

GENERAL AGREEMENT ON TARIFFS AND TRADE

Consultative Group of Eighteen
Twenty-second Meeting
19-20 October 1983

THE RELATION BETWEEN THE INTERNATIONAL TRADING SYSTEM AND THE INTERNATIONAL FINANCIAL SYSTEM

1. This paper is organized along the same lines as the paper prepared for last May's CG.18 meeting (CG.18/W/74, 26 April 1983). Part I deals with the interaction between the debt problem and problems in the trade area. Part II describes developments in co-operation between the secretariats of the GATT and multilateral financial institutions, and deals with actions within the GATT framework to facilitate the search for solutions.

I. TRADE POLICY AND THE INTERNATIONAL FINANCIAL SYSTEM

2. The current state of international indebtedness requires action to simultaneously solve a short-term and a longer-term problem. In the short term there is the need to maintain adequate debt service while, at the same time, providing for at least the minimum import capacity necessary for stable functioning and continued growth of the debtor economies. In the longer term, the debtor countries' ability to service their debts out of expanding production will have to be restored. Achievement of these twin objectives ultimately depends on increased opportunities for multilateral trade brought about by policy reforms in both the creditor and debtor countries.

3. In order to find permanent solutions to these problems, they must be addressed in a multilateral framework so that account may be taken of the multilateral nature of trading relationships and distortions of trade flows avoided.

4. Without liberal access to foreign markets for the goods the developing countries can produce with comparative advantage, their current international indebtedness cannot be serviced in full, let alone repaid. In this regard, it is important to note that more than two-thirds of the indebted developing countries' exports are sold to the developed countries. The remainder of their exports goes to countries whose purchasing power is likewise dependent on access to world markets.

5. Adjustment in countries with debt service problems generally begins with changes in monetary and fiscal policies. Once the necessary policy changes have been made, the particular way in which the current account deficit will be reduced is not easy to predict. However, when the world economy is expanding and markets are open, current account deficits are more likely to be corrected by an accelerated growth of exports, while in a period of world economic stagnation reinforced by protectionist actions and pressures, the correction is more likely to be attained through a contraction in imports.

6. Given the trading conditions that existed in 1981-82, it is not surprising that the partial adjustment which occurred was of the latter kind. There was a moderate decline in the combined merchandise trade deficit of the oil-importing developing countries in 1982, which occurred through a steeper fall in the dollar value of imports than in the value of exports (by 7.5 versus 5.5 per cent). As the terms of trade of these countries worsened in 1982, rough estimates point to a 1 per cent increase in¹ the volume of exports and a 4 per cent decline in the volume of imports.

7. More generally, recent trends in world trade indicate that the mechanism by which national upswings are transmitted internationally is not functioning in the same way as in previous recoveries. There are several factors that explain this, for example the need to set aside a part of foreign exchange earnings for debt service rather than for increased imports. But surely one of the reasons behind this development is the impact of trade restrictions, and the uncertainty generated by threats of further restrictions, on the extent to which the recovery is stimulating increased trade, including increased imports from developing countries.

8. A determined liberalization of conditions of access for the debtor countries' exports to their major markets would soon be reflected in improved foreign exchange earnings. Even more important, however, would be the subsequent emergence of profitable and secure investment opportunities in the debtor countries which would (a) facilitate the process of adjustment and (b) raise their creditworthiness, greatly aiding, if not eventually making superfluous, the political task of mobilizing emergency credits.

9. All countries stand to gain from an adjustment process in the indebted countries that emphasizes increased growth and increased export earnings, rather than a process based on restraining the indebted economies to the point that imports decline more than exports. In order for the first alternative to be realized, there are three considerations to take into account in setting policies in both developed and developing countries.

10. First, there is the need to deal with an overall shortage of capital - as indicated by declining savings ratios and high real interest rates - which has emerged in the last year or so. In part, this will depend on increasing net national savings. Since most

¹See Chapter 1 of the secretariat's latest annual report International Trade 1982/83 (published as GATT Press Release GATT/1340, 30 August 1983) for additional details on this point, as well as on other points mentioned in Part I of this paper.

government expenditure goes for consumption, reducing government deficits is an effective way of increasing the amount of savings available for productive investment. The other effective response to the increased scarcity of capital is to increase the efficiency with which each unit of capital is used.

11. This leads to the second consideration, which is the need to improve the functioning of the price system; in other words, a greater willingness to rely on the price system - relatively unencumbered by intervention in the form of subsidies, tied credits and restrictions - to determine resource allocation domestically and internationally.

12. The distortions and rigidities in national price systems, and hence the impairment of the international price system, owe their existence in many instances to protective measures that isolate the economies of the industrial and developing countries from world market prices. The third consideration, therefore, is that trade liberalization is the most promising method of restoring both efficiency in the allocation of resources through the price mechanism and flexibility to industrial structures in the developed and developing countries.

II. ACTION IN THE GATT FRAMEWORK

A. Cooperation between the GATT and the International Monetary Fund

13. In his concluding remarks at the last meeting, the Chairman noted that there was clear support for closer cooperation between the GATT and the IMF secretariats and that, when the matter would be taken up again at this meeting, the Group might wish to consider specific proposals or suggestions to this end. Since that meeting, the Director-General and the Managing Director of the IMF have met on several occasions to discuss this question. The Director-General also undertook to consult the Chairman of the Committee on Balance-of-Payments Restrictions on suggestions made by members of the Group regarding the possibility of improving the Committee's procedures.

14. Paragraph 4 of CG.18/W/74 pointed out that the basic problem is one of ensuring appropriate coordination between trade and financial policies in national capitals. At the same time, an effective working relationship between the GATT and the IMF would enable these institutions to make, each in its respective field, appropriate contributions to helping countries maintain or restore external financial equilibrium in the short run and the competitiveness of their economies over time.

Procedural aspects

15. Following the exchange of views between the Director-General and the Managing Director, a number of informal contacts have taken place between the staffs of the two organizations to exchange data on the situation of individual countries consulting with the IMF under Article IV of the Fund, as well as on the situation of some developing countries.

16. This process of exchange of data has been conducted thus far on a tentative and unsystematic basis. Further exchanges will be necessary to identify the specific information needs of both institutions. At this stage, it would appear useful to institute a practice of periodic meetings of members of the two secretariats to promote mutual understanding of their respective approaches to these problems, taking into account the great disparity between the GATT and the IMF as regards functions, working procedures and staff resources. Apart from the Balance-of-Payments Committee, the intention is to keep Fund-GATT cooperation on an informal level.

Policy aspects

17. Action by the two institutions along the lines described above would be helpful in the context of in the IMF's Article IV consultations and standby and extended arrangements on the one hand, and GATT balance-of-payments consultations on the other. It would make for a better appreciation of the inter-action between trade policy and financial issues as they affect the balance-of-payments situation of developing countries.

18. The stand-by and extended arrangements negotiated with the IMF are often accompanied by stated objectives with respect to the borrowing country's trade policy actions for the duration of the arrangements. Standby and extended arrangements clearly are not intended to deal with external trade policy factors affecting the financial and trade situation of the borrowing countries.

19. Under the terms of Article IV consultations with other countries, the Fund exercises surveillance over the exchange rate policies of its members, and oversees their compliance with the general economic policy obligations defined in that Article, which includes consideration of trade policy. There is no direct link, however, between actions which countries take in response to Article IV consultations and actions taken by countries which have negotiated a stand-by or extended arrangements with the Fund.

20. In the GATT context, the examination of trade restricting measures adopted by contracting parties for balance-of-payments purposes is traditionally focussed on the level of the consulting country's restrictions. However, the balance-of-payments consultations can give attention to external trade factors affecting the ease with which a country can restore balance-of-payments equilibrium. This is clearly the intention of the procedures for "expanded" consultations adopted in April 1970 (BISD 18S/48), as well as of paragraphs 11 and 12 of the Declaration on Trade Measures for Balance-of-Payments Purposes of 28 November 1979 (BISD 26S/205). The approach followed in these instances is consistent with the specific rôle of GATT in furthering the expansion of world trade.

21. Consultations held under Article XVIII:B of the General Agreement could provide a forum for dealing with the trade problems of developing countries, both because of the existing institutional link between the IMF and the Balance-of-Payments Committee, and because of the experience, albeit limited, gained in looking at ways in which such consultations may be used to discuss the impact of the trade policies of the consulting country's trading partners on its balance-of-payments adjustment process.

22. For example, trade liberalization measures or efforts by countries in balance-of-payments difficulties to reduce their reliance on direct restrictions of imports, could be supported by action on a multilateral basis by their trading partners to reduce trade barriers on products of major export interest to them. Such actions would increase the likelihood that the balance-of-payments adjustment would rely more on export expansion than import contraction. To the extent that they assisted developing countries to avoid reliance on trade restrictions, they would provide the ground for securing progress in trade liberalization on a more enduring basis than if such actions remained unilateral.

23. However, in order to take full advantage of these possibilities, a reappraisal of the rôle of the Balance-of-Payments Committee may be needed. The Committee, as it presently operates, does not provide the strong institutional support needed to initiate bold and wide-ranging action to assist consulting countries in solving their balance-of-payments problems. While preserving the fundamental rôle of the Committee under the provisions of Articles XII and XVIII:B of the General Agreement, attention could be given to the possibility of approaching these problems in the spirit of Article XII:5 of the General Agreement. Proposals and suggestions in this direction are contained in the Annex.

B. Cooperation between the GATT and the World Bank

24. At the last meeting of the Group some members raised the question of the relationship between the activities of the World Bank and the GATT. Though there is no formal institutional link, as there is with the IMF, there are long-standing informal contacts with the World Bank, and these are being intensified.

C. Actions in the Committee on Trade and Development

25. The Committee on Trade and Development has adopted a programme of work, based on the decisions of the November 1982 Ministerial Meeting of the CONTRACTING PARTIES, which may also provide a framework for seeking means to pursue mutually advantageous action in the trade field, taking into account the financial and debt situation of the developing countries. Two elements of the Committee's programme of work could be considered relevant to this: (i) consultations in the Committee on Part IV; and (ii) work on paragraph 5 of the Ministerial Decision on GATT Rules and Activities Relating to Developing Countries, concerning prospects for increasing trade between developed and developing countries. The annex to this paper contains information on the work being undertaken in these two areas.

D. Creation of a trade policies division

26. A new Division has been established in the secretariat whose main task will be to follow, for the first time on a comprehensive and systematic basis, the trade policies and measures of Contracting Parties, with a view to ensuring transparency and thus awareness of trade-related measures. This will reinforce the capacity of the contracting parties to respond to developments in the trading system. It is also expected that this new organizational structure will facilitate the exchange of information with the IMF and the World Bank.

SUMMARY AND CONCLUSIONS

27. The actions described above and the proposals for further action cover three main areas:

- (a) reinforcement of cooperation between the GATT and the IMF as well as with the World Bank;
- (b) expansion of the scope of the activities of the Balance-of-Payments Committee; and
- (c) full utilization of the opportunities afforded by the work programme of the Trade and Development Committee in seeking solutions to the debt problem through enhanced trade opportunities.

28. Even if it is to be recognized that these institutional and organizational measures are modest in relation to the magnitude of the problems faced, their implementation could be considered as a point of departure for more ambitious steps. The essential message of the present paper and of the one prepared for last May's CG.18 meeting is that there can be no lasting solutions to the closely related problems of indebtedness and protectionism without further liberalization of access to national world markets.

29. It may be worthwhile recalling in this respect that contracting parties would effectively contribute to easing the adjustment problems of countries facing severe financial difficulties by making concerted efforts to implement the undertakings of the CONTRACTING PARTIES at their 1982 ministerial Session, in particular paragraph 7 of the Ministerial Declaration. Despite the steps taken to implement the ministerial work programme, and despite the economic recovery in North America and some other industrial countries which many argued would help alleviate the problems, there has been negligible progress since the Group's discussion last May in dealing with the fundamental issues analyzed in this paper. The forthcoming CG.18 meeting offers a welcome opportunity for consideration of any practical actions going beyond the propositions contained in this note, with a view to reviving world trade.

ANNEX

(A) Committee on Balance-of-Payments Restrictions

1. As a first step, in expanding the activities of the Balance-of-Payments Committee, the balance-of-payments consultations with developing countries could be reoriented so as to focus to a greater degree on:

- (i) the rôle of the trade policies of the consulting country in promoting an efficient use of resources and development, and
- (ii) the payments prospects of the consulting country as they are affected by trade barriers or conditions of access in export markets.

Such an effort would go beyond the narrow question of the current account deficit to include the broader questions of efficient resource use, improved investment prospects, and the extent to which the balance-of-payments adjustment process would entail export expansion rather than import contraction.

2. Expansion of the activities of the Balance-of-Payments Committee would be possible only if there were more active and high level representation in the Committee from both developed and developing contracting parties, as well as wider participation by contracting parties in the work of the Committee.

3. In order to facilitate the work of the Committee, the documentation provided for the consultations could focus not only on the financial and trade situation of the consulting country but also on the general trade environment confronting it. In addition, consulting developing countries could notify to the GATT any measures of trade liberalization agreed by them under standby or extended facility arrangements with the IMF. Such measures could then be taken into account in the consultation. A limiting factor, of course, is that presently only eight of the twenty-eight contracting parties with which the Fund has standby or extended facility arrangements consult in the GATT Balance-of-Payments Committee.

4. Finally, an important procedural improvement would be to ensure a greater synchronization between the IMF standby consultations and the balance-of-payments consultations in the GATT.

(B) Work in the Committee on Trade and Development

(i) Consultations on Part IV

5. It was agreed at the Ministerial Meeting that the Committee on Trade and Development would carry out individual and collective consultations to examine how individual contracting parties have

responded to the requirements of Part IV. Aside from consulting on the implementation of Part IV by developed contracting parties, the Committee is also expected to consult with less-developed contracting parties individually or collectively. It could be considered whether the consultations with developing countries could take place also against the background of Article XXXVIII:2(c) of Part IV, which states that the CONTRACTING PARTIES shall "collaborate in analysing the development plans and policies of individual less-developed contracting parties and in examining trade and aid relationships with a view to devising concrete measures to promote the development of export potential and to facilitate access to export markets for the products of the industries thus developed and, in this connexion, seek appropriate collaboration with governments and international organizations ...".

6. It may be recalled that the Sub-Committee on Trade of Least-Developed Countries has established its own programme for ad hoc consultations with interested least-developed countries on their trade problems. Such consultations may also be considered relevant to the issues discussed in this paper in the case of specific least-developed countries.

(ii) Prospects for increasing trade between developed and developing countries

7. Paragraph 5 of the Ministerial Decision on GATT Rules and Activities Relating to Developing Countries provides for an examination in the Committee on Trade and Development "of the prospects for increasing trade between developed and developing countries and the possibilities in GATT for facilitating this objective." In carrying out an examination of measures and opportunities for seeking greater expansion and liberalization of trade, the Committee on Trade and Development could be expected to take into account the relationship between the current financial situation of developing countries and their trade problems.