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A two-front attack to overcome the payments crisis of developing countries

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The developing countries' payment crisis has reached dramatic proportions, and cannot be overcome without large-scale action compassing the two variables that determine payments capacity: the capacity to possess or create liquid assets and the capacity to generate foreign exchange income, especially by means of external trade. The measures proposed in the present article relate to the establishment of an international currency based on primary products, which could be administered by the International Monetary Fund, and to the adoption by the developing countries of a more persuasive strategy in negotiations on access to markets. To implement the measures in question the developing countries would need to assume an active role, inasmuch as they would have to turn their own natural resources and import markets to account, manipulating them as bases for negotiations. The payments problems of the developing countries are too acute to be resolved through mere international co-operation commitments or through the adoption of world programmes, which by themselves will never improve the developing countries' bargaining power. This two-front attack would, however, improve the power of the developing countries to negotiate debt maturities and terms of payment and would also considerably lighten the burden of the adjustment programmes which the said countries are adopting.

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In 1981, the magnitude of total world debt was estimated to be equivalent to 1.4 times world GNP, exclusive of centrally-planned economies. Moreover, world GNP in nominal terms has been growing at an annual rate of 7%, whilst the annual average rate of interest has been above 10%. This economic growth, therefore, has not been enough to cover interest payments.

The situation is particularly grave for an increasing number of developing countries. The outstanding external debt of net-debtor developing countries was estimated to have exceeded US\$ 600 billion by the end of 1984, or 1.8 times their total export earnings during that year (UNCTAD, 1984, table 11). The liabilities of developing countries have been aggravated further by the considerable appreciation of the United States dollar over the past few years, as a large part of the external debt of these countries is denominated in dollars. And while a timid fall in borrowing rates has taken place lately, such rates remain above both the rate of export growth of developing countries and the expected rates of return of most development projects.

At the same time, net transfers of financial resources to developing countries have been declining. Net flows of banking funds to non-OPEC developing countries dropped from US\$ 31 billion in 1981 to US\$ 15 billion in 1982 and to only US\$ 2 billion in 1983; whilst interest payments made by these countries in 1983 amounted to US\$ 15 billion. Gross borrowing of non-oil-developing countries, exclusive of "managed" loans (i.e., loans extended in the context of debt rescheduling), amounted to only US\$ 9.7 billion in 1983 as compared to US\$21.9 billion in 1982. As a result, there was a net transfer from developing countries in their transactions with banks of about US\$ 7 billion in 1982 and US\$ 21 billion in 1983 (UNCTAD, 1984, paragraphs 113, 114 and 153). This pattern is likely to have persisted during 1984 inasmuch as overall foreign lending by banks reporting to the Bank for International Settlements slowed down considerably during the first half of 1984, and declined by US\$ 37 billion in the third quarter (*Wall Street Journal and Financial Times*, 19 February, 1985). Official flows too fell from US\$ 61.4 billion in 1980 to US\$ 48.1 billion in 1983 (UNCTAD, 1985 (a))-

Multilateral institutions providing financial assistance to developing countries have been experiencing growing difficulties in securing an adequate volume of resources. The IMF has not been able to proceed to a new allocation of Special Drawing Rights because of lack of agreement on the part of major financial powers. A number of industrial countries have shown reluctance to expand their contributions to multilateral agencies, as reflected in the recent failure to agree on an adequate replenishment of the International Development Association (IDA) and of the United Nations International Fund for Agricultural Development (IFAD), and in the refusal of some of these countries to join the Special Facility for Africa South of the Sahara which has been recently established by the World Bank (UNCTAD (b), TD/B/AC. 17/25/Add. IA, paragraph A, 19).

As their borrowing capacity attains critical limits, a growing number of developing countries have had to submit their economies to adjustment programmes designed in accordance with the conditionality principle and the performance criteria of the International Monetary Fund (IMF). The adjustment programmes are intended to eliminate, or at least substantially reduce, balance-of-payments deficits, in particular by means of exchange rate depreciation and of austerity measures. The social and political cost of such programmes is very high, as they impinge heavily upon the living conditions of the population in the countries concerned. But implementation of these programmes by debtor countries has become a *sine qua non* requirement for the renegotiation of their debt and for securing further credits from lending banks and governments. On the other hand, the programmes do not provide for complementary action to be taken by developed countries with a view to reactivating sluggish demand for imports and arresting protectionist trends, which are major causes of developing countries' losses of export earnings. The burden of adjustment thereby falls upon the shoulders of debtor developing countries alone. Moreover, the adjustment programmes tend to exacerbate cyclical trends for two different reasons. First, the programmes are imposed at times when countries face severe balance-of-payments difficulties, and these normally arise during periods of sluggish world de-

mand. Secondly, they involve a reduction of the demand of debtor countries and, therefore, contribute to a further decline in the levels of total world demand.

Expectations have been nurtured on the prospects for economic recovery in major industrial countries and on the ensuing expansion of the exports of developing countries. The average rate of growth of industrial countries did indeed reach 4.75% in 1984, the highest level since 1976 and contrasting with 2.6% in 1983 (OECD, 1984). The volume of world trade increased by 9% in 1984, and the export earnings of developing countries by 7.5% (GATT/1371). But OECD forecasts point to a slower growth again in industrial countries in 1985; and the IMF predicts an annual growth rate of only 3% in the world economy as a whole for the rest of the decade, a forecast which may even turn out to be over-optimistic (OECD, 1984 and *Financial Times*, 17 April 1985). The menace of protectionism is thus likely to gain renewed strength. The tendency is towards continuing aggravation of the payments position of the developing world.

The payments capacity of any country is essentially determined by three variables, namely: the capacity to create liquid assets of international acceptability; the capacity to generate foreign exchange, notably through earnings from foreign trade; and the capacity to borrow in international markets, which is in turn a function of the first two variables. The gravity of the debt problem of the developing countries and the ensuing need for immediate financial relief have forced these countries to concentrate efforts upon the third, the dependent, variable. Developing countries thus have had to divert their attention from the two key and independent determinants of payments capacity. But action with regard to borrowing capacity alone can at best postpone for some time the showdown, the moment at which the two key issues will have to be seriously tackled. International concern will therefore have to be reoriented towards finding ways of enabling developing countries to participate effectively in the creation of international liquidity and of expanding their export earnings. This paper attempts to identify the major issues at stake as well as the possible elements of a meaningful, effective international line of action.

The two key determinants of the payments capacity

1. *Creation and distribution of international liquidity*

Throughout the whole postwar period, the volume of international liquidity has been determined by a handful of countries and in particular by the United States. No development has made any real difference to the concentration of the power to create international liquidity. The establishment of the markets for Eurocurrencies and petrodollars has not undermined this concentration; by controlling the conventional money supply, key-currency countries can control the world supply of their currencies (Lindert and Kindleberger, 1982). A new multinational asset has seen the light of day: the Special Drawing Rights (SDRS) issued by the International Monetary Fund. But the SDRS represent a trivial proportion of world liquid assets. They are merely a reserve asset, and have not thus far been utilized on a significant scale as a vehicle of non-official transactions. Even as a reserve asset, SDRS only represent 5% of total official reserves. Moreover, the level and the international distribution of SDRS are decided in accordance with the Fund's quota system and are therefore controlled by the same few traditional financial powers.

The concentration of world liquidity power is reflected to a certain extent in the inadequate growth of the volume of official reserves and in their uneven distribution amongst countries. Reserves have not grown at the same pace as international trade transactions. It is true that reserves are needed not so much to finance trade transactions as to finance deficits. The evolution of the reserve-import ratio, however, is normally used as a proxy for purposes of measuring the adequacy of the magnitude of liquid funds, inasmuch as deficits have actually expanded at least as fast as overall trade transactions. The ratio of world reserves to imports has decreased steadily from 85% in 1950 to less than 25% at the present time. World official reserves in 1953-1954 were equivalent to 37 weeks of imports, but they represented no more than 11 weeks of imports in

1982. Moreover, reserves have remained unevenly distributed. The share of industrial countries in world reserves in accounting values dropped from 77% in 1951 to 58% in 1982 (IMF, 1984). But the actual share of such countries is likely to have remained much the same as in the 1950s; industrial countries hold the bulk (around 90%) of official gold reserves, and the accounting value of such reserves is calculated in terms of prices which are far below prevailing world market quotations. If the value of gold reserves were estimated in terms of world market prices, it would then appear that industrial countries have probably kept their share in world reserves approximately constant even though other countries have meanwhile significantly increased the weight they carry in international transactions and/or are experiencing acute liquidity needs resulting from their heavy debt burden. The gap between reserve holders and reserve seekers is therefore likely to have expanded considerably.

The flow and magnitude of international liquidity is thus chiefly dependent upon the monetary and related policies of a few developed countries. The level of supply of the major vehicle currencies naturally responds to the national concerns of the reserve-currency countries rather than to the objective of meeting the world demand for international liquid assets. Discrepancies can, therefore, easily arise between the growth rates of supply of and demand for liquidity. What is questionable in this regard is not that reserve-currency countries formulate their monetary and trade policies according to their own national needs and priorities. Every country has or should have the sovereign right to establish its own policy objectives and to pursue them by applying policy measures of its own choice. The problem arises rather from the fact that the present international monetary system does not contain a built-in mechanism whereby the market for international liquid assets tends towards equilibrium.

During the early postwar period, the mechanisms of liquidity creation fulfilled their

function reasonably well, inasmuch as the United States was willing to maintain a balance-of-payments deficit and the world was in turn willing to absorb dollars as a means of enhancing war recovery and economic growth. Discrepancies in the liquidity market were thus attenuated by world trade flows. Subsequently, discrepancies between supply of and demand for international liquidity changed their sign: the supply of dollars continued to grow at a relatively fast pace as a result of persistent deficits in the United States balance of payments and of the proliferation of Eurodollar transactions. Countries were accumulating more dollars than they wanted. From the dollar shortage of the 1950s, the world economy moved in the late 1960s into what could be described as a dollar glut. The new situation led to the devaluation of the dollar in 1971 and to the establishment of the flexible exchange rate system in 1973. During the 1970s, two major events momentarily restored confidence in the international monetary mechanism and diluted concern over the possibility of persistent and dangerous gaps between supply and demand in respect of international liquid assets. These two events related to the ability of private banks to ensure the recycling of petrodollars and to the relatively stable operation of the new, flexible exchange-rate system.

The concentration of power and the uneven distribution of international liquidity has been accentuated considerably during the past fifteen years by the macroeconomic policies of key-currency countries as well as by the lending strategies of the major banks. During the 1970s, the policies in question involved in many cases inflationary expansion of domestic aggregate demand aimed at compensating for the deflationary effects of oil price increases. Petrodollar recycling through private banking also probably helped to accelerate inflation; the flow of petrodollars brought about a liberal lending policy on the part of private banks which manifested itself, *inter alia*, in relatively low interest rates and high gearing-ratios.

Because of their inflationary effects, the macroeconomic policies of key-currency countries during the 1970s and the recycling of petrodollars through private banks were tantamount to a re-transfer of real wealth away from developing countries, both oil- and non-oil-producing,

and towards the traditional financial powers. Oil-producing developing countries had thus extracted from the soil and surrendered a non-renewable resource in exchange for financial assets that were denominated in currencies depreciated by world inflation. The reserve assets of non-oil developing countries also depreciated for the same reasons. Some developing countries even engaged in sophisticated portfolio-diversification policies, and they did so under the expensive guidance of private firms of consultants from developed countries. Such eminent guidance, however, proved to be no hedge against the fall in the real value of their financial assets. Moreover, a large number of developing countries had to resort to international borrowing to maintain normal import levels in an inflationary world. As their terms of trade simultaneously deteriorated, these countries had to commit a larger amount of domestic resources to meet their import bills and service their growing foreign debt. The payments crisis and the ensuing demand for dollars in their turn reinforced the United States' privilege of running persistent balance-of-payments disequilibria, a privilege which had been under momentary strain during the time of the dollar glut.

The misadventures that developing countries have experienced in terms of depreciation of their financial wealth *via* world inflation are largely related to the fact that these countries gave up the custody of their wealth to the traditional financial centres and, therefore, had no control over policies which directly affected the real value of that wealth. The increases in oil prices had indeed caused a substantial transfer of income to oil-producing countries. But these countries did not acquire a corresponding say in the creation of international liquidity. Apart from some increase in their IMF quota and some involvement in international banking, no more was made at that time to develop mechanisms whereby oil-producing countries could take a share in decision-making with respect to the creation of international liquidity. Whether or not these countries could or should have envisaged the establishment of alternative mechanisms of liquidity creation is now a matter of hypothetical history. The fact is that the power to create international liquidity was not significantly altered by the emergence of oil power and, furthermore,

that the financial wealth of developing countries has been diminishing steadily and is even pursuing a negative trend.

The macroeconomic policies of the major industrial nations have been appreciably modified in response to the economic recession of the early 1980s. The new policy mix consists in general of i) budgetary policies aimed at attenuating the tax burden of domestic firms and households and/or coping with the effects of rising unemployment; and ii) tightening monetary policies designed to reduce inflation rates. The policies adopted have certainly varied among developed countries, notably as regards their scale and the moment at which they were adopted. But their nature has been, all in all, similar, and they have conduced to unusually high interest rates. The debt burden of developing countries has been aggravated as a result.

Of particular importance for the international liquidity market have been the implications of the new policy mix of the United States. The French economist Paul Fabra has asserted that Chairman Volcker of the Federal Reserve Bank has accomplished a revolution in the world monetary system by de-linking the United States money supply from a target level of the interest rate: a revolution which, in his view, has had profounder consequences than the abandonment of the fixed exchange rate system in 1973 (*Le Monde*, 16 February 1985).

Under the Federal Reserve Bank's new policy, the net capital outflow from the United States has considerably declined, while the foreign trade deficit has reached unprecedented levels. The main supplier of international liquidity is on the verge of becoming a net debtor. According to American Express, the United States' foreign debt (excluding direct foreign investment) will probably reach US\$ 400 billion by the end of 1985, or 126% of the country's export earnings (*The Economist*, 4 May 1985).

A few figures will make it possible to ascertain the magnitude of the phenomenon. The United States' balance on current account has moved from a surplus of US\$ 6 billion in 1981 to a deficit of US\$ 100 billion in 1984 (Karczmar, 1985). Foreign capital inflows finance one-half of United States government borrowing (*Financial Times*, 2 January 1985). Gross purchases of United States long-term securities by foreigners

increased from less than US\$ 50 billion in 1978 to US\$ 224 billion in 1983 and nearly US\$ 250 billion in 1984 (*The Economist*, 2 January 1985). From a net lending position of US\$ 45 billion in 1982, United States banks became net borrowers in 1983 with a net deficit of US\$ 24 billion (*Wall Street Journal*, 10 February 1985). At the same time, new United States investment and lending abroad dropped from US\$ 107.8 billion in 1982 to only US\$ 43.3 billion in 1983, and may have plunged to US\$ 1.8 billion in 1984 (*Wall Street Journal*, 25 February 1985). American banks have reportedly been borrowing from their foreign subsidiaries and lending the funds in the home market. In unprecedented fashion, an increasing budget deficit in the United States is accompanied by more and more net borrowing on the part of United States corporations: a US\$ 200 billion United States Government deficit plus a US\$ 40 billion deficit of corporations in 1984 (*Wall Street Journal*, 10 February 1985). In January 1985, United States borrowers raised US\$ 5.17 billion in the Euromarkets as compared to only US\$ 4.36 billion in the domestic market (*Financial Times*, 11 February 1985). All these figures mean that the amount of dollars available to the rest of the world is shrinking alarmingly, and this tendency imposes serious limitations upon the world's ability to pay dollar-denominated debt and to conduct international trade transactions smoothly.

The inadequate size of capital inflows into the world economy has thus far been compensated to a certain extent by the expansion of world trade resulting from economic recovery in the North during the past two years, particularly in the United States, Japan and Canada. The slower growth expected in industrial countries in 1985, however, will have adverse effects upon the volume of world trade due both to diminishing world demand and to stronger protectionist pressures. Decreasing trade growth will in turn further aggravate the present world liquidity crisis. But even if the decline in the flow of dollars to the rest of the world should come to a halt in the future, the payments difficulties of the developing countries are likely to remain at a critical level: such a halt would probably lead to interest rate increases as a means of recapturing the dollars needed to finance the United States budget deficit. And higher interest rates would entail a

heavier debt services burden for the net-debtor developing countries.

The time has therefore come to seriously consider alternatives to a monetary system based essentially on reserve currencies issued by national authorities in the light of their own concerns, needs and *Weltanschauung*. The mere fact that the traditional main supplier of international liquidity is becoming a net debtor is *per se* a sufficient reason for exploring alternative mechanisms. In addition, the weight of international trade in the world economy has doubled during the past three decades and economic relations are far more pluralistic today than they used to be at the time of the Bretton Woods conference: in the new circumstances, the supply of international liquidity can hardly continue to rely essentially on flows of a few key national currencies.

2. Foreign exchange earnings

It is difficult to conceive that a stable solution to the current payments crisis can be found without securing significant improvements in the gains derived by developing countries from international trade. The conditions which prevail at present in world trade relations do indeed set serious limits to the benefits that developing countries can derive therefrom. These conditions relate in particular to sluggish world demand, protectionism in developed countries, and adverse evolution of the terms of trade of developing countries. The countries in question have been actively pursuing the objective of improved treatment in international trade relations. Efforts in this respect have multiplied, particularly since the 1960s, when a major diplomatic offensive was launched by developing countries with a view to obtaining international recognition of the detrimental effects that prevailing trade relations had upon their development programmes and policies. The diplomatic

offensive brought about a number of positive results which include: the establishment of the United Nations Conference on Trade and Development (UNCTAD) as a permanent organ of the General Assembly; the incorporation of Part iv into the General Agreement on Tariffs and Trade (GATT), allowing Contracting Parties to grant non-reciprocal treatment to developing countries; the institution of the Generalized System of Preferences (GSP); and the negotiation of various international commodity agreements and of a Common Fund to Finance commodity buffer stocks and related measures.

The above-mentioned results, however, have not been free from serious limitations. Notwithstanding the positive aspects of the GSP, the actual gains derived from the system have been very much reduced by the narrow product coverage of the national schemes of preferences as well as by a number of restrictive provisions concerning, in particular, safeguard measures, insufficient tariff cuts, and restrictive rules of origin. A large proportion of imports from developing countries thereby fall outside the GSP and hence do not benefit from it. The trade liberalization secured through GATT's multilateral trade negotiations has been more important for products of export interest to developed countries than for those exported by developing countries. Protectionist measures have been proliferating in many developed countries and they affect numerous products of export interest to developing countries. Industrial policies in developed countries are often designed in such a way as to perpetuate inefficient industries competing with imports from developing countries rather than to facilitate the smooth transfer of resources away from such industries. As regards commodity agreements, major difficulties have arisen even in the renegotiation of agreements already existing. The Common Fund for commodities has not started operations as the minimum number of ratifications has not yet been secured.

II

The present strategy of developing countries

The difficulties that developing countries are encountering in regard to their payments capacity appear to be largely related to the nature of the strategy followed by these countries in international economic negotiations. A major revision of the negotiation styles has become an urgent necessity if the payments crisis of developing countries is to be overcome. This section contains a discussion of the major limitations and shortcomings of the present strategy.

1. *Absence of major initiatives aimed at securing participation of developing countries in the creation of international liquidity*

Developing countries have systematically striven for a share in the world financial assets commensurate with their economic weight and development needs. Their efforts have certainly produced many positive results. As early as during the Bretton Woods negotiations, it was the lobbying conducted by a number of developing countries which succeeded in placing the objective of development finance for the Third World on the same level of the World Bank's priorities as that of the recovery of war-torn industrial nations (Ackeson, 1969).

It is also by the active diplomacy of developing countries that a number of facilities have been established in the International Monetary Fund with a view to increasing and smoothing the flow of financial resources available to developing countries.

All these endeavours, however, are intended to alleviate the severe financial constraints which developing countries face rather than to reduce the concentration among a few industrial countries of the power to create and distribute international liquidity. Some action has recently been taken within the framework of the IMF with a view to enlarging the share of developing countries in international liquid funds. This action relates essentially to more ample participation of some developing countries, notably oil producers, in the Fund's quota system, and to the emission of Special Drawing Rights. But these

measures have not significantly modified the concentration of the power to create international liquidity.

The lack of participation of developing countries in the creation and distribution of international liquidity is largely responsible for the acrimoniousness of the relations that many developing countries maintain with the IMF. The Fund's conditionality principle and performance criteria have been under sharp and increasing criticism by developing countries, as they involve severe austerity programmes which undermine the standard of living of large sectors of the population of the countries concerned. There is indeed great scope for improvement of the aforesaid principle and criteria. The question of whether the burden of adjustment should fall upon debtor or upon creditor countries, or on both, is among the long-standing controversies in international economics and has been raised on several occasions ever since the Bretton Woods negotiations. It ought to be admitted, however, that balance-of-payments adjustment inevitably has to form part of any effective action aimed at correcting persistent deficits and at securing viable economic growth. But the application of the Fund's conditionality principle is understandably repugnant to debtor developing countries which have no meaningful say in the creation of international liquidity, while at the same time, they see that the richest key-currency nations can maintain enormous trade deficits without having to undergo any international sanction. Conditionality principles would be more easily justified if debtor countries had a voice in decision-making with respect to the creation and distribution of international liquidity.

2. *Insufficient persuasive power of the present strategy*

The strategy followed by developing countries in international negotiations on monetary, financial and commercial issues has essentially consisted of pleas addressed to the international community in favour of action aimed at enhanc-

ing their trade gains and at increasing the flows of financial resources towards them. The claims made to the international community have been grounded essentially on the benefits that the community as a whole is to derive from more equitable, expanded and stable economic relations. It has further been argued that economic recovery in the West could be accelerated by increased demand from the Third World: an argument which calls both for bigger flows of financial resources and for better access to the developed markets.

The incitements thus offered to governments of developed countries, however, are not infrequently nullified by active counteracting pressures from groups and authorities in the developed countries themselves. These countries have their own priorities, their own conceptions and, most important, their own lobbies which in many cases exert pressures in favour of policies different from and even opposed to those requested by developing countries. The argument for a transfer of resources towards developing countries, for instance, is countered by local lobbies on the grounds that an alternative transfer within the domestic economy could lower the prevailing unemployment rates. Strong protectionist pressures emanate in turn from local groups which are afraid of being jeopardized by increased import competition. Governments of developed countries can hardly meet the claims made by developing countries unless they receive more effective incentives to do so than they have thus far been given.

The ability of any diplomatic strategy to achieve its objectives depends indeed upon its capacity to exercise bargaining leverage so as to mobilize national and international support. The power to create international liquidity has not been a gift received from heaven by any country. Such power has always been secured by the ability of reserve-currency countries to exercise the leverage given by their economic weight, to manipulate successfully their monetary, Fiscal and commercial policies, and to persuade other countries of their capacity and readiness to honour monetary and financial commitments. Market access has in turn been secured principally by offering reciprocal concessions, or threatening removal of concessions, to other partners. Any trade liberalization is likely to be more significant

for products of interest to countries which provide concrete concessions than for products of interest to countries which request non-reciprocal treatment, however just the cause of the latter may be. Developed countries normally resort to reciprocal concessions, and this behaviour can be regarded as a major reason why trade liberalization in multilateral trade negotiations has concentrated on products of export interest to them.

3. Excessive expectations from bilateral dealings in debt negotiations

Any viable international institutional framework inevitably has to assign a place to bilateral as well as to multilateral dealings. These two forms of negotiation are actually complementary rather than alternative means of securing mutually beneficial results. They are used in a complementary manner, for instance, in the field of market access: major negotiations are regularly carried out within the framework of GATT, which is a multilateral institution, and they are often complemented by bilateral dealings between individual countries.

But the negotiations on debt relief have not yet been placed in a similar broad framework. Creditor countries and institutions have invariably advocated a bilateral, case-by-case approach. Developing countries, in their turn, would appear to prefer, or at least accept, the bilateral form in the hope of thereby securing better and more liberal relief conditions than if they had to share concessions with other debtor countries. But by acquiescing in bilateral dealings, debtor developing countries may be overlooking the leverage that this type of negotiation gives to their creditor partners. Before agreeing on debt relief in favour of a particular debtor country, such creditors will no doubt bear in mind the concessions that they have granted or are to grant to other debtor countries, even if the latter are not present at the negotiating table. As a token example, the United States was reportedly reluctant to agree on a multi-year government rescheduling package for Yugoslavia's debt on the basis that major debtors from Latin America might seek to avail themselves of the precedent (*Financial Times*, 7 January 1985). Within a pure-

ly bilateral framework, therefore, creditors are in a particularly strong position, inasmuch as they can weigh and actually distribute concessions among debtor countries without having to face a co-ordinated stance on the latter's part. Certainly, some co-ordination among debtor developing countries is secured, notably by the Group of 24

in IMF and by agreements on common positions reached in regional organizations of the Third World. This co-ordination, however, consists in little more than the definition of guiding principles, and has not significantly altered either the bilateral nature or the outcome of international negotiations concerning debt relief.

III

The proposed two-front attack

The preceding section was intended to demonstrate the limitations and shortcomings of the strategy which developing countries at present utilize in international negotiations related to payments problems. A new and more forceful strategy appears to be necessary for securing adequate levels both of financial flows and of foreign exchange earnings for developing countries. The new strategy would need to recast the priorities of developing countries in international economic negotiations, and to reorient attention towards the two key determinants of the payments capacity: the creation and allocation of international liquidity and the generation of foreign exchange earnings. To be effective, the strategy further ought to hold out enough inducements to persuade developed countries to share with developing countries the creation of international liquidity and to carry out adjustments in their own economies with a view to facilitating access to imports from developing countries of origin. To use the jargon of international politics, developing countries need to move from a debate to a game strategy. A debate strategy essentially aims at convincing the counterparts of the validity of one's own arguments, at obtaining consensus, and this is precisely the nature of the present strategy. A game strategy, on the other hand, would seek to secure favourable behaviour on the partners' side by providing them with appropriate incentives and disincentives in the context of a bargaining process (Frankel, 1973, and Rapoport, 1974). The capacity to provide such incentives and disincentives is generally called bargaining leverage, and is determined both by the means at one's

own disposal and by the ability to deploy and utilize them effectively during the negotiation process.

A game strategy for developing countries appears to be not only necessary but also feasible. These countries do have bargaining leverage which stems from the importance of their natural resources and of their import markets. The American Geological Institute, for instance, has drawn attention to the strong dependence of the United States upon foreign supplies of a number of metals and minerals, some of which come from developing countries. Developing countries provide to countries members of the European Economic Community (EEC) a large proportion of the latter's imports of crucial raw materials: manganese (42%), copper (57%), phosphates (68%), tin (85%) and cobalt (92%) (*Europe*, 9 November 1977). Japan's dependence upon purchases of foreign raw materials is likewise a well-known fact. As regards the imports markets of developing countries, their significance has been increasing over time, and today they represent an appreciable proportion of the total exports of developed countries. Developing countries purchase almost one-half of United States exports of manufactures and two-fifths of total EEC exports. It has been assessed that debt-induced import cuts made by Latin American countries accounted for US\$ 15 billion of the deterioration in the United States trade balance over 1982-1983 (Brown, 1984).

¹*Washington Post* Editorial reproduced in the *International Herald Tribune*, 22 September 1980.

Of course, the bargaining leverage given to developing countries by their supplies of raw materials and by their import markets is not unbounded. A fresh example of its limits is to be found in the misadventures that the Organization of Petroleum-Exporting Countries (OPEC) has been undergoing in attempting to preserve the real value of its foreign exchange earnings and of its financial wealth. It is true that the present difficulties of OPEC have probably arisen, not from any inherent insurmountable handicap, but rather from two corrigible features of OPEC'S policy: i) the lack of counter-cyclical mechanisms to cope with the adverse effects of sluggish world demand (a matter which will be touched upon in the next section of this paper); and ii) a portfolio policy which actually gave up the control of the real value of OPEC'S financial assets to private Western banks and to the Central Banks of the traditional reserve-currency countries. In any event, the aforementioned cards held by developing countries in the bargaining game could, if played effectively and tactfully, enable these countries to launch a major diplomatic attack on the two key determinants of the payments equation. The possible basic elements of the suggested diplomatic initiative are discussed below.

1. *Establishment of an international commodity currency*

The present world monetary system was established at Bretton Woods in 1947 in accordance with the necessities and with the international balance of power prevailing in those times. The system, therefore, ought not to be regarded as an immutable framework. It has undergone major transformations as new concerns have arisen and as the balance of power has evolved. The abandonment of the fixed exchange rate régime in 1973 constitutes an outstanding example of the system's capacity to adapt itself to changing circumstances. It should indeed respond to a permanent quest for means of ensuring both monetary stability and adequate liquidity flows in an ever-changing world. The present payments crisis calls for a new major transformation, notably in respect of the mechanisms of creation and distribution of international liquidity.

Developing countries do have the need and the means to play an active role in the mechanisms of creation and distribution of international liquidity. They could in fact pledge and pool natural resources to create an international currency whose supply would be a function of the level of world demand for liquidity rather than, as is at present the case, contingent upon the policy priorities of reserve-currency countries and upon the IMF quota system. The commodity basket would comprise key raw materials and precious metals, and the number of such resources should be large enough to prevent any new concentration of monetary power in the hands of a few commodity-producing countries. The commodity currency could be issued against liabilities denominated in terms of the natural resources committed. The value of the currency could in turn be expressed in coefficients of the reserve resources. All countries, both developing and developed, would be entitled to participate in the supply of the new currency by committing resources which they possess or can acquire through world market operations. Preferential pricing policies and swapping arrangements could further be instituted between developing reserve-commodity producing countries and other developing countries so as to facilitate the latter's participation in the creation of international liquidity.

No currency could, of course, be imposed upon the international community. It has to be willingly accepted by major partners. To ensure universal acceptability, the new currency would have to be managed in line with rigorous criteria by an international authority of established reputation such as the IMF. Management by the IMF would not, however, imply that decisions concerning the level and distribution of supply would be taken in accordance with the quota system. Precedents exist in international institutions of sub-groups of member States which have set up commissions or facilities without having to surrender decision-making autonomy to the universal organs of the institutions concerned. Such precedents include the group of 16 developing countries set up under GAIT, which is charged with instituting special tariff preferences among developing countries, and the IMF oil facilities, which were fed by a number of oil-producing countries of the Third World. De-

cisions concerning the supply and distribution of the international currency, therefore, would be free from the limitations relating to the IMF quota system and would rather depend directly upon the willingness of participating countries to commit their own resources so as to secure international liquid funds. This autonomy *vis-à-vis* the IMF quota system would in itself constitute a major advantage as compared to the mechanisms of creation of SDRs. On the other hand, the countries involved would not have to surrender their natural resources but would be committed only to honour their resource-denominated liabilities. Their sovereignty over their natural resources, therefore, would not be impaired. The preservation of the national sovereignty would constitute a major advantage as compared to a proposal, which has been aired for some time, to convert the foreign debt of developing countries into equity shares in natural resources and in State enterprises (*South*, February 1984, p. 71; and *Wall Street Journal*, 1 April 1985).

The idea of establishing an international commodity currency is not new. Its origins could be traced as far back as the late nineteenth century, when the British economist Stanley Jevons put it forward for the first time. Suggestions of a similar nature were subsequently made on various occasions (Goudrian, 1942; Graham, 1944; and United Nations, 1953).

A sound proposal in this regard was put forward in 1964 at the first session of the United Nations Conference on Trade and Development (UNCTAD) by three eminent economists: A. Hart, N. Kaldor and the Nobel Prize-winner Jan Tinbergen (1964). At that time, the proposal did not receive the attention it deserved because international concern was then oriented essentially towards trade issues and because the international monetary system had not yet been shaken by the onslaught of the events which have taken place since the late 1960s. Subsequently, with the abandonment of the gold exchange standard in 1971, attention was concentrated upon the workability of the floating exchange rate system, notably in terms of its capacity to secure monetary stability. In fact, the central concern of the international community regarding monetary matters during the 1970s was exchange-rate stability rather than adequate liquidity flows. However, with the growing risks of debt defaults

and of world financial collapse, proposals for an international commodity currency deserve fresh consideration by the world community as a whole.

It is not the purpose of this paper to endorse *in toto* the Hart-Kaldor-Tinbergen proposal. The conditions and problems of world monetary relations have changed dramatically since 1964. Kaldor himself made elaborations on the original proposal in articles written in the early 1970s (Kaldor, 1971, 1973 and 1974).

The concrete modalities and characteristics of an international currency would have to be worked out by well-prepared negotiations taking full account of prevailing circumstances, needs and interests. But a number of considerations could be made beforehand, and these are discussed below.

The establishment of the proposed currency should not be of an inflationary nature. The creation of an international currency must have a greater impact upon the distribution of liquidity than upon its magnitude. Inflationary effects would be produced if, and only if, the supply increase were to exceed the unmatched demand (Mundell, 1971). As mentioned before, the growth of reserve supply has substantially lagged behind the growth of international transactions. A recent study commissioned by the Institute for International Economics (Director, C. Fred Bergsten) calls for a new allocation of SDRs to meet present liquidity demand and argues that such an allocation would not have inflationary pressures as long as the growth of reserves were no greater than the corresponding demand (Williamson, 1984). Actually, the issuance of the proposed currency would be even more neutral, in terms of inflationary effects, than the emission of SDRs. The latter are created and distributed among countries according to the IMF quota system (irrespective of whether such countries have liquidity shortages), whilst the currency would be issued only in the measure of the liquidity needs of purchasing countries. An emission of SDRs aimed at meeting liquidity needs would therefore involve a greater increase in world liquid funds than the issuance of the proposed currency. Moreover, the fact that the international currency would be supported by the reserve commodities would in itself be a means of preserving the real value of the currency in a world where

fiat money tends to depreciate as a result of inflation. The currency could thus become a non-depreciating asset in which financial wealth could be placed and protected from inflation-induced erosion of its real value.

A commodity currency could further have beneficial counter-cyclical effects. At times of sluggish world demand, deficit countries would be inclined to purchase the commodity currency from the IMF against liabilities denominated in terms of reserve resources. Countries would thereby be securing a volume of international liquidity which their foreign trade was momentarily not providing. The commodity currency would accordingly enhance international purchasing power in times of recession. Conversely, these countries may be required to repurchase their resource-denominated liabilities as their export earnings re-establish their trend values. Export earnings would be higher during world economic booms, and the repurchase of resource-denominated liabilities would thus help to deflate the world economy, precisely at times when inflation may be needed or viable. The counter-cyclical effects of an international commodity currency have been admitted even by one of its critics, Milton Friedman (1951). And its counter-cyclical elements constitute a conspicuous merit if compared with the pro-cyclical effects of present adjustment programmes based upon conditionality clauses. The counter-cyclical potential of the commodity currency should not, however, foster a belief that the currency would constitute a disguised mechanism for the operation of commodity buffer stocks. The purpose of the currency would not be to stabilize commodity prices but rather to guarantee adequate liquidity flows.

The proposal of an international commodity currency deserves particular attention in the light of recent moves in favour of a rehabilitation of gold in world monetary affairs and of the creation of new currencies for developed countries. The return to a gold standard was ventilated by the United States Administration a few years ago and has been supported in particular by some "supply-side" economists. It has not yet been considered formally, but neither is it buried (Wanniski, 1984 and 1985; and Anderson, 1985). The gold standard, however, seems to be an inferior alternative to an international com-

modity currency for a variety of reasons, such as: concentration of liquidity power among a few producers or holders of gold; inelasticity of the gold supply; and difficulties inherent in the maintenance of gold parities by national Central Banks. Such disadvantages do not arise in the case of an international (as compared to a national) currency supported by a basket of commodities rather than by gold alone.

Two proposals have been put forward for the use of gold holdings in favour of developing countries. De Silva (1979) proposed the creation of a new currency unit which would be 100% supported by IMF gold holdings and would be aimed at promoting economic transactions within the Third World. Brodsky and Sampson (1980 a) and b)) have in their turn suggested that the differential between the market value and the under-rated official value of world gold reserves (largely held by developed countries) should be distributed to all countries in accordance with the IMF quota system: developing countries would receive a proportion of this differential value and their liquidity position would thereby be strengthened.

Whilst these two proposals reflect noble pro-Third World sentiments, past experience in international relations does not warrant envisaging that major holders of official gold would relinquish a significant portion of their financial wealth on the grounds of solidarity with poorer countries. As a matter of fact, a gold-backed "substitution account", aimed at channeling financial resources towards developing countries, was considered in IMF in 1980 but failed to see the light of day because of the reluctance of major financial powers to sponsor it. The solution of the payments crisis of developing countries cannot come from hopes of solidarity action by the North but rather from skilful bargaining by the South.

Other proposals have been recently put forward by Richard Cooper (1984) for the creation of a new currency for industrial countries, and by M. Jacques Delors, President of the European Commission for an expanded role of the European currency unit (ECU) as an official reserve currency among EEC countries (*Financial Times* and *Wall Street Journal*, 15 January 1985). The creation of a new currency for developed countries and/or a more important role for the ECU would improve the distribution of liquidity pow-

er among such countries, but it would be ineffectual as regards reducing the existing gap between those who create liquidity and the major debtor nations.

2. *A new strategy for the negotiation of market access*

The second part of the proposed diplomatic initiative relates to the negotiation of market access. Developing countries are in a position to resort to a more forceful strategy in this regard. They could manipulate their import markets and their supplies of natural resources so as to secure more liberal access to the markets of developed countries. The conditions of access to developing countries' markets and to natural resources could be laid down in such a way as to accord individual developed countries differential treatment depending upon whether, and to what extent, the latter's import markets were accessible to developing countries. Developing countries could resort to a differentiated imposition of import and export duties and quantitative restrictions on products of interest to developed countries. Imports from and exports to developed countries granting easy access would accordingly be subject to lower duties and/or larger quotas than those originating from or destined to more restrictive developed countries. Import and export duties could thus consist of two different components: i) one fixed MFN (most favoured nation) component, which would be applied, as is traditionally the case, irrespective of the origin of the imports or the destination of the exports affected; and ii) one variable component, imposed on individual developed countries according to how stringent their commercial policies were. The new strategy could further involve the use of counter-trade or package deals whereby sets of goods of export or import interest to developed countries would be bartered against sets of goods of export interest to developing countries. Developed countries would thereby feel encouraged to acquire large quantities of goods of export interest to developing countries so as to secure reciprocally natural resources from and sales to developing markets (Fiallo, 1978 and 1971; for a similar proposal, see Schafaeddin, 1984).

The suggested two-component system

would constitute a qualification of GATT's MFN principle. Despite its non-MFN element, however, the system can be implemented in conformity with GATT rules. Article xix provides that, in the absence of adequate compensation, exporting countries affected by safeguard measures may be authorized to impose non-MFN restrictions against imports from the offending country. Non-MFN countervailing action may similarly be authorized in the light of Articles xxn and xxin, particularly in the case of Contracting Parties affected as a result of measures taken by other parties (Jackson, 1969; and U.S. Executive Branch, 1973). Moreover, the numerical majority which developing countries hold within GATT unquestionably allows them to exercise the voting power provided for essentially by Article xxv. The voting power gives authority to the majority of Contracting Parties for an extremely wide range of action (Jackson, 1969, appendix to section 5.4). As regards export controls, these measures are not stipulated by the General Agreement as possible countervailing elements. An interpretation made in 1950 asserted that export restrictions are not to be resorted to for the purpose of obtaining the relaxation of another Contracting Party's import restriction (GATT, 1950). But such an interpretation does not form part of the Agreement. It can be reviewed in the light of present circumstances, notably in the context of the powers conferred by Article xxv. In any event, developing countries could hardly be prevented from resorting to export restrictions when they are forced to impose upon themselves voluntary export restraints or orderly marketing arrangements as a means of avoiding the further protectionist action that would otherwise be taken by their developed partners in

GATT.

The proposed strategy could best be adopted through consultations among developing countries aimed at ensuring adequate policy co-ordination. Policy would need to be co-ordinated in such a way as to allow each developing country to determine and impose commercial policy measures, especially where variable components were involved, in accordance with its own concerns and priorities. Thus, the co-ordination exercise need not entail a high degree of harmonization of the commercial policies of developing countries. In fact, access to the markets

of individual developing countries is of interest to developed partners irrespective of how restricted the markets of other developing countries may be: countervailing measures may, therefore, diverge among developing countries, yet their effectiveness as instruments of persuasion will not be impaired thereby. In the case of controls on export supplies, harmonization would certainly be necessary so as to avoid self-defeating competitive bidding among developing countries. But such harmonization should not be expected to be as deep and sophisticated as that necessary for the successful operation of international producers' associations: the purpose of the strategy would not be the appreciation and/or stabilization of international prices (which indeed requires production and sale arrangements and homogeneous pricing by all producers) but simply a differentiated access to natural resources. Hence the use of resource diplomacy in the context of the proposed strategy is likely to be effective even in cases where concerted pricing has not proved successful.

The strategy could encourage in developed countries a policy environment of less readiness to yield to protectionist pressures from local groups. It would make governments of developed countries more inclined to formulate alternative policies such as those designed to facilitate the reallocation of factors of production away from inefficient industries facing import competition. The proposed strategy would further strengthen the bargaining weight of government branches and of private groups in developed countries which do not share the protectionist ideology and are instead interested in granting more liberal access to imports from developing countries. Such sectors include: monetary authorities which are aware of the inflationary effects of protectionist measures; anti-trust authorities and commissions on restrictive business practices, inasmuch as tariff barriers tend to reinforce unduly the dominant market position of local corporations; importers, retailers and consumers interested in low-cost supplies; and firms in developed countries which depend upon export sales to and/or commodity supplies from developing countries, and which could be affected by the countervailing measures that these latter countries might take. What is more, the proposed strategy may induce pro-

tectionist groups in developed countries to reconsider their positions and to search for alternative approaches to the solution of their problems. Likewise, the strategy would tend to provide the less protectionist States members of economic groupings of developed countries with the motivation necessary to defend their positions and to resist claims from other developed partners in favour of restrictions on imports from developing countries.

The aforementioned considerations should by no means be interpreted as suggesting that developing countries should attempt to exploit divergences of approach among governmental authorities or local private groups in developed countries. After all, authorities and groups within developed countries normally tend to have common national interests, and it is thus legitimate for them to adopt common stances, particularly in foreign trade issues. It is, however, equally legitimate for them to differ as to priorities and/or in opinions on how to meet and accommodate common concerns. The proposed strategy would accordingly be useful, not for exploiting conflicts or divergences, but for fostering within developed countries the understanding that it is in their national interest to facilitate access to imports from developing countries. Such a strategy would contribute to the mobilization in developed countries of non-protectionist forces in favour of imports from developing countries: forces which might otherwise either remain passive or tend to advocate market access in favour only of developed partners which do resort to game strategies.

The proposed strategy could lead to a move in favour of imports from accessible countries even if these do not represent the most efficient and/or cheapest suppliers. The system might, accordingly, give rise to some diversion of trade towards less efficient sources. But the net impact of such diversion should not necessarily be negative. Firstly, restrictions could be imposed mainly on the least essential imports, thereby avoiding trade diversion in cases where domestic economic development and/or social welfare could be significantly jeopardized. Secondly, the strategy is intended to stimulate improved market access for exports from developing countries. The alternative may, therefore, be a lower level of purchasing power and hence a smaller volume of

imports rather than a better, cost-efficient allocation of purchases. Thirdly, the strategy would entail an incentive to domestic production of the goods of which imports are restricted. Variable components can, in fact, be used as a means of providing protection to domestic industries without unnecessarily harming the interests of those developed partners which grant relatively easy access to exports from the developing country concerned. The burden of protection for the development of infant industries would thus be basically removed from the less restrictive developed partners. Finally, the system might constitute a meaningful instrument to promote trade among developing countries. In fact, intra-Third-World trade would be free from variable components and, therefore, imports from other developing countries would enjoy preferential access as against those originating in restrictive developed countries.

The level of foreign exchange earnings of developing countries is not determined only by conditions of access to the markets of developed countries. Other factors also play a crucial role, and these include: the terms of trade and their evolution; the limitations of foreign exchange earnings which arise from monopolistic practices of transnational corporations, such as transfer pricing and territorial market allocations; the

terms and conditions of the transfer of technology to developing countries; the participation of these countries in world shipping; and the promotion of economic co-operation among developing countries. The emphasis placed in this paper upon the need for a new negotiation strategy in the field of market access should by no means be construed as reflecting an underestimation of the importance of the other determinants of the level of foreign exchange earnings. The emphasis is due rather to the fact that the strategy currently used by developing countries in the negotiation of market access has not been subject to any major revision since the 1960s, when developing countries succeeded in securing international support conducive to the incorporation of Part iv into the General Agreement and to the establishment of the General System of Preferences. The present circumstances, in particular protectionism and sluggish world demand, are substantially different from those prevailing in the 1960s, and the revision of the strategy has become an imperative and urgent need. Moreover, liberal market access is in consonance with the free market philosophy that major developed countries invoke and, therefore, negotiations in this field are likely to have particularly good changes of success provided that they are carried out with an effectively persuasive strategy.

IV

Negotiation of debt payments and implementation of adjustment programmes

1. *Negotiation of debt payments*

The establishment of an international commodity currency and the adoption of a more persuasive strategy in the field of market access would strengthen the leverage of debtor developing countries in the renegotiation of their debt payments. Of relevance in this context is the possible establishment of a debtors' club, an idea which has been attracting some attention. The

club would seem to be intended to strengthen the position of debtor developing countries in their effort to obtain from lenders better terms and conditions of payment. The club's power would lie in the possibility of resorting to the threat of a joint repudiation of its members' foreign debt. Action along such lines, however, would not be exempt from adverse boomerang effects. A joint debt repudiation would no doubt shake the bases of the world financial system. But, at the same

time, the doors of the international capital markets would be shut for the debt-repudiating countries.

A debtors' club would, however, become a viable project in the context of the proposed two-front attack. In this case, the card that the club could play in the bargaining game would relate not to debt repudiation but rather to making debt payments conditional on the creditors' acceptance of the international currency as well as on liberal access to the creditors' import markets. Agreements could be reached between debtors and creditors whereby: i) a proportion of the foreign debt would be paid in the international commodity currency; and ii) the size of debt payments would be made dependent upon the level of the debtors' exports to the creditor countries. The IMF's conditionality upon adjustment policies would thus be matched by a debtors' conditionality upon currency acceptance and upon market access. Negotiations on these matters could best be conducted in a multilateral framework and would be complementary to the traditional bilateral dealings of debtor countries with their respective partners.

It would be difficult to conceive of major countries refusing to accept payments in an international currency managed by such an orthodox institution as the IMF. Lenders could even

become active supporters of the new currency inasmuch as its establishment would facilitate the reimbursement of their loans. As regards the linking of debt payments with the level of the debtor's exports, this type of trade-off has already been used by a few pioneers among the debtor developing countries, and would become more effective if resorted to jointly by a group of such countries.

2. Implementation of adjustment programmes

The adoption of the two-front initiative would considerably enhance the ability of debtor developing countries to effect their debt payments without having to submit their domestic economies to unduly over-deflationary policies. An increase in foreign exchange earnings as a result of better market access would narrow the balance-of-payments deficit and, therefore, would reduce the magnitude of the adjustment which the national economy required. As regards liquidity, it is certainly a separate and different dimension, and does not constitute an alternative to adjustment.² But an increase in liquidity could complement adjustment programmes and could thus alleviate the burden of the austerity which such programmes normally embody.

V

Conclusion

The payments crisis of the developing countries has attained dramatic proportions and cannot be overcome without major action upon the two key determinants of payments capacity, namely, the capacity to hold or create liquid assets and the capacity to generate foreign exchange, notably through earnings from external trade. The action proposed in this paper relates to the establishment of an international commodity currency which could be managed by the IMF, and to the adoption by developing countries of a more persuasive strategy in market access negotiations. The proposed action would require developing countries to play an active role, notably

by committing their own natural resources and import markets and by manipulating them as negotiating cards. The payments problems of the developing countries are indeed too acute to be resolved by mere pledges of international cooperation or by the adoption of global agendas which will not *per se* improve the bargaining leverage of developing countries. The two-front initiative would further strengthen the leverage of developing countries in the negotiation of the terms and conditions of debt repayment and

²The difference between liquidity and adjustment is explained in detail by Mundell (1971).

would serve to alleviate considerably the burden of the adjustment programmes which developing countries need to implement.

The proposed action would constitute a breakthrough in international economic relations and would represent a major departure from prevailing conventional wisdom. Wisdom today indeed avers that developing countries do not have the resources and the power to participate actively in international bargaining, and that their role should thus be limited essentially to attempting to convince other partners by means of debate exercises. A story of the blinding effects of conventional wisdom appears to be useful in this context. It relates to the rational expectations theory, which, to put it roughly, asserts *inter alia* that an individual can hardly take advantage by himself of his own expectations on

the future (unless he holds relevant information which is not available to others[^]: if his expectations were wrong, he would obviously be a loser; if they were correct, others would have already thought on the same lines and acted accordingly, and, therefore, both the present and the future would already have been modified. According to the story, a professor of rational expectations theory was walking along the university campus with one of his students. The latter saw a US\$ 20 bill on the floor and drew the attention of his professor, who replied without even looking at the floor: "It can't be. If there were such a bill, someone would have already picked it up". The bill for the solution of the payments crisis of the developing countries is on the floor too. It is waiting to be picked up and put on the negotiating table.

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