South-South financial cooperation: a window of opportunity

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MOVES towards greater cooperation between developing countries have been given added impetus recently by the deterioration of the international economic environment. In trade, the slower growth experienced by the European and Japanese economies and the growing protectionism evident in all industrialised countries have exerted powerful pressure on the developing countries to expand their markets through greater mutual trade. Again, in finance, the severity of the debt problem, the level of world interest rates and the conditions required by some lenders have persuaded a growing number of developing countries that new arrangements are urgently needed both between themselves and with the North.

The need for cooperation is all the more pressing in view of the setbacks which mutual trade has suffered in recent years, and the continuing pressure on the balance-of-payments and the economies of individual developing countries despite intense efforts at adjustment.

It is now nearly twenty years since the Group of 77 (which now numbers 126 members) was formed precisely to promote the interests of the developing countries both by extending co-operation among them and improving their position in the world as a whole. This provides a useful opportunity to assess the progress that has been made in these areas so far to outline the problems and to examine the prospects for long-term solutions.

South-South trade

In mutual trade two distinct phases are discernible over the last quarter of a century. In the first, between 1955 and 1970, the rate of expansion was slower than that of world trade as a whole and slower than the expansion of the overall trade of the developing countries, and the share of mutual trade fell. In the second period, between 1970 and 1981, this trend was reversed. Trade among developing countries rose at the remarkable rate of 25 per cent a year, exceeding the growth rate for world trade and for the overall trade of the developing countries. It reached the level of 29 per cent of the total trade of developing countries in 1981, compared with 19 per cent in 1970 and 24 per cent in 1955.[1] Contributing to this increase were the rapid expansion of output in a number of developing countries, the diversification of their production and increasing technological maturity, as well as the growth of markets, particularly in the petroleum exporting countries. But this trade was also facilitated by policies deliberately adopted by developing countries in order to foster it. They included the reduction of obstacles to trade, and various other arrangements within regional and subregional groupings.[2]

The outlook for this mutual trade depends partly on the outcome of the financial crisis which affects most of Latin America and Africa, as well as some other developing countries. The effects of this crisis have been intense. The capacity of countries with major debt burdens to import goods in return for convertible

1. UNCTAD, *Trade and Development Report, 1983*, p 126.
2. UNCTAD, *Economic Cooperation among developing countries: Review of activities in the major programme areas and proposals for further work*, TD/281, June 1983.

currency has fallen sharply, as has that of countries heavily dependent on exports of some primary commodities. A major transfer of purchasing power in favour of world financial centres is taking place, reducing the liquidity of the trade. Some multilateral payments arrangements have been suspended, most importantly in Latin America, and others appear to have been operating in low gear. It was recently reported that trade within Latin America had fallen by 50 per cent or more since the 1980–81 peak (excluding trade in fuels).[3] In 1983, the latest period for which aggregate data are available, trade among developing countries as a whole was 7–10 per cent below 1981. This is a smaller fall than the individual country data suggest, and smaller than the reported 14 per cent decline in developing countries' overall trade.[4] The full story is not yet known. The financial crisis has been accompanied by rising unemployment and underutilisation of resources in the affected countries.

What steps have been taken, and what can be taken, to resolve the problem, both in the long and short term? Some countries have drawn up bilateral agreements in order to revive trade and production. However, while these are better than no trade at all, they provide, as a rule, only limited opportunities for trade. As developing countries collectively can now produce a wide range of industrial, mining and agricultural goods with reasonable efficiency, a strong case exists for a payments arrangement among them which would facilitate a multilateral exchange of goods on a large scale, with minimum use of convertible foreign exchange. The latter should be reserved for the net settlement of these multilateral accounts and to pay for direct imports from the convertible currency area, as well as for the debt service payments due to it. The theoretical basis for such an arrangement in conditions of scarce convertible exchange was worked out by Professor Jaroslav Vanek, and elaborated by Professor Daniel M Schydlowski, almost twenty years ago.[5]

Professor Sir Arthur Lewis, in his 1979 Nobel Prize lecture argued that the developing countries needed to adopt preferential trade and payments arrangements in the 1980s if they were to achieve the rapid economic growth of which they were capable in the face of a likely slowdown in world trade—an expectation which has since materialised.[6] A similar set of ideas was recently put forward by the Institute for Latin American Integration (INTAL).[7] INTAL proposed a sizeable tariff preference—for example, half the import duty paid on a given non-region item; elimination of non-tariff restrictions on intra-Latin American trade; the establishment of a minimum common external tariff—say, 10 per cent; and payments arrangements.

Dr Shaheen Abrahamian of UNCTAD has pointed out that the present 'adjustment' process in which individual countries take corrective action—for example, by reducing imports of 'non-essential' items—serves only to shift deficits around the developing countries:

> It is clear that here, as in other areas, the existing system of trade and payments is not equipped (or even designed) to handle a substantial and simultaneous turnround in the trade balances of all developing countries, particularly when the need for this turnround stems from, and takes place in, the midst of a world recession. This makes

3. Jose Antonio Ocampo, 'Intraregional trade and the payments problem', paper presented at the South-South Conference on the Role of Regional Integration in the Present World Economic Crisis, Cartagena, Colombia, 23–26 February 1984, p 4.

4. United Nations, *Monthly Bulletin of Statistics*, June 1984, IMF Survey, 16 July 1984.

5. Jaroslav Vanek, 'Payments unions among the less developed countries as a powerful tool of economic integration', *El Trimestre Economico*, Mexico, July–September 1965, reprinted in UNCTAD, TD/B/AC.3/R.24, 17 March 1966; Daniel M Schydlowsky, *Une Union des paimentes entre pays sous-dévéloppés*, UNCTAD, TD/B/AC.3/R.29, 10 June 1966.

6. Arthur Lewis, 'The slowing down of the engine of growth, *The American Economic Review*, September 1980.

7. 'External debt and integration', in *Integracion Lationamericana*, Buenos Aires, September 1983, directed by Dr Eduardo Conesa.

it all the more urgent to devise special trade and payments arrangements among developing countries designed to promote trade among themselves.[8]

Past efforts to expand trade among the countries of the South have attracted criticism on two fronts. One school, while in favour of cooperation, has questioned the method. It is argued that regional cooperation schemes simply end up favouring the larger and more advanced countries and also bring more benefit to large foreign-owned firms than to locally-owned economic activities. Thus they effect little structural change.[9] To counter these effects, it is suggested that cooperation should concentrate on broadening the technological and productive capabilities of the countries concerned through joint improvement programmes and on enhancing their decision-making capacity *vis-à-vis* the rest of the world: i.e., cooperation (or integration) should be externalised. This approach was tried in the Andean Pact countries, and to some extent in ASEAN, through an attempt at planned inter-country allocation of major new investment projects and joint or coordinated negotiations on trade and foreign investment with the outside world. The latter effort—a common stand in external economic relations—has generally been successful and is being pursued, but the joint planning, allocation and implementation of major investment projects has proved rather more difficult.

The second group of critics has questioned the fundamental rationale of intra-South trade. Working within a World Bank research project, 'The Direction of Developing Country Exports', Oli Havrylyshyn and Martin Wolf have argued that the tendency of comparative advantage suggests that efficient trade should be predominantly with industrialised countries, especially in manufactures, as this would be less capital- and skill-intensive than trade between developing countries. They also argue that intra-South trade is already substantial and it is a myth that there is a bias against such trade. No special measures are therefore warranted for its promotion.[10] It is further argued that the main determinant of export success for developing countries is supply-side promotion, not the influence of demand. Therefore, it is argued, the link between Northern growth and Southern exports is only a tenuous one, and Professor Lewis is wrong in emphasising the weakening of Northern demand as grounds for the promotion of intra-South trade.

There are several weaknesses in the thesis of these World Bank consultants. Their implicit assumption is that developing countries as a group could achieve what a single country can do by itself by pushing its exports in developed countries' markets. But the logic is faulty: what may be true for one country may not be true for all. Also, when pushed to its logical conclusion, the claim that intra-South trade is of lower efficiency than North-South trade, is an argument against the policy of technological advance in developing countries. But while many, perhaps most, developing countries made the mistake in the past of moving too fast into heavy and complex manufacturing, the lesson to be drawn now is surely that more careful planning is needed in the future, and not that industrialisation and its supporting trade policies should be dropped altogether. Finally, the implicit economic model employed by the World Bank consultants does not seem to take account of the pool of unused resources in terms of labour, materials and expertise in the

8. Shaheen Abrahamian, ' "Adjustment", recovery and development: another perspective on interdependence', 14 March 1984 (mimeo.), draft.

9. Constantine V Vaitsos, 'Crisis in regional economic cooperation (integration) among developing countries: a survey'; Peter Robson, 'Regional economic cooperation among developing countries: some further considerations'; and Miguel S Wionczek, 'Can the broken Humpty-Dumpty be put together again and by whom? Comments on the Vaitsos survey'; all in *World Development*, (6) 1978.

10. Oli Havrylyshyn and Martin Wolf, 'Trade among developing countries: theory, policy issues, and principal trends', *World Bank Staff Working Paper No. 479*, August 1981.

developing countries. Almost none of these can be employed at present by exporting to the North, but much can be absorbed by increased intra-South trade. Havrylyshyn and Wolf are right in stressing the need for more supply, efficient production, appropriate prices, and more exports to developed country markets. They are wrong in arguing that one needs to scrap all deliberate policies to expand South-South trade. There is room for both as long as there are unemployed resources in the South and market limitations in the North.

On what scale would arrangements to promote the trade of developing countries be? Professor Lewis has argued that trade and payment arrangements should be worked out on a worldwide, rather than a regional, basis, as mutual interests are likely to be better served by trade across regions rather than within small units. Transport costs are now lower than in the past and neighbouring countries are likely to be producing the same kind of goods for reasons of climate, soil and history.[11] Similarly, the President of the Inter-American Development Bank recently argued that Latin America must expect to base its future development, not only on the growth of domestic markets but also on the expansion of its trade with the rest of the developing world. He pointed out that the level of development achieved by some Latin American countries opened up major opportunities for expanding trade with African and Asian countries and suggested that among the possible instruments for expanding this trade was the contemplated Global System of Trade Preferences among developing countries.[12] Similarly, India recently began preparations in Africa for launching an engineering industry development programme. Indeed, in recent years trade across regions has been developing at a greater rate than more local trade. It accounted for 24 per cent of the total mutual trade of developing countries in 1955, grew to 31 per cent by 1970 and then leaped to 51 per cent in 1980.[13] While there has been some weakening since, there is no reason to expect a reversal of the trend and on the basis of both this experience and Professor Lewis's reasoning, it could be argued that any new payments arrangements to replace those now suspended or dormant should be on a worldwide, rather than a regional, basis. The long-cherished hope that the existing regional and subregional payments arrangements could somehow be tied together into a world system has been disappointed, as the difficulties of merging schemes with different product coverages, credit swings and settlement periods have become evident. Now may be the opportunity to get the system right. Establishment of a worldwide payments scheme would in no way militate against the expansion of trade within individual regions. This would, in fact, benefit from all the facilities built into the worldwide system and it would also retain any advantages in terms of lower transport costs and regional trade preferences that may already exist.

Cooperation in sector policies

Individual regional schemes, which may or may not be efficient in promoting trade, have a role in developing coordinated approaches to sector issues and in aligning administrative practices within a region. Existing cooperative efforts cover an impressive range of activities. In South Asia, for example, where such efforts are being organised for the first time, they cover agriculture, rural development, telecommunications, meteorology, health and population, postal services, transport, science and technology, sports, arts and culture. The recently established Southern African Development Coordination Conference (SADCC), with nine member-countries, has programmes for agriculture, energy, manpower development, industry, transport and communications. The

11. Lewis, *op. cit.*, p 561.

12. Antonio Oritz Mena, Address to the Sixth Session of UNCTAD, Belgrade, 17 June 1983, p 7.

13. UNCTAD, *Economic cooperation, op. cit.*, p 3.

Gulf Cooperation Council (GCO), which covers six countries, has a common understanding on oil policy and has agreed on an agricultural strategy to ensure a degree of security in food supply. It is also considering the coordination of the petrochemical industry throughout the Gulf and will undertake joint internal and external investment through the Gulf Investment Corporation.[14] In the Caribbean, a 1981 report by a group of experts stressed that CARICOM is more than a trading community.[15]

The ministerial meeting of the Group of 77 on the economic cooperation of developing countries, which was held in Caracas in May 1981, laid the basis for systematic and comprehensive sectoral activity across regions. Inter-regional Group of 77 programmes now cover industry, agriculture, energy, transport and communications, and the exchange of skills and knowledge. Pride of place goes to energy. In this field the Group of 77's cooperative efforts have moved on from meetings of technical groups to the establishment of an Intergovernmental Action Committee for fossil fuels. Activities of the Organisation of Arab Petroleum Exporting Countries (OAPEC), in the energy field, both in the Arab region and beyond, such as in its relations with OLADE (the Latin American Energy Organisation) indicate the scope of the opportunities for technical cooperation and open up the way for future policy coordination. One inter-regional development which may help in promoting mutual trade, as well as the exchange of knowledge and skills, is the recently agreed establishment of an Association of State Trading Organisations of Developing Countries (ASTRO). This will become operative when a sufficient number or organisations accept the already agreed draft statutes, a process which has started and which, it is to be hoped, will be completed soon.

South-South finance

On the financial front, OPEC countries have been devoting a remarkable proportion of their income to official development assistance. The average in 1979–81 was 2.14 per cent of GNP.[16] Aid fell in more recent years, but the full statistical picture is not yet available. Generally, it can be argued that the national income of OPEC countries is overstated, as it includes the value of depletion of irreplaceable natural resources to a substantially larger degree than in non-oil countries.[17] Should an adjustment to income be made on this account, the proportion devoted to external assistance would be far higher than that shown in the present conventional statistics. Substantial resources from OPEC countries also flow through market channels. Syndications led by Arab banks accounted for 30 per cent of total borrowings of non-OPEC developing countries in 1981, compared with 8 per cent four years earlier.[18] Of particular interest among inter-Arab agencies for the promotion of investment is the Inter-Arab Investment Guarantee Corporation which insures investors against non-commercial risks.[19]

The main unfinished business in the field of official financial assistance for the developing world is the proposed setting up of a Bank for Developing Countries—a South Bank. This project would differ from the existing OPEC-

14. Partly based on a statement by Mr Abdallah Bishara, the Secretary-General of the Gulf Cooperation Council, as reported in *Arab Times*, Kuwait, 5 April 1984.

15. *The Caribbean Community in the 1980s*, Report by a Group of Caribbean Experts, Barbados: Coles Printery Ltd, 1981, p 19.

16. UNCTAD, *Financial Solidarity for Development*, 1984 (manuscript).

17. Thomas Stauffer, 'National incomes of oil producers are overstated', *OPEC Bulletin*, February 1984.

18. Morgan Guaranty Trust Company, New York, and *IMF Survey*, 8 February 1982.

19. The Corporation is discussed in more detail in a paper by Vijay L Kelkar, 'Promotion of investment flows among developing countries: South-South multilateral investment guarantee schemes', published in Dragoslav Avramovic (ed), *South-South Financial Cooperation*, London: Frances Pinter, 1983, for the Centre for Research on NIEO, Oxford.

supported institutions, in that its membership would be open to all developing countries, who would also be its potential beneficiaries. The new bank would perform functions now largely uncatered for by the existing institutions and it would be controlled by developing countries. The scheme as at present outlined envisages an institution which would lend money for development projects, including joint ventures, provide export credit, assist in providing commodity stabilisation finance and help with payments and reserve credit schemes and balance of payments finance. Furthermore, the bank would provide financial management services and investment and marketing advice tailored to its members' needs.[20] Despite the present economic difficulties, it has been argued, there are still enough financially strong developing countries to carry the initial burden of providing convertible exchange for the bank's paid-up capital, to be followed later by the provision of convertible finance by other developing countries as their financial position recovers.[21]

A statement issued at the end of a developing country conference jointly convened by the Chinese Academy of Social Sciences and the Third World Foundation for Social and Economic Studies, held in Beijing on 4–7 April 1983 argued:

> Cooperative action in finance deserves high priority . . . It would help to close several key gaps in the international financing structure which have adversely affected the developing countries over the years. The existing financing institutions have not found it possible to fill these gaps. A cooperative financial institution would enable the developing countries to assure financing of programmes whose benefits would be widely shared among them . . .

The statement goes on to point out that such an institution would help to strengthen the bargaining power of developing countries in their relations with transnational corporations.[22]

No final agreement has been reached on the South Bank, though all the non-OPEC developing countries that have taken part in the discussions so far have been in favour of it. Among the OPEC countries, Algeria and Venezuela have given it support and recently it was reported that Libya had agreed that developing countries needed to establish a bank which would stimulate cooperation.[23] On the other hand, Qatar said in October 1983 that it did not support proposals for setting up 'new financial mechanisms' to tackle the inequities of the world economic system. 'As much as they would like to help', it was stated, 'oil producing countries could not take on any new responsibilities because of the negative effects of low oil revenues'.[24] Kuwait, Nigeria, Saudi Arabia and the United Arab Emirates have taken a similar position on different occasions during the past two years.

Apart from the South Bank project, several other proposals for providing Third World finance have been put forward in recent years. At the Group of 77 consultations held in New Delhi in February 1982, the Director-General of the Kuwait Fund for Arab Economic Development proposed the establishment of a joint venture investment institution for

20. Two experts group meetings of G 77 were held on the issues of the need for, and the feasibility of a South Bank: in Kingston, Jamaica, in late March 1982, and in Ljubljana, Yugoslavia, in late August 1983, respectively. The technical documentation was prepared by UNCTAD for both meetings, at the request of the Group of 77. The documentation for the Jamaica meeting is published in Avramovic, *op. cit.*, and that for the Ljubljana meeting in *Report on the South Bank*, Office of the Chairman of the Group of 77, New York, and International Center for Public Enterprises in Developing Countries, Ljubljana, 1983.

21. The capital structure of the bank is discussed in Report on the South Bank, *op. cit.*, p 83; and *Report on the Technical Meeting*, South Bank, Office of the Chairman of the Group of 77, New York, 23–27 April 1984.

22. *Beijing Statement 1983*, para. 27, issued by Third World Foundation, London, May 1983.

23. Report from a meeting of the representatives of Libya and Yugoslavia, *Politika* (Belgrade) 21 February 1984.

24. Statement by Mr Bin Saif Al-Thani, the Qatari Minister of State for Foreign Affairs, as reported in *OPEC Bulletin*, November 1983, p 83.

developing countries, whose main task would be to intensify and prepare projects of interest to two or more partners. Resources for financing specific projects would then be mobilised on an ad hoc basis.[25] While the proposal falls short of a fully fledged investment institution, it might develop into one if the idea is taken up and the resource situation improves.

In July 1983 Agha Hasan Abedi, the president of the Luxembourg-based Bank of Credit and Commerce International SA, with headquarters in London and majority-owned by financiers from the Gulf, suggested the setting up of a consortium of commercial banks of developing countries, both public and private, and open to the countries' central banks.[26] The most important function of the consortium bank, or 'Third World commercial bank', would be to support clearing arrangements among developing countries and to finance the resulting debt payments to creditor countries in convertible currency. By this means, the bank would be able to finance trade many times the value that would be possible on a simple transaction by transaction basis. Furthermore, the bank would consider issuing a common unit of account, equivalent to the US dollar, backed by convertible currencies and other liquid assets, for the settlement of transactions.[27] At a later state, it has been suggested, the backing for the units of account could be extended to include commodities, valued on an international basis.[28] This recalls the long-cherished idea of a commodity reserve currency last proposed by Professors A G Hart and Jan Tinbergen and Nicholas Kaldor at UNCTAD I twenty years ago. The consortium bank has the potential of becoming a payments union for developing countries. The consortium bank would also provide pre-export commodity finance and import finance for vital goods.

Mr Abedi's proposal has the merit of addressing the most urgent problem facing developing countries—the shortage of foreign exchange with which to finance trade and for export and import stabilisation. To some degree it covers the proposed functions of the South Bank in export credit, support of payments arrangements and commodity stabilisation, but it would operate at the short end of the market and would therefore need the support of arrangements for longer-term investment finance and for the mobilisation of exportable goods in deficit countries. The two schemes are in fact complementary. Mr Abedi said that the idea was not to compete with the South Bank proposal. The consortium Bank would be willing to be associated with the South Bank as a lending window.

Another initiative under way is the establishment of a Latin American Multinational Commercial Bank, proposed by the Economic Commission for Latin America and the Caribbean (ECLAC) and the Latin American Federation of Banks. This institution would also aim at reducing the use of convertible currency in regional trade. It would introduce financial mechanisms to facilitate the expansion of this trade and develop machinery which would serve as a basis for attracting extra-regional resources.[29]

All these different proposals were reviewed at the Group of 77's New York technical meeting in April 1984, which was attended by bankers and economists from the public and private sectors and representatives of various international organisations. The South Bank scheme was endorsed as a business-like intergovern-

25. Statement by Mr Faisal Abdul Razzak Al-Khaled, as reported by *Interpress Service*, 26 February 1982.

26. Address by Mr Agha Hasan Abedi at the Third Conference of Banks from Developing Countries, Ljubljana, 5 July 1983.

27. This description is based on the Address, *op. cit.*, the articles in *South* (London), August 1983, and the BCCI paper 'The Bank of the Third World', 1983 (mimeo).

28. 'Shahid Ahmed, Increasing LDC trade: a proposal', *BCCI Economic Survey*, September 1983. Dr Ahmed provides an excellent theoretical background to the BCCI proposal.

29. Manual D Casanova, Consultant, ECLAC, 'Establishment and Operations of a Latin American Multinational Bank', April 1984 (mimeo.).

mental institution which would command respect and have access to resources in international capital markets. The meeting suggested that it should initially focus on a limited set of functions—export finance, support for payments arrangements and related activities, commodity stabilisation, finance, project finance and programme finance would also be covered. The meeting also regarded the proposed Third World commercial bank and the Latin American multilateral bank as timely and important initiatives and suggested that they should be supported. It was agreed that co-operation between these institutions and the South Bank would be facilitated by a regular exchange of views and information and technical collaboration.[30]

The intergovernmental meeting on the South Bank that took place at the end of August 1984 in Caracas recommended the establishment of an Intergovernmental Initiative Group of countries wishing to participate, which would undertake further work on the South Bank proposal, to be completed by June 1985. This recommendation was adopted by the Intergovernmental Follow-up and Coordinating Committee of G77, the senior body, which met in Cartagena, Colombia in early September 1984. The delegations of Saudi Arabia and Kuwait continued to express reservations concerning the South Bank proposal.

Commodity stabilisation

The stabilisation of commodity prices, which would be a major facility provided by the South Bank, is of crucial importance to many developing countries. But the hopes of many of them that an across-the-board commodity arrangement could be reached—generated by the success of OPEC in reversing the fortunes of the petroleum market—have so far been disappointed. Only one new commodity agreement, with price provisions, has been concluded—for natural rubber, making a total of five (the others being for cocoa, coffee, tin and sugar). The commodity crisis of 1980–82 consequently caught the markets with insufficient defences and the price index of the principal commodity exports of developing countries other than petroleum fell by 35 per cent between October 1980 and October 1982 with severe effects on the revenue of the producers.[31] A third of the loss sustained in 1981–2 was recovered by the commodity prices upswing during 1983 but the market started weakening again in March 1984.[32]

The Common Fund for commodities is in the process of being ratified. By April 1984 this had been done by seventy-four countries accounting for 45 per cent of the fund's directly contributed capital. For it to be fully effective, the minimum need is ratification by ninety countries accounting for 66.7 per cent of the capital. Additional commodity agreements also need to be concluded for full effectiveness.

It is difficult to be optimistic about the prospects for a broad North-South arrangement on commodity prices, in the light of past history, conflicting interests and the economic philosophy prevailing in some major countries. A further complicating feature has been the animosity of a large part of the economics profession to commodity stabilisation. These people may have had more influence on administrations and international agencies than is frequently thought. It is too early to judge whether the balance of academic thinking may now be shifting back to a more detached stance. A new paper by Professor Kaldor, a long-standing believer in commodity stabilisation, stresses the importance of stabilisation for both international monetary stability in the short run and the assurance of supplies of primary products for growth in the long term.[33]

30. Report on the Technical Meeting, *op. cit.*

31. UNCTAD, *Monthly Commodity Price Bulletin*, March 1984.

32. UNCTAD, *Monthly Commodity Price Bulletin*, *op. cit.*

33. Nicholas Kaldor, 'The role of commodity prices in economic recovery', *Lloyds Bank Review*, July 1983, p 34.

All things considered, while efforts to secure a North-South arrangement on commodity prices must continue, the developing countries should rely more on self-help in trying to get better and more stable prices for their commodity exports. Three conditions must be met: first, finance must be available for at least an initial stocking period, however brief, in view of the fact that measures to control production and thus improve prices take time (in the absence of finance, the producing countries have no choice but to sell on the market, however weak it may be).[34] Secondly, countries must be prepared to agree on production controls in times of surplus. Finally, target prices must initially not be too ambitious. It is difficult to envisage these efforts being mounted without assistance from a financing agency of developing countries, and even then it will not be an easy task.

Debt

It is the debt problem which is currently hampering so many efforts of the developing countries to build up their economies. According to the World Bank, the long- and short-term debt of the developing countries at the end of 1983 amounted to $810 billion.[35] The salient features of the situation are that:

- The peak of the debt service will, according to the World Bank's president, A W Clausen, occur in 1985–7 as the recent postponements of amortisation and IMF drawings become due.[36]
- It is not only Latin American countries which are under heavy pressure from debt service payments: a number of other middle-ranking countries in the Group of 77 and in Eastern Europe (the Philippines, South Korea, Poland, Romania, Yugoslavia) are affected. Furthermore, virtually the entire African continent has incurred heavy debt servicing obligations.
- Periods of repayment are too short. At the amortisation (repayment) rate of 1982, the aggregate medium- and long-term debt of developing countries would be cleared in seven-and-a-half years. This is shorter than the life of most development projects. During the past few years there has been a marked shortening of debt maturities, resulting from the replacement of maturing medium-term bank credit with shorter-term loans.[37]
- Interest rates on market debt, most of them on a floating basis, were more than 14 per cent per annum in the summer of 1984. In 1983, it is estimated that as much as 42 per cent of Latin American exports of merchandise were absorbed by interest payments. If amortisation, which took at least another 20 per cent, is added, the total debt service ratio of these countries was close to two-thirds of exports.[38] This is worse than during the Great Depression of the 1930s. In the case of the top six debtors—Argentina, Brazil, Mexico, South Korea, Venezuela and the Philippines—interest payments now absorb between 5 and 7 per cent of their GNP, that is, between one-quarter and one-third of total domestic savings.[39]
- Developing countries as a whole are having to endure a net resource outflow, as debt service is larger than their borrowings. For medium- and long-term lending by private sources to all developing countries the net transfer (new lending minus repayment of

34. Dr Ali Ahmed Attiga has made this point succinctly as it applies to petroleum exporting countries in: *Option de développement des pays Arabes exportateurs de petrole*; lecture given at the World Bank Staff Seminar, 18 December 1981, published by OAPEC, Kuwait, 1983, p 13.

35. World Bank, *Debt and the Developing World: Current Trends and Prospects, An Abridged Version of the World Debt Tables*, 1983–84 Edition, January 1984.

36. A W Clausen, 'Priority Issues for 1984', Remarks at the European Management Forum, Davos, 26 January 1984.

37. Dragoslav Avramovic, 'External debt of developing countries: a global view', in Miguel S Wionczek (ed), *Politics and Economics of Latin American Indebtedness*; Boulder, Colorado: Westview Press, (forthcoming).

38. Pedro-Pablo Kuczynski, 'Latin American debt: act two', *Foreign Affairs*, Fall 1983, pp 19–20.

39. Dragoslav Avramovic, 'Interest rates, debts and international policy', paper presented at the North-South Roundtable, Santiago, 27–29 February 1984, published in UNCTAD, *Trade and Development*, 1984 (forthcoming).

principal and interest) was $16 billion in 1982. However, in 1982, the net transfer was a negative $7 billion and in 1983 it was a negative $21 billion.[40] This is the extent of the deflationary pressure to which developing countries have been subjected as a result of debt service requirements and capital outflows. To this has to be added the deflationary pressure arising from the fall in commodity prices and the depression of export prices of manufactures as developing countries push exports at almost any cost in order to meet debt service payments.

- It is now almost universally agreed that it is difficult to repeat the year-by-year emergency operations of the past two years, however salutary for the entire financial system they have been. The pressure on the resources of many developing countries has become so great that in one case after another social and political troubles have arisen which could lead to a cessation of debt service payments on an indefinite basis. These troubles have frequently been exacerbated by external pressure to adopt economic measures ill-suited to a country's circumstances and leading to internal tension, the acceleration of inflation, bankruptcies and higher unemployment than might otherwise have been the case.
- The majority of the more advanced debtor countries had achieved rapid rates of growth over a fairly extensive period, with accelerating investment, diversified production, a foothold in the world market for industrial goods and an impressive range of skills and technical and managerial talent among their workforces. There should be little doubt about the capacity of these countries to repay their debts in the long term, provided interest rates can be brought down.

What is needed is to devise a solution which could help restore the momentum of growth in the developing countries while preserving the health of the international financial system. While the solution needs to be long term, it is essential that it take effect quickly—i.e. while the present emergency schemes are still in force. It is important to ensure that capital inflows, both public and private, are maintained, while at the same time the burden of servicing the existing debt is reduced.

It is also clearly in the interest of the major banks and of the monetary authorities of the developed countries to find a solution. Loans to developing countries are a small proportion of total bank lending, but they are a large proportion of bank capital. At the end of 1981, the US banks had outstanding loans to developing and Eastern European countries of about $100 billion. This compares with a total capital of the thirty largest US banks of $40 billion. The one hundred largest non-US banks had an estimated total of $200 billion in outstanding loans to these two areas. Against this they had a total capital of $120 billion. The exposure of the banks on average was 200 per cent of capital.[41] The situation may have improved somewhat since 1981 as banks have tried strenuously to broaden their capital base, but the essentials have not changed.[42]

Creditor countries developed a coordinated approach to the debt problem and created a consultative machinery quickly after the eruption of the debt crisis in 1982. Debtor countries have been slower. In 1984, the Latin American governments met in Quito, Ecuador, and then in Cartagena, Colombia, adopted a broad platform of objectives and agreed on a need for consultations. It is unclear whether this will evolve into a consultative machinery of all debtor countries.

40. Munir P Benjenk, Vice-President, The World Bank, *Finance for Developing Countries: Conditionality and Security*, Remarks at the Quadrangular Forum, Center for Strategic and International Studies, Georgetown University, Washington DC, 12 March 1984, p 7.

41. Avramovic, 'External Debt' *op. cit.*

42. David Lascelles, 'Why the banks have built up their reserves', *Financial Times* (London) 2 April 1984. Lascelles reports that the outstanding loans of US banks to developing countries now (May 1984) amount to US $120 billion.

International financial and monetary reform

Three intra-governmental groups have recently been working on international financial and monetary reform. First, the Group of 10 developed countries (the United States, Britain, West Germany, Japan, France, Italy, Canada, Belgium, the Netherlands and Sweden) is examining possible improvements in the international monetary system and the part that could be played in this by a high-level monetary conference, based on the mandate given by the Williamsburg Summit of industrialised countries of May 1983. The main topics under study are:

- the causes and effects of exchange rate fluctuations;
- the creation and management of international liquidity, including a possible reform of special drawing rights (SDRs); and
- the strengthening of the role of the IMF in the surveillance of economic and monetary policies and in promoting adjustment.[43]

Secondly, an *ad hoc* group of five developing countries (India, Mexico, Algeria, Tanzania and Yugoslavia) is preparing a proposal for consideration by the Group of 77, outlining the position of developing countries on the issues to be negotiated at the International Conference on Money and Finance for Development, proposed by the New Delhi Non-Aligned Summit in March 1983 and the Group of 77 Buenos Aires Ministerial Conference of May 1983.

Third, a Commonwealth consultative group of eight developed and developing countries (Britain, Canada, New Zealand, India, Tanzania, Zimbabwe, Trinidad and Tobago, and Fiji) will be attempting to reach a joint position on reform of the international monetary and trading system in line with a decision of the Commonwealth Heads of Government meeting in New Delhi in November 1983. This follows their examination of the report 'Towards a New Bretton Woods', prepared by the Commonwealth Group of Experts in July 1983.[44]

All this amounts to a massive effort and it continues the evolution of the international financial system since its formal establishment in 1945. To summarise the most important changes, there has been the establishment of the Compensatory Financing Facility in the IMF which helps to offset the effects of fluctuations in export earnings and cereals import costs; the establishment of SDRs as an intended future reserve asset; the creation of the IDA, the soft-lending affiliate of the World Bank; the broadening of the sectoral composition of World Bank lending and its expansion, as well as that of the International Finance Corporation (another affiliate); the setting up of regional development banks and the associated broadening of control; the establishment of the International Fund for Agricultural Development and the intended setting up of the Common Fund, based on the sharing of responsibility between developed and developing country groups.

But while this evolution must be recognised, it also needs to be stressed that substantial gaps have remained in the structure—in long-term programme lending and in debt reorganisation, as well as in export finance, commodity stabilisation and ECDC finance. And there has been no essential change at the apex of the system in the World Bank and IMF. Even more important, in my view, there has been no essential change in the theory of economic policy which is dominant in these institutions. This is of particular relevance in relation to the IMF, the key agency providing precious assistance for adjustment and the one which holds the key to the release of other funds.

There can be no serious argument with one strand of this dominant theory—the need for fiscal responsibility in view of the ravages which deficit spending and associated inflation have

43. *Journal de Genève*, 18 and 19 November 1983.

44. The Group was headed by Professor G K Helleiner, and included eight prominent public figures from both developed and developing countries in the Commonwealth.

inflicted on many developing countries. But the other main strands—the free trade doctrine; liberalisation of all markets for both imports and finance, virtually under any conditions; the anti-wage bias; a large part of the monetarist prescription—essentially reflect value judgements. They are not universal economic truths. Under some circumstances, they will represent an appropriate course of action but under others they will not. It is the persistence with which these prescriptions have been pushed—the institutional 'mindset' in the eloquent phrase of Camps and Gwin, which bears a large share of the responsibility for the conflict in relations between the IMF and a varying number, sometimes large, of its members.[45] Shifts in percentages of the votes in the institutions and the issue of new policy papers, while needed, will have a limited effect on actual operations until the 'mindset' approach is replaced by a broader view.

Secondly, there is the 'frightening state' of the monetary system, to use the description of Professor Johannes Witteveen, former managing director of the IMF. He has made a number of important proposals for future action, including the issue of SDRs, improvements in their marketability, and ultimately their central place in the international monetary system and in the operations of the IMF.[46] He has not mentioned the need for change in the principles governing the allocation of SDRs, from a quota-based to a need-for-liquidity-based system. This is an issue of vital importance to most developing countries. The future role of SDRs is also of direct concern to the primary-producing countries in connection with the question of commodity price stability.

Provided the marketability of SDRs is improved and their supply augmented, they would in principle be superior to European Currency Units (ECUs) of the European Monetary System as a wider-based reserve asset. Unlike SDRs, ECUs exclude the US dollar, a key world currency, from their base. ECUs are rapidly gaining in popularity with the capital markets, however, and this makes the question of the reform of SDRs as a world reserve asset a matter of urgency.

Thirdly, the operating principles of development finance agencies, essentially based on financing the predetermined foreign exchange cost of specific investment projects, have proved inadequate, particularly in the present crisis. Borrowing countries, affected by slump, have been unable to provide their local currency contributions in the required amounts and therefore the take-up of loans has stagnated in spite of an increase in approved loan commitments. The Inter-American Development Bank's disbursements in 1983, for example, amounted to $1,730 million, a negligible increase over the $1,663 million of 1982, despite a record level of commitments in 1983 of $3,045 million.[47] It is a similar story with the Asian Development Bank, in the case of countries like Indonesia, Malaysia, Thailand and the Philippines;[48] while, in the case of Africa, loan disbursements by official lending agencies actually fell from $2.6 billion in 1980 to $2.2 billion in 1983. Combined with an even steeper fall in disbursements by private lenders and a rising debt service burden, net transfers to Africa plummeted from $2.7 billion in 1980 to $1.1 billion in 1983.[49] If these astonishing figures are correct, a new look at assistance to Africa is needed.

Fourthly, it is unlikely that developing countries will achieve more than marginal adjustments to the international financial and

45. Miriam Camps, with the collaboration of Catherine Gwin, *Collective Management: The Reform of Global Economic Organisations*, New York: McGraw-Hill, 1981.

46. H Johannes Witteveen, *Developing a New International Monetary System: A Long-term View*; The 1983 Per Jacobsson Lecture, Washington DC, 1983.

47. Based on the IADBs Annual Report, as reviewed in *Journal de Genève*, 27 March 1984.

48. Statements by Mr Masao Fujioka, President of the ADB, as reported in the *Wall Street Journal*, 4 December 1983.

49. The World Bank, *Debt and the Developing World . . ., op. cit.*, p ix.

monetary system unless they show they themselves have something to offer, as well as making demands. There are, in fact, three things they can offer—opportunities for investment, markets and a home for lending.

Management of the South's efforts

In conclusion, the Caracas decisions of 1981 made a significant beginning in setting up machinery for intra-South cooperation, but further steps are needed. As Ambassador Faizook Sobhan, former chairman of the Group of 77 said in his last report in September 1983:

> Now that the first phase of the Caracas programme of action—namely, the technical meetings—is complete, we have to get down to the much more difficult business of implementation; putting together concrete programmes of cooperation; setting up action committees; improving the flow of information . . . persuading member states to do the needful.

The report adds: 'The truth of the matter is that without this active promotional role, member states left to themselves—and this is what we have learned from hard experience during the past year—may not be able to take action.'

With respect to the management of the South's efforts, while progress has been made in laying the organisational basis, through the establishment since 1981 of the Office of the Chairman of the Group of 77 with a skeleton staff, the present arrangements are insufficient to cope with the huge scale of the task ahead. This refers both to the South-South and the South-North dimensions of developing country collective efforts.