DEVELOPING COUNTRIES IN THE INTERNATIONAL ECONOMIC SYSTEM: THEIR PROBLEMS AND PROSPECTS IN THE MARKETS FOR FINANCE, COMMODITIES, MANUFACTURES AND SERVICES

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Preface

The four essays in this publication were prepared in response to the request by Dr. Mahbub ul Haq, Special Adviser to the Administrator of the United Nations Development Programme. He asked that I prepare an analysis of the operation of the international economic system as it affects the developing countries, as a background for UNDP's *Human Development Report 1992*. Dr. Haq's specific question was: how efficient and equitable are the functionings of the present markets in commodities, manufactures, services and finance?

These are issues on which I have spent much of my working life, and I welcomed this opportunity to set out both the results of my earlier work and thinking, and the findings of the research specifically undertaken to throw light on the latest facts and ideas in these areas.

Three major impressions have emerged. First, developing countries have suffered and are now suffering from an enormous deterioration of their terms of trade. Their export commodity prices in real terms are lower than at any time in the last 10, 40 and 120

years. Their export prices of manufactures also are falling in relation to the manufactures they import during the last decade. This deterioration is at least partly responsible for the great fall in real wages which developing countries have been experiencing. Secondly, despite these price and income developments, developing countries have managed to achieve an advance in industrialization which was not considered possible by almost all observers several decades ago. These countries have left a major mark on international trade in manufactures, and a number of them have established efficient industries in many fields. Thirdly, most international markets remain dominated by the financial power of developed countries. This power concentration results in a lack of bargaining strength of developing countries in commodity markets, services markets and partly manufactures.

The work on these essays was completed at the end of November 1991. For purposes of the present publication, I have updated the material to April 1992, where relevant.

I owe much gratitude to colleagues and friends in international institutions dealing with issues of commodities, trade and development, and finance. All errors are mine.

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Part I: International, Financial Market, Poor Countries, and Poor People

A. INTRODUCTION

This chapter discusses the position of developing countries in world financial markets. The majority of these countries buy finance abroad: for investment in fixed and working capital; for financing a part of current expenditures in some cases: and for meeting shortfalls in external receipts, which frequently occur for reasons beyond their control.

The following section reviews the costs of international borrowing: after a period in the 1970s in which this costs was below the rate of price increases, leading to negative interest rates and excessive borrowing, it rose sharply in the 1980s to a level without precedent in the last hundred years. The increase affected particularly severely the debtor developing countries dependent heavily on export of primary products, whose prices fell simultaneously with the rise in the international rate of interest. The third section considers fluctuations in the volume of international market lending: this reached an unsustainable peak in the early 1980s, to be followed by a precipitous fall which pushed a large number of debtor countries into deflation and stagnation lasting a decade. This market failure affected both the countries which had borrowed excessively and some of those which had not. This section also reviews the emerging resumption of voluntary capital inflow into Latin America and the factors which are influencing it. The fourth

section focuses on the activities of international financial institutions in meeting the needs of developing countries in the face of market fluctuations and collapse. These institutions filled a part of the needs in the early part of the debt crisis: but in the largest of them debt service reflows exceeded cash outflow as the 1980s progressed and they are now absorbing cash net from developing countries. This issue and the issue of loan conditionality are among the central in North-South economic relations. The fifth section examines the international management of the debt problem, particularly as it has affected the Sub-Saharan Africa and Latin America, the main debtor regions of the 1980s. Some recent proposals for handling the debt problem are also reviewed. The last section discusses foreign private investment in developing countries: direct investment which has only now recovered from the debt and commodity shocks of the 1980s and which is heavily concentrated in some ten developing countries, although it also plays a considerable role in some smaller economies in view of its relative size, particularly in mining development, but has almost completely bypassed the least developed countries: portfolio investment in share (stock) markets of a limited number of developing countries, which has risen sharply in recent years in the expectation of high profits form price appreciation; and the rates of return on private investment projects supported by International Finance Corporation, an affiliate of the World Bank. Questions are raised concerning sustainability of recent high returns in developing country stock markets and of interest rates currently charged in the international capital market on borrowings by developing countries.

Financial markets are generally considered efficient: funds move quickly from one placement to another in response to small changes in interest rates and security prices. The U.S. Government securities market -- a very important segment of the aggregate world financial market in view of the size of U.S. Government debt and many foreign holders of portions of it -- has been widely considered as the single most efficient market in this generally efficient industry, as reflected in razor-thin "spreads" or gaps between bid and asked prices. Government officials have claimed for years that this market is simply too big to be easily manipulated by a single participant.[1] And yet, the events of the summer 1991 have shown that this is not true even for this market, as a major investment firm managed to buy large quantities of U.S. Government obligations and then fix their prices, on a number of occasions.

In the international financial market where developing countries have to borrow, inefficiencies abound, as shown in enormous price fluctuations over the short-term, in cycles of excessive lending and withdrawal from markets over the medium and long-term and in frequent arbitrary determination of prices and access to markets available to individual borrowers. This market can also be unfair, as shown in the recent experience: debt capital finance moved from the South to the North for years in the last decade, to reach a staggering cumulative sum of US $ 176 billion in 1984-90.[2] The former President of the Bundesbank, Dr. Karl Otto Poehl, called it a "net resource transfer in the wrong direction."[3].

B. INTERNATIONAL INTEREST RATES

Growing fluctuations and rising trend in real terms

The following two charts show both the growing amplitude of fluctuations in interest rates over time and their upward trend in real terms. Chart 1. refers to the London Inter-Bank Offer Rate, a standard used as a basis for fixing international interest rates over the short term; for individual borrowers a margin is added to reflect a specific country risk; and in all cases interest rates differ depending on the length of maturities. Chart 2 shows the average real long-term government bond yield in the Group of Seven (U.S., Japan, Germany, U.K., France, Italy and Canada). Table I below gives the specific data on individual country long-term bond yields over the last 100 years.

Chart I: Real and nominal LIBOR, 1950-90 - not yet available
Chart 2. Group of 7: Real interest rates - not yet available

Table I. Long-term real interest rates in selected industrial countries, for selected years, 1890-1989
(percent)

Country	1890-99	1990-13	1955-59	1960-73	1974-79	1980-84	1985-89
France	3.6a	2.0a	0.3	1.4	-0.9	3.1	5.1
Germany, Fed. Rep.	--	--	3.9	2.7	2.8	4.8	4.0
Italy	--	--	4.0	1.5	-3.7	1.9	3.6
Japan	--	--	--	0.5	-0.2	5.7	3.9
United Kingdom	2.6 b	2.0 b	1.3	2.5	2.1	2.7	4.1
United States	4.5 c	1.7c	0.8	1.5	0.3	5.4	5.4

Note: Long-term real interest rates are calculated by dividing long-term government bond yields by the GDP deflator.
a. Government stock, b. Consols., c. New England municipal bonds.
Source: World Bank data.

Interest rates in real terms in the 1980s and early 1990s were more than double the level that prevailed in most of the period for which data are available. In the eloquent phrase of Chancellor Helmut Schmidt in 1983, interest rates had reached a point higher than at any time since Jesus Christ.

Impact on developing countries

Increases in international interest rates are transmitted to the debtors in developing countries on an expanded scale as other related charges pile up, mainly on the ground of protection of the intermediary institutions against developing country risk. In Mauritius, a country with relative monetary stability, the effective domestic rate paid by the sugar industry on foreign borrowing, based on LIBOR of 10 percent per annum, worked out at 18.5 percent per annum in early 1983; with LIBOR at 14.5 percent, it amounted to 23.3. percent. The domestic interest cost went up on account of the "country (borrower) risk" of 2.5 percent above LIBOR, premium for expected currency depreciation of 6 percent, and banking charges. 4 In 1983 in Latin America, where devaluations were much larger,

"the effect on the individual private sector, which in [some] cases had been encouraged by the policies of the authorities to borrow, has been devastating:....the amount needed in local currency to service external debt has increased three or four times" in one year. 5 In the estimates of the Institute of International Finance Inc., Washington, D.C., each one percentage point change in the international interest rate used to change the amount of interest payments of developing countries by US$ 3-4 billion per year in the late 1980s. The effect is now smaller as a part of the debt has been shifted from a floating rate to a fixed rate basis. Nonetheless, the effect is still formidable.

The real interest rates shown in Charts 1 and 2 and Table I are calculated by deducting the increase in domestic prices of developed creditor countries from their nominal rate of interest. For developing debtor countries, the relevant real interest rate on their foreign debt is the nominal (money) interest rate adjusted by the rate of change in their dollar export prices. When these prices fall, more goods must be sold to pay the interest due which is fixed in money terms, i.e. the real rate of interest increases. As developing country export prices have been generally falling in the postwar period, the real interest rates they have been paying have been higher than the nominal rates stipulated in their debt contracts. During the commodity price slump in the first half of the 1980s, the average real rate these countries were paying amounted to close to 17 percent per year (Table II).

Table II. Real interest rates paid by selected major debtors, 1980-85

	1982	1983	1984	1985	Average
Argentina	26.3	23.8	11.3	11.6	18.25
Brazil	22.2	19.6	12.6	12.0	16.00
Chile	33.8	8.9	21.6	8.4	18.20
Mexico	27.4	16.9	9.9	15.0	17.30
Nigeria	25.9	25.4	11.5	18.2	20.25
South Korea	14.0	12.5	5.8	7.1	9.90
Average	24.9	17.8	12.3	12.3	16.73

Note:Real rates are nominal (money) rates adjusted by the country's export price index.
Source: Dragoslav Avramovic, Developing Country Debts in the Mid-1980s: Facts, Theory and Policy, in Policies for Development, ed. by Sidney Dell, Macmillan Press, 1988.

These rates are more than three times higher than the rates experienced by developed countries in the same period.

Prospects for future level of interest rates

The World Bank, in a 1991 staff study, believes that "there is a significant probability that real interest rates will remain relatively high in the 1990s because of several new or continuing claims on the world's resources that will maintain upward pressure on interest rates. Among these are the costs of German reunification, the continuing claims of the

U.S. budget deficit, the need to strengthen the capital base of the U.S. and Japanese bank, the social and physical needs of Eastern Europe, the postwar reconstruction of Kuwait and Iraq, and the creation of a single internal market in Europe by 1992." 6

The record of interest rate forecasting has been generally poor. Nobody expected that interest rates in the U.S. today, on 8 October 1991, would amount to 5.12% (Federal Funds, short-term) and 7.7% (30 years U.S. Treasury bond), compared to 8% and 9.05% respectively, a year ago. It is the present recession in the U.S. which has driven down the interest rates and overwhelmed the forces discussed in the World Bank analysis. The benefits to developing countries of the decline in U.s. rates have been offset to a considerable degree through the renewed fall in commodity prices since mid-1989, and though interest rate increases in Germany and Japan.

From the long-run viewpoint, the crucial question is whether the profitability of investment in the leading developed countries has increased to a degree that it has pulled up the demand for real capital and the real rate of interest, and whether these factors will continue to operate in the future. OECD has estimated rates of return on capital stock in major industrial countries for the period 1975-1990, and this indicates a moderate increase in profitability (Table III).

Table III. Rate of return on nonresidential capital stock in major industrial economies, 1975-90
(profit income as a percentage of capital stock)

Economy or group of economies	1975-79	1980-87	1987	1988	1989	1990
United States	17.0	16.8	18.7	19.3	20.0	19.8
Japan	14.9	14.5	15.0	15.2	15.2	14.9
Germany, Fed. Rep.	13.8	13.5	14.6	15.2	15.6	15.8
G-7	14.8	14.7	16.0	16.5	16.8	16.7

Note: The measure of return to capital is taken as the difference between value added at factor cost and compensation of employees (the gross operating surplus of enterprises). The capital stock is adjusted for inflation and covers only assets included in nonresidential gross fixed capital formation and hence excludes dwellings, inventories, monetary working capital, land, and natural resources.
Source: OECD (1990).

But the computation excludes land, natural resources, inventories and monetary working capital, and it is not clear how this affects the profit rate: if prices of the excluded items have increased faster than the general price level, the increase in profitability has been less than shown or non-existent. The U.S. Department of Commerce collects data on rates of return in U.S. corporations. The series on 500 largest corporations shows an increase in profitability since 1970, although some indicators do not present a clear picture (Table IV).

Table IV. 500 U.S. Largest Industrial Corporations -- Selected Financial Items: 1970-88

	1970	1980	1981	1982	1983	1984	1985	1986	1987	1988
Return on stockholders' equity, percent	9.5	14.1	13.6	10.9	10.7	13.6	11.6	11.6	14.4	16.2
Return on sales, percent	3.9	4.5	4.3	3.6	3.8	4.5	3.9	4.1	5.1	5.5
Total return to investors (*), percent	6.5	21.6	1.4	21.2	30.2	-0.8	26.3	15.1	6.6	14.1

Note:(*) Includes both price appreciation and dividend yield, i.e. to an investor in the company's stock.
Source: U.S. Department of Commerce, Statistical Abstract 1990.

Further work is needed in this area. If it is confirmed that an increase in profitability has taken place in developed countries, an important question is whether it is primarily due to productivity growth through accelerated technological advance or to reduction in real wages and in prices of inputs (energy and raw materials) many of which are imported; such reduction has taken place in wages in some countries and in inputs, and it is in principle reversible at least to some degree. If irreversible factors are at work, the implications would be far-reaching: further flight of capital from developing to developed countries and continuing and perhaps accelerated migration of both skilled and unskilled labour, unless massive public investment and a sharp and sustained increase in profitability takes place in developing countries on a broad scale.

Coping with fluctuations

Fluctuations in interest rates can be moderated through policy actions of leading countries. This calls for international macro-economic coordination and for readiness to restore regulation of interest rates if necessary. An effective coordination in this field is unlikely to be possible without readiness of stabilize exchange rates; and restoration of regulation calls for a reversal of some elements of philosophy of economic policy which has been pursued by a number of developed country governments for a number of years. An alternative is a broad compensatory financing for debtor countries experiencing interest rate increases. At present, some financing can be obtained from the IMF through its Compensatory and Contingency Financing Facility, "provided to members pursuing economic policies supported by the Fund under stand-by or other arrangements." 7 This financing is both limited and conditional. It is paradoxical that conditionality is imposed on the victims of interest rate increases which frequently result from policies pursued by their creditors.

C. VOLUME OF LENDING

Lending cycles

Professor F.W. Taussig, writing in 1927, described the cyclical nature of lending which has operated for a long time:

"Loans from the creditor country, far from being granted at an equal annual rate, begin in modest amounts, then increase, and reach a crescendo. Usually they are granted in exceptionally large sums when a culminating phase of activity and speculative fever approaches, and during this phase they become over larger from month to month for as long as the upswing continues. With the emergence of the crisis, loans suddenly fall off

or even cease altogether. Payment of interest on old loans is not any more compensated by the granting of new ones; interest becomes the net burden for the debtor country. A sudden reversal takes place in the balance of payments of the debtor country; it feels the consequence suddenly in the form of immediate need to make remittances in favour of the creditor country, pressure on its banks, in a high discount rate, in falling commodity prices. And this sequence may occur not only once, but two or three times in a row. After the first crisis and recovery, it is possible that the debtor country will manage to get on its feet. After several years the loans from the creditor country will start flowing again, another period of activity and speculative investment takes place, the old round gets repeated, until finally another crisis comes and another sudden reversal in the debtor country's balance of payments." 8

International lending, after a large expansion in the 1920s, stopped almost completely during the Depression of the 1930s and many defaults which accompanied it. It will always be a cause for wonderment how was it possible that the same sequence, to the Taussig's crescendo, occurred in the 1970s and 1980s again, despite the universally available knowledge, much better education and still vivid experience of inter-war speculation and tragedy. Moreover, it was in some leading international financial agencies that a doctrine of "debt-led growth" was proclaimed in the late 1970s, in pursuit of a broader view that markets could make no mistake and that commercial banks knew what they were doing.

Financial transfer and its reversal, 1972-1990

Lending commitments to developing countries by the international capital market, mainly commercial banks, reached a peak of US $ 51 billion in 1981, on the eve of the eruption of the debt crisis in August 1992 when Mexico stopped paying. The market collapsed quickly thereafter. Table V sets forth the data on net transfer of funds (loan receipts minus debt service): the funds moved to developing countries until early 1980s and from developing countries to their creditors thereafter.

Table V. Net financial transfers on long-term lending 1972-90, US $ billion

Year	All developing countries	Major borrowers (a)	Year	All developing countries	Major borrowers (a)
1972	7.1	n.a	1982	20.1	11.1
1973	10.8	8.1	1983	3.7	-6.3
1974	16.7	10.5	1984	-10.2	-14.3
1975	n.a.	n.a.	1985	-20.5	-21.2
1976	21.5	n.a.	1986	-23.6	-20.0
1977	25.0	n.a.	1987	-34.0	-17.1
1978	33.2	17.2	1988	-35.2	-26.0
1979	31.2	18.8	1989	-29.6	-21.2
1980	29.5	15.1	1990 (b)	-21.7	-13.7

1981	35.9	24.8	1991 (c)	-23.4	-19.4

Notes: (a) From 1978, "severely indebted countries', (b) Revised, (c) Projected.
Sources: World Bank, World Debt Tables, 1982-83 Edition, First Supplement, for 1972, 1976 and 1977; WDT 1983-84, for 1973 and 1979; WDT 1984-85, for 1974 and 1978; WDT 1990-91, for 1980-89; and WDT 1991-92, for 1990 and 1991.

The data refer to disbursements. The latter normally lag behind commitments and therefore it took some time for the collapse of lending to be fully felt. The peak reverse flow of resources was recorded in 1988.

The collapse of capital inflow affected not only the countries which were experiencing debt servicing difficulties, but also others. According to an African Development Bank memorandum of 1988, in Africa "in particular, suppliers have become increasingly concerned about sovereign risk factors, especially the ability of governments and their central banks to make foreign exchange available to importers to meet their obligations. Furthermore, the world debt problem, associated mainly with Latin American countries, has caused the major international banks as a matter of policy, to sharply reduce their total cross border balance sheet exposure. This sharp reduction by commercial banks has hit Africa most. In several cases, e.g. Zimbabwe and Cote d'Ivoire, banks have cut credit lines which they were willing to extend previously, even though these lines were properly serviced." 9

Transfer cost

The mechanism through which reverse transfers have been extracted has frequently included devaluation of debtor country currencies significantly in excess of domestic inflation. The resulting greater profitability of export industries has led to export volume expansion and to a declining tendency for dollar export prices. Export sales have been maintained in the face of heavy competition, insufficient foreign demand, particularly for primary products, and frequent trade obstacles; a large number of primary producing countries have devalued one after another in order to be able to compete at low world prices; as demand is frequently depressed and does not respond to price cuts, the main result of devaluations in these cases has been to reduce real wages all around and further depress world prices.

During the great debate concerning payment of German reparations in the inter-war period, Keynes was of the view that debtors face the double burden: paying the debt service (budget burden) and experiencing a deterioration in their terms of trade (transfer burden). 10 This view was vindicated in the present debt crisis: the inelastic demand of the debtors for foreign exchange confronted the inelastic demand for the debtors' primary products, and the terms of trade gave in. The effect was a significant transfer of income of primary producers, which was additional to that reflected in the monetary amounts of debt service payments which they were making.

The experience of the 1980s with the transfer problem confirmed the earlier experiences:

"When credits are no longer extended to the same degree as before, cash-hungry debtors begin to liquidate inventories. Prices of many commodities begin to fall, a phenomenon long described by economists. The fall in prices makes life much harder for the debtors, because the value of the dollars owed, in terms of those commodities they are producing, is rising. It may even happen, as Irving Fischer so magnificently put it in an article published in Econometrica, 1933, first quarter, that 'the liquidation of debts cannot keep up with the fall in prices which it causes. In that case, the liquidation defeats itself. While it diminishes the numbers of dollars owed, it may not do so as fast as it increases the value of each dollar owed... Then we have the great paradox which, I submit, is the chief secret of most, if not all, great depressions: *the more debtors pay, the more they owe* (Fischer's italics.)"11

This does not mean that the depression in Latin America and Africa, the two main debtor regions, and in debtor countries elsewhere during the 1980s, was due exclusively to the debt problem or that the entire fall in commodity prices can be attributed to the transfer problem. There also were other factors at work. But the collapse of international credit, the debt problem and the terms of trade deterioration did play a major role. In the judgment of the United Nations Secretariat, "if commodity prices, including oil, had remained at their 1980 levels throughout the decade, it is likely that the debt crisis would have been averted."12 The World Bank index of real commodity prices other than oil declined 41% and oil declined 50%, between 1980 and 1990.

Human cost

Stagnation and decline in the reversal phase affected the lower income groups with a particular force. Real wages fell drastically in many countries. In Africa, non-agricultural wages fell 29 percent in 1980-86, or at 5.5 percent per year; and agricultural wages fell at 6 percent per year in the early 1980s. These declines came on top of the declines which had occurred in the 1970s, thus making them even more difficult to bear. In Latin America, average non-agricultural wages fell 17% between 1981 and 1990, or at 1.5 percent per year, minimum non-agricultural wages fell as much as 41 percent in this period (5.5 percent p.a.), and agricultural wages at 4.5% p.a. on the average in the early 1980s. Unemployment and underemployment have increased almost everywhere. Adjustment programmes have not helped:

"There was very limited attention in the first group of structural adjustment loans to the social implications of adjustment..." 13 "As the decade [of the 1980s] progressed, the impact of stabilization and certain types of structural adjustment on the most vulnerable and disadvantaged socio-economic groups became an important concern." 14 "Adjustment-induced growth is proving to be a far-off achievement, and trickle-down has

not reached the poor adequately. Because of the weight of human suffering we cannot simply sit back and wait for growth and adjustment to occur."[15]

Considerable attention is now paid to poverty problems in adjustment programmes; but its effects inevitably will be limited unless there is resumption of economic growth, increase in employment, and fairness in income distribution. These things are yet to come.

In a paper written in July 1987, I described the human situation in two key Latin American debtor countries at the peak of the debt crisis:

"Minimum wages in Brazil are now estimated to be the lowest in 37 years.[16] Unemployment is increasing sharply -- the reported unemployed have almost doubled from January to March 1987.[17] Real wages in Mexican manufacturing have been cut 50% in five years.[18] The Mexican exports, oil and non-oil, are now in a very good shape and foreign exchange reserves are up sharply; but the internal social pressures are enormous. One outlet -- illegal emigration to the United States -- is now more difficult as U.S. legislation and controls have been tightened. Horrifying stories of labour trying to cross illegally from Mexico to Texas in closed railroad cars through July heat in the desert and dying when cars get switched around, are indications of a desperate search for jobs at good wages. A Swiss newspaper has called it a Maginot line on Rio Grande."[19]

A recent report by the United Nations Economic Commission for Latin America and the Caribbean has described the current situation in the region, following the adjustment in the last decade:

"Despite the fragility still displayed by some stabilization processes, most of the economies of the region are now functioning on new foundations. They are characterized in general by the consolidation of an export-oriented approach, greater external openness, fiscal austerity, more prudent management of monetary policy, and greater reluctance to engage in public regulation of economic activity, while the international financial community, for its part, is showing some tolerance with regard to the need for leeway in economic policy. Without doubt, these new forms of operation are based on even greater inequalities in income distribution than in the past, greater precariousness of employment, tighter fiscal restrictions and even less leeway for economic policy management. All this means less capacity to make transfers between economic sectors or social strata..."[20]

Resumption of voluntary capital inflow into Latin America, 1991

It has come as a surprise that a considerable inflow of private capital seems to be taking place in Latin America in 1991. It is occurring both in countries which have achieved macro-economic stability and in those which have only recently embarked on adjustment processes or are still only groping towards them. In Argentina and Mexico,

these flows include foreign direct investment which is partly connected with the privatization of public enterprises, but there are also cases of substantial portfolio investments and even moderate sale of bonds. Further, in these and other countries, such as Chile, Colombia, Venezuela and Brazil, there have been considerable inflows of short-term capital.[21]

The key factors responsible for the resumption of capital inflow seem to be three: first, large difference between high real domestic rates of interest in these countries (partly linked to stabilization policies) and declining U.S. rates; secondly, expectations of large gains in domestic stock markets from price appreciation; and thirdly, confidence that these countries will give priority to maintaining convertibility of currencies, particularly for claims of foreign lenders and investors. Interest rates offered by Brazil have ranged from 11.66% (five year bonds) to 13.5% (two-year maturity) and by Argentina 11.3% per year (two-year bonds). U.S. interest rates for similar maturities now range from 5 to 6 percent, or one-half the rates the Latin American countries are paying. Sustainability of Latin American capital inflow depends on the ability of these countries to continue to pay high interest rates and maintain convertibility of currencies in the face of slow economic growth, latent social tensions, uncertainty concerning returns on real investment and a likely level of commodity prices, and on the feasibility of continuing low U.S. interest rates.

Note on capital flight and repatriation

It has been reported that a part of the present capital inflow into Latin America represents repatriation of capital held abroad by Latin American nationals. It is believed that capital flight was substantial, particularly from Mexico and Venezuela in Latin America, and the Philippines and some African countries, during several preceding decades. Many of the reasons for capital flight are domestic, but there is also an important reason of international nature. The upswing in interest rates in developed countries in the late 1970s and during the 1980s was a powerful stimulus for capital outflow from developing countries: for example, an interest rate in the U.S. for government securities or certificate of deposits guaranteed by the U.S. Government of 9% p.a., risk-free, was a very attractive financial proposition. Moreover, interest earnings on bank deposits, including CDs, held by non-residents were, and are, tax-free. In Switzerland, interest on investments in the Euro-market, i.e. outside Switzerland, made through Swiss banks, are also tax-free, these investments are normally more risky, in principle, than investments in Switzerland itself; but it appears that this risk can be avoided by investing in foreign affiliates of Swiss banks.

If it is true, as it seems from the recent experience, that capital does come back when the interest rate differential is heavily in favour of the developing countries where the funds originated, repatriation can be stimulated by eliminating tax privileges on earnings from deposits owned by developing country nationals.

D. INTERNATIONAL FINANCIAL INSTITUTIONS

The key international financial institutions, International Monetary Fund, the World Bank and its affiliates, and three regional development bodies -- Inter-American Development Bank Group, Asian Development Bank Group and African Development Bank Group -- have done two major things for the developing world. First, they continued and expanded their lending when the debt crisis struck in the early 1980s and thus helped absorb a part of the shock. Secondly, right from the start of their operations, in the late 1940s in the case of the Bretton Woods institutions and subsequently in the case of regional institutions as they were created, they transmitted, each in its own way, methods of analysis, implementation and monitoring of development activities important for economic advance. This included work on investment projects and sectors in the case of development finance agencies, and techniques of financial and monetary management in the case of the IMF and some of the other agencies.

Two major disappointments concern the insufficient staying power of some of them in providing finance during the debt crisis, and imposition by some of a type of conditionality which many borrowers have found difficult to accept and bear.

Supply of international liquidity

The sharp upswing in IMF assistance to developing countries took place in 1981-85, and their debt to the Fund shot up from SDRs 7,442 million (US $ 9,525 million) in 1980 to SDRs 34,776 (US $ 42,414) in 1986. This was the second fastest intervention of the Fund after lending to alleviate the consequences of the increase in oil prices in the 1970s. A sharp reversal occurred from 1986. In the five years 1986-90, net repayments to the Fund by developing countries amounted to SDRs 2,560 million per year; adding their payment of interest ("periodic charges"), the yearly net transfer from these countries worked out at SDRs 4,700 million per year, equivalent to US $6,300 million yearly -- a formidable figure on any reckoning. In the last year, ending 30 April 1991, the transfer was reduced sharply, to US $ 800 million (Table VI).

A part of repayment was done by developing countries running surpluses, e.g. South Korea; but at the same time a group of developing countries in difficulty incurred arrears which, had they been paid, would have raised the aggregate outflow.

Table VI. IMF transfers to developing countries, 1980-91, SDRs mln.
(-indicates transfers to IMF)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Disbursements	2211	4386	6960	10258	10164	6060	3941	3307	4562	2682	5266	6823
Repayments	3574	2811	1894	1488	2129	2943	4702	6749	8463	6705	6399	5608
Net capital inflow (1-2)	-1363	1575	5066	8770	8035	3117	-761	-3442	-3901	-4023	-1133	1215
Income from loans	n.a.	n.a.	1097	1545	2364	2969	2740	2089	1865	1719	1825	1825
Net transfers (3-4)	n.a.	n.a.	3969	7235	5671	148	-3501	-5531	-5766	-5742	-2958	-610
Net transfers in US $ mil equiv.	n.a.	n.a.	4366	7597	5558	163	-4271	-7854	-7798	-7522	-4200	-817

Note: Years shown are the IMF financial years, ending 30 April, i.e. 1980 is year ending 30 April 1980.
Source: IMF Annual reports.

The fund has been extending the repayment terms of its loans through adding new facilities which have a longer repayment period than the original 3 to 5 years. The latter continues to apply to stand-by arrangements, still the single largest IMF lending window, as well as to the Compensatory and Contingency Financing Facility which is fairly important. Repayment of 4-10 years applies to the Extended Financing Facility, the second largest, and 5 to 10 years to Structural Adjustment Facility for low income countries. But this gradual adaptation to the debt crisis appears to have worked slowly in reducing the cash outflow from developing countries. The immediate issue is how to avoid that repayment of existing debts to the IMF does not exacerbate the debt problem of the present severely indebted debtors. The current developing country debt to the Fund is SDRs 25,550 million (US$ 33.8 billion). It would be necessary to examine the part owed by severely indebted countries and its repayment schedule, and consider the possibility of consolidation of the early and middle maturities into long-term low-interest debt.

The liquidity situation of developing countries would have been less strained in the 1980s and would look brighter for the 1990s if issues of SDRs were resumed and significant amounts allocated to developing countries. This did not occur as several key developed countries did not find it possible to agree to such course of action. This issue, of major importance for the future of the international monetary system and for the supply of liquidity for developing countries in particular, remains on the international agenda.

Supply of development finance

Loan commitments of multilateral development finance agencies doubled in the last ten years, from US$ 16.6 billion in 1980/81 to US $ 33.9 billion in 1990/91. In real terms the increase was probably between one-third and one-half. The World Bank-IDA continue to have a commanding position, although growth has been fastest in the African and Asian Development Bank Groups in recent years (Table VII).

Disbursements, i.e. the actual flow of funds, have increased faster than commitments, perhaps as a result of deliberate measures to increase the share of fast-disbursing non-project loans in total lending so as to alleviate the cash shortage in debtor countries during the debt crisis. But the reverse flow, amortization and interest on existing debt, has been increasing at an even faster rate, leading to a decline in net transfer (Table VIII).

Against disbursements of US$ 23.1 billion in 1990/91, the reverse flow amounted to US $ 22.5 billion, thus resulting in a net transfer to debtor countries of only US $ 0.6 billion. Disbursements vary greatly from year to year. The average for the last four years

(1987/88-1990/91) works out at US$ 1.1 billion. This is only one-fifth of the preceding four-year average of US $ 5.1 billion. The peak transfer, above US $ 6 billion per year, took place in 1983/84 and 1984/85. It is crucial that a large and growing net transfer from multilateral development finance agencies be maintained. An urgent consultation with management of these agencies is needed concerning factors at work determining net transfer, a range of realistic projections which can be made, and the policy options for increasing net transfer. IMF management should be invited to attend also.

Table VII. Loan Commitments of Multilateral Development Finance Agencies, 1980/81-1990/91
(in billions of US $)

	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
World Bank and IDA	12,291	13,016	4,479	15,522	14,384	16,319	17,674	19,221	21,367	20,702	22,685
IADB Group	2,309	2,493	2,744	3.045	3,567	3,061	3,037	2,361	1,682	2,618	3,881
Asian Development Bank Group	1,436	1,678	1,684	1,893	2,234	1,812	2,005	2,462	3,163	3,680	4,004
African Development Bank Group	579	636	766	899	897	1,154	1,640	2,140	2,077	2,842	3,281
Total	16,615	17,823	19,673	21,359	21,082	22,346	24,356	26,184	28,289	29,842	33,851

Note: 1980/81 (July 1-June 30) for the World Bank and IDA; calendar year 1990 for other agencies. The same periodization applies to all years.
Source: Annual reports of the agencies.

Table VIII. Disbursements, Repayments, Interest Payments and Net Transfers of Multilateral Development Finance Agencies, 1980/81-1990/91
(in billions of US $)

	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
(1) Disbursements	9,172	10,802	12,151	14,124	14,801	15,302	18,432	19,129	20,501	23,991	23,113
(2) Repayments	2,042	2,386	2,843	3,438	3,925	4,903	7,020	9,897	11,296	10,491	11,760
(3) Net capital inflow (1-2)	7,130	8,416	9,308	10,686	10,876	10,399	11,412	9,232	8,755	13,500	11,347
(4) Income from loans	2,791	3,075	3,590	4,035	4,633	6,091	8,088	9,166	9,166	9,266	10,790
(5) Net transfers (3-4)	4,449	5,341	5,718	6,631	6,243	4,308	3,324	66	-411	4,234	553

Note and sources: See Table VII, please.

Conditionality

International financial institutions, particularly the IMF, are identified with conditionality, and particularly when providing finance for adjustment. A key facet of the social and economic

problem during adjustment is the real wage, especially in urban area. Adjustment liberalizes interest rates and product prices: it thus increases incomes of owners of capital and, in the case of independent producers having saleable surpluses (e.g. in agriculture), their incomes as well. By the same token it reduces real wages, at least for as long as total output falls or remains stagnant. In contrast to owners of capital, labour cannot move across national borders or can do so only to a limited degree; therefore it must accept a wage reduction until it is bearable, and at that point riots and bloodshed may hit the street. International development banks in the main have managed to avoid getting involved in such disastrous events. IMF has not. The general point was made by Dr. Paul Fabra, the first winner of the Jacques Rueff prize on the role of money in the economy:

> "It is illegitimate to see in the wage, and particularly in the wage of the poorest, a variable on which one can act at will in `adjustment' programmes. At the end of the 18th century and the dawn of the 19th, the founders of political economy recognized this and considered the wage as a datum prescribed by the mores of the society at any given time. In other words, the workers' standard of living, particularly when it is low, is not a thing one can play with. The Monetary Fund, too much influenced by neo-liberal economists, for whom wage is a price like any other, would be well advised to be a little more `Smithian' and a little more `Ricardian', and a little less `Friedmanite', in this matter." 22

The President of Ecuador has recently set out the differences in programmes of adjustment as they affect income distribution, responding to a question as to whether he thinks that his gradual economic reform, as opposed to a short, sharp shock, is the best option for the Ecudorean people:

> "There are two options in the measures we have to take to confront the economic crisis in our country. One, shock measures; two, gradual measures. We have rejected as socially unjust the first because the measures have a very severe impact on the poor levels of the population: unemployment, repressed wages, sharp price rises for gasoline and public services, and other similar measures that seriously affect the less fortunate. The second option is gradual measures that progressively produce changes and modifications and allow us to confront the economic crisis with, comparatively speaking, consequences that are less grave than in other Latin American countries. Brusque measures seriously affect small businesses, the middle-level companies, the micro-enterprises and people of low income while they favour large companies." 23

There have been new developments in the theory and practice of conditionality in recent years. In the theory of conditionality, the Japanese officials have raised serious questions concerning the appropriateness of import liberalization as a major element of adjustment in developing countries, argued in favour of subsidized interest rates for priority projects, and, more generally, suggested a considerable role of the government in promoting specific economic activities and development generally -- positions considerably removed from the dominant donor view of conditionality so far. Also in the theory of conditionality, Dr. Mahbub ul Haq and professor Paul Streeten, working within UNDP, have proposed introduction of "social conditionality of aid", consisting of measures focused on human and social development; this conditionality would be additional, and possibly superior to, the present conditionality of international financial institutions, which is focused mainly on monetary, fiscal, exchange rate and trade policies.

In the practice of conditionality, there has occurred a major emphasis by donors on privatization and, most recently, on internal political practices in borrowing countries. This emphasis has raised issues of social and political organization and policies which did not exist before. In addition, and cutting across both conditionality theory and policy, the issue of "shock" vs. gradual approaches to stabilization and adjustment has become acute, particularly stimulated by the events in Eastern Europe and the former USSR.

E. INTERNATIONAL MANAGEMENT OF THE DEBT PROBLEM

Total external debt of developing countries was estimated at US $ 1,341 million at the end of 1990, compared to US $ 639 billion at the end of 1980. Of the present debt, 57 percent is owed by severely indebted countries, low income and middle income, in World Bank classification. 24 Most of the increase in debt was an increase in real terms, as commodity export prices of developing countries, oil and non-oil, fell both in money (current dollars) and in real terms (constant dollars); while prices of their manufactured exports rose negligibly (12%) in current dollars and fell in real terms. The debt situation continues very difficult in many African countries, and their debts continue to grow. Stabilization of debt has been achieved in most of Latin American countries, but the creditors continue to report debt servicing problems in the forms of accumulation of arrears in many cases.

Africa

Sub-Saharan Africa's debt of about US $ 150 billion is equivalent to more than 100% of its GDP, compared to less than 50% in Latin America. The weight of Africa's debt burden is exacerbated by its lower per capita income, and its debt servicing is made more difficult than elsewhere due to its heavy dependence on primary product exports. Sub-Saharan African countries are now paying less than one half of the scheduled debt service (about 40%). The incidence of arrears falls severely on bilateral official creditor governments and their agencies in developed countries: they received only 20 percent of the debt service due to them in 1989. Multilateral official agencies received a preferred treatment (86% paid). Private creditors were paid almost one-third. However, short-term trade credits are fully serviced by most borrowers even when they are accumulating arrears on long-term debt to the same creditors.

The major traditional form of debt reorganization -- debt rescheduling on conventional terms -- has proved ineffective. It has led to "steady accumulation of debt to bilateral creditor governments, resulting from repeated debt reschedulings and the resulting capitalization of interest, including arrears."25 The other form, debt forgiveness by official creditors, adopted at the Group of 7 meeting in Toronto in 1988, also proved of limited significance. "Nine donor countries in the OECD have so far announced plans to cancel or convert bilateral loans owed by various low-income countries into grants. The total amount of debt forgiven or converted up to the end of 1989 is almost US $ 6 billion."26 This reduction represents less than 10 percent of this class of debt aggregating US $ 64 billion; it compares with the reduction of 50 percent or more of Poland's official bilateral debt.

The World Bank, which as a matter of policy has neither rescheduled its loans nor scaled them down so far, has individual country programmes of accelerating the quickly disbursing loans to Africa, so as to assure that there will be no net financial transfer to the Bank/IDA from severely indebted African countries. As a result, net transfers from the World Bank/IDA amounted to US $ 1 billion annually on the average during the latter half of the 1980s. 27 This does not mean, however, that each country individually obtained resources net from the Bank/IDA in these years. Such important debtors as Cote d'Ivoire and Nigeria were transferring resources net during 1987-89, and also, so did such important borrowers as Zimbabwe and Mauritius. IMF has been withdrawing resources from Sub-Saharan Africa for several years. Adverse net financial transfers averaged US $ 0.7 billion per year in the five years 1986-90, and the debt outstanding to the Funds was US $ 6.4 billion at the end of 1990. Withdrawal of resources has occurred despite the introduction by the Fund of special facilities on concessional terms (SAF - Structural Adjustment Facility and ESAF-Extended Structural Adjustment Facility).28

No substantial remedy has yet been applied to Sub-Sahara's debt owed to private banks and other private parties. The proposal of the African Development Bank, prepared with the advice of

Warburgs, the British investment bank, three years ago, which envisaged the retirement of these debts through a sinking fund on favourable terms, was not implemented. The World Bank established in 1989 the "IDA Debt Reduction Facility" which is to provide grants up to US $ 10 million per country to the poor countries with adjustment programmes to buy back or exchange commercial bank debt at a discount. Sixteen African countries have requested the use of this facility, with an aggregate debt to banks of about US $ 2 billion. Niger and Mozambique have been the only beneficiaries until 30 June 1991, with the additional assistance for debt purchasing given by France, Switzerland, Sweden and the Netherlands. The prices were 18% and 10% respectively, of face value. Much of the delay in drawing on the resources of this facility is due to the reluctance of banke to participate, in part to avoid setting precedents for other debtor countries where their exposure is larger. 29 Furthermore, this facility cannot be used to help countries such as Nigeria and Cote d'Ivoire, major debtors to private banks and suppliers in Africa, first because they are not classified as IDA-only (very poor), and secondly, they need much more than US $ 10 million to buy back any significant portion of their commercial debt: Nigeria's debt to private creditors amounted to US $ 16.8 billion at the end of 1989 and that of Cote d'Ivoire at least US $ 4 billion.

The conclusion follows that, while some efforts have been imaginative and generous, the overall debt strategy has been weak, uncoordinated and of limited effectiveness. African debt continued to grow at 10 percent per year as the economies of many African countries were weakening.

On 7 September 1990, the Netherlands Development Minister of Jan Pronk proposed that creditor countries collectively extend a complete forgiveness of bilateral official debt to the poorest developing countries facing severe debt problems. Forgiveness should be conditional on the debtor countries implementing sound economic policies. On 20 September, Mr. Major, then U.K. Chancellor of the Exchequer, proposed changes in the present "Toronto" terms for official debt and debt service reduction of the poorest countries, which call for a cancellation of two-thirds of the stock of eligible debt and a rescheduling of the remainder over twenty-five years with five years of grace; interest due during the first five years after rescheduling could be capitalized; later payments could be graduated and related to the debtor's ability to pay ("Trinidad proposal"). Prior to the London meeting of the Group of 7 in July 1991 it was believed that the "Trinidad proposal" would be adopted. However, it appears that no decision was made: it seems that the London meeting concentrated on the issue of possible assistance to the USSR and ended up not deciding either on Africa's debt or on Russian help. At the United Nations General Assembly, on 15 September 1991, "wealthy nations promised to help reduce Africa's staggering debt and pledged more foreign aid, but declined to commit themselves to specific targets." 30

Table IX. Composition of Debt Service Paid by Sub-Saharan Africa, by Creditor Source, 1990 (a) % Shares

Creditor source	1990
Medium and long-term	86.0
Official	55.1
Multilateral (b)	32.5
World Bank	14.8
IMF	10.2
Others	7.7
Bilateral	22.6
Paris club	15.1
Arab	2.6
CMEA	2.0
Others	2.9

Private	30.9
Total commercial banks	22.9
Suppliers and others	8.1
Short-term	14.0
Total external debt	100.0

Notes: (a) Preliminary, (b) Includes IMF.
Sources: World Bank, World Debt Tables, op.cit., page 91

If the Pronk-Major proposals were adopted, they would provide cash relief to those poorest debtors which are still servicing their bilateral official debts, and would regularize the situation of those debtors which are not paying now. However, not all problems would be resolved by these proposals. Paid debt service on official bilateral debt now accounts for only 23 percent of total debt service of Sub-Saharan Africa, and within this the Paris club creditors account for only 15 percent. (The remaining 8 percent is owed to governments of Arab and CMEA countries, and to "others.") In contrast, debt service paid to multilateral institutions accounts for 33% of total debt service (1990), having risen from a 15% share in 1980. It follows that alleviation of the position of Sub-Saharan debtors and the solution of the Sub-Saharan debt problem are very difficult to envisage without new actions of these institutions. With respect to private creditors which still absorb as much as 31 percent of Sub-Saharan debt service (and 45 percent if service on short-term debt is included, see Table IX), the World Bank makes the following suggestion:

> "Commercial banks also must expect to share debt relief burden. If comprehensive settlements through discounted purchases are blocked, debtor countries may want to use concessional aid available for this purpose to buy out those creditors willing to settle. The resolution of the bond crisis of the 1930s followed that pattern: debtor countries repurchased bonds at a deep discount on the secondary market, followed, often after many years, by settlements at less than par with the remaining bond holders."31

But in order to buy their debts in the secondary market, debtor countries need funds. Some, perhaps most, aid funds are not available for his purpose; and those that are need to be diverted from other uses in meeting the frequently vital current expenditures and essential investment needs. Debtor countries normally need additional resources to be able to buy their debts, even at a deep discount. Strapped for cash, they need to borrow. Again the main prospective lenders are international financial institutions, from their existing resources or from additional resources they might be able to mobilize; unless a special institution for repurchase of Sub-Saharan Africa's debts is created, which will need resources also.

Severely indebted middle income countries

The statistical debt position of twenty severely indebted middle income countries has improved on the average since the peak of their debt crisis in the mid-1980s. As their debt outstanding has stabilized and their exports have increased, the ratio of debt to exports has declined; and this factor, and the fall in the dollar interest rates in 1991, have brought down the proportion of their exports absorbed by debt service also. However, these ratios are still at a level which the UN Latin American experts believe the capital market would consider too high.32 "The fall in accrued interest on the debt, coupled with the expected slight rise in the region's export earnings, will mean that Latin America's (excluding Panama) interest payments/export ratio should decline to 23%, from the 25% recorded last year. This would be the fifth consecutive year that the coefficient has fallen and would bring it down to a level which is nearly half of the peak of 41% recorded in 1982. Nevertheless, the region's interest/export ratio remains very troublesome and above the 20% that is

often considered a threshold for financial crisis. As for the relation between the region's debt and exports, the similar rates of growth expected for these two variables will mean that the coefficient should be similar to last year's 285%. While this ratio is well below the peak level of 416% registered in 1986, it still remains considerably above the 200% which is often used as a ceiling for creditworthiness."[33]

A factor in stabilizing the debt level has been the debt reduction programme with respect to commercial bank loans, carried out with the assistance of the World Bank, IMF and Japan (Brady plan). Five countries have benefited from this programme: Mexico, Costa Rica, Venezuela, Uruguay and the Philippines. The net effect of these operations is not clear-cut, in the view of UN ECLAC: "With regard to the Brady plan, its [debt] contractionary impact in 1991 is still uncertain. On the one hand, it is still not clear whether negotiations will advance quickly enough in Brazil and Argentina to finalize accords this year. [34] On the other, while Brady accords have reduced the present value of the debt owed to banks, they have also often generated enough new debt-related collateral requirements and refinancing to result in little or no reduction in overall gross external obligations." In the 1991 assessment of the World Bank, "the results have been very positive for Mexico, in terms of both growth and improved financial conditions, through return of flight capital, increased foreign direct investment, and access to external capital, albeit at higher spreads... In the case of other countries, the impact of the Brady-initiative operations is not yet clear."[35]

When this initiative was launched, in March 1989, it was estimated that there would be 39 beneficiaries over three years. It is now clear that implementation will be very much smaller. In its progress report of March 1991, the World Bank states: "Certain challenges to the program remain. Most importantly, arrears have become both larger and more widespread. This makes it more difficult to reach further agreements, and it increases the requirement for the Bank to exercise careful judgment when providing support for debt and debt service reduction operations."[36] In mid-1991, accumulations of interest arrears were still running in the majority of Latin American countries, and the UN Latin American experts estimated the end-1991 arrears at about US $ 25 billion.[37] For developing countries as a whole, arrears on debts both to private and official creditors, and including both interest and principal, amounted to US $ 112 billion at the end of 1990, compared to 69 billion at end-1989 and 40 billion at end-1988, according to World Bank data (World Debt Tables 1991-92, page 15).

Accumulation of arrears at the time of improvement of the statistical debt position shows the limitation of the latter in portraying the debt problem. Debt servicing capacity primarily depends on whether sufficient income growth takes place so that a surplus can be generated which can be used for debt service while simultaneously leaving a margin needed for a satisfactory increase in domestic consumption and investment; whether income increments are fairly distributed so that social stability is sustained; whether the fiscal system is sufficiently efficient so as to capture the needed flow of public savings out of income; whether the balance of payments structure and the foreign exchange system permit a smooth transfer of savings abroad; and whether the domestic returns on investment are higher than the international rate of interest. While debt ratios are important in indicating the initial debt burden position, it is these other relationships and their dynamics over time which are determining factors for debt servicing capacity.

Flaws in the analytical framework

Two flaws in the analytical framework used in the formulation of international debt policy of the 1980s were identified by an international group of experts in June 1990:

a. No detailed estimates appear to have been made, on a country-by-country basis, of the capital requirements for overcoming the crisis and restoring a satisfactory rate of growth

over the medium term; or if such estimates were made, they do not appear to have been used in putting forward the past overall debt policies.

b. No attempt seems to have been made to examine the prospects for long-term debt servicing capacity, on a country-by-country basis, and determine the extent of debt relief or of cash-flow rearrangement accordingly.38

Several prominent economists have drawn attention to the analytical empty space concerning estimates of capital requirements for resumption of economic growth. According to Sidney Dell: "The Bank and the Fund have not received a mandate to work out the implications for the debtor countries of resuming the growth process which North and South both agree is an indispensable objective for growing out of the debt crisis. This in turn means that the capital requirements for adjustment with growth in the debtor countries as a whole have not been studied by the Bretton Woods institutions, let alone agreed upon by the international community. The rate of growth of the debtor countries emerges as a residual, a by-product of the feasible rate of borrowing... The figures for debt relieve or debt reduction currently discussed are based more on some kind of guess as to political feasibility than on any scientific analysis of the data. In the absence of such an investigation, the debt strategy will continue to be an improvised affair in which the solutions proposed tend to amount to the minimum steps necessary to keep things going instead of being reasonable approximation to growth requirements... The capital exporters obviously have the right to take their own positions on the capital to be provided both overall and to individual countries. But they should at least be in possession of independently determined facts and analyses."39

Concerning the second analytical gap, missing estimates of debt servicing capacity, the Report of experts stresses that in the absence of such estimates, the extent of debt relief and cash-flow rearrangement is now determined by unequal bargaining between the banks as a group and individual debtors in the case of debts to banks: and by decisions of creditor governments in the case of official loans.40 A comment on present practice suggests "injection of much-needed economics into the negotiations and use of such [analytical derived] estimates as a starting point for guided bargaining on the extent and form of debt reduction."41

Proposals for procedural and interim arrangements

In order to remedy this situation, one of the recommendations of the 1990 Report called for the establishment of independent teams of experts for each debtor country and wants them, headed by a prominent person in finance, economics or political life, to work out proposals for restoration of economic growth, suitable debt reorganization, and domestic measures to support them. These teams would draw on all sources of information and advice: from debtors, bilateral official creditors, creditor banks and international financial and development institutions. The responsibility for the proposals would rest with the teams.42 It would be up to the debtors and the creditors whether to accept the proposals. Past successful precedents for this procedure are the German and Indonesian debt settlements of 1953 and 1970, respectively; both were prepared and negotiated by a well known German banker, Hermann Abs. The German settlement reduced its obligations by some 74%. Reduction in Indonesia is quoted at 57%, but it is not clear whether this estimate includes all forms of debt relief.43 The aim of the Indonesian settlement was to restore Indonesia to international creditworthiness with access to normal credit facilities, to make it eligible for loans from the international financial institutions and from private sources, to restore the country as an important partner in world trade with a view to reducing dependence on foreign aid, and "to give the Indonesian government freedom and independence in its decisions on fundamental economic questions."44

In view of the possible extra demand in financial markets resulting from requirements of Eastern Europe, and the time it would take to prepare and agree on a lasting solution of the debt and resource flow problems, the Report of experts suggested that consideration be given to an interim bridging arrangement which would include postponement of amortization and fractional

payments of interest in foreign exchange, in local currency of the debtor, and through capitalization into new loans. Such an interim arrangement would provide relief to debtors immediately, without prejudging the final outcome. The interim arrangement would apply to both private and official loans. The danger of rapid accumulation of debt through interest capitalization would be reduced as it would affect only a fraction of interest, and it would be eliminated if a concessional rate of interest could be agreed. The size of the fractions would depend on the economic position of the debtor country. The lowest income countries would be required to make the lowest payment in foreign exchange. The scheme would not apply to concessionary debts and to trade credits. Also exempted would be those creditors whose disbursements exceed a country's debt service. Appropriate adjustments would be made in cases of partial coverage of debt service by disbursements.45

F. FOREIGN PRIVATE INVESTMENT

Geographic distribution of foreign direct investment

In the estimate of the International Finance Corporation, a World Bank affiliate, foreign direct investment in developing countries reached a peak in 1990, double the low point of the 1980s, recorded in 1983.46 From the previous peak, in 1981, the increase in U.S. dollar terms was 43 percent; in real terms, there probably was no increase. The World Bank series shows an increase in U.S. dollar terms of 69 percent from peak to peak; this is probably no more than one-fifth in real terms over 9 years.47 This is a modest advance, but it is better than what happened to international private lending.

Table X shows a declining share of developing countries in total inflow of foreign direct investment, from 25% in 1980/84 to 17% in 1988-89. In the judgment of the UN Centre on Transnational Corporations, "although current trends indicate a strengthening of the position of certain developing countries and regions, especially in light of the emerging regional core network strategies of transnational corporations, it is unlikely that the declining share of world-wide foreign-direct-investment flows to developing countries will be reversed in the near future, despite efforts by nearly all these countries to open up their economies to foreign direct investment and liberalize their policy regimes."48

Footnotes:

1: The Wall Street Journal, 12 August 1991

2: World Bank, World Debt Tables 1990-91, Table 4, page 17.

3: Deutsche Bundesbank, 28 January 1985.

4: Mauritius Sugar Producers Association, An Analytical Review of the Financial Situation of Sugar Estates with Factories, Port Louis, February 1983.

5: Pedero-Pablo Kuczynski, Latin American Debt: Act Two, Foreign Affairs, Fall 1983, page 22.

6: World Bank, Global Economic Prospects and the Developing Countries, 1991, page 34.

7: International Monetary Fund, Annual Report 1991, page 53.

8: Frank W. Taussig, Harvard University, International Table, 1927

9: African Development Bank, Memorandum to the Board of Directors, Proposal for intervention in trade financing, 1 April 1988.

10: For the debate, see J.M. Keynes, "The German Transfer Problem" and "Views on the Transfer Problem", in Economic Journal, March 1929, June 1929 and September 1929; Bertil Ohlin, "The Reparations Problem". Index, Svenska Hendelsbanken, April 1928; Bertil Ohlin, "Transfer Difficulties, Real and Imagined", Economic Journal, June 1929; and Bertil Ohlin, Inter-regional and International Trade, Cambridge, Mass., Harvard University Press, 1935.

11: Paul Fabra, in The Wall Street Journal, 15 December 1983.

12: United Nations, The state of international economic cooperation and effective ways and measures of revitalizing the economic growth and development of developing countries, 30 January 1990, page 9.

13: Operations Evaluation Department of the World Bank, Structural Adjustment Lending, 24 September 1986, page 57.

14: World Bank, Report on Adjustment Lending, 8 August 1988, page 25.

15: Statement by Elaine Zuckerman, former World Bank staff member specializing in poverty issues, in SID, Development Connections, Washington D.C., March 1989, pages 5 and 7.

16: Neue ZŸrcher Zeitung, 3 July 1987.

17: Financial Times, 1 July 1987.

18: The Economist, 4 July 1987.

19: Journal de Geneva. 17 June 1987.

20: UN ECLAC, Economic Panorama of Latin America 1991, page 5, Santiago, Chile, September 1991.

21: Ibid., page 8.

22: Paul Fabra, La politique d'austerite en accusation, Le Monde, 29 January 1984.

23: Interview with President Borja, International Herald Tribune, 25 February 1991.

24: World Bank, World Debt Tables 1990-91, Tables 1 and 5, pages 12 and 18.

25: Ibid.

26: Ibid., page 93.

27: Ibid., page 92. In another programme, introduced in 1988, the World Bank approved an allocation of 10 percent of IDA repayments and interest income to eligible countries in proportion to their IBRD interest payments so as to help these countries to pay interest due. Norway and Sweden also made grants to help meet IBRD debt service.

28: Percey S. Mistry, African Debt Revisited, July 1991, page 21 (mimeo).

29: World Bank, World Debt Tables 1990-91, page 94.

30: The New York Times, 17 September 1991.

31: World Bank, world Debt Tables, op.cit., pages 29-30.

32: Twelve of the twenty countries are Latin American, including the three largest debtors (Brazil, Mexico and Argentina).

33: UN ECLAC, Economic Panorama 1991. op.cit., page 10.

34: Debt accord between Argentina and commercial banks was reached on 7 April 1992, with details to be worked out in the following two months. Debt agreement with Brazil was not yet reached as of 20 May 1992.

35: The World Bank, Annual Report, 1991, page 35.

36: The World Bank, Review of Progress under the Program to Support Debt and Debt Service Reduction, 1 March 1991, page 2.

37: UN ECLAC, op.cit., page 3.

38: Debt and Development in the 1990s, Report of the International Group of Independent Experts, Belgrade, World Scientific Banking Meeting, 25 June 1990.

39: Sidney Dall, Reforming the World Bank for the Tasks of the 1990s, lecture at the Exim Bank of India, 5 March 1990, Bombay, pages 7-8.

40: Report of experts, op.cit., page 17.

41: Shafiqul Islam, The Mexican Debt Accord: Lessons for the Brady Plan, 7 February 1990, page 19.

42: Professor Gustav Ranis, Yale, and former Administrator of AID, U.S. Government, has argued for the establishment, at the request of the debtor country, of "self-destructing, quasi-independent teams' to do the assessment of policy changes Debt. Adjustment and Development: The Lingering Crisis, in Khadija Haq ed., Lingering Debt Crisis, North South Roundtable, 1985, Islamabad, and his study Adjustment, Growth and Debt Fatigue: Can the Case-by-Case and Global Approaches be Combined?, International Center for Economic Growth, Panama and San Francisco, Occasional paper No. 17, 1989.

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Part II: Commodity Problem, Poor Countries and Poor People

A. INTRODUCTION

International commodity markets represents a major outlet for developing country total sales. Integration into the world economy of these countries, and frequently their growth process, normally start with the development of primary products for which markets are abroad, as it is the foreign richer countries which have sufficient purchasing power, and also, there are those abroad which experience deficiencies of particular resources and must meet them through imports. Since 1950, many developing countries have gone through a significant industrialization drive, and since 1970 a limited but growing number have succeeded in developing considerable and rising exports of manufactures for the world market. Nonetheless, the majority of developing countries have remained dependent on primary products for welfare and growth: African countries depend on primary products to an overwhelming 80 to 90% of their total exports, these products account for more than 65% of Latin American exports, and similar dependency is encountered in many other developing countries.

Commodity markets are among the most volatile of markets; and poor countries suffer from this volatility most, first because of their heavy reliance on these markets, and secondly, because they are less able, due to shortage of finance and poverty, to adapt their sales to changes in demand and to vicissitudes of prices so as to maximize revenue and minimize losses. Furthermore, long-term demand for primary products expands less fast than the demand for manufactures and services, while supply shows a persistent tendency to over-production because of shortage of alternative employment opportunities in developing countries and in primary production (agriculture) generally, and because of insufficiency of skills for diversified production. Hence there has been a persistent tendency for prices of most primary products to fall in relation to prices of most manufactures, and this adverse movement in the terms of trade was one of the key unfavourable features with which developing countries had to cope both in the inter-war period and since 1950.

Downward fluctuation and adverse trend are fully at work since 1989, and the developing world is now experiencing another collapse of commodity prices, which has brought them down, in real terms, to the lowest level since 1950, and, according to The Economist and World Bank analysts, over the last 100-150 years. The current situation in commodity prices and finance is discussed in section B. This is followed by an assessment of short and medium-term fluctuations (section C), and long-run trends (section D). The position of developing countries as sellers and buyers is discussed in section E, and the situation in their plantations, farms and mines -- the human factor, wages -- in section F. Commodity price stabilization, alternatives to it, past experience with it, and the ways in which it can be approached in the future are reviewed in section G.

B. COMMODITY SLUMP 1990-91

Prices

Between early 1989 and mid 1991, export commodity prices of developing countries fell about 20%, according to UNCTAD, World Bank and IMF indices, a speed of decline only slightly lower than during the slump in 1980-82, which triggered the international debt crisis and ushered "the decade lost for development." The Economist's index shows a decline of about 30% between 1988 and 1991.49 In any case, prices of primary products in real terms are very much lower now than they were in the early 1980s, and therefore any additional fall is felt with ever greater hardship.

Table I. Weighted index of commodity prices, 33 products (a)
(excluding energy, constant US dollars, 1979-81 = 100)
1980-91

1980	104.8	1986	69.3
1981	90.9	1987	63.4
1982	82.6	1988	71.1
1983	89.1	1989	70.3
1984	92.3	1990	62.1
1985	81.3	1991	57.0 (b)

Notes: (a) Weighted by 1979-81 developing countries' export values; (b) First half; preliminary. For the entire 1991, the index is 58.2. The World Bank projection for 1992 is 56.1.
Sources: World Bank, Quarterly Review of Commodity Markets, June 1991: and Quarterly Review of CM, April 1992.

Most of the key products are affected by the present commodity depression. "Aluminium prices are probably at an all-time low in real terms"; 50 tin prices in August 1991 were at a level "at which most of the world's tin mining and smelting operations are loss-makers";51 "our dollar metals index has fallen 27% over the past year and it is now more than 50% below its June 1988 peak";52 "combined stocks of base metals on the London Metal Exchange have risen to an all-time high";53 "Malaysian rubber output is at the lowest level for 20 years";54 the price of coffee in real terms is lower than at any time since 1950;55 cocoa is undergoing a major depression; the real price of jute since 1986 is a fraction of the historical level;56 and sugar at 8.8 U.S. cents per pound57 is once again "cheaper than the sand scooped up from the beaches", in the phrase of the Australian Trade Minister during another sugar crisis, in the 1960s. Only tropical timber seems to have gone up in price.

Incomes

In Malaysia, one of the most efficient commodity producers, rubber growers' net monthly income dropped 33% from 1988 to 1990; oil palm farmers were even worse off, with incomes falling 50 percent.58 "Planters testify to how the peaks in the markets' cycles are becoming shorter-lived and the troughs ever longer. It used to be two years,

sometimes three', according to one producer. Now it is seven or eight, with a brief year in-between.' Malaysia's plantation industry is entering its twilight years."[59] Even Australia's rural sector "is facing its worst financial crisis for a century", according to the president of the National Farmers Federation. The Australian Bureau of Agricultural and Resource Economics forecasts that average prices received by farmers would fall by five percent in 1991, following a decline of 13 percent in 1990 Net farm cash incomes would fall by 24 percent following 35 percent in the last financial year. "The rural sector has been hit by weal prices for a range of commodities, including sugar, dairy products, and beef. However, the biggest problems have been caused by competition from subsidized wheat exports an the collapse of the wool market because of over-production and falling demand."[60]

Over vast areas of Africa, Latin America and partly Asia, it is the collapse of the coffee and cocoa markets which have caused enormous damage. Coffee export earnings have been cut in half, with a loss estimated at US $ 4 to 7 billion per year. [61] Coffee is the second largest primary export of developing countries after petroleum; and the suspension of the operating provisions of the international coffee agreement in 1989 has affected some of the poorest developing countries and regions with large populations. An excessive investment in cocoa growing, partly financed from external sources and stimulated by currency devaluations, ended in the late 1980s, when the price was driven to below US$ 1,000 per ton, compared to an average of more than US $ 2,000 in 1980-87. (At its peak, in 1977, the price was US$ 5,467). Parts of West Africa have been devastated by the cocoa crisis. Similar economic circumstances in the mid-1960s led to political upheavals in the region, whose effects are still partly felt.

Factors at work

The slow-down in the world economy, with recessionary tendencies in some important parts, and the previous excessive investment in some primary products, have been the dominant factors in causing the downturn. But changes in the USSR have affected commodity markets also, in two directions. First, increased Soviet demand, actual or expected, for foodstuffs, has strengthened or prevented the weakening of the grains and meat markets. Secondly, increased Soviet sales of metals -- aluminium, nickel, copper, platinum and minor metals -- have contributed to the weakness of the metal market during the last two years. These increased sales, induced by the shortage of foreign exchange in the USSR, and therefore the need to sell even at falling prices, have attracted much attention. It is not clear to what extent they can be sustained: this will depend primarily on the state of mining equipment within the former USSR. But it is likely that the pressure to sell will be present for some time, in view of the independence of the states and a growing autonomy of the producers and foreign trade organizations, all with their needs for foreign exchange, unless commodity arrangements can be made with other producers providing for orderly marketing.

Withdrawal of commodity finance

In February 1991, it was reported from London that "international banks, already shaken by mounting bad debts in property, industry and the Third World, are reeling again, this time from multi-million dollar losses on commodity lending. Some banks, aghast at the growing pool of red ink, are expected to quit commodity financing altogether, while others are set to charge higher fees to all but top-notch customers... The recent failure of one of Britain's oldest commodity houses, Woodhouse Drake and Carey, has sent shock waves through banking boardrooms. The 223-year-old trading firm collapsed with debts of US $ 150-200 million. More generally, plunging raw materials prices, squeezed commissions, and soaring costs have caused a flurry of financial problems in world commodity houses. As a result, one bank has already decided to quit commodity lending and others are expected to follow, bankers say. This follows a steady exodus of U.S. banks from commodity financing in recent years."[62]

In March 1991, it was reported from Paris that Sucres et Denrees, the leading French commodity trader with a heavy involvement in world trade in cocoa, coffee, rice, sugar and oil, was getting a large loan from French banks to cover losses in its trading activities, on condition that in the future "it will embark on fewer big trades and will put more emphasis on less risky downstream activities" (mainly food processing).[63] This firm had bought 400,000 tons of cocoa from Ivory Coast or one-fourth of the world crop, in 1988, and 10% of Iran's entire oil output in 1989.

In April 1991, it was reported from London that Philip and Lion, one of the last privately-owned international metal-trading groups, ceased trading and would seek voluntary liquidation, because of extreme liquidity shortage. The company trading activities were mainly in non-ferrous metals, both primary and scarp. "Metal traders suggested that there were some signs that many banks were now unwilling to keep a high financial exposure in volatile commodity markets. The physical merchanting business had contracted in recent years and this trend was likely to continue, traders added. Other merchants were believed to be in difficulties."[64]

These instances of traders and banks withdrawing from commodity finance because of increased risks associated with price falls and resulting losses on inventory make the position of commodity producers even more vulnerable than so far: as the pool of funds available to finance stocks (inventories) is being reduced, the likelihood of deep price falls would be increasing. The need for public stocks to fill the gap therefore increases also.

C. PRICE FLUCTUATIONS

Magnitude and increase over time

Chart I below shows the range of price instability indices for 34 commodities in the 1980s. Differences in instability among commodities are wide: the index for the least stable (sugar) is more than eleven times that for the most stable (oranges).

Table II below follows the individual commodity instability indices over time, through four successive decades from the 1950s to the 1980s, for fourteen agricultural commodities. "For bananas, coconut oil, groundnut oil, and palm oil, price instability appears to have increased unambiguously sine the 1960s, and for coffee, copra, cotton, maize, tea and wheat, price instability was higher in the 1970s an 1980s than it was in the 1950s and 1960s. For cocoa, rice, rubber and sugar, evidence is mixed, but regression of ten-year moving coefficients of variation shows that the trend of instability has been positive for all these crops except cotton and rubber."65 For both cotton and rubber, the price trend was consistently downward in real terms in 1950-1990, however, so their producers did not get much comfort from relatively low price variability around generally falling movement.

Chart I. - not yet available

Causes

Fluctuations result from a number of causes, which, while largely independent from each other, frequently coincide. When they do, fluctuations can take on catastrophic dimensions.

First, there is the influence of cyclical income fluctuations in consuming countries, corresponding to the broad movement of the general business cycle. "For most commodities, economic activity in the industrial countries continues to be an important -- often the most important -- determinant... Ups and downs in industrial country production have important consequences for commodity exporters, particularly exporters of metals and agricultural raw materials." 66 But they affect exporters of foodstuffs also as changes in industrial country production cause changes in their employment and consumer incomes.

Secondly, there are short-period fluctuations which are due primarily to good or poor harvests caused by variations in weather conditions. In some commodities there is also a tendency towards a two-year production cycle, a year of good yield followed by a year of poor yield, with corresponding variations in prices in the opposite direction.

Thirdly, price fluctuations resulting from either the demand or supply shifts can be accentuated by speculative trade -- when one buys things one does not need and sells things one does not have, in the phrase of the Nobel Prize winner professor Maurice

Allais. The conventional view holds that speculation is normally of a price stabilizing nature; what it forgets is that the stabilizing function -- buy the commodity when the price is low as well when the price is high -- frequently takes place only after the price has fallen sufficiently low (or risen sufficiently high); the term "sufficiently" reflecting the judgment of the market of the likely bottom and the likely peak of the price. In practice, and based on past experience, commodity speculators frequently expect the price, when it starts falling, to fall a long way; consequently, once the decline starts, they sell; consequently the price decline accelerates. Since much of commodity speculation is carried on borrowed funds against collateral of commodity contracts, the price fall reduces the value of the collateral; and as this reduction takes place, the lenders call their loans. If chances of price improvement in the near future are judged limited, commodity speculators prefer to lose their deposit (cash margin) rather than put up more collateral; they get sold out by the lenders, and the price falls further, perhaps in successive waves as lower and lower commodity contract prices and associated collateral values are reached. Brokerage houses advise selling once the decline starts:

"If you as a speculator have a position at a time when an unfavourable major trend develops, you may postpone liquidating your position until you have a substantial loss. It is easy to defer taking a loss in the hope that prices will recover and the position can be liquidated without any loss at all. But once started, commodity prices frequently move in one direction for some time. If you do not liquidate promptly at a small loss you may be forced to take a sizeable loss"67

Keynes put the matter in a more general fashion. When a surplus of a product develops, the costs of storage and interest are involved, and these costs -- negative return, he called them -- must be absorbed. In the process, great damage can be inflicted to income, output and investment. As Keynes put it:

"The competitive system abhors the existence of stocks, with as strong a refle as nature abhors a vacuum, because stocks yield a negative return in themselves. It is ready without remorse to tear the structure of output to pieces rather than admit them, and in the effort to rid itself of them."68

This was the theoretical basis for Keynes' long efforts to get commodity stabilization, organized and financed by public authorities, politically accepted, which carried the idea through almost to Bretton Woods, but fell short of the objective mainly because of opposition of vested interests and perhaps partly due to misunderstandings.

The opposite to cumulative price declines in case of surpluses is the situation of cumulative price increases in case of shortages, again induced by the possibility of destabilizing behaviour of privately-held stocks. When prices are on the upswing, the demand for private stocks may increase as prices increase, because the latter are expected to increase even further.

A reasonable price stability under circumstances of these destabilizing movements of private stocks calls for, and justifies, operation of publicly-held stocks, under international control or under export control of national authorities, or a combination of both.

Commodity cycles in tree crops

Commodity cycles in tree crops, characterized by alternating phases of high prices, low prices and price recovery, are engendered partly by the fundamental features of the industry and partly by a special constellation of demand and supply price elasticities. Coffee is an outstanding case. It is a tree crop which requires a fairly long gestation period: coffee trees begin to bear within three to five years after planting and come into full bearing only about 7-10 years after planting. The short-run response of supply to an increase in price is weak: high prices lead to some increase in current yields, by more expenditure on pruning, weeding, spraying and fertilizer. Their main effect, however, is on new investment in coffee production (purchase and preparation of land, planting, buildings), i.e. the major thrust is on long-run supply. Investment responds sharply to high and rising prices. However, once a substantial number of young trees begin to come into production, the process reverses itself. The stream of new supplies come to the market and causes a very heavy pressure on prices, as demand responds very weekly to price changes; and the short-run response of supply is also low since variable costs (wages) are relatively low, while shifts into alternatives require cash outflow for new investment. Prices have to fall to a very low level to affect current output. However, depressed prices do affect investment activity in coffee production. New investment ceases, while old trees go out of production. There is a painful readjustment which may last almost two decades, until consumption catches again with output, leads to a new shortage and a new cycle. And intertwined with this multi-year cycles are purely short-term fluctuations. 69

CHART II. - not yet available

The multi-year cycle, and the associated waste of resources and human misery, can be overcome to a substantial degree through public (government) restraint on new investment during the upswing phase and through systematic diversification and productivity improvements throughout the cycle at a regular pace.

Effects on exporting countries

Some academic writings have questioned whether commodity fluctuations have a negative effect on exporting countries.70 An effective response has been provided by a

close observer, Dr. D. C. Rao, Director of the International Economics Department of the World Bank:

"As has been made painfully obvious during the 1980s, the developing countries face great difficulties in raising external finance and in servicing their external debts, due in large part to the sharp fluctuations in the prices received from their primary commodity exports. Their terms of trade are also very susceptible to import price shocks, especially for the most important primary product import for most of them -- petroleum.
In turn, the terms-of-trade shocks from primary commodity price fluctuations are a major problem for the management of firms and, probably most important, for the macro-management of the developing countries themselves. It is probably fair to say that the effort that has had to be devoted to macro management of these economies in the wake of such shocks has detracted seriously from the effort that would have otherwise been given to getting on with the process of development."71

At the sectoral level, fluctuations have an adverse effect on investment in, and working of, the mining industry. During the recovery of the metals market in 1986-88, major supply disruptions occurred in Peru (copper, lead and zinc), Papua-New-Guinea, Zambia, Chile and Zaire (copper). "It has been most unfortunate that developing country producers have been unable to take full advantage of the metals price boom. but the low prices of 1982-85 period made it difficult for them to import material and to maintain their production capacity. So that when the demand for metals increased, they were unable to respond. In fact, the lack of facility maintenance led to breakdowns in production. The high prices also led to a sharp increase in strikes as labour attempted to recover the losses in real wages, suffered during the period of low prices." 72 In contrast, large rich companies in developed countries managed to restructure and cut costs in the first half of the 1980s, and therefore were able to reap the full benefits of the demand and price increases later on.73 In tin in Malaysia, it is small, labour-intensive mines which are particularly adversely affected by price falls, as they have higher average costs and less resources to tide them over the slump.74 Large labour reductions then take place.

In coffee, large farms reduce labour force some during the price slump as they cut down on pruning and somewhat on picking.75 In cocoa, it is likely that wages will be cut first, followed by a reduction of inputs such as fertilizers, insecticides, etc.76 In sugar, large companies are likely to maintain their output or even increase it despite price fall, because they have written off the capital investment in the sugar mill -- a reaction which aggravates further price instability; while small-scale outgrowers generally will switch their efforts away from sugar case to other crops more readily.77

At the level of public finance, "the effects of price fall can be very important, since for many commodity-exporting countries a substantial proportion of government revenue is derived from export taxes and taxes on corporations involved in foreign trade. Consequently, a large and prolonged fall in export prices is likely to cause an immediate budgetary difficulty or even crisis, followed by cuts in spending -- often spending on social services (health, education, etc.)."78

Effects on financial markets in developed countries

Sharp fluctuations in commodity prices have had adverse influences on financial markets in developed countries in two directions. First, on the level of overall finances, sharp increases in commodity prices have led to the introduction of more restrictive domestic monetary policies in industrialized countries, which in turn has led to slow-downs in their economic activity on several occasions. And conversely, a contraction in real export earnings of developing countries following a fall in their export prices, has resulted in a reduction of exports to them from industrialized countries. Moreover, a prolonged period of depressed commodity prices, as in the 1980s, undermines the ability of commodity exporting countries to service their external debts and thus inevitably has an impact on the profitability of the private banking sector of the developed countries.79

Secondly, on the level of securities markets, in much of the 1980s share markets have been heavily influenced by interest rates, while the latter, in turn, have been greatly affected by expected movements in commodity prices. The implicit theory has been that commodity futures are a fairly reliable indicator of inflationary expectations which determine the rate of interest (or at least determine the policies of central banks which then influence the rate of interest). The stylized sequence would be: a rise in commodity prices causes an increase in inflationary expectations; the latter lead to an increase in interest rates and yields to offset the expected loss in value of financial assets due to inflation; the counterpart of the interest rate increase is a fall in prices of bonds and other fixed-income securities; the fall in bond prices induces a switch of funds from shares to bonds, and a corresponding fall in the price of shares (stocks). A report on trading in U.S. on 19 May 1988 shows how this works:

"In a large degree, the behaviors of the Dow Jones industrial stocks average mirrored movements in the bond market, which in turn were in line with the Commodity Research Bureau index, a key measure of inflation that tracks commodity figures prices in Chicago. The CRB index rose sharply in the morning, heightening inflation fears, raising yields in the bond market and depressing stock prices as bonds became a more attractive alternative to stocks. The index later retreated when soybeans futures weakened, easing bond yields and helping the stock market rise. The funny thing is how the market is so tuned to inflation, it turned on the commodity price index, which was turned on and off on soybeans' according to one financier. This shows how graphically the stock market has become a commodity business."80

According to some financial analysts, prices for commodities and bonds have consistently moved in opposite directions, "a pattern which they call the most important of all market links. In the most celebrated example, the Commodity Research Bureau index surged and bonds began to drop in April 1987, which set the stage for October's stock market crash (1987)." 81

The reported disruptive impact of commodity price fluctuations on interest rates, and via the latter, on share markets raises the question of the need for international commodity stabilization from an unexpected angle. The major interest in stabilization so far has been that of primary producing developing countries. Consuming countries have joined in this quest on rare occasions and mostly for limited periods. Most of them have been apprehensive, it would seem, that benefits from international stabilization would

primarily occur to the exporters, while the consumers would pay higher prices on the average. But if the costs of commodity instability in causing financial destabilization in developed countries are factored in, interest of these latter countries in commodity stabilization should be expected to increase at some point, as financial destabilization can be expected to lead to losses in employment and output, additional to those caused by price instability directly.

D. LONG-TERM PRICE TRENDS

Statistical findings

Set forth below are the five-year averages of the price indices in real terms of 33 commodities exported by developing countries for the period 1948-1990.

Table III. Weighted index of commodity prices, 33 products (a)
(excluding energy, constant US dollars, 1979-81=100 (b)
1948-90

1948-50	124.4 (c)	1971-75	110.0
1951-55	141.6	1976-80	109.1
1956-60	122.7	1981-85	87.2
1961-65	111.9	1986-90	67.2
1966-70	112.8		

Notes: (a) Weighted by 1979-81 developing country export values; (b) Deflated by using the unit value index in US dollars of manufactures exported by G-5 countries; (c) Three-year average.
Sources: World Bank, Quarterly Review of Commodity Markets, June 1991.

Prices in the five years 1986-90 averaged barely one-half the level recorded forty years ago, in 1948-55. Most of the decline occurred in 1980-90, but there also was a significant downward movement in the earlier decades.

Chart III shows the indices of real prices computed for the period 1900-86 for 24 non-fuel commodities (GYCPI/MUV line) and for 26 commodities including oil and coal (GYCPI'"/MUV line), by World Bank analysts Enzo R. Grilli and Maw Cheng Yang.82 They have linked to their index the indices for the period 1870-1899 computed earlier by The Economist, London, and Nobel Prize winner professor Arthur Lewis. Downward trend over 120 years is unmistakable, although the two world wars, the Korean war and the events in the Middle East in the 1970s provided what turned out to be temporary reliefs. If the last five years 1987-91 were added to the chart, the picture would be even gloomier.

The Economist's index "has tumbled to virtually its lowest level in real terms in its 150-year history", according to The Economist of 10 August 1991.

CHART III. - not yet available

Projections

The World Bank expects that non-oil commodity prices will continue to fall over the next two years, then stabilize in the mid-1990s, and recover about 10% during the subsequent decade. Recovery in oil prices during 1995-2000 is expected to be somewhat stronger.

Table IV. World Bank price projections
(constant US dollars, 1979-81=100)

	33 Commodities	**33 Petroleum**
Actual 1986-90 average	67.2	44.3
Actual 1990	62.1	53.6
Actual 1991	58.2	42.7
Projections	56.1	38.4
1993	55.2	39.7
1994	56.0	41.6
1995	56.9	42.8
2000	61.9	54.4
2005	60.5	51.7

Notes:(a) Excluding energy.
Source: World Bank, Quarterly Review of Commodity Markets, April 1992.

An implicit assumption of price recovery seems to be that prices now are at or below costs of production. But in developing countries, wages, a major component of costs, have been falling as export prices fell; hence production costs are to some extent a moving rather than a stable quantity and therefore further price declines are possible.

For export commodity prices of developing countries to stabilize and reverse course, which is badly needed, three conditions need to be met, in my view:

Investment in expansion of primary production for exports must be brought in line with realistically estimated world demand. In the past, it has been excessive. It has

been argued that there has been no coordination among, and perhaps even within the international agencies which have financed a considerable part of the investment.83

A new action is needed to conclude stabilization agreements on key commodities, which would operate price bands adjustable over time, supported by international stocks, export controls and national stocks, and stand-by production controls as required.

Capacity of exporting developing countries, particularly those at low incomes, to time
their sales properly must be improved, so that they can deal with international trading and finance companies on more equal footing than in the past.

E. DEVELOPING COUNTRIES AS SELLERS AND BUYERS

Export sales: insufficiency of market staying power

As matters now stand, the many financially weak producing countries, mostly low income, have a limited staying power in the international market. Financially unable to carry stocks and in urgent need of foreign exchange, the low-income countries are frequently compelled to sell competitively on a falling market the commodity surpluses which periodically inevitably arise because most commodity production is highly variable and cannot be adjusted quickly to changing demand. These distress sales, usually accompanied by sales from speculative stocks, force event the financially strong developing countries into competitive selling as they become concerned about a loss in market share. The pressure of sales occurs in the face of a limited number financially strong buyers in developed countries who postpone purchase in the expectation of still lower prices, apprehensive of losses on inventory if they buy prematurely. It is these circumstances which frequently lead to extremely sharp price falls and to associated declines in producers' incomes, sometimes disastrous. Even under normal circumstances, when crops are near average, the bunching of competitive sales in the face of a limited number of buyers will lead to erosion of the market price, or to special sales under the market, or both.

The losses incurred by low-income sellers in falling markets normally cannot be compensated by gains in rising markets. To achieve such gains, the sellers would need financial power to hold supplies off the market for a considerable time while it is rising. The developing countries do not have such financial power, although there are rare and temporary exceptions. If international public funds were available to help absorb temporarily the surpluses and gave the producers the breathing time to adjust their production and deliveries, distress sales would be avoided. More generally, low income countries would be able to time their sales properly and thus improve their bargaining position in relation to buyers in industrialized countries. Smaller quantities would be sold when prices are low, and larger when they are high.

Evidence

Numerous specific cases are known where substantial losses were sustained by low income producers because of inadequate financial power and improper timing of sales.84 On a more general level, a study, carried out in 1978, established that in the fifteen years 1961-75 developing countries were receiving considerably lower prices for their exports than the prevailing world market prices and the prices obtained by developed countries. Export unit values received by developing countries (i.e. the average prices at which their primary products were actually sold) were compared with market quotations. The same comparison was made for developed countries' exports of the same products. A sample of 12-19 products was included. The following findings emerged:

In 1971-75, prices actually received by developing countries averaged 85 percent of world market prices.

Among the developing countries, it was the African countries, i.e. often the lowest-income producers, which received the lowest prices: 80-82 percent of world market prices in 1971-75.

In contrast, the prices received by the developed countries were close to, or exceeded, world market prices: 94-101 percent in 1971-75.

The shortfalls experienced by developing countries widened during the fifteen years 1961-75, from 12 percent in 1961-65 to 15 percent in 1971-75. For the African countries, they widened from 11 percent to 19 percent. The premiums of the exporting developed countries fell, from 4 percent above the market in 1961-65 to 1 percent. It follows that the share of the market price occurring to import trade increased, at the expense of producers, in all exporting countries, both developing and developed, with the worst deal experienced by the African producers.85

No similar investigation seems to have been undertaken of the developing country experience in the 1980s, but it would be surprising if it were any different. Foreign exchange was event more scarce in the 1980s than in the earlier periods, hence the pressure on debtors to sell at any price should have been even greater, and this probably explains, at least in part, the steepness of the export price fall experienced by the developing country producers in the 1980s.

Import prices: the African case

A recent analysis by Dr. A. Yeats, a World Bank economist and formerly on UNCTAD staff, has established that African countries pay more for imports than other countries, developing and developed, on the average. 86 His finding is based on an examination of import prices of iron and steel into Africa from France during 1982-87, showing an average 20-30 percent premium over the price paid by other importers. He

also provides additional material, suggesting that Africa pays higher prices for products other than iron and steel, and that it pays higher prices also to suppliers other than France.

Among Dr. Yeat's findings are that:

- the lowest-income countries pay the highest import prices;
- as the quantity purchased increases, the relative import prices decrease;
- as the total value of imports increases, the relative import prices decrease;
- a developed country with countervailing power will normally pay less.

Implicit in these findings is that a poor payments position will lead to higher import prices through lower quantities purchased, lower value of imports, ad hand-to-mouth purchasing pattern.

F. SITUATION IN PLANTATIONS, FARMS AND MINES

Wages and living conditions on plantations

Committee on Work on Plantations of the ILO, in its 1982 report, commenting on the situation in thirteen countries, stated that "wages or incomes are too often below the poverty mark and do not permit the worker to meet the basic needs of his family."87 Included were coffee, sugar-cane, rubber, palm oil, tea, coconuts, tobacco, cocoa and banana plantations -- all export crops.

In its latest report, in 1989, the Committee, commenting on the situation in seventeen countries, with the same product coverage as in 1982, stated that "The current situation of plantation workers is in many respects similar to that which prevailed 20 years ago."88 It then adds two important points:

"Plantations managers have from the start been obliged to provide accommodation and specific social benefits in view of the remoteness of production sites from urban centres... Despite efforts in a number of countries to renovate existing dwellings or erect new ones, the buildings in which workers and their families are lodged are still too often old and lacking sanitary arrangements. In some countries accommodation conditions have actually deteriorated over the years for lack of upkeep... Moreover, the structure of the workforce on plantations has changed. In many countries there has been an ageing of the workforce, due partly to a lack of interest in the sector on the part of the younger generation.

There is another worrying factor. To make up for difficult working and living conditions, the plantation sector generally used to offer relatively secure employment... Now, the

proportion of permanent staff in the total workforce on plantations is diminishing and employers are more and more frequently resorting to temporary or seasonal workers... This practice has extremely serious social implications. Most of the benefits in kind are guaranteed, in practice or by collective agreement, only to permanent workers. Thus, a new social stratification is coming into existence, in which permanent workers, whose number is constantly decreasing in relative terms, form a class of better protected workers, while temporary workers are disadvantaged."89

Set forth on the next page are daily wage rates of plantation workers in 1983 or 1984, the last year for which reasonably comparable data are available.

Table V. Daily wages of plantation workers, 1983 or 1984 in U.S. dollars (a)

Liberia	0.27	Mauritius	2.95
Zaire	0.35	Honduras	3.33
Sri Lanka	0.86	Seychelles	4.62
India	0.96 (b)	Guyana	4.76
India	1.20 (c)	Fiji	5.44
Bangladesh	1.03	Suriname	5.49
Madagascar	1.68	St. Lucia	5.83
Zimbabwe	2.43	Belize	7.50
Malaysia	2.46	Barbados	11.52
		Venezuela	13.95

Notes: (a) Original data were given in local currency. They were converted into US dollars at IMF-quoted market rated (International Financial Statistics). Original data were sometime given on a monthly or hourly basis; they were converted into daily wages using 25 working days per month and 40 to 50 hours per week, depending on the case; (b) Coffee and tea plantation; (c) Rubber plantations.

Source: Jean Paul Sajhau and Jürgen von Muralt, Plantations and plantation workers, International Labour Office, Geneva, 1987, pages 136-37, 141 and 143.

The median daily wage is US $2.95. This value is heavily influenced by small countries in the Caribbean which have relatively high nominal wages. If these countries, as well as Seychelles and Fiji, are excluded, the median falls to US $ 1.35 per day. This wage level compares with the median of US $ 75.00 in manufacturing of 12 developed countries in 1983 (by 1989, this rose to US $ 120.000 per day).90 As purchasing power is much greater in developing countries, such comparisons have limited value -- see the earlier issues of the Human Development Report. Nonetheless, they provide some perspective to the fundamental inequality in the international exchange of export products embodying plantation labour and manufactured goods coming from factories of industrial countries.

Real wages in agriculture

Table VI sets forth the readily available knowledge on real wages in agriculture in developing countries. This is a broader concept than wages in export industries; but in view of the importance of exports in most developing country agriculture and the likelihood that wage movements in the export and non-export parts move in parallel to a considerable degree, the data may be taken as indicative of the possible wage trend in the export sector.

Table VI. Real wages in agriculture in developing countries

A. Africa, indices

	1971	1973	1975	1980	1981	1982	1983	1984	1985
Ghana	114	97	100	32	23	22	15	n.a.	n.a.
Kenya	113	104	100	116	113	93	88	87	n.a.
Tanzania	96	99	100	70	64	n.a.	n.a.	n.a.	n.a.
Burundi	n.a.	117	100	n.a.	106	91	95	83	83
Cote d'Ivoire	111	103	100	62	57	59	56	52	n.a.
Malawi	127	120	100	97	104	126	97	86	n.a.
Swaziland	n.a.	92	100	146	132	143	142	n.a.	n.a.
Zambia	n.a.	110	100	114	98	90	86	n.a.	n.a.
Zimbabwe	86	90	100	111	157	178	n.a.	n.a.	n.a.

B. Asia, indices

	1971	1973	1975	1980	1981	1982	1983	1984	1985
Burma	n.a.	140	100	115	105	105	100	n.a.	n.a.
Bangladesh	n.a.	130	85	95	105	100	95	95	100
Philippines	n.a.	n.a.	90	90	80	80	80	70	70
South Korea	50	58	65	125	120	122	125	128	138
Malaysia									
Rubber tapers	75	90	65	100	110	90	90	65	n.a.
Palm harvesters	n.a.	80	98	120	90	130	100	120	n.a.

C. Latin America, annual growth rates

	Type of wage	Mid-1960s to mid-1970s		End of 1970s		Early 1980s	
Argentina	average	1965-74	3.6%	1976-80	-21.9%	n.a.	
Brazil	average	1967-74	3.3	1974-80	1.8%	1980-83	-4.5%
Chile	minimum	1965-70	2.7	1975-81	4.7%	1981-84	-12.2%
Colombia	average	1965-70	0.5	1976-80	4.5%	1980-84	-1.2
Costa Rica	average	1971-74	-4.2	1974-79	11.7%	1979-83	-4.5%
Ecuador	minimum	1965-73	-7.2	1973-79	2.3%	1980-84	-12.1%
Guatemala	minimum	1965-70	-11.7	1977-80	-3.4%	1980-82	3.1%
Mexico	minimum	1965-77	3.7	1977-81	1.0%	1981-84	-15.0%
Panama	minimum	1965-73	3.6	1977-81	1.3%	1980-84	-3.3%
Paraguay	minimum	1966-76	-1.1	1976-80	3.0%	1982-84	-3.8%
Uruguay	average	1965-74	1.9	1974-80	-2.3%	1980-84	-6.3%

Source: International Labour Office, World Labour Report 3, 1987, Geneva, pages 71, 81 and 87.

In Sub-Saharan Africa, between 1971 and 1984, real agricultural wages fell in seven countries out of nine. In Asia, between 1973 and 1985, they fell in four series out of six.

In Latin America (11 countries), they rose at a median rate of 1.8 percent per year between the mid-1960s and end 1970s, but then fell at 4.5% per year in the early 1980s. On the whole, it was an unfavourable record, influenced, at least in part, by falling export prices. In Malaysia, this influence is formalized: plantation wages move in accordance with export prices, with allowance for productivity growth. The latter was very strong in palm oil, therefore real wages rose despite falling prices; but in rubber, real wages fell as the decline in export prices was the dominant force.

Distribution of gains from productivity growth

In the judgment of the ILO staff, productivity growth in export industries in developing countries resulted mostly in falling export prices rather than in rising domestic wages during the last several decades. The known exceptions are only Malaysia, where both palm oil and cocoa production booms led to a shortage of labour and rising wages, and Mauritius where growth of diversified industrial exports led to a liquidation of unemployment and shortage of labour in the sugar industry in less than a decade. But in other countries, the main beneficiaries of productivity growth in export industries appear to have been importers abroad. A partial statistical confirmation of this assessment is found in the evidence that labour productivity rose in the agricultural sectors of C™te d'Ivoire, Kenya and Malawi during 1970-84, while their agricultural real wages fell.[91] In coffee, "as a general rule, most of the gains from increased productivity have accrued to consumers in periods of low prices, and to state agencies in periods of high prices. They have not resulted in increased wages in real terms to plantation labourers".[92] And as periods of low coffee prices have been much longer than the periods of high prices -- please see Chart II, page 31 -- most of the gains have gone to the consumers. In Central America, over the period from the late 1940s to the early 1970s, banana output per hectare more than doubled as the producing countries switched to Panama disease-resistant varieties, capital per worker increased by nearly four times, whilst the number of workers per hectare decreased by around 20%. With wages approximately constant in real terms, the major beneficiaries of this rapid technical change were the producing companies and the consumers, who experienced a fall in the real price of bananas of about 50%."[93]

The issue goes beyond agriculture. In its Trade and Development Report 1990, UNCTAD has argued that "higher productivity is a major factor behind expanding output, which is the main cause of lower export prices for several export commodities of developing countries. Palm oil and cocoa are good examples in this respect in the agricultural field, where productivity has increased because of cloning and hybrids. In the case of metals, lower production costs have likewise exerted a downward pressure on market prices. For example, substantial cost reductions have been achieved for copper and tin in recent years, basically through a reduction in employment, profit-related wage rates, new technologies, closure of high cost mines and the coming on stream of more efficient installations."[94]

G. STABILIZATION

Alternatives to stabilization

Compensatory financing. It has been argued that compensatory financing provided to developing countries experiencing export shortfalls is a generally superior substitute for commodity price stabilization. It will be readily agreed that such financing is an indispensable device for commodities where price stabilization is not technically feasible or cannot be agreed upon on other grounds: the number of commodities on which stabilization agreements can be concluded will be limited, and also, price stabilization will not help where the reason for an individual country's export shortfall is a decline in its own commodity supply, e.g. a crop disaster. But the difficulties with compensatory financing as a general remedy are three-fold: it lead to additional indebtedness of already indebted developing countries, it requires very large resources to be effective, and it does not prevent or moderate the multi-year production cycles. Moreover, in practice compensatory financing has become entangled in loan conditionality which has adversely affected its original purpose.95 Two recent international report have stated:

"There has been a general recognition by the world community in the postwar period of the need for contingency provisions, by way of mechanisms for compensatory and supplementary financing, to be built into the operations of international financial institutions to cushion developing countries against a sudden reversal of their economic prospects. The establishment by the IMF in 1963 of a Compensatory Financing Facility (CFF) to provide assistance to developing countries facing unexpected shortfalls in exports was a limited response to this need. In the 1970s, the scope of this facility was expanded to include the financing of contributions to international buffer stocks of primary commodities and to cover unexpected increases in the cost of cereal imports.

The increased uncertainty and fluctuations in the world economy in the 1980s -- and the continuing vulnerability of developing countries -- amply justify a further widening and deepening of the Compensatory Financing Facility. Unfortunately, the trend has been in the reverse direction. The CFF was originally designed to provide quasi-automatic support for developing countries whose export revenue fell sharply. Its initial conditionality was very low. Until the 1970s, the access limits which govern how much a country may borrow were also gradually increased. However, in the 1980s, under the ideological pressure of some developed countries, the IMF substantially tightened the conditions associated with support under this facility.

In 1988, the IMF merged the CFF in a new Compensatory and Contingency Facility (CCFF). This has the merit of covering a wider range of external shocks than falls in export earnings and increases in cereal import bills. For example, it can also assist countries to meet unexpected increases in interest payments on external debt. But the new facility lowered the limit on drawings from 83 to 65 per cent of a country's IMF quota, and also made the conditionality more severe. Under the earlier CFF, countries could draw up to 50 per cent of quota without having to subject themselves to adjustment programmes prescribed by the Fund. By contrast, under the new facility almost all

support is conditional upon the Fund's approval of adjustment policies. Compensatory drawings have been further tightened by the introduction of phasing. All these features involve a far more restrictive approach than the semi-automaticity originally associated with compensatory financing. The facility as it now stands is extremely complex and does not provide a reasonable assurance of support when a country is driven by external shocks to turn to the IMF."96

"Compensatory finance is one way of providing bridging finance to tide a country over a temporary, self-reversing shortfall in foreign exchange earnings. While it should provide a relatively quick disbursement of foreign exchange, some difficulties have been experienced in its operations -- in its timeliness, the amount obtainable, the conditionalities which were progressively introduced and very tight repayment conditions. A new facility, providing short-term contingency financing, has recently been integrated into that of compensatory finance but because of the complications it introduced, this short-term contingency mechanism has not been used by African countries.

A United Nations Secretary General's Advisory Group on Financial Flows for Africa97 agreed in 1988 that the lack of an effective compensatory financing mechanism has contributed to the long-term financing problems of many African countries since it forced them to the less satisfactory ways to cope with the unpredictable changes in the export earnings of commodity producers. The [Fraser's] Group endorses this conclusion."98

Commodity risk management and finance. In recent years, the World Bank staff has been suggesting the use of "commodity price-related financial instruments" in order to manage the volatility of export earnings and import payments of developing countries. The common feature of such instruments "is to provide insurance against commodity price risk (i.e. unanticipated fluctuations), not to try to improve the average price... In other words, hedging... accepts market prices and trends, but aims to reduce risk..."99 Three main types of financial instruments appear to be involved: futures contracts, commodity swaps, and commodity bonds.

Concerning futures contracts, the prospects of their widespread use and usefulness for developing countries appear limited. According to a recent study of the Venezuelan oil situation:

"[In principle], it may be optimal to transfer the risk to some other agent using contingent claims such as futures and options. If such markets exist, it is possible to calculate a hedge ration that would optimally reduce the uncertainty in the income stream, given the costs involved and the benefits from risk reduction. By either selling the oil forward, selling futures or selling calls to buy put it is possible to look into a known oil price for a given period of time, thus eliminating any price uncertainty for that term.

There is a problem with this solution: even though markets exist, and have been growing very fast in recent years, they still do not go far enough in time nor are they liquid enough to deal with a relevant fraction of Venezuela's oil uncertainty... Most oil-related futures

contracts negotiated in open exchange markets go out for less than a year...Moreover, the markets are small compared to the volume of Venezuelan exports, while their liquidity drops dramatically with the time to maturity. For example, the total number of contracts outstanding on 9 April 1991...was 158.7 million barrels for one month deliveries (May), 23.4 million for six-months delivery market. The market for futures options has similar problems. These only go out for three months and the volume of contracts negotiated are of the order of 120 to 150 million barrels for all maturities. This number must be contrasted to the 180 million barrels that Venezuela would export in that period of time. The lack of liquidity in these markets implies that if Venezuela really attempted to hedge a sizeable fraction of its risk, it could not take prices as given. Knowing this, other market participants would take into account the possibility that Venezuela may include this aspect in their assessment of the risk associated with the traded securities, making hedging very expensive." 100

Engel and Meller, after studying the situation in Chile and Bolivia, in addition to that of Venezuela, have concluded that "except in the case of a country which is not a world producer of importance, futures contracts do not offer an attractive mechanism of revenue stabilization." 101

Concerning commodity swaps (medium-term contracts involving exchange of specified cash flows at specified intervals, which can be used to effectively fix a commodity price in advance), the World Bank notes that "markets for commodity swaps are not yet as active as the currency and interest swap markets, and have been largely confined to metals and energy." 102

Commodity-linked bonds provide for variation of interest rate or principal or both in relation to the international price of the commodity. Alternatively, they can be issued as convertible to claims on specific quantities of the commodity at specific option prices. The opportunity for increased profit, if the commodity price rose, might make creditors willing to accept a lower interest rate, while any increased obligation at a higher commodity price would be more than offset from the country's standpoint by the increased capacity to service the instrument.103 In practice, complex and paradoxal situations may arise. In 1990, Algeria managed to borrow from a bank consortium against an oil-delivery contract stretching over several years. An interest rate margin above the London Inter-Bank Offer Rate (LIBOR) was fixed at a specific level for as long as the price of oil stayed within an agreed specific range. If the price fell below the range, Algeria was to pay an additional interest margin, because it now presented a greater credit risk. If the price went up above the range, Algeria again was obliged to pay extra interest, now because its capacity to pay was increased. It can, of course, be argued that without these provisions Algeria might not have been able to borrow at all, or would have had to pay much wider margin above LIBOR taking the transaction as a whole. But the fact that it had to accept an asymmetrical treatment -- to pay more both when the price of oil went up and when it fell -- raises doubts as to the fairness in the sharing of benefits and risks in this type of transaction: the international capital market will take some risk, but the debtor country will have to pay for it, and the crucial question is how much.

A broader problem concerns the overall commodity price effect of the use of commodity-linked bonds. If it is massive, it will stimulate more investment in primary production for exports on a world scale and thus contribute to a further pressure on primary product prices which are already in deep depression. If the use of commodity-linked bonds is only sporadic, it will be of help to the individual country concerned -- provided it is able to conclude a favourable deal with its lenders and buyers -- but it will not make a serious dent to the commodity problem as a whole.

As practical steps, the World Bank proposes to continue with its technical assistance programme to individual countries in economics and finance of commodity risk management, and Meller and Engel recommend that the Latin American countries-exporters of natural resources (energy and minerals) begin to operate in financial instruments, but in modest volume in order to acquire know-how and avoid any sharp increases in insurance premia and trading margins. It is probable that advances in this field will be slow in coming and of limited significance. In any case, existence of commodity-linked financial instruments and markets in developed countries has not eliminated the need for a widespread use of government programmes to support primary product prices and incomes. How can this be expected in the case of developing countries?

Criticisms of international commodity agreements

Professor Gilbert, Oxford, Dr. Maizels, Oxford and formerly with UNCTAD, and the World Bank staff have made six criticisms of postwar international commodity agreements (ICAs):

ICAs can only be successful provided that they command a consensus in their industries. This is particularly important in export control agreements, since otherwise there can be no agreement on quota allocation. 104 Inability to reconcile the different interests of the countries involved leads to erosion of the rules, smuggling, and free-riding.105

The agreements have not been endowed with financial resources adequate for achieving their specific stabilization objectives. Future ICAs should consider much more carefully than hitherto the probable call on their finances which would arise from alternative price range targets. 106 Dr. Maizels calls the role of finance crucial.

Prices or price bands have not been adjusted to ensure long-run equilibrium in demand and supply. It has proved difficult to set appropriate prices and to adjust them regularly to changing market conditions. 107

A commodity agreement normally runs for five years and the question arises whether any international authority can be expected to deal satisfactorily with the long-term problems which may dominate the dynamics of a particular commodity market. In sugar, for example, the major problem has been persistent over-supply, the difficulties of stabilization being greatly increased by the residual nature of the world market given the heavily protectionist policy of major consuming countries. An agreement which sets out merely to even out short-term fluctuations cannot be expected to achieve even this limited aim if the underlying longer-term forces in the market continue to put downward pressure on the price.108 In tree crops, the multi-year cycles call also for a longer-term approach.

The agreements were poorly drafted, at least in some cases. This was demonstrated by the controversy following the tin collapse (1985) as to whether the buffer stock manager was acting within the terms of the agreement, and more especially, by doubts as to whether member governments were legally responsible for debts incurred on their behalf by the international authority.109 The collateral arrangements with banks through pledging tin did not prove satisfactory. As the price fell, the value of the collateral fell in proportion; in this "meltdown", either additional collateral or cash had to be put up; as neither was available, the brokers' and banks' loans partly failed. This would have been avoided if the agreement's borrowings, in addition to collateral's cover had guarantees of member governments.

The agreements were not robust with regard to exchange rate changes. A major factor behind the collapse of the tin agreement was that, as a consequence of the appreciation of the U.S. dollar, the market was being supported at too high a level. The fluctuating rates of major currencies led to "currency scissors" for tin stock assets, liabilities, purchases, sales and valuation of the debt service.

The currency issue (item f) can be handled, perhaps by defining support prices in terms of SDRs (proposed by professor Gilbert), although additional action may be needed also, such as currency swaps and insurance. The issue of clarity of the agreements (item e) is also a technical problem which can be handled, although it raises the question of additional responsibility of governments. (They were prepared to take it in the case of the agreement on the Common Fund for Commodities, which is a problem which probably can be surmounted by having some provisions of agreements lasting 10-15 years and some five. Even the issue of price determination and updating (item c), while difficult, is now somewhat easier to solve than before: there is more realization in developing countries that competition from synthetics, new technologies and developed countries call for moderation in price objectives and for flexibility in a range of products. It is in the first two items -- consensus within the industry, and finance - where greatest efforts will need to be made.

Burden of export and production controls

In the case of export quotas and supply management, there are two adjustments: first, the burden is allocated internationally among countries through international quota allocation, and secondly, it is then allocated internally within each country amongst its various producers. Even where formal export quotas do not exist but it is government support purchases which are used to maintain export prices, there is still the problem of within country allocation.

International quota allocation is known; it is normally based on past exports, with some privileged position given to small producing countries. Much less is known about internal quota (or government purchase) allocation. Available information is set out in Table VII.

Table VII. Internal allocation of the burden of export controls and of limitations on government purchases

Country	Product	Control authority	Allocation principle	Comment
Malaysia	Plantation crops generally	Committee of government, plantations and smallholders, which decides on size of output cut and form it will take	Privileged position given to smallholders	Situation of plantations is generally better as they have more resources for switching into alternatives. Smallholders may move into vegatable gardening, animal husbandry or urban jobs.
Malaysia	Rubber		Most of burden falls on large plantations as they can be more easily controlled	
Malaysia	Tin	Local committees of producers, on whose assessment decisions there is right of appeal to a central committee	Proportion of potential output applied to all producers equally	Employment in small mines is more adversely affected because they are more labour intensive. But the same happens then price falls as small mines have higher cost
Mauritius	Sugar	Ministry of agriculture	Privileged position of smallholders in allocation of acreage and in paying lower export tax	
Kenya	Coffee		Privileged position of smallholders, but expansion subsequently checked	
Colombia	Coffee		Privileged position of smallholders, but some had to move to cocoa	
Brazil	Coffee	Government and planters (Brazilian Coffee Institute; now abolished)	When in effect, export quota is allocated to exporting firms, usually on past performance. This affects the amount they buy from	Smallholders were adversely affected during GERCA diversification programme in 1960s; some purchased land on credit elsewhere to grow

			producers, but producers are not allocated any production quotes	soybeans; recently some are coming back to coffee, filling the gap left by Uganda and Angola coffees

Sources: Malaysia: interviews with professor Meyanathan and Dr. David Eliiot, UNCTAD; William Fox, Tin -- the Working of a Commodity Agreement, London, 1974; Redzman Sumun, Status of the Tin Industry, Kuala Lumpur, April 1986 (mimeo.); Mauritius: work on the Commission of Inquiry into the Sugar Industry, 1983; Kenya, Colombia and Brazil: interview with Dr. J.A.N. Wallis; Brazil: communication from Dr. A.F. Beltrao and interview with Dr. J.O. Santos.

Three conclusions follow. First, it appears that in the majority of cases smallholders had a better treatment in the allocation of export quotas and supply management than the large plantations. Secondly, the latter were in a better position to absorb the export cut as they had more resources and facilities to switch into other activities than did the smallholders. Thirdly, if instead of export quotas or supply management, prices had been allowed to fall, smallholders would have been as much and probably even more adversely affected than with the imposition of export quotas and of supply management.

A possible road ahead

Out of five international commodity agreements -- coffee, cocoa, sugar, tin and rubber -- only that on rubber is in operation. The other four need to be revived. Another four products -- tea, cotton, jute and copper -- were also in the list of "core" commodities of UNCTAD's Integrated Programme.110 In addition, there is petroleum. This is the scope of the task of stabilization with which developing countries need to cope initially.

The hard core of the commodity problem is in products of agricultural origin. In most developing countries, the agricultural sector occupies a key place in the economic structure. This is the sector in which most of the population works, and in which a high proportion of underemployed resources are to be found. This is the sector where most of the income is generated and where incomes are lowest. A sustained and broadly based growth process cannot occur if the agricultural sector stagnates. Agricultural incomes and productivity have to increase if there is to be effective and increasing demand for the goods and services which can be produced by those who cannot be effectively absorbed in agricultural production; and agricultural production, surplus to the requirements in the rural areas, has to provide for the growing needs of those employed in nonagricultural production. In three prosperous areas of the world economy -- North America, Western Europe and Japan -- vast programmes of support of agriculture are in operation, including price stabilization and support, income support, farm credit, government technical assistance, storage facilities, etc., which, for all their blemishes and even harm inflicted on the outside world, have shown two fundamental achievements: first, an enormous improvement of agricultural productivity and standard of living in agriculture, and secondly, a continuing generation of purchasing power which has supported the demand for manufactured goods and assisted a sustained economic growth over the last fifty years.

It is now clear that developing countries will have to rely essentially on themselves for building up and modernizing their agricultural support systems. With respect to crops for their own use, they can do this each on its own to the extent that resources permit. With

respect to commodities that are exported, this lone approach can be taken only at a great cost because of falling export prices. Hence a collective developing country approach is necessary. Attempts to revive international commodity agreements and create new ones, covering both producing and consuming countries, should not be dropped; but for such attempts at universal arrangements to be successful, it is necessary that the developing countries reach a full understanding among themselves first as to the essentials of the specific schemes they want to pursue and be ready to implement on their own if necessary, to the extent possible.

The second crucial issue is that of finance for commodity stocks. A part of this finance would have to be supplied by the participating producing countries in the form of building national stocks, but under collective supervision of all participants. The other part, international stocks, can be financed to some extent by borrowing from commercial banks against commodity collateral: it was reported recently they might be prepared to provide as much as 50 percent of the money needed for a coffee retention scheme.[111] But the hard core of finance for international stocks would have to come from international financing agencies. The recently established Common Fund for Commodities is an obvious source; but it is reported that for the time being it focuses on preparatory work to support research and investment projects (Second Window) rather than on stabilization and stock financing (First Window). Their work programme and prospects for financing need to be explored with the Common Fund further. Possibilities of drawing on the IMF buffer stock financing, the amounts which might be available in competition with other claims on the IMF, and its current conditionality requirements should also be explored. But perhaps the main support for international stock financing can come from regional development banks. The President of the African Development Bank, at its annual meeting in Cairo in June 1987, stressed the need for efforts to achieve the critically required effective stabilization of export commodity prices, and urged an exploration of concepts and steps for this purpose.[112] There is a long tradition of close relations between the Inter-American Development Bank and the UN Economic Commission for Latin America and the Caribbean which had pioneered the analytical and policy work in this area. The Asian Development Bank's views probably will be sensitive to the thinking of India, Indonesia, Malaysia, Pakistan, Philippines, Sri Lanka, Bangladesh and Thailand, all major primary product exporters among its members. Regional development banks have been engaged recently in exploring the areas for their cooperation: a coordinated and imaginative action on the commodity problem would seem to be both most useful and most urgent. Of course, no international financial institution can act without agreement of key developed country members; but perhaps progress can be achieved in getting this agreement for creating international financial consortia for support of stabilization of specific commodity proposals, put forward by interested countries, contain:

(a) a convincing economic justification in terms of economic benefits, costs, and risks;

(b) a realistic and sound financing plan;

(c) a credible statement of the likely financial outcome of its operations for the medium term;

(d) an assessment of supporting measures, such as diversification and productivity increase, needed to make stabilization a long-run success; and

(e) a scheme of cooperation with other agencies, national and international.

Footnotes:

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51: Financial Times, 2 August 1991.

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54: Financial Times, 27 February 1991.

55: World Bank, Price Projections 1990-2005, Volume I; World Bank News, 10 October 1991.

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63: Financial Times, 4 March 1991.

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73: Interview with ILO staff, Geneva, August 1991.

74: Interview with professor Sanathavan Meyanathan, Malaysia, now at the Economic Development Institute of the World Bank, October 1991.

75: Communication from Dr. Marcial Plehn Mejia, UNCTAD, of 23 September 1991, and interview with Dr. J.A.N. Wallis, formerly with the International Coffee Organization and now at the Economic Development Institute of the World Bank.

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81: The Wall Street Journal, 19 August 1991.

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Part III: Developing Countries in the World Manufactures Market: Achievements and Problems

A. GROWTH

An overview

During the last thirty-five years, the developing countries as a group, in the wake of successful industrial and technological changes, have managed to increase their share of world exports of manufactures from 4.1 % (1955) to 18.75 % (1989). 113 The latter percentage exceeds that of Germany (F.R. - 14.85%), Japan (12.8%) and the most important structural changes in the world economy since the 19th century: it has broken the monopoly of industrial countries in the most lucrative market and opened the door for self-reliant growth in the South through the development of its capital goods industry.

Between 1975 and 1990, the volume of developing country exports of manufactures increased more than five-fold, compared to a two-fold increase for developed countries.

Table I. Exports of manufactures, 1975-90 (a)

	1975	1980	1985	1989	1990
A. In billions of US $					
Developing countries	39.42	126.16	182.69	390.30	420.00
Developed countries					

Germany, F.R.	79.62	166.92	161.58	309.59	361.92
Japan	53.17	124.50	170.88	266.59	277.44
U.S.	70.97	144.09	145.34	245.17	282.46
All Developed countries	433.85	923.10	955.64	1,687.80	1,956.40
Developing countries	100	189	296	523	553
Developed countries					
Germany	100	135	174	211	215
Japan	100	156	225	244	256
U.S.	100	133	109	160	180
All developed countries	100	137	164	204	214

Note: (a) Exports of Eastern Europe and USSR are not included.
Source: United Nations, Monthly Bulletin of Statistics, June 1991 and March 1992.

The bulk of exports of manufactures from developing countries comes from a small number of economies: in 1988, five top countries accounted for 54% of total developing country manufactured exports. Nonetheless, both the number of countries exporting manufactures in significant amounts -- more than US $ 1 billion per year -- and their export volumes have been increasing rapidly.

Table II. Top 20 developing countries exporting manufactures rate of growth in volume of manufactured exports, p.a.

		Rate of growth in volume of manufactured exports, p.a.	
	1988 export value US $ million	**1980-88**	**1970-80**
South Korea	56,432	13.7	23.4
Taiwan	55,486	13.1	16.1
Singapore	27,554	7.3	18.2
Hong Kong	26,597	11.2	10.5
China	21,995	12.5	8.3
Brazil	17,262	6.0	18.8
Mexico	10,393	19.1	6.3
Yugoslavia	9,850	0.5	7.2
Malaysia	9,197	14.8	15.1
India	8,605	4.5	7.5
Thailand	8,033	17.6	16.2
Turkey	7,492	23.3	13.2
Indonesia	5,623	30.3	20.8
Pakistan	2,961	10.1	-0.4
Argentina	2,889	-1.3	9.1
Philippines	2,274	3.8	25.6

Egypt	2,016	7.7	-10.4
Morocco	1,807	11.3	13.7
Tunisia	1,617	8.3	19.3
Colombia	1,207	0.3	12.8

Source: UNCTAD Secretariat, based on data from the U.N. Statistical Office and other official international sources.

Sub-Saharan Africa

Most of the expansion of manufactured exports has been concentrated in more advanced developing countries. But industrialization drive has been almost universal, and expansion of non-traditional exports has been a policy target virtually everywhere. Perhaps the most striking and the least known development in Africa during the last two decades has been a significant growth of manufactured exports:

Between 1980 and 1987, exports of manufactures from Sub-Saharan African countries
rose 42% in U.S. dollar terms, or at 5.7 percent per year. For 1988, out of 33 countries for which data are available, exports of manufactures rose in 28, and the overall increase for the 33 was 15.6%. For 1989, out of 6 Sub-Saharan countries for which data are available, exports of manufactures rose in five.

In 1988, eleven Sub-Saharan African countries exported manufactures in excess of US
$ 100 million each, compared to seven in 1980; in 1965 (and in 1969), there was none.

Table III. Exports of manufactures from Sub-Saharan Africa above US $ 100 million each in 1988 (US $ millions)

	1965	**1980**	**1988**
Mauritius	0	125	692
Zimbabwe	61	404	638
Botswana	1	353	540
Côte d'Ivoire	15	295	317 (a)
Kenya	14	210	200 (a)
Senegal	4	72	182
Gabon	10	26	165
Cameroon	6	50	164
Nigeria	17	130	155
Congo	24	64	14 (b)
Zaire	28	158	44

Notes: (a) 1989; (b) 1987
Sources: World Bank, Sub-Saharan Africa: From Crisis to Sustainable Growth, 1989, page 250; World Bank, World Tables 1991.

There also have been setbacks, for various reasons. But taking Sub-Sahara as a whole, to achieve a 60% increase in exports of manufactures to US $ 4 billion on a non-negligible base of US $ 2.5 billion in 1980, over an eight-year period marked by a commodity collapse and associated curtailment of the capacity to import, droughts, debt crisis, wars and policy disasters, is remarkable by any standard.

B. FALLING REAL EXPORT PRICES

Between 1980 and 1990, prices of manufactures exported by developing countries rose 12 percent (unit values in U.S. dollars), in money (nominal) terms. In comparison, prices of manufactures exported by developed countries rose by 35% in the same period. Furthermore, prices of manufactures exported by G-5 developed countries (Germany, Japan, U.S., U.K., and France), weighted proportionately to the countries' exports to developing countries, rose by 39%; and prices of machinery and equipment exported by Germany, Japan, U.S., and Sweden rose by 48%. The GNP deflator of G-5 countries, measuring the overall aggregate price increase in these countries, rose 58%, and the consumer price index in G-7 countries (G-5 plusCanada and Italy) rose 57%. Consequently, in real terms, prices of manufactured goods exported by developing countries fell, the size of the fall depending on the index used. Table IV shows the range of these falls. Their average, about 30 percent, can be taken as the probable fall in developing country export prices of manufactures in real terms, or 3.5 % per year.

Table IV. Fall in developing country export prices of manufactures in real terms, 1980-90, range

		Percent
(1)	When adjusted by the index of export prices of developed countries	20
(2)	When adjusted by the index of export prices of G-5 countries	24
(3)	When adjusted by the index of export prices of machinery and equipment of 4 developed countries	32
(4)	When adjusted by the consumer price index of G-7 countries	40
(5)	When adjusted by the GNP deflator of G-5 countries	41
(6)	Average of (1) through (5)	31

Sources: Indices (1) and (3) from the UN Monthly Bulletin of Statistics, June 1991 and August 1911; indices (2), (4) and (5) from the World Bank, Revision of Primary Commodity Prices and Quarterly Review of Commodity Markets, 29 July 1991.

This finding is consistent with the estimates of the World Bank and UNCTAD. The World Bank indicates that already in 1973-80 export prices of developing countries increased at a much slower pace than the export prices of developed countries (6.8 percent per year, compared to 10.7 percent); while in 1980-87, export prices of developing countries fell in money (nominal) terms -- and even more in real terms -- while developed country export prices continued to rise.[114] UNCTAD shows a reduction in export until values of developing country manufactured exports in 1980-85, followed by recovery in 1986-89, [115] but the recovery was probably no higher than the price increase in developed countries. Furthermore, it is reported that in 1991 export prices of Latin American manufactures are falling both in real and in money (dollar) terms.

Why the fall in developing country export prices of manufactures? Three reasons may be listed, and all of them worked simultaneously.

Devaluations in developing countries, partly under the pressure of debts and conditionality, forced out exports in excess of market demand at unchanged prices, and got the prices down.

Slow-down in the world economy since 1980 compared to the earlier period weakened
the aggregate demand.

The sheer mass of additional export production placed on the market by an increasing number of sellers, some of them operating from export processing zones and having no other outlet but exports even when export demand is weak, tended to drive down selling prices.

C. RESTRICTIONS ON ACCESS TO DEVELOPED COUNTRY MARKETS

Tariffs

"Successive GATT rounds, and particularly the Tokyo Round, have succeeded in lowering tariffs considerably in the industrial countries. The post-Tokyo weighted average most-favoured-nation rates (MFN rates) have fallen to 5.6, 5.5 and 4.8 percent respectively in the EEC, Japan and the U.S. In all these markets exports of Third World countries face higher average MFN rates than exports of industrial countries. Average also blur substantial discrepancies and peaks. In the EEC, Japan and U.S., tariffs above 10 percent still account for 21.5, 17.1 and 16.0 percent respectively of all tariff lines. Most of these high percentages are concentrated in food and textile and clothing categories, items of most interest to the Third World. Also, bound tariffs in agricultural items are small, which means industrial countries can raise them at will. There are also problems of tariff peaks and tariff escalation at every stage of processing." 116 Chart I shows the bias against processed products in the tariff structures of industrial countries.

Chart I. Average tariffs in industrial countries for selected primary and processed commodities - not yet available

Non-tariff barriers

It is non-tariff measures (NTMs) which have been the main obstacles to expansion of developing country manufactured exports. They have proliferated during the last several decades and now affect some of the key product groups in which developing countries have a major advantage. In the assessment of the World Bank staff, almost one-half of

OECD imports in 1986 was affected by non-tariff measures: 54% in the European Community, 45% in the U.S., and 43% in Japan.117 The 1986 aggregate OECD restriction effect was double the level in 1966. 118

Table V sets forth the 1990 incidence of selected non-tariff barriers, as computed by UNCTAD. These measures affect more than 22% of non-fuel developed country imports from developing countries; this is a proportion one-third higher than in the case of imports from other developed countries. An analysis of a detailed breakdown for 1988 shows that the most important single non-tariff measure affecting developing countries is the Multi-fibre Agreement (MFA), which restricts developing countries exports of textiles and clothing: it affects some US $ 36 billion worth of trade, of which US $ 14 billion corresponded to agricultural products. Countervailing and anti-dumping actions affected about US $ 8 billion of trade, covering a wide range of products. Price control measures, including variable levies, affected about US $ 4.5 billion of trade, covering principally agriculture. Some US $ 8 billion worth of trade was covered by "voluntary export restraints" (VERs).

The figures quoted above and the percentages shown in Table V are only illustrative. They show the trade that was affected; they do not show the potential of trade that would have taken place on the basis of new investment and associated employment if non-tariff obstacles had not existed in the first place. It is a testimony to the vitality of developing country export industries -- and to the existence of loopholes in the protective legal system in developed countries -- that manufactures have shown such rapid export growth in the past; but there is no doubt that a much larger export flow, particularly in textiles and other light industry, steel, shipbuilding, and electronics would have taken place had it not been for the barriers and the severity with which they have affected the developing countries. At the end of 1990, there were in existence 284 export-restraint-type arrangements involving GATT members. An many as 107 of these covered product groups in which developing countries are substantial actual or potential exporters: agricultural products (59), textiles and clothing (51), steel and steel products (39), electronics (37), and footwear (21 arrangements).119

One of the severe non-tariff barriers have been anti-dumping and countervailing actions taken against imports. The number of outstanding cases world-wide, of which the over whelming number is in developed countries, stabilized between 1987 and 1990, but within this table total, the number of cases against developing country exports increased 20%. Developing country exports accounted for 35% of the total number of antidumping and countervailing cases in 1987; by 1990, the proportion rose to 45%.120 These proportions are very much larger than the shares of developing countries in total world exports and in world exports of manufactures.

Table V
Import coverage ratios (a) of selected non-tariff measures (b), by country groupings, applied in 1990 by selected developed market-economy countries (c)

SITC	Product groups	World	Developed countries	Developing countries	USSR and Eastern Europe

		Broad	Narrow	Broad	Narrow	Broad	Narrow	Broad	Narrow
0+1+22+4	**All food items**	35.9	31.8	41.8	35.4	28.7	26.6	56.7	54.9
0	food and live animals	39.3	34.5	47.3	39.2	31.0	28.7	61.1	59.3
22	Oil seeds and nuts	7.4	6.9	5.7	4.9	10.3	10.3	8.5	8.5
4	Animal/vegetables oils	10.0	9.6	12.9	12.1	7.6	7.3	23.8	23.7
2 less (22+27+28)	**Agricultural raw materials**	4.3	2.9	3.4	2.5	5.9	3.9	5.7	2.1
27+28+67+68	**Ores and metals**	17.9	11.6	20.4	14.2	11.9	5.6	25.3	15.9
67	Iron and steel	52.9	35.3	56.8	40.7	40.6	19.7	67.1	44.0
68	Non-ferrous metals	0.8	0.2	0.8	0.1	0.3	0.1	2.4	1.4
3	**Fuels**	17.9	13.5	23.8	17.2	12.6	9.3	43.8	36.9
5	**Chemicals**	10.8	6.6	10.9	7.0	8.1	4.3	15.8	6.4
6-8 less (67+68)	Manufactures, not chemicals	17.8	11.0	15.5	7.2	24.2	21.2	18.9	14.6
61	Leather	13.2	1.3	7.4	1.7	16.8	1.0	16.2	2.5
65	Textile yarn and fabrics	38.7	34.3	17.0	11.8	61.6	58.1	69.3	61.2
84	Clothing	63.1	56.6	27.6	6.8	71.6	68.5	75.1	72.9
85	Footwear	19.7	8.0	14.2	0.2	20.9	10.9	52.5	6.1
0-9 less 3	**All items, excluding fuels**	18.5	12.5	16.8	9.6	22.4	19.2	22.7	17.1
0-9	**All items**	18.4	12.6	17.1	9.9	19.9	16.8	30.4	24.4

Source: UNCTAD Data Base on Trade Control Measures. Reproduced in: Protectionism and Structural Adjustment, op.cit.

(a) Ratios have ben computed using as far as possible 1988 trade weights; otherwise trade statistics for 1986 (or 1989 in the calculations regarding the United States) were used.; (b) The "broad" group of NTMs includes certain para-tariff measures, surcharges, variable levies, anti-dumping and countervailing actions, quantitative restrictions (including prohibitions, quotas, non-automatic licensing, state monopolies, "voluntary" export, restraints and restraints under MFA and similar textile arrangements), import surveillance, automatic licensing and price control measures. The "narrow" group of NTMs excludes from the "broad" group defined above, para-tariff measures, antidumping and countervailing actions, automatic licensing and import surveillance measures.; (c) Australia, Austria, Canada, EEC (12), Finland, Japan, New Zealand, Norway, Sweden, Switzerland and the United States.

In the time remaining for the conclusion of the Uruguay Round of trade negotiations, the developing countries are facing a formidable undertaking of persuading the developed countries to make substantial progress in opening their markets to developing country exports.

D. IMPORT LIBERALIZATION AND INTERNATIONAL TRADE NEGOTIATIONS

In reporting to the GATT Council in April 1991, Dr. Dunkel, Director-General, stated that some 30 developing countries and several Eastern European countries had liberalized their imports since the beginning of the Uruguay Round in 1986.[121] Professor Henderson, Head of the Economics and Statistics Department of OECD, stated in May 1991 that "For the first time in economic history the impetus to trade liberalization is not

coming from industrial countries which profess to accept liberal norms, but rather from countries whose past tradition has been to reject them."[122] The representative of Brazil in trade negotiations, speaking on behalf of a group of developing countries, said on 30 July 1991 that "without waiting for the conclusions of the Uruguay Round, we have opened our markets: we have reduced our tariffs, we have given away our non-tariff measures and our exceptions for balance of payments protection. We have not kept waivers, derogations, grey area measures as bargaining chips for the last stage of negotiations."[123] In a number of cases, import liberalization has been motivated by the country's belief that rigid trade and foreign exchange controls introduce distortions, may adversely affect exports, and are difficult to enforce. In most cases, import liberalization has been one of the key conditions for financial support extended by the IMF and the World Bank in its structural adjustment loans.

Countries which dismantle or reduce their import restrictions unilaterally do not obtain "credit" for these actions automatically at GATT negotiations,[124] and possibly in their bilateral trade negotiations as well. As of mid-1991, the situation at GATT was unresolved. In its July 1991 report on GATT activities in 1990, and referring to the unsuccessful Uruguay Round meeting held in Brussels in early December 1990, the Secretariat states that "while there were significant {concession) offers on the table, serious problems remained... differences remained on the approach to be used to give credit for tariff bindings, and the appropriate level of recognition to be accorded to autonomous liberalization measures taken since the start of the Round. A number of developing and East European countries had taken such measures."[125]

A sea of ink has been spilled in trying to convince the developed countries to reduce and eventually eliminate their trade barriers on developing country exports, in the interest of these latter countries' growth, as well as in the interest of improvement of welfare in the developed countries themselves. Without these writings, the situation today may have been worse; but it is difficult to see any improvement, The reason for ineffectiveness of arguments and appeals was stated by Sir Edmond Dell, the former British Trade Minister, succinctly and clearly:

"Trade negotiations are about reciprocity, that is an exchange of reciprocal concessions, not about unilateral gestures or 19th century liberalism.[126]"

If it is true that it is reciprocity which counts in international trade negotiations, two things follow for developing country policy makers and their bankers:

a. Except when they decide that unilateral import liberalization is in their direct national interest, developing countries should resist external pressures for such liberalization since they need it is a bargaining asset in trade negotiations with developed countries. By the same token, their lenders should reconsider their conditionality requirements, in the interest of their borrowers and thus of themselves: why should they, pressing for unilateral import liberalization, deprive their customer of the opportunity to obtain a wider foreign market and better prices?

b. Developing countries are not likely to get a significant opening of developed country markets without counter-concessions in trade in goods and services. Since the developed country markets are much larger than those of developing countries, the latter will be a net gainer, under good negotiating circumstances. The developing countries' negotiating strength will increase if they negotiate as a group, since they would be offering a broader market. This would be more practicable in regional groupings across products, or in particular products across countries, than globally with respect to both countries and products; although the latter would be desirable.

E. EXPANSION OF TRADE AMONG DEVELOPING COUNTRIES

Another avenue for widening the market of developing countries and reducing the pressure on their export prices is expansion of South-South trade. This has been a long-standing objective. In an important respect, of fundamental nature, conditions for its realization are now nearer than before. As stated by the South Commission:

"Progress within the South can give new substance to the process of cooperation among developing countries. Many of them have greatly diversified their economies in the last three decades. High levels of industrialization have been achieved, giving rise to new complementarities among developing countries, both within regions and interregionally. These broaden the potential scope for flows of trade, technology, and capital between developing countries on mutually beneficial terms. The newly industrializing economies of the South have now established their competitive credentials in a broad range of manufactured products, and in some cases are outselling the North in world markets. The increasing sophistication of the South's exports [is indicated by their growing] research and development intensity. Thanks to the high quality of its exports, the traditional prejudice against products from the South in the world at large, including the South itself, in breaking down."127

The need for expansion of South-South trade has been put forward recently by professor Singer, a well known development economist and social scientist:

"It is an anomaly that the 75 percent or so the world's population who live in Third World countries should only do some 7 percent of their world trade with each other whereas the 12 percent or so of the world's population living in the western industrialized (OECD) countries should do over 79 per cent with each other. There is no economic rhyme or reason for this. Third World countries have become more dissimilar to each other in the post-second world war period while industrial countries have become more similar. And it is a well-established theorem of foreign trade, ever since the days of Adam Smith and Ricardo, that foreign trade flourishes on the basis of different endowments. So why is it that, over the past two decades, the volume of developing countries' intra-trade has only

increased by 3.9 percent per annum whereas that of developed countries has increased by 5.2 percent."[128]

A Global System of Trade Preferences (GSTP) has been envisaged as a major instrument of South-South trade cooperation. It became effective in April 1989, after a process of negotiations started in 1976. A system for promoting interregional trade among developing countries, it is based on the principle of mutual advantage. In order to ensure that all participants benefit equitably, it takes into account differences in levels of industrial and economic development and trade, and contains special provisions to favour the least developed countries. The scheme is seen as complementing existing regional and subregional preferential trading arrangements. The GSTP Agreement establishes a global framework of rules for the reciprocal exchange of concessions as regards tariff, para-tariff, and non-tariff measures covering all types of products, for direct trade measures including medium-and long-term contracts, and for sectoral agreements. However, the trade liberalization implicit in the first round of negotiations within the GSTP, in which countries exchanged bilateral concessions in April 1988, is not very significant. As of now, the GSTP is largely of symbolic value, concludes the South Commission, and sets a challenge that it evolve a coherent strategy so as to ensure that by the year 2000 the GSTP will cover a substantial proportion of the intra-South trade. a href=#foot129>129

The key question in trade expansion and in South-South economic cooperation generally is that of finance. This became clear during the intensive work on this cooperation in the early 1980s, when the proposal for the establishment of a South Bank was formulated.[130] It envisaged an institution with a broad mandate, covering trade financing, support to payments arrangements of developing countries, commodity stabilization, investment (project) finance and balance of payments finance. The governments of developing countries have not yet reached agreement on the establishment of the bank. South Commission has supported the proposal, with a suggestion that its different functions may evolve gradually, starting with export financing and support to payments arrangements.[131] In July 1991, UNCTAD organized a meeting of an Expert group on trade financing mechanisms in and among developing countries. The meeting concluded that:

a. Many developing country exporters suffer an acute paucity of foreign exchange resources for trade financing. This paucity of credit exists for all classes of exports, especially non-traditional exports for a wide range of developing countries in different stages of development.
b. In most developing countries there are functional and institutional gaps in the financial

   infrastructure which cannot be met by domestic resources. Consequently, there are real merits to the idea of establishing an International Trade Financing Facility (ITFF) as complementary to national institutions and initiatives.

c. A facility which finances and refinances in foreign exchange developing country exports can be commercially feasible. It should initially concentrate on short-term credit and increase gradually its medium-term credit. A broadly based shareholding would be highly desirable. The initiative for launching the Facility must come from developing countries and their institutions, public and private. The participation of developed countries and their institutions, public and private, and the appropriate multilateral funding institutions, would be crucial for its success and market credibility.132

Further technical work on the facility is envisaged, and the experts have also suggested broadening substantive consultations on the ITEF to include the multilateral financial institutions and the OECD Secretariat.

No order of magnitude of finance required for the Facility has yet been indicated.

F. A POSSIBLE GROWTH MIX

If sufficient export outlets are not found either in developed country markets or in an expanded South-South trade, real export prices of manufactures of developing countries would continue to be under pressure, leading to further devaluations. This would partly sustain a competitive position in exports, but it would also stimulate import substitution. Furthermore, in light of possible losses on exports (private losses and official losses in the form of export subsidies) and resistance to devaluations, attractiveness of the domestic market may increase, both for market agent and for public authorities. There would be a partial shift away from almost exclusive emphasis on export growth, which has dominated the scene in the past decade, to a mixed pattern of production expansion both for the export and for the home market, but the latter under protection considerably lower than in the past.

Annex
Levels of protection

The table below shows tariff and non-tariff barriers in developing countries in 1987, i.e. before the liberalization of recent years.

Tariff and non-tariff barriers in developing countries, 1987

REGION	MANUFACTURERS		ALL GOODS	
	TARIFFS	NTBs	TARIFFS	NTBs
East Asia	22	20	21	22
South Asia	81	47	77	48
Europe, Middle East & North Africa	26	31	24	32
Africa	30	30	33	30
Latin America and the Caribbean	34	20	33	21
Average	34	27	32	28

Notes:NTBs, non-tariff barriers. Data are unweighted tariff averages for tariffs. For NTBs, percent of all imports affected.
Sources:World Development Report (World Bank) 1991, page 98, based on UNCTAD data for 1987 on eighty-two individual country sources. For Republic of Korea, World Bank estimates.

With the liberalization of recent years, it is probable that the average level of tariff on manufactures has fallen from 34% in 1987 towards a 25-30 % range. (I have not seen any specific estimate.) This remains much higher than the present average tariff in developed countries of about 5%; but we have also the Iglesias' statement of 15 November 1991 that "effective protection levels in Latin America now are nearly as low as in the industrialized countries."133 Historically, average tariff on manufactures in twelve industrial countries ranged from 11 to 32 percent between 1820 and 1950: 22 % in 1820, 11-14 % in 1875, 17% in 1973, 19% in 1925, 32% in 1931, and 16% in 1950.134 The fall to the 5% level is of a very recent vintage and is offset, partly or fully, by the rise in non-tariff barriers.

In non-tariff barriers, the average 1987 proportion in developing countries of 27-28% has now probably been brought down to under 25%. At this level, it is quite close to the proportion of imports affected by selected non-tariff barrier in developed countries of 20-22 % (see Table V). The World Bank's World Development Report 1991 suggests that the developed country NTBs could be higher than the level estimated for developing countries in 1987 if the coverage was identical.135 For 1986, the Report has estimated the developed country barriers as affecting almost one-half of their imports (see page 6).

An up-to-date estimate on a comparable basis is needed on both tariffs and non-tariff barriers in both developing and developed countries.

Footnotes:

113: Exports of Eastern Europe and USSR are not included.

114: World Bank, World Development Report 1991, page 189.

115: UNCTAD, Protectionism and Structural Adjustment, Statistical and Information Annex, TD/B/1282/Add.l, 22 January 1991.

116: Chakravarthi Raghavan, Recolonization: GATT, the Uruguay Round & the Third World, Third World Network, Penang 1990, page 181, based on UNCTAD sources (TD/328, Add. 4, Table IV, 2.B, and R. Erzan and J. Karsenty, UNCTAD Discussion Paper No. 22).

117: World Bank, World Development Report 1991, page 104.

118: Ibid.

119: GATT, International Trade and the Trading system, Report of the Director-General 1990-91, May 1991, Appendix Table 1.

120: UNCTAD, Protectionism and Structural Adjustment, op.cit.

121: GATT, op.cit., Appendix Table 2.

122: Statement at the Institute for International Economics, Washington D.C., as reported in UNCTAD, Trade and Development Report 1991, page 37.

123: Statement by Ambassador Rubens Recupero, as reported by Special United Nations Service (SUNS), Geneva, 31 July 1991.

124: Statement by the World Bank representative at the Rount Table on Trade, Society for International Development, Geneva, 16-17 February 1989. It was reported that the Bank had tried to convince the Contracting Parties that developing countries should be so credited, in vain.

125: GATT, Activities 1990, July 1991, page 30.

126: Letter to Financial Times, 19 February 1985.

127: The Challenge to the South, The Report of the South Commission, 1990. page 151.

128: Letter to Financial Times, 21 August 1991.

129: The Report of the South Commission, op.cit., pages 174-75.

130: See, South-South Financial Cooperation, The Jamaica Papers, edited by Dragoslav Avramovic, 1983; Report on the South Bank, Office of the Chairman of the Group of 77, New York, and International Center for Public Enterprises of Developing Countries, Ljubljana, Yugoslavia, 1983, Feasibility study by Dragoslav Avramovic.

131: Report of the South Commission, op.cit., pages 171-72.

132: Report of the Expert group on trade financing mechanisms in the among developing countries, Geneva, 11-12 July 1991.

133: Remarks by Dr. Enrique V. Iglesias, President of the Inter-American Development Bank, in the Seminar on "Latin American Thought: Past, Present and Future", Washington D.C., 15 November 1991, pages 19-20.

134: World Bank, World Development Report 1991, pages 97-98.

135: Ibid., page 105.

Part IV: Developing Countries in the World Services Market: Scope,

Competitive Position and Reciprocity

A. INITIATIVE FOR NEGOTIATIONS AT THE Uruguay Round

G. Russell Pipe, a telecommunications policy consultant, Amsterdam, Netherlands, wrote in 1989, in the midst of the Uruguay Round negotiations:

"To a considerable extent, the inspiration and pressure brought to bear on governments to launch multilateral negotiations on trade in services emanated from transnational corporations based in developed countries. TNCs and other enterprises are expected to be beneficiaries of an eventual agreement to create a liberalized environment allowing further globalization of their operations. International business has mobilized political and economic resources at the national level and through three principal international organizations. These are the Business and Industry Advisory Council (BIAC), a recognized body in the OECD: the International Chamber of Commerce (ICC); and Coalition of Service Industries, a confederation of national coalitions in ten countries."136

B. SCOPE AND FOREIGN EXCHANGE BALANCES

The field of services is wide. Those of importance in international trade include: transportation, travel, telecommunications, audio-visual activities (film, television and other media), business services, engineering and construction, banking and financial services. Conventional analysis also adds income from property, including intellectual property, interest, and income from labour (labour remittances); the latter may frequently result from engagement in services trade; but the former -- earnings from property and interest -- are a function of ownership rather than of current trading activities.

Developing countries have a negative foreign exchange balance in services.

Table I. Exports and imports of services of developing countries, 1984, in US $ billions

	EXPORTS	IMPORTS	BALANCE
All services	111.7	205.7	-94.0
Shipping	8.0	31.8	-23.8 (a)
Travel	20.1	16.1	4.0
Passenger services	14.1	12.7	1.4
Other transportation	10.3	9.2	1.1
"Other" services	23.5	32.1	-8.6

Note: (a) US $ 21 billion in 1987.

Sources: UNCTAD, Trade and Development Report 1988, pages 289-92, based on IMF balance of payments statistics; Peter Faust, Shipping Services, in UNCTAD, Trade in Services: Sectoral Issues, 1989 page 124.

It is possible that the enormous size of the deficit (US $ 94 billion in 1984) is in large part a function of interest payments, although they are not specifically identified in Table I. These payments amounted to US$ 68.4 billion in 1984. 137 Deducting these from the aggregate deficit, leaves a deficit of developing countries in services net of interest of US $ 25.6 billion -- still a formidable figure on any reckoning. In the assessment of UNCTAD analysts:

"Developing countries as a whole, and most developing countries individually, run deficits in trade in services, the main exceptions being the tourism sector, and the services rendered through the movement of labour abroad... In construction, for example, where a few developing countries have had a relative export success, this has been largely attributed to their ability to move persons across national frontiers."138

C. COMPARATIVE ADVANTAGE OF DEVELOPED COUNTRIES

Analysts seem to be unanimous that foreign exchange deficits reflect a generally weaker competitive position of developing countries in most services that are internationally traded:

"The competitive weakness of developing country vis-a-vis developed country firms in the world market appears to be a general phenomenon in all service sectors, thus underlying the need for any multilateral framework to take account of this situation and provide for compensatory action to increase the participation of developing countries in the world market for services." 139

"In all sectors, even where developing countries may show 'strength' based on balance of payments figures, developed country firms would seem dominant."140

"Developed countries overall are likely to be more competitive than developing countries in most services."141

The reason for this situation is comparative advantage of developed countries derived from factors which are not "natural", but are a result of the level and pattern of prior development: their endowment is a function of the amount of resources invested in research and development and education, of the existing industrial and technological development, as well as the state of regulation.

> "Firms from developed market economy countries are dominant in virtually all main traded service sectors. Their competitive strength is based upon the underlying comparative advantage inherent in developed economies as well as specific factors at the micro-economic level. Such factors include:
>
> (a) financial capacity;
>
> (b) accumulated knowledge and skills, and established reputation;
>
> (c) access to and domination of telecommunications and information technologies;

(d) established relationships and market presence;
(e) "networking" ability;
(f) ability to provide a package of services;
(g) domestic market size;
(h) economies of scale; and
(i) government incentives."[142]

Most of these elements are self-explanatory. Of particular interest and widespread effects is the financial capacity of firms. "Financial resources are the key factor in the competitiveness in the world market for a variety of service sectors. The more obvious ones are banking, securities trading and insurance, where the weakening of financial resources of developing country firms has resulted in a decline in their participation in world trade in these services, while even very large developed country banks are finding it necessary to merge to strengthen their financial capacity so as to maintain international competitiveness. Air transport is another sector where financial resources are becoming crucial given the pressing need for airlines to modernize their fleets. The provision of enhanced information services may involve important expenditure on infrastructure, not to mention that necessary to develop or acquire the technological capacity. Even in construction and engineering consultancy services, where the competitive position of developing countries may be somewhat stronger, financial resources, in the sense of the sense of the ability to finance a package of engineering services, construction and capital goods available to developed country firms, enables them to dominate international markets. Such situations are obvious in most service sectors where developing country firms simply lack the financial strength to compete, particularly given that one of the main competitive factors is the ability to move "upstream" and "downstream" and to offer a "package" of services. Regardless of technical competence, firms cannot compete in world markets without adequate financial backing. Asymmetries in the distribution of financial resources thus constitute a major factor distorting the possibility of an international division of labour in the service sector based upon comparative advantage. This would imply that the ability of developing countries to compete in trade in services, and thus to benefit from progressive liberalization by their trading partners, will be related to broader solutions to their financial and debt problems."[143]

D. DEVELOPING COUNTRY COMPETITIVE SUB-SECTORS

Three sub-sectors where developing countries have shown some competitive strength, or where such strength is emerging, are discussed below. They are tourism, construction, and data processing.

Tourism

which attract foreign tourists, on the one hand; and the poverty of broad masses of their population, which eliminates their capacity to travel abroad as consumers-tourists, on the other.

Most developing countries have promoted foreign tourism in recent years and in the process eliminated most of the administrative and trade obstacles to its development. Obstacles which have remained are mostly financial: lack of resources for tourism and infra-structure development, such as roads, other transportation, adequate water supply and reliable electricity. At the same time, benefits from tourist development are unequally shared. The existing statistics -- the "travel" item in the balance of payments account -- underestimate the size of the tourism market, as they omit much of the revenue obtained from the tourist before he leaves his own country; thus, developing countries are likely to have a much lower share of the overall "tourism" market than that indicated in balance of payments data.144 More important, world-wide tourist revenues are dominated by developed country firms which have been able to establish information networks, hotel chains, travel agencies and computer reservations systems (CRS).145 "The effect of these changes for the tourist industry in developing countries is mixed. On the one hand, the potential increase in efficiency and international contact is vital to a tourist industry that is distant from its clients. The networks create certainty and security for the client and hotel. Tourist resorts which are not able to get information into the network will find traffic diverted elsewhere. On the other hand, the cost of participating in these networks may be high in foreign exchange, serving as an added charge against potential earnings. The networks are likely to reinforce the market dominance of the larger hotels and tour operators, whose integrated management systems and co-ownership with airlines and network operators give them a pre-eminent position." 146 It has been suggested that developing countries, either singly or in cooperation with other developing countries, can set up their own national or regional networks of information in order to maximize their returns from tourism. 147

Construction and engineering design (CED)

Developing countries had great expectations in the early 1980s that both their volume and share in international construction will grown steadily. These expectations were based on the successes achieved following the oil boom in the producing countries, and the technological and managerial breakthroughs which several developing countries had made. In the judgment of a 1987 study of the U.S. Office of Technology Assessment, an agency of the U.S. Congress:

> "Many foreign engineering and construction firms, including those in the Third World, can now adapt and apply a relatively broad group of technologies as needed. Once the backbone of the U.S. industry, technologically based strategies are now open even to firms from the

NICs, many of which have become quite competent in design and engineering."148

The results did not meet the expectations. Developed country firms have remained dominant in this field. Developing country companies are still important players, but the slow-down in massive construction in the open markets of the Middle East has stopped these companies' advance and led to a setback.

In engineering design services, the international market as measured by foreign billings of top 200 international design firms amounted to US $ 4.2 billion in 1988, compared to US $ 3.8 billion in 1983. About 70 percent of the international market is presently found in the developing countries, compared to 85 percent in the early 1980s. In 1988, Asia was the largest single market (US $ 1,150 million), followed by Africa ($ 824 million), the Middle East ($ 809 million), Europe ($ 622 million), the U.S. ($ 388 million) and Latin America ($322 million). In 1988, 10 of the 20 most attractive markets in the world were Asian countries, among them Indonesia, China, Thailand, the Philippines, India, Malaysia, Bangladesh, Australia and Singapore.

U.S. international design firms remain in a leading position with 25 percent of the aggregate market in 1988. Canada accounted for 16%. European firms as a group captured 47 percent, and Japan 6 percent. Among the developing countries' total of 6 percent, the Republic of Korea has maintained its share at around 1.5 percent. Firms from a few other developing countries have also been present in the international market, but their individual shares remain small. 14 out of the top 200 international design firms came, in 1988, from developing countries, compared to 17 in the previous year. Two such firms, Dar Al Handasah Consultants, previously located in Lebanon and now based in Egypt, and Energoproject Consultancy and Engineering from Yugoslavia, figured among the top 20 international design firms. The other firms in the 200 came from Korea (3), India (3), Brazil (2), Yugoslavia (1), Hong Kong (1), Taiwan (1) and Saudi Arabia (1). However, "firms from developed countries control over 90 percent of the market and as such remain the undisputed leaders in this branch of the CED services industry."149

The international construction market, as measured by the value of foreign contracts awarded to the top 250 international contractors, amounted to US$ 94 billion in 1988, more than twenty times the value of engineering designs billings in that year (see above). The 1988 construction total was an improvement over the previous several years, but was very much lower than the peak of US $ 134 billion reached in 1981 (Table II). Foreign contracts as a proportion of total contracts have been declining steadily since 1982: this proportion was close to 27% in 1987, compared to 52% in 1982. Developing countries accounted to 60% of the international construction market in 1988, down from 80% during the early 1980s. The largest part of the market in 1988 was in Asia (US $ 20.5 billion), followed by Europe (US $ 19 billion), Middle East ($ 17 billion), U.S. ($ 13

billion), Africa $10 billion) and Latin America ($7.5 billion). Low levels in the latter two regions reflect the debt crisis.

Table II.
Market Share of International Construction
(measured by new contracts awarded to the top 250 international contractors)
(Billions of dollars, and per cent share in brackets)

Country	1980	1981	1982	1983	1984	1985	1986	1987	1988
United States	48.3	48.8	44.9	29.4	30.1	28.2	22.6	18.1	25.9
	(45)	(36)	(36)	(31)	(37)	(35)	(31)	(24)	(27)
France	8.1	12.1	11.4	10.0	5.4	6.7	7.1	8.6	11.1
	(7)	(9)	(9)	(11)	(7)	(8)	(10)	(12)	(12)
Germany, Fed. Rep. of	8.6	9.9	9.5	5.4	4.8	5.4	5.5	5.9	8.1
	(8)	(7)	(8)	(6)	(6)	(7)	(7)	(8)	(9)
Italy	6.2	9.3	7.8	7.2	7.8	8.7	7.4	9.2	13.3
	(6)	(7)	(6)	(8)	(10)	(11)	(10)	(12)	(14)
United Kingdom	4.9	8.7	7.5	6.4	5.7	5.6	7.0	7.9	9.4
	(5)	(6)	(6)	(7)	(7)	(7)	(9)	(11)	(10)
Other Europe	9.2	12.6	10.3	9.1	7.2	6.2	6.7	8.9	7.3
	(8)	(9)	(8)	(10)	(9)	(8)	(9)	(12)	(8)
Japan	4.1	8.6	9.3	8.7	7.3	11.6	9.4	9.9	11.6
	(4)	(6)	(8)	(9)	(9)	(14)	(13)	(13)	(12)
Rep. of Korea	9.5	13.9	13.8	10.4	6.8	4.8	2.6	2.1	1.4
	(9)	(10)	(11)	(11)	(8)	(6)	(4)	(3)	(2)
All other countries	9.4	10.5	8.6	7.0	5.9	4.4	5.6	3.3	6.0
	(9)	(8)	(7)	(7)	(7)	(5)	(8)	(4)	(6)
Total	**108.3**	**134.4**	**123.1**	**93.6**	**80.5**	**81.6**	**73.9**	**73.9**	**94.1**

Source: Yehia Soubra, Construction and Engineering Design Services, in UNCTAD, Trade in Services, 1989, page 214, based on Engineering News Record, various issues, McGraw-Hill Inc.

U.S. continues to be the world's largest individual exporter of construction services, although its share is declining. In contrast, the shares of Italy and Japan are rising rapidly. Among the developing countries, the Republic of Korea continues to be present in the international market, but with its share constantly declining since 1983. Yugoslavia has also built up an export capacity in this sector: the construction specialties of Yugoslav firms, figuring on the list of the top 250 international contractors, encompass various types of projects, ranging from such infrastructure as buildings, bridges and railways to power plants and manufacturing facilities. Firms from other developing countries have also penetrated the international market, but their individual shares are very small. They come from India, Brazil, China, Singapore, Argentina, Mexico and Hong Kong. "Some kind of specialization of specific CED services and sectors helped these few countries to develop an export capability. While Korea specialized mainly in infra-structure related services, Brazil built up specific competence in

mining and petroleum-related CED services, and India in steel and metal work. Very often the success of firms from developing countries in entering the international market was very much dependent on their ability to move skilled and unskilled labour to the construction site from their country of origin and/or other third-world countries."150

The firms from the developed countries have, since the early 1980s, increased their control of the international market with a share at present exceeding 90 percent, while the position of developing countries has been worsening, with the decline in the share of the construction market from more than 15 percent to less than 5 percent.151 A part of this loss is due to unafavourable terms of contractor finance. "The financial packages offered by developing country suppliers are not as attractive as those provided by firms from developed countries. Financing remains one major obstacle for firms from developing countries to consolidate their position in international markets."152 It has been suggested therefore that effort would need to be made to facilitate access of developing countries to international financing, including a more explicit policy by international and regional financial institutions to promote further the participation of developing country engineering firms in the provision of CED services on projects funded by them in developing countries.153

The second factor has been the shrinking of the most dynamic export market in developing countries due to the fall in commodity prices and the debt crisis. Furthermore, partly as a result of government procurement policies, construction markets in developed countries tend to be relatively less open than in developing countries.154 Also, the decline in the developing market share of the international construction market might reflect to a large extent the existence of prohibitive barriers to the movement of personnel in developed country markets.155

"In the Uruguay Round discussions, developing countries have consistently maintained the position that any liberalization of trade in services, in the form of temporary movement of the factors of production, should provide [for] symmetrical treatment to the capital and labour factors. Although developed countries tend to view labour mobility as an issue that is regulated by immigration laws and regulations which embody national policy objectives, their submission to the GNS (Group of Negotiations on Services in GATT's Uruguay Round) recognizes that the process of liberalization of trade in services would have to cover temporary movement of persons. Such proposals have referred to the category of 'senior management personnel', but it is clear that to provide benefits to developing countries, any agreement in the GED services would have to provide for movement of semi-skilled and unskilled labour... It may be relevant here to note that the Canada/United States Free Trade Agreement shows that movement of persons supplying services can be effectively incorporated into trade agreements."156

New Fields: data processing, research contracts and educational establishment

"This advent of information technology has enabled corporations from the developed countries to relocate some of the labour-intensive segments of their service activities to certain developing countries that offer suitable conditions and have lower wages. Labour-intensive data processing operations of U.S. corporations have been carried out in Caribbean countries. This kind of service export can play a role as foreign exchange earner and generator of employment in some countries. Another service export of this kind of rapidly increasing importance is software."[157]

"Computer software is the pride of the Indian business services exporters, having grown very rapidly during the second half of the 1980s, owing to both government policies aimed at developing exports in that sector and to the ingenuity of Indian software entrepreneurs. Until recently, the bulk of software exports by Indian firms came in the form of 'consulting services', also referred to in the industry as 'body shopping'. Under body shopping, the software firm provides system analysts and programmers as staff on projects that are managed by other firms. To their credit, however, Indian software firms have been moving upstream in recent years, by increasing their volume of work as prime contractors on customized software and turnkey systems integration projects, and in a few cases, by breaking into the packaged software market with their own products such as accounting software packages, banking software products, etc."[158] In May 1991, it was reported that Motorola, a well known U.S. electronics group, is seeking Indian Government's approval to set up an export-oriented company with a string of manufacturing units (semi-conductors, portable and mobile telecom systems, cellular mobile radio equipment and radio paging systems) and that it is setting up a software export center at Bangalore, South-Central India, which will largely cater for the requirements of the Motorola group. a href=#foot159>159 Bombay also has attractions, as a business and business-training center: in August 1991, Swissair announced that it is transferring its revenue accounting activities to Bombay.[160] But not everything goes smoothly with foreign interests in India: a number of foreign companies in Bangalore still prefer to export highly skilled Indian nationals --body-shopping--it was reported earlier this year, rather than buy computer software.[161]

Barbados, Jamaica, the Philippines, Singapore and Ireland have emerged as among the most popular "back office" locations for major corporations. The jobs range from simple data entry to accounting, medical transcription, telemarketing, and technical support for high-technology products.[162] The reason, like in India, is much lower labour cost than in the developed country corporate headquarters, but this contributes to local employment. The other side of the coin is vulnerability of this "labour-intensive high-tech" strategy to advances in information technology, which have resulted in the sudden elimination of labour-intensive segments of this industry.[163] "One of the Ireland's chief competitors for

foreign investment, Scotland, has deliberately steered clear of data processing. Robert Crawford, North American, says new technologies, director of the Locate in Scotland programme such as electronic scanning of printed material, will render many data-entry jobs obsolete. 'If you think this will create lots of jobs, you better be careful, you'll loose them' says Mr. Crawford...He says Scotland prefers to continue focusing on manufacturing, where the toe-to-toe battle with Ireland for foreign investment has raged for years, and continues."164

It is not only in data processing and information technology that export services jobs can be found. Bio-technologists in Belgrade, Yugoslavia, highly trained, work on contract for research institutes in the U.S. on projects of common interest. Both Colombia and Singapore export medical services from their newer medical and educational establishments. Some universities in Mexico and the Caribbean have large contingents of medial students from the United States.165

These developments in new service fields in the countries listed are both impressive and promising despite risks they involve in view of rapid technological changes in the newly established activities. But except in very small countries where labour force is small, these developments cannot change the fundamentals of unemployment and low real wages. In countries with large and mega-large populations, a sustained and broad-based change affecting agriculture, other primary activities, and manufacturing is needed in addition to the welcome growth of modern export-oriented service industries.

E. RECIPROCITY

Analysts of services economics have been trying to find a solution to the problem of reciprocity of concessions between the developed and the developing countries within the Uruguay round. "The problem of reciprocity is that it is primarily developed countries which seek access commitments in developing country markets. The problem in the negotiations on trade in services is not the ability of developing countries to grant reciprocity, it is rather how developing countries will obtain reciprocity from developed countries in respect to any concessions they might agree to make...'Relative reciprocity' [concessions granted by developing countries matched by much more substantial liberalization by developed countries] has emerged in the negotiations as a means of calibrating developing country concessions in line with their development situation. However, the ability of developing country exporters to translate such liberalization into export gains appears extremely limited under the prevailing situation of asymmetry with respect to the factors on which competitiveness in trade in services depends."166

The answer provided by both the UNCTAD analysts and the OECD Secretariat is to search for solutions within the services sector.

> "OECD Secretariat has recognized that 'the realization of developing countries' export potential in services will depend, in large measure, on the scope for acknowledgement [within] a services framework of the need for services to provide [for] mobility in the form of temporary relocation of essential personnel." 167

Suggestions offered by Messrs. Gibbs and Hayashi, UNCTAD analysts, are broader:

> "If liberalization in services is to benefit developing countries, their firms will have to acquire [a range of] capacities [such as those listed on page 3 of this paper] which may only be possible in the context of solutions to the more general problems of debt and infrastructure development. It will also have to provide for access to foreign markets for their professional, skilled and unskilled labour, where this is essential to their ability to supply the service and compete against developed country firms."168

Messrs. Gibbs and Hayashi further suggest that possibilities that could be explored might include:

(a) strict maintenance of the principle of symmetry between movement of capital and movement of labour;

(b) obligation of the developed country beneficiary of liberalization of service to transfer service technology to the developing country;

(c) reciprocity across service sectors, where market access concessions could be provided in one sector to "pay" for liberalization in another (e.g. access to developing country financial service markets exchanged for concessions in the areas of construction, professional services, etc.).169

Going beyond the present discussion, three questions need to be answered in further analysis:

(a) What is the degree of infant industry protection which developing countries need for their service industries?

(b) In view of the cyclical and other fluctuations affecting which the construction industry, what allowance should be made for this instability in working

out the
services concessions which need to be offered to developing countries?
(c) It is quite possible that reciprocity cannot be achieved within the services sector. It is
unclear whether the shortfall in services will be compensated by concessions to
developing countries in access to markets for goods. An overall balance, maintenance
of peace and avoidance of massive migration from the developing to the developed
countries call for inclusion into the debate of the commodity problem and its possible
solution, and of the issue of transfer of financial resources, its size and modalities.
Where and how will all these different aspects of the problem be pulled together, in
the interest of human development?

Footnotes:

136: G. Fussel Pipe, Telecommunications Services: Considerations for Developing Countries in Uruguay Round Negotiations, in UNCTAD, Trade in Services: Sectoral Issues, 1989, page 84.

137: As shown in World Bank Debt Tables 1990-91, Volume 1, 1990, page 126.

138: Murray Gibbs and Michiko Hayashi, Sectoral Issues and the Multilateral Framework for Trade in Services, in UNCTAD, Trade in Services, op.cit., page 3.

139: B.L. Das, Coordinator of International Trade Programmes, UNCTAD, Introduction, in UNCTAD, ibid., page XXXII.

140: Gibbs and Hayashi, ibid., page 8.

141: OECD, Trade in Services and Developing Countries, Paris 1989, page 7, quoted in Gibbs and Hayashi, ibid.

142: Gibbs and Hayashi, ibid., pages 45-46.

143: Ibid., pages 9-10.

144: Gibbs and Hayashi, ibid., page 4.

145: Ibid., page 32.

146: UNCTAD, Trade and Development Report 1988, page 183.

147: Ibid., page 184.

148: International Competition in Services, Office of Technology Assessment, Congress of the United States, July 1987, page 145.

149: Yehia Soubra, Construction and Engineering Design Services: Issues Relevant to Multilateral Negotiations on Services, in UNCTAD, Trade in Services, op.cit. , pages 194-96.

150: Ibid., page 199.

151: Ibid., page 206.

152: Ibid., page 193.

153: Ibid., page 206-207.

154: Ibid., page 203.

155: Gibbs and Hayashi, op.cit., page 6.

156: Yehia Soubra, op.cit., page 208.

157: UNCTAD, Trade and Development Report 1988, pages 181-82.

158: Thierry Noyelle, Business Services and the Uruguay Round: Negotiations on Trade in Services, in UNCTAD, Trade in Services, op.cit., page 349.

159: As reported in Financial Times, 10 May 1991. Bangalore has become a major center of the India's high technology industries, thanks in part to extensive training and scientific facilities and concentration of talent in the area.

160: International Herald Tribune, 15 August 1991.

161: The Economist, 4 May 1991.

162: The Wall Street Journal, 23 August 1991. For software development in the Phillippines, please see The Wall Street Journal, 10 May 1991.

163: UNCTAD, Trade and Development Report 1988, page 182.

164: The Wall Street Journal, 23 August 1991.

165: UNCTAD, Trade and Development Report 1988, page 184.

166: Gibbs and Hayashi, op.cit., page 43.

167: OECD, op.cit., page 8, quoted in Gibbs and Hayashi, op.cit., page 31.

168: Gibbs and Hayashi, op.cit. , page 46.

169: Ibid., pages 43-44.