIVALENTS OF NON-TARIFF BARRIERS IN FRANCE, JAPAN, SWEDEN AND THE UNITED STATES IN THE MID-1970s a/
(Percentage)

CCCN	Product group	France		Japan		Sweden		United States	
		Nominal tariff	NTB-price relative b/	Nominal tariff	NTB-price relative b/	Nominal tariff	NTB-price relative b/	Nominal tariff	NTB-price relative b/
02	Meat products	15	67	13	161	-	133	7	54
03	Fish and seafood	10	34	8	72	-	64	1	78
04	Dairy products	18	15	35	-	-	23	10	-
07	Vegetables and products	12	30	12	72	7	80	13	50
08	Edible fruits and nuts	14	22	14	180	4	51	7	128
09	Coffee, tea and spices	10	83	6	155	1	100	1	38
10	Cereals	13	11	11	16	-	12	5	-
11	Mill products	21	40	25	158	-	85	8	57
15	Processed fats and oils	7	-	8	50	-	94	5	-
17	Sugar and products	38	9	66	68	18	51	6	23
18	Cocoa and products	12	-	16	157	5	47	2	2
19	Cereal preparations	10	94	23	92	19	113	5	47
20	Vegetable preparations	23	63	23	76	11	54	13	3
22	Beverages	28	-	47	-	8	73	5	19
24	Tobacco and products	74	-	352	-	14	72	20	-
27	Mineral fuels	6	107	17	110	-	97	6	-
30	Pharmaceuticals	15	28	13	75	2	153	12	9
33	Toilet preparations	12	57	18	156	9	75	8	61
34	Soaps and detergents	12	49	13	-	8	115	7	-
48	Paper and products	7	67	13	33	2	75	5	39
60	Knitted goods	13	92	16	44	15	15	28	61
61	Apparel and clothing	15	16	19	-	15	-	21	32
64	Footwear	17	28	18	11	14	62	15	70
82	Tools and cutlery	7	41	12	59	6	121	17	82
87	Vehicles	14	-	11	19	13	5	5	-
92	Instruments and recorders	6	25	10	32	1	41	6	-
	Average	17	40	32	70	7	70	9	35

Source: UNCTAD Data Base on Trade Measures.

a/ The mid-1970 period was specifically chosen for this analysis in order to avoid the problem posed by widely fluctuating international exchange rates when comparing international prices.

b/ Estimated ad valorem equivalents of all non-tariff restrictions applied, exclusive of tariffs and general taxes. For procedures used in deriving these estimates, see the text.

For example, high rates for most of the processed agricultural products in Sweden and Japan are an obvious consequence of the high levels of agricultural price support existing in these countries (see table D.3 as well as the previously cited studies by Cline and Hamilton). For the apparel and clothing group (CCCN chapter 61) non-tariff restrictions in the United States are estimated to afford domestic producers with a margin of protection that exceeds 30 per cent, while for knitted goods (CCCN chapter 60) the margin of protection is estimated to range as high as 90 per cent in France. Apart from these products, footwear, tools and cutlery, and instruments and recorders have (excluding the agricultural-based processed goods) some of the highest NTB price relatives in the table.

26. While the information reflected in table D.7 relates to the level of protection at a given point in time, trends in protectionism are certainly of equal importance. A sectoral focus may be useful in this context, specifically on the evolution of the trade regime governing international trade in textiles and clothing. The bulk of trade in these sectors has been regulated through "voluntary export restraints" for more than 20 years, first under the short-term and long-term Arrangement Regarding Trade in Cotton Textiles in 1961, and subsequently under the Multifibre Arrangement (MFA) which came into force on 1 January 1974. While the stated aim of the MFA was to liberalize trade in these sectors and accommodate the expansion of developing country exports without "disrupting" developed country markets, it has evolved into a discriminatory system of broad industry protection in developed countries.

27. The first MFA is recognized as having been more liberal than the preceding arrangements. Among its provisions were a 6 per cent annual growth rate in exports subject to restraints and flexibility in transferring quota allocations between product categories and between years. While MFA I was negotiated during a period of considerable economic growth, the Protocol extending the MFA was negotiated in the aftermath of the 1975 recession. MFA II, which came into effect on 1 January 1978, represented a significant tightening of restrictions. The "reasonable departures" clause enabled importing countries to resolve "pressing import problems" bilaterally "with a view to reaching a mutually acceptable solution . . .", including "the possibility of jointly agreed reasonable departures from particular elements in particular cases". Such departures were to be temporary.

28. All importing countries resorted to such departures, which consisted of (i) reductions in quotas compared to their previous levels or actual trade, (ii) growth rates of less than 6 per cent for cases which would not have been justified before the inclusion of the clause, and (iii) the lifting of, or reduction in, flexibility provisions. Despite provisions for special treatment, textile and clothing exports from small suppliers were also subject to restraints on grounds of "cumulative" market disruption.

29. MFA III, which came into effect 1 January 1981, in some ways reverted to the situation before the "reasonable departures" clause. It affirmed support for the discipline of annex A of the Arrangement and the provisions regarding base levels, growth rates, and flexibility to be accorded to exporting countries. A Sub-Committee of the GATT Textiles Committee was established to monitor structural adjustment policies to be undertaken in the textile and clothing industries of the importing countries. However, MFA III marked the increasingly frequent recourse to Article 4 of the MFA, which allows the negotiation of "mutually acceptable" agreements intended to eliminate real "risks" of market disruption in importing countries.

30. Table D.8 examines the bilateral agreements of the United States and EEC with selected MFA exporters during MFA II and MFA III. In the case of EEC, product and country coverage had increased substantially from MFA I to MFA II. During the latter period the Community invoked the "reasonable departures" clause to cut back the quotas of several suppliers, and growth rates for the most sensitive categories (eight products comprising Group I) were greatly reduced. During MFA III, the country coverage of restraints remained similar to that in the preceding period and the number of restrained products declined slightly from MFA II.

31. With a few exceptions, growth rates of imports were significantly

Table D.8

Voluntary restraints on trade: the case of textiles and clothing *a/*

Selected MFA exporters	Products	European Economic Community: Number of categories subject to specific restraints		European Economic Community: Average annual import growth (%) provided under:		United States: Number of categories subject to specific restraints		United States: Average annual import growth (%) provided under:	
		MFA II	MFA III	MFA II	MFA III	MFA II	MFA III	MFA II	MFA III
Hong Kong	Textiles	9	6	3.4	1.9	3	1	3.9	1.5
	Clothing	35	35	3.7	2.2	39	32	3.8 (1.0)	0.7 (0.5)
Rep. of Korea	Textiles	14	14	4.6	3.3	2	4	5.0	4.1
	Clothing	31	32	4.2	2.5	30	35	5.1 (1.0)	2.4 (0.5)
China	Textiles	5	4	4.2	..	1	3	.	6.1
	Clothing	7	6	2.5	..	14	31	17.6 (1.0)	3.1 (1.0)
India	Textiles	3	3	3.8	3.8	-	1	.	7.0
	Clothing	10	11	3.2	3.6	7	9	4.1	5.0
Brazil	Textiles	5	6	3.4	2.6	9	3	7.0	7.0
	Clothing	7	5	4.4	2.4	8	-	7.0	.
Singapore	Textiles	3	3	3.6	1.8	-	2	.	5.0
	Clothing	13	9	3.5	2.6	18	18	4.8 (1.0)	4.8 (1.0)
Colombia	Textiles	3	2	0.5	0.3	1	1	7.0	7.0
	Clothing	-	-	.	.	4	4	7.0 (1.0)	7.0 (1.0)
Mexico	Textiles	1	1	0.5	0.1	-	-	.	.
	Clothing	-	-	.	.	14	14	7.0	7.0
Haiti	Textiles	-	-	.	.	-	-	.	.
	Clothing	-	-	.	.	6	9	7.0	7.0
Sri Lanka	Textiles	-	-	.	.	-	-	.	.
	Clothing	3	4	2.5	2.9	9	17	7.0	6.0

Source: Derived from *Accords Textiles CEE* (Promethee, Brussels) and *Status Reports on Import Quotas*, United States Customs Service.

Note: MFA II = 1978-1981.
MFA III = 1982-1986.

a/ Textiles include yarns, fabrics, made-up and miscellaneous non-apparel articles. Percentages for clothing in brackets refer to wool categories.

reduced. The use of simple average annual growth rates disguises the relatively greater reductions in growth rates in the most sensitive categories in which the developing countries by definition tend to be more competitive.

32. In the case of the United States there has been a trend away from control of the textiles and clothing trade as a whole in favour of quotas for specific categories. Except for a few supplier countries, the bulk of restrictions has been on clothing items, and the increase in product coverage from MFA II to MFA III has reinforced the trend. Average annual growth rates for East Asian suppliers were cut drastically during the same period and growth rates for wool products have remained as low as 1 per cent or even less.

IV. DISCRIMINATION AND THE PATTERNS OF PROTECTION

33. One important adverse consequence of the increased reliance on non-tariff protection is that many forms of NTBs can be applied in a differential (discriminatory) manner among countries and products. Country-specific import quotas, "voluntary" export restraints, prohibitions and embargoes, and special licensing arrangements are among a number of non-tariff measures that are either directed at, or can be used against, specific countries or groups of countries. In contrast, under the MFN provisions of GATT, all contracting parties are to receive, at least in principle, equal treatment as far as the imposition of import duties is concerned.[19] While exceptions have been made, one of the more important being the adoption of preferential rates in favour of the developing countries, MFN treatment is held to be one of the cornerstones of the General Agreement.

34. While the analyses must still be considered preliminary, there is some empirical support for the proposition that non-tariff measures are applied in a way that discriminates against trade in processed goods, particularly those which are of special export interest to the developing countries. As an illustration, table D.9 employs a processing chain framework (i.e., a classification scheme that traces a given commodity through successively higher stages of processing) to examine the application of volume-restraining non-tariff measures in developed market-economy countries. It shows the percentage of four-digit CCCN products affected by non-tariff barriers out of the total number of such products in the group (i.e., the NTB frequency ratios). For purposes of comparison, the average pre- and post-Tokyo tariffs applied to the goods at different levels of fabrication are shown. Finally, the table also indicates the four-digit CCCN products which fall within each processing stage.

35. As far as the behaviour of tariffs is concerned, the table provides ample evidence of "escalation" in practically all of the processing chains. As an illustration, exports of fresh vegetables and fruit to the industrial countries face post-Tokyo average tariffs of 8.9 per cent and 4.8 per cent, respectively, while exports of processed (prepared) forms of these pro-

[19] However, even within the principle of MFN treatment, it has been shown that in industrialized countries tariffs still have adverse differential effects on developing countries. First, it has been demonstrated that tariffs on products of special export interest to developing countries tended to get reduced far less than other items in the previous multilateral trade negotiations. In addition, the structure of tariffs has been shown to increase or escalate with the level of fabrication, and this produces an important disincentive to the domestic processing of natural resources in developing countries. (UNCTAD, *The Kennedy Round Estimated Effects on Tariff Barriers* (TD/6/Rev.1), United Nations publication, Sales No. E.68.II.D.12.) It has also been shown that the industrial country-specific tariffs (i.e., import duties which are expressed as a fixed charge per unit of imports) generally have a far greater *ad valorem* incidence on developing country exports, due to the tendency for these shipments to have lower unit values. It is also widely recognized that tariff line classifications can be defined by importers in a way that discriminates against particular countries or products.

Table D.9

Escalation of non-tariff barriers and tariff protection in industrial countries
(Percentage)

Product	Processing stage	CCCN	Average applied tariff		NTB coverage ratio
			Pre-Tokyo	Post-Tokyo	
Meat	fresh	0201-04,06	8.1	6.8	49
	prepared	1601-03	15.8	21.7	43
Fish	fresh	0301-03	4.3	3.5	35
	prepared	1604-05	6.1	5.5	31
Vegetables	fresh	0701-03,05,06 1204-06,08	13.3	8.9	39
	processed	0704,1103-06,1904, 2001-02	18.8	12.4	48
Fruit	fresh	0801-09,0812	6.0	4.8	20
	processed	0810,11,13,2003-07	17.0	14.4	54
Coffee	green, roasted	0901	10.0	6.8	11
	extracts	2102	13.3	9.4	17
Oils	oil seeds	1201	2.7	2.7	33
	oils	1507	8.5	8.1	56
Sugar	raw	1701	14.0	14.0	78
	processed	1701,03,04,05	10.9	9.9	56
Cocoa	beans processed	1801	1.8	1.0	-
	chocolate	1803-06	9.6	9.2	14
Tobacco	unmanufactured	2401	56.1	55.8	11
	manufactured	2402	82.2	81.8	22
Rubber	natural	4001	2.8	2.3	-
	processed	4005-09,15	4.6	2.9	6
	rubber articles	4010-14,16	7.9	6.7	14
Leather	hides, skins	4101	1.4	-	-
	leather	4102-08,10	4.2	4.2	13
	leather articles	4201-05,6401-06	9.8	9.2	26
Wood	rough	4403-04	2.6	1.8	6
	simply worked	4405-07,13	8.7	6.5	9
	manufactured	4408-12,14-28	8.1	6.6	12
Paper	pulpwood	4403	-	-	6
	papermaking mat	4701-02	1.6	0.7	-
	paper products	4801-21	9.0	5.8	8
Wool	raw	5301	3.7	1.5	-
	carded, combed	5305	3.7	1.5	44
	yarn	5306,07,10	11.0	17.6	57
	woven fabrics	5311	24.1	21.5	72

For source see end of table.

Table D.9 (cont'd)

Escalation of non-tariff barriers and tariff protection in industrial countries

Product	Processing stage	CCCN	Average applied tariff		NTB coverage ratio
			Pre-Tokyo	Post-Tokyo	
Cotton	raw	5501	1.1	0.6	6
	carded, combed	5504	6.6	6.0	44
	yarn	5505,06	9.8	7.4	61
	woven fabrics	5507-09	17.6	11.4	57
Jute	raw	5703	4.0	2.9	-
	fabrics	5710	5.6	4.7	33
	sacks	6203	9.1	8.3	44
Sisal	fibres	5704	-	-	-
	cordage	5904-06	8.9	7.2	56
Metallic ores		2601	0.2	0.1	17
Iron,steel	semi-processed	7301,02,04,05	3.6	3.4	10
	processed	7306-18	6.7	5.6	23
Copper	unwrought	7401-02	2.4	1.9	3
	wrought	7403-08	9.9	5.1	3
Aluminium	unwrought	7601	6.5	5.8	39
	wrought	7602-06	11.2	9.7	16
Lead	unwrought	7801	4.2	3.7	6
	wrought	7802-05	9.2	7.2	6
Zinc	unwrought	7901	3.1	3.0	22
	wrought	7902-04	7.4	4.9	9
Tin	unwrought	8001	-	-	-
	wrought	8002-05	5.9	3.6	-
Phosphates	natural	2510	-	-	-
	phosphoric acids	2810	8.2	5.9	-
	superphosphates	3108	2.3	2.3	6

Source: UNCTAD Data Base on Non-tariff Measures.

ducts encounter considerably higher tariffs (12.4 per cent and 14.4 per cent). The general tendency of tariffs to be higher (i.e., to escalate) for processed goods imports has been widely interpreted as having a bias against trade in the goods in processed-form of products.[20] As may be seen from table D.9, tariff escalation is evident in practically all of the processing chains, with a few isolated exceptions.[21]

36. When examined in the processing chain framework, there is evidence that non-tariff barriers are also applied in a way that discriminates against trade in processed commodities. As an illustration, non-tariff restrictions are applied to 20 per cent of the four-digit CCCN products classified as fresh fruit, while 54 per cent of the preserved fruit products face similar measures. In the case of fresh vegetables, 39 per cent of these products face NTBs, while the corresponding share for processed products is almost 10 percentage points higher. For the 24 processing chains listed in table D.9 the proportion of processed products covered by non-tariff restrictions is as high, or higher than, the primary (unprocessed) stage for three-quarters of the cases. Such evidence suggests, in no uncertain manner, that non-tariff measures (as well as tariffs) are employed in a manner that discriminates against trade in processed goods.[22]

37. Further evidence concerning the discriminatory application of non-tariff barriers against both products and countries is presented in table D.10, which shows the shares of selected developed countries' 1980 imports that are subject to non-tariff barriers. This information is presented separately for agricultural and manufactured goods in order to illustrate the differential application of NTBs to the two categories of products. The data are also shown for selected regional groups of countries in order to assess the incidence of NTBs on different exporters.

38. A key point to emerge from table D.10 concerns the differential (discriminatory) application of NTBs to agricultural products in all of the selected developed country markets. As can be seen, the share of these imports facing non-tariff measures is higher than that for manufactures in every instance, with the exception of the United States, and in some countries the differences is as much as 30 percentage points or more. As an illustration, Austria and Japan apply NTBs to between 5 and 6 per cent of total manufactures imports, while the corresponding coverage ratio for agricultural imports is over 40 per cent in both countries. Similarly, Norway applies non-tariff measures to almost 6 per cent of imported manufactures and 23.5 per cent of agricultural products. However, the greatest divergence occurs for Switzerland, where 13.4 per cent of all manufactured goods are subject to NTBs, while the corresponding

---

[20] The importance that developing countries attach to tariff escalation is highlighted by the fact that this was one of the major issues these countries stressed in the November 1982 GATT ministerial meeting. However, recent studies have shown that even in cases where tariffs do not increase over stages of a processing chain, there may be an important bias against trade in processed goods because generally higher import demand elasticities exist in industrial countries for processed goods and, as a result, these goods are more sensitive to changes in tariffs (or NTBs) than primary products. Consequently, a given (say, 10 per cent) tariff will have a greater restraining effect on processed than primary commodities. (See UNCTAD, TD/B/981 (Part I), *op. cit.*, chapter II, C, for a further discussion).

[21] Balassa has argued that in cases where tariffs do not continually escalate, other forms of protection, such as technological protection, are being substituted. In other words, tariffs need not continually increase for some sophisticated processed goods, due to the fact that developing countries do not have the capacity to produce such items. (See *The Kennedy Round Estimated Effects on Tariff Barriers*, part two.)

[22] The difficulty in interpreting these figures is that they merely indicate the frequency of application of NTBs, but do not provide sufficient information for assessing the *ad valorem* incidence of these measures. While there may be a presumption that a relation exists between frequency of application and restrictiveness, there is no hard evidence.

TABLE D.10

SHARE OF SELECTED DEVELOPED MARKET-ECONOMY COUNTRIES' 1980 IMPORTS OF AGRICULTURAL AND MANUFACTURED PRODUCTS SUBJECT TO NON-TARIFF BARRIERS (BY MAJOR GROUPS OF EXPORTERS)

Importers	Agricultural products a/							Manufactured products b/						
Exporters	USA	Japan	EEC	Switzerland	Sweden	Norway	Austria	USA	Japan	EEC	Switzerland	Sweden	Norway	Austria
Developing countries of which in:	19.6	71.4	39.8	74.4	60.7	10.9	47.0	21.8	4.0	32.0	12.5	34.5	23.9	10.9
America	22.3	75.2	46.2	74.6	78.3	12.9	59.7	9.8	0.8	18.6	2.4	8.9	9.2	9.8
Africa	15.7	67.3	36.7	87.2	35.6	0.9	35.9	4.1	0.6	23.6	4.3	3.3	84.3	0.1
Asia and Pacific	14.3	70.8	9.9	59.9	1.6	8.7	18.0	30.8	5.4	32.7	17.3	45.4	32.3	12.5
Socialist countries of Eastern Europe	7.0	66.2	42.0	80.0	31.6	38.0	44.8	12.2	2.3	30.3	17.4	5.3	35.3	2.2
Socialist countries of Asia	32.9	42.2	36.6	31.8	0.5	30.6	10.4	50.7	7.6	30.4	14.5	12.2	7.1	4.9
Developed market-economy countries	10.1	41.4	41.2	69.5	10.1	27.2	38.5	7.6	8.7	18.7	13.3	4.8	4.3	4.9
TOTAL	15.9	49.6	40.9	70.3	23.4	23.5	41.0	10.2	7.0	20.6	13.4	6.0	5.5	5.0

Source: See note a/ to table 14 of the main text.

a/ CCCN 0101-2402.
b/ CCCN 2801-9906.

proportion for agricultural imports is some 57 percentage points higher. Clearly such statistics reflect the discriminatory application of non-tariff barriers against agricultural products in all of these industrial markets.[23]

39. A second major point reflected in table D.10 is that the existing pattern of NTB application appears to discriminate against specific groups of countries, as well as among products. As an example, all of the industrial countries (excluding Japan) have a higher-than-average NTB coverage ratio for exports of manufactures from developing countries in Asia, with the share of imports affected in Sweden and Norway being at least six times the overall average for these countries' total imports from that region. With regard to agricultural trade, the barriers appear to bear heavily on exports from the socialist countries of Eastern Europe, since their products encounter NTBs with a higher-than-average frequency in all markets except the United States. The non-tariff measures also appear to fall particularly severely on agricultural exports from the countries of Latin America. For example, in Sweden slightly over one-quarter of total agricultural imports are subject to NTBs, whereas over three-quarters (78.3 per cent) of the exports from Latin American countries encounter such barriers.

40. The previous examples relate to the general application of non-tariff barriers in a differential and discriminatory fashion against specific groups of countries. However, in compiling its UNCTAD Inventory of Non-tariff Measures, the UNCTAD secretariat has found that numerous trade interventions, such as bilateral quotas, country-specific prohibitions, seasonal restrictions on agricultural imports, surveillance schemes, and discriminatory licensing systems are measures applied (or which can be applied) in a differential (adverse) manner to specific countries or groups of countries.[24] The fact that such discriminatory trade interventions exist and appear to be proliferating increasingly threatens to undermine accepted (GATT) principles for the conduct of international trade.

V. NATIONAL OBJECTIVES OF TRADE INTERVENTION MEASURES

41. In assessing the empirical and other information relating to trade intervention measures, perhaps one of the most important points to be borne in mind is that countries without a natural comparative advantage in some areas of production (particularly agriculture) nevertheless seek to maintain domestic production at a level higher than would exist under free trade. National security may be one reason for such an approach (again, particularly in the agricultural sector). Another is the argument advanced by governments that in certain sectors like textiles and steel intervention is necessary to allow the industries time to undertake appropriate structural adjustment measures. Unfortunately, in these cases there appears to be a tendency for the protectionist measures to become institutionalized and for the needed structural reforms not to be implemented.

42. A second important point is that the specific national policies adopted to achieve certain goals are often far from optimal from either a national or an international standpoint. In part,

---

[23] Although the United States also applies NTBs to a higher proportion (15.1 per cent) of agricultural imports than manufactures (6.7 per cent), the degree of discrimination is obviously far smaller than for the other developed market-economy countries. Also, the extent of non-tariff barrier application on agricultural imports is far smaller in the United States, being less than half the average (42 per cent) for the other countries listed in the table.

[24] See UNCTAD, *op. cit.* (TD/B/940), for details relating to the construction of the Inventory. It should also be recognized that certain institutionalized arrangements, like the Multifibre Arrangement, specifically discriminate against the exports of developing countries. (See Vincent Cable, "An Evaluation of the Multifibre Arrangement and Negotiating Options", *Commonwealth Economic Papers No. 15* (London: Commonwealth Secretariat, 1982.)

this may be due to a failure to consider international responsibilities when adopting national policies, but it may also be due to a failure to adopt domestic policies that have clear and consistent long-term objectives. In other words, the present interventionist policies of some countries may be viewed in varying degrees as a collection of *ad hoc* measures designed to meet short-term problems, often at odds with longer-term national objectives.

43. In a number of important industrial and agricultural sectors it is apparent that the interventionist policies presently being pursued are not the most appropriate as soon as one considers some of their serious adverse effects on the international community. These include: (i) greater instability in world markets, particularly for agricultural products; (ii) welfare losses due to misallocation of both domestic and international resources; (iii) displacement of traditional suppliers in third markets; (iv) adverse price and consumption effects in both producing and consuming countries; and (v) lower prices and foreign-exchange earnings for exporters of the affected goods. Apart from these effects, it is becoming increasingly clear that present protectionist policies are not serving the needs of the highly protected countries themselves, given the increasingly onerous financial burden of maintaining such support programmes.[25]

44. A key question is whether the different objectives of the various countries could be better met through the use of a more efficient set of policies than the sum of those adopted in isolation by each country. If, for example, the importing country's aim is to provide a specific level of protection for domestic producers, the selection of a nominal or specific tariff would be preferable to the use of a variable levy. However, there is little evidence that countries have considered the international implications of their trade intervention practices, or alternatives open to them, when applying different measures.

45. In terms of international economic efficiency or welfare effects, some trade intervention measures are generally acknowledged to be less harmful than others. For example, with a tariff, the domestic and world prices cannot differ by more than the amount of the duty. Domestic producers can scarcely raise prices above the level of the world price plus the duty, since more would then be imported. An additional factor is that, under a fixed, legally-bound tariff, foreign producers may be gradually able to overcome the cost disadvantages imposed by the duty through increased efficiency. However, under a quota or variable levy, this would not be possible. With a bound tariff, the quantity of imports is strictly limited, irrespective of the competitiveness of foreign producers, while under a variable levy, any increase in efficiency, reflected in lower prices, would be offset by a corresponding increase of the levy. Thus, these non-tariff measures are generally held to be much greater impediments

[25] For a concise summary of the findings of studies which have examined the adverse effects of current protectionist practices, see table D.1 of this annex. Concerning the costs associated with maintaining some of the inefficient protectionism and support programmes, the observations of the late Finn Olav Gundelach, Vice-President of the Commission of the European Communities, are particularly revealing in the area of agricultural policy. "We are conducting an effective export policy, going to the utmost limits of what the European taxpayer is willing to pay - and in the case of butter and sugar, beyond them. . . . (Of the) Community's total expenditure, some 70 per cent is currently accounted for by agriculture, and of that amount 42 per cent by the dairy sector alone . . . Does anybody really believe that more money can be raised from taxpayers in order to stock more than 400,000 tons of butter we already have in stock, or to export more than three million tonnes of sugar we are exporting with restitutions higher than its value? Can any Prime Minister or Minister of Finance explain away the necessity of chalking up more billions of ECUs in order to finance operations of this kind? The answer is pretty obvious." (See Finn Olav Gundelach, "Prospects for the Common Agricultural Policy in the World Context", in College of Europe, *Prospects for Agriculture in the European Economic Community* (Bruges: College of Europe, 1979).)

to changes in the structure of trade and production than fixed and legally-bound tariffs. It follows that, if governments wish to promote positive structural adjustment, the types of trade intervention measures applied will influence their success. It has also been recognized that there are different costs associated with different types of trade barriers, in terms of market instability and economic efficiency in both domestic and international markets. In selecting appropriate policies, governments should seek to attain their stated objectives taking fully into account the international implications of their policies.

كيفية الحصول على منشورات الامم المتحدة

يمكن الحصول على منشورات الامم المتحدة من المكتبات ودور التوزيع في جميع انحاء العالم · استعلم عنها من المكتبة التي تتعامل معها أو اكتب الى الامم المتحدة ،قسم البيع في نيويورك او في جنيف ·

如何购取联合国出版物

联合国出版物在全世界各地的书店和经售处均有发售。请向书店询问或写信到纽约或日内瓦的联合国销售组。

HOW TO OBTAIN UNITED NATIONS PUBLICATIONS

United Nations publications may be obtained from bookstores and distributors throughout the world. Consult your bookstore or write to: United Nations, Sales Section, New York or Geneva.

COMMENT SE PROCURER LES PUBLICATIONS DES *NATIONS UNIES*

Les publications des Nations Unies sont en vente dans les librairies et les agences dépositaires du monde entier. Informez-vous auprès de votre libraire ou adressez-vous à · Nations Unies, Section des ventes, New York ou Genève.

КАК ПОЛУЧИТЬ ИЗДАНИЯ ОРГАНИЗАЦИИ ОБЪЕДИНЕННЫХ НАЦИЙ

Издания Организации Объединенных Наций можно купить в книжных магазинах и агентствах во всех районах мира. Наводите справки об изданиях в вашем книжном магазине или пишите по адресу: Организация Объединенных Наций, Секция по продаже изданий, Нью-Йорк или Женева.

COMO CONSEGUIR PUBLICACIONES DE LAS NACIONES UNIDAS

Las publicaciones de las Naciones Unidas están en venta en librerías y casas distribuidoras en todas partes del mundo. Consulte a su librero o diríjase a: Naciones Unidas, Sección de Ventas, Nueva York o Ginebra.

Printed in Switzerland
GE.85-50148–February 1985–4,445

ISBN 92-1-112181-7

01800P

United Nations publication
Sales No. E.84.II.D.23

UNCTAD/TDR/4/Rev.1