

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

Spec(83)26
29 June 1983

THE RELATION BETWEEN TRADE POLICY AND THE INTERNATIONAL FINANCIAL SYSTEM

Record of Discussion in the Consultative Group of Eighteen, 6 May 1983

1. The Group had before it a paper on this subject by the GATT secretariat (CG.18/W/74) the first part of which dealt with international financial systems and their connection with international trade, and the second part with cooperation between the GATT and the IMF.
2. Introducing the discussion, the Chairman said that the dependence of the financial system on the maintenance of an open trading system, which the GATT had been preaching for several years, was now generally recognized and widely discussed. The GATT secretariat was increasingly involved in discussions with governments and other institutions on the trade/finance link and it would be very helpful for this purpose to have the views and advice of the Group. On the subject of cooperation between the GATT and the IMF, the Chairman informed the Group that the Fund had undertaken to finish its contribution to the study on exchange rate fluctuations before the end of this year and that the GATT secretariat would be invited to comment on this element of the study before its submission to the Executive Directors of the Fund. More generally, relations between the secretariats of the Fund and the GATT had been extended and would be further reinforced, since both organizations felt the need of additional information on each other's activities and researches in the trade policy field, notably in connection with the Fund's consultations with individual countries.
3. In the discussion which followed there was complete agreement on the importance of the links between trade policy and the health of the financial system. The secretariat's paper was found helpful and illuminating and with a few qualifications its analysis of the origins and scope of the problem of indebtedness, and of the importance of open markets as a contribution to its correction, was supported. Other major themes touched upon in the discussion were the scope for increased cooperation between the GATT, the Fund and the World Bank, and the forms which such cooperation might take, the possibility of improving the procedures of the GATT Balance-of-Payments Committee and extending the ambit of its concerns, and the difficulty of ensuring symmetry of treatment between indebted countries, or those in balance-of-payments difficulties, and creditor countries.
4. The first speaker emphasized the critical importance of greater convergence in national trade and financial policies, for the recovery and health of the world economy. This would be a major concern at the forthcoming meeting of trade and finance ministers in Paris and at the Williamsburg Summit meeting. It was hoped that future meetings of trade and finance ministers might include developing countries, whose rôle in the world recovery would be of crucial importance. It would entail reform and

adjustment in their economies: but the success of these efforts would depend on the existence of open markets for their exports, and on the availability of finance. In the GATT the trade/money link found expression in the Balance-of-Payments Committee, the adequacy of whose procedures should perhaps be reviewed. Outside that Committee, there was inadequate interaction between the GATT and the Fund (and virtually none with the World Bank.) These contacts should be extended, firstly by increased exchanges of information with the Fund. The GATT secretariat could, for example, provide information and advice to the Fund for the purposes of its Article 4 consultations and even for loan negotiations. Members of the secretariat might also participate in Fund country missions in order to state the GATT view on the trade policies under review. It was important to correct a widespread miscomprehension that IMF stabilization programmes commonly restrict imports: in fact, the Fund actively promoted liberalization and the policies it advised normally permitted higher import levels than would otherwise have been achieved. The CG.18 and the contracting parties generally should consider how the benefits of trade liberalization that would flow from IMF consultations could be disseminated through the system.

5. Another member expressed the hope that from recognition of the link between trade and financial problems the Group and the GATT could move towards identifying possible solutions. However, in both areas there were severe technical difficulties, and it would be wrong for the contracting parties to try to become involved in the technicalities of finance. The discussion should be directed towards helping the secretariat make the case for the open trading system in its contacts with the Fund and the Bank, and more widely. In the GATT Balance-of-Payments Committee itself the trade/money link was neglected to the extent that the Committee looked at only one side of the equation - the justification and the effects of measures taken for balance-of-payments reasons - but never at the means by which a consulting country's balance-of-payments position might be so improved as to make trade restrictions unnecessary. The Balance-of-Payments Committee should relate more directly with the other organs of GATT. The secretariat paper should be expanded for the next discussion and should consider more fully the reasons for the erosion of the buying power of many developing countries, which was at the root of their debt problems and of the overall decline in world trade. On cooperation with the Fund, he warned that involvement of the GATT in Fund conditionality exercises would be counterproductive. A later speaker, however, suggested that the presence of GATT representatives in Fund missions might inject greater realism into Fund programmes which too often ignored social considerations and thereby provoked unrest.

6. Several other speakers agreed that in the examinations carried out by the Balance-of-Payments Committee inadequate consideration was given to the external factors contributing to the balance-of-payments problem of the consulting countries. One member said that his country welcomed the advice received from the Balance-of-Payments Committee and elsewhere but in fact had limited control over its own destiny: so many of its exports - in

agriculture, steel, textiles and so on - were subject to quota restrictions so that devaluation, for example, could have no effect in stimulating trade.

7. Another speaker said that the main causes of the high indebtedness of certain developing countries were recession, protectionism and inflation in the industrial world rather than faulty policies in the indebted countries. His own country, because of the imperative need to develop the economy, was obliged to import all that it could afford, but could not continue to import, or finance its debts, if its exports were restricted. At present some 50 per cent of its exports of manufactured products to the US, for example, were under restriction. It was true that the Fund advised liberal rather than restrictive import policies, but unless it could bring equal pressure to bear in favour of open markets in the developed world, it was hard to see how increased imports could be reconciled with the burden of debt servicing. Because of the asymmetry flowing from the Fund's limited influence over creditor countries, he found the idea of GATT participation in Fund missions alarming. By increasing pressure on developing countries for liberalization it would increase the existing imbalance. He suggested that if the secretariat were to increase its contacts with the Fund and the World Bank, which he thought desirable, the private banking sector should also be brought in, in view of its important rôle in development financing.

8. The Chairman commented that under Article 4 of its Articles of Agreement the IMF sent missions to industrialized countries, which involved a serious examination of trade policies. It was in this context that the Fund had sought information from the GATT secretariat. The proposal that secretariat members should participate in Fund missions had never in fact been put to the GATT because the Executive Board of the Fund had not approved it.

9. A later speaker drew attention to the overwhelming influence of exchange rate fluctuations and high interest rates on the problem of debt. For example, it was calculated that debt service in the current year would cost Latin American countries some 63 per cent of their export earnings: but a 2 per cent drop in interest rates would be equivalent to an \$8 billion saving in debt service which was in turn equivalent to a 10 per cent rise in the exports of these countries to the seven industrialized countries represented at the Williamsburg Summit. Trade liberalization alone should not therefore be seen as a panacea, though it was certainly essential that markets be kept open. The effects of world economic recovery, if it developed as hoped, would vastly outweigh any conceivable change in trade policies, because the root of the current recession was lack of demand. In the EEC, for example, textile quotas were not being filled.

10. The damaging effects of high interest rates were emphasized by several other speakers. One speaker recalled that it had been suggested that if not brought under control they would be the cause of a major recession. In addition to this, durable recovery would require reasonable convergence of macroeconomic policies, since otherwise divergent growth rates might provoke protectionism. Another destabilizing factor was the exchange rates of a number of major currencies, which bore little relation to the competitive strength of the economies in question. Nor should it be forgotten that energy prices, which had been very disruptive indeed, could become so again. An important contribution to solution of the debt problem would be to ensure adequate financing of the relevant international institutions, including the IDA. (The recent increase in Fund quotas was a signal case of failure on the part of governments to understand the relationships which were the subject of today's discussion.) On the subject of "conditionality", he pointed out that unless the adjustment programmes negotiated by the Fund carried conviction with the private banks, the latter would be disinclined to lend to the countries in question: less "harsh" or realistic programmes would therefore lead to a fall in private sector lending. In the trade field, the main contribution to recovery would be the elimination of restrictions, subsidies and other causes of rigidity in national economies. Another speaker suggested that to seek to allocate blame for the debt crisis was somewhat futile - among its many causes were the financial flows which, in the 1970s, had helped to promote the development of the third world and to assist economic activity in the industrialized countries. The crux of the problem now was the size of the debt burden. Economic adjustment must feature largely in any solution. Debtor countries in particular needed basic structural adjustment, notably improvement of the infrastructure, to which IDA assistance could contribute. Similarly, the only way to keep markets open, in both developed and developing countries, was to maintain economic policies focussed on the need to adjust. There were real political obstacles to open market policies and the idea that more talking between trade and financial experts would in itself remove them was illusory. International institutions could help by stating the problem clearly and effectively. The GATT should seek to develop a strategy to this end in consultation with governments and the other institutions, but it should not involve itself in Fund missions or in the issue of conditionality, necessary though that concept was.

11. One member suggested that the GATT should consider initiating or endorsing a standstill on trade restrictions affecting the exports of developing countries, and the secretariat paper should be followed up by a more detailed study on the effects of protectionism on the payments situation of the indebted countries. The suggestion in the present paper that excessive controls on foreign transactions have worsened the position of developing countries seemed to him questionable, since a number of developing countries were in fact suffering the consequences of over-rapid liberalization. Furthermore, investment in developing countries had increased faster than elsewhere, from 19 per cent of GNP on average in 1960 to 25 per cent in the late 1970s. Was it not the case that unfavourable

terms of borrowing, and the changing economic environment, rather than excessive borrowing in itself, were at the root of the current crisis? It was in any case clear that urgent action was necessary on the financial plane because private lending to developing countries would take a long time to return to its former level.

12. Another speaker argued that the connection between debt and protectionism, though real, should not be over-stressed: it was in fact impossible for a country like his own to pay off its debt by running a trade surplus, which would imply becoming a net exporter of capital. Debt repayments must be balanced by capital inflows. Nor should the institutional relationship between the Fund and the GATT be overstated. Improving national policies was the essential requirement and GATT's contribution should be to demonstrate how markets should and could be kept open.

13. Another speaker agreed that the secretariat paper overstated the possibility for developing countries to finance their debts through trade surpluses. The origin of their indebtedness should be more closely analysed. Though his own country had had a positive balance of trade in recent years, it had gradually lost access to different forms of development assistance and multilateral loans and had fallen back on the commercial banking system, which was not an adequate source of development finance. Very high inflation and "positive" interest rates attached to short term loans had compounded the problem and effectively drained the country's economy. The international financial system was now so disordered that a solution was hard to envisage. Certainly, it could not be done by a few countries or without concerted action and participation by all competent international organizations. He proposed that the Group of 18 might meet with similar groupings representing the IMF and the World Bank with a view to seeking solutions to the related problems of debt, interest rates and trade. The situation of his own country might for example be analysed at such a meeting.

14. Summarizing the discussion, the Chairman noted the general view that this subject should be discussed further and proposed that it be placed on the agenda of the next meeting. At that stage we should perhaps adopt a more concrete and action-oriented approach on the basis of some of the ideas expressed today. On the possibility of improving GATT procedures, he undertook to consult the Chairman of the Balance-of-Payments Committee on the suggestions made by members of the Group. He had found the comments of the Group on cooperation with the IMF very helpful. There was clear support for closer cooperation between the two secretariats. Different views had been expressed on the presence of GATT staff in Fund missions, but this was not in any case a live issue. Proposals for a joint meeting of the Group with similar groups of the Fund and the Bank and for

involvement of private bankers would also be kept in mind. The proposal of a standstill on protective measures affecting developing countries would be analysed. He proposed that CG.18/W/74, together with the record of this discussion, should be circulated to all contracting parties. This was agreed. The secretariat would prepare a further background paper for discussion at the Group's next meeting in October.