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March 7, 1984

To: Members of the Committee of the Whole on the Development Committee

From: The Secretary

Subject: Linkages Between Trade and the Promotion of Development

The attached revision to the paper on linkages between trade and the promotion of development relates only to the revised data included in the paper on the general survey on the world economic outlook (EBS/84/33, 3/2/84).

Also attached is the original paper showing the changes that have been made.

If Executive Directors have technical or factual questions relating to this paper prior to the discussion by the Committee on Friday, March 9, 1984, they should contact Mr. Anjaria, ext. (5)8357.

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INTERNATIONAL MONETARY FUND

Linkages Between Trade and the Promotion of Development

Prepared by the Exchange and Trade Relations Department

(In collaboration with the Research and Area Departments)

Approved by Donald K. Palmer

March 6, 1984

1. Introduction

For the April 1983 meeting of the Development Committee, the background paper prepared by the Fund and Bank staff on "Linkages Between Trade and the Promotion of Development" (EB/CW/DC/83/2, 3/7/83) described the main trade policy developments during 1980-82, and highlighted the major costs of protectionism. The present paper reviews trade policy trends in the light of developments in 1983. Section 2 outlines recent trade policy developments and issues, with the focus on industrial countries. Section 3 summarizes the main features of developing countries' balance of payments and external debt developments over the recent period. Against this background, recent trends in the trade and payments policies of developing countries are summarized in section 4. Section 5 underscores the importance of trade liberalization for developing countries' export and development prospects. The final section provides an overview.

2. Recent trade policy developments and issues

The world economy in 1983 displayed signs of recovery from the recessionary conditions prevailing over the previous three years. World production and trade expanded, although the magnitude was modest, with the increase in each being 2 percent. In the industrial countries, the expansion of output averaged about 2 1/4 percent, although its geographical distribution was uneven. Import volumes rose for the first time in three years--by nearly 4 percent (compared to a decline averaging 1.3 percent annually in 1980-82)--and export volumes increased by about 2 percent. In the developing countries, economic and financial conditions remained difficult, but there were some signs of improvement compared with the previous year. Export volumes of the non-oil developing countries grew in 1983 by over 5 percent and the decline in import volumes (0.6 percent) slowed down significantly; their overall real economic growth averaged 1 1/2 percent, arresting the declining trend which had begun in 1979.

International trade relations remained very difficult in the past 12 months. Despite the acknowledged need to stem and reverse the drift toward protectionism, liberalization efforts were limited. Tokyo Round tariff reductions took place, but little progress was made in removing nontariff trade barriers progressively introduced in specific sectors since the mid-1970s. In Japan, however, new measures aimed at streamlining import procedures and accelerating tariff reductions agreed during the Tokyo Round were put in place, as a continuation of liberalization efforts initiated since late 1981. In a few developing countries, the adoption of comprehensive adjustment policies aimed at restoring balance of payments viability enabled them, inter alia, to establish more realistic exchange rates and reduce external payments arrears, thus setting the stage for reducing reliance on nontariff trade barriers.

Apart from these few instances, resort to protectionist measures continued to increase. Among industrial countries, these measures frequently took the form of nontariff barriers negotiated on a bilateral basis outside the GATT framework, thereby further weakening the open multilateral trading system. Trade restrictions were extended or intensified, particularly in the steel, automobiles, textiles and clothing, electronics, and agricultural sectors. 1/ In a number of developing countries, severe balance of payments difficulties prompted increased reliance on exchange and trade restrictions over the past several years, as described in section 4.

Recent resort to nontariff trade barriers has taken a variety of forms, ranging from explicit import quotas to "nuisance" measures such as limitation of customs clearance to a few and/or less accessible locations. Among the myriad techniques employed, two stand out as the most frequent. The first is the technique of the "voluntary export restraint" arrangement (VER) under which the exporting country limits exports to a specific level or exercises moderation, thus avoiding the imposition of unilateral --and presumably more severe--import restrictions by the importing country. VERs have been the predominant technique for new restrictions on automobiles, steel, consumer electronics, and certain other manufactured products. Although bilaterally negotiated agreements have long been the

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1/ The main measures taken in 1983 were: (1) a three-year understanding between the EC and Japan, under which the latter will exercise moderation in export of ten sensitive manufactured products to the EC, including price and/or quantity provisions for some of these products; (2) U.S. safeguard actions under Article XIX of GATT on specialty steels and motorcycles; (3) extension to a fourth year of the three-year U.S.-Japan agreement on automobiles negotiated in 1981; (4) extension of the bilateral restraint agreement on Japanese automobile exports to Canada; (5) voluntary export restraint agreements on meat until end-1983 concluded by the United States with Australia, Canada, and New Zealand; (6) the new U.S. textile policy announced in late 1983, which expands the scope for surveillance and restrictions on exports of developing countries; (7) recourse by the EC and the United States to export subsidies in competition for third country markets for agricultural products; (8) increased frequency of countervailing duty actions in the United States and the EC; and (9) tightening and extension of bilateral agreements on steel negotiated by the EC with foreign suppliers.

practice in the textile and clothing sectors, these have been developed within the overall framework of the Multifiber Arrangement, with some assurance, in principle, of international surveillance. The newer VERs, however, have been a clear manifestation of the move toward managed trade and fragmentation of markets, and thus against multilateral principles. The implementation of VERs has necessitated increased surveillance of trade flows on both the import and export side, involving additional administrative costs. The second increasingly popular form has been resort to avenues for redressing "unfair" competition from abroad, made available under existing legislation. This has frequently involved a plethora of antidumping and countervailing suits by well-organized and powerful industries. Their most important effect has been to create uncertainty in trade flows and investment decisions. In order to avoid these effects, supplying countries have sometimes accepted VERs. Thus, the filing of suits has often been a precursor of a VER or a tightening of existing restrictions. The events leading to the U.S.-EC VER on carbon steel in late 1982 and the new textile policy announced by the United States in late 1983 are notable examples. Furthermore, moves to strengthen the legislative provisions for combating "unfair" competition are under way in a number of industrial countries, including Canada, the EC, and the United States.

An issue which has become increasingly contentious is that of subsidies--the predominant source of complaints about unfair competition and a major cause of friction in the steel and agricultural sectors. Within the EC, for example, notwithstanding plans to phase out state aids for steel by member states by 1985, the disruptive impact of subsidization on intra-EC trade flows has become a source of discontent for the more efficient EC producers and has threatened the operation of the Community's internal steel price and production regulation system. In the United States, attention has to some extent shifted from EC steel subsidization, following negotiation of the three-year VER in late 1982, to subsidies of developing countries to steel industries. More generally, the concern about foreign subsidization is rapidly spilling over from export subsidies per se to the broader issue of foreign official support through industrial "targeting" 1/ that may affect the competitiveness of a range of export sectors. This concern has raised demands for protection, and for matching subsidies and increased intervention.

Recent developments have again demonstrated the fallacy of relying on protectionist measures as temporary solutions and the ease with which protectionist sentiment tends to become entrenched. In addition to the classic cases of textiles and steel, a notable recent example is the

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1/ "Targeting" refers to the selection by government of target industries, product areas, or technologies for special government guidance and assistance in promoting their development. Targeting policies may include subsidies, pro-merger policies, protection of the favored sector from imports, buy-national procurement policies, discriminatory technical standards, and similar measures to favor domestic production and eventual export expansion from the secure home base.

extension of the three-year U.S.-Japan VER on automobiles, despite evidence of an improvement in domestic sales and prospects of U.S. car manufacturers. Another lesson being relearnt is the inherent tendency of protection to spread across sectors and countries. For example, vertical and horizontal linkages (inputs and substitutes) encourage protectionism intra- and intersectorally, as evidenced by efforts to regulate imports of cereal substitutes in the EC. Trade restrictions also spread across countries, both when a country introduces a restriction to forestall deflection of exports from another market (exemplified by the Canada-Japan VER on automobiles which followed on the heels of the U.S.-Japan agreement), and when existing restrictions are broadened to encompass emerging new suppliers (for example, the EC expanded the number of bilateral agreements on steel to include Korea, Brazil, and South Africa in recent years). Thus, moves toward managed market-sharing in a dynamic framework inevitably face potential loopholes which need to be plugged by additional protection.

Another source of concern is that the threat of retaliation has become increasingly real, as illustrated by developments in the agricultural sector. While agricultural protectionism has long been entrenched and relatively high in most major industrial countries, the mounting frictions in international agricultural trade, particularly over the past two years, have centered around the operations of the Common Agricultural Policy (CAP) of the EC, which has induced the production of large surpluses, the disposal of which has caused problems for other major agricultural producers in third markets. Proposals by EC members to reform the CAP, motivated primarily by severe budgetary constraints, remain under discussion; in any case, these proposals are considered by the EC's trading partners to be inadequate to address the issue of surpluses, and problematic because they include measures to discourage imports of cereal substitutes and to tax vegetable oils and fats. The United States has responded to EC export subsidization by entering into subsidized sales of wheat flour to Egypt and has warned the Community of the possibility of further similar actions. Some Community members, in turn, have proposed intensified cereal export subsidization to counter the U.S. moves. Other moves of a similar nature include the Chinese action in early 1983 to limit certain agricultural imports from the United States pending agreement on textiles, and Turkey's import surcharge, imposed in 1982, on steel imports from the EC following the latter's measures on imports of Turkish textile products.

In the final analysis, however, the spread of protectionism is simply a manifestation of the weakening of the trade policy stance of governments and of the frequency with which they grant requests for protection against foreign competition. In the earlier stages of the recent recession, such a weakening was attributed primarily to concerns about rapidly rising unemployment levels, and the expectation was that the rising trend in protectionism would be, at the very least, arrested when recovery commenced. Despite recent signs of actual or prospective recovery, however, protectionist pressures continue to rise. A multiplicity of arguments is advanced for protectionism, such as concerns about safeguarding employment and avoiding disruption in the affected industries, the magnitude of bilateral trade balances, the impact of exchange rate movements on export competitiveness, strategic reasons, and combating a host of practices considered to be unfair. Indeed, it is tempting to deduce that some justification can be found to fit any case. In effect, however, governments have placed priority on short-term economic and political considerations, to the detriment of policies to promote structural adjustment and a lasting economic recovery. At the same time, there have been several antiprotectionism pledges by governments--for example, at the November 1982 GATT Ministerial meeting, the OECD Ministerial meeting in 1983, the Williamsburg Summit, and UNCTAD VI.

At their 39th session in November 1983, the GATT Contracting Parties reviewed progress on the work program adopted at the November 1982 Ministerial meeting. Since the latter meeting, little progress has been made on the issue of safeguards and the dispute settlement mechanism. However, new procedures or bodies have been set up to facilitate the review of the international trading system and to examine trade in agriculture, as well as quantitative restrictions and other nontariff measures. A study is in preparation on textiles and clothing to help explore possibilities of reverting to normal GATT rules in this sector; some GATT members have undertaken national studies in the services sector; and work has commenced on harmonization of tariff coding systems. The GATT Committee on Trade and Development has launched a series of consultations on tropical products and implementation of Part IV of GATT, which provides differential and more favorable treatment for developing countries. On the occasion of the 39th session, Japan and the United States proposed the launching of a new round of multilateral trade negotiations; certain other countries, including some developing countries, expressed reservations and attached greater importance to satisfactory implementation of the current work program. The Director-General of GATT has set up an independent study group to identify the fundamental causes of the problems affecting the international trading system and to consider how these may be overcome during the remainder of the 1980s.

3. Balance of payments and external debt situation of developing countries

a. Balance of payments developments

The overall balance of payments performance of the non-oil developing countries weakened progressively in 1980-82, at first in the face of a deteriorating balance on current account and then, in 1982, because of the sharp decline in aggregate net inflows of capital chiefly due to the reduction in lending by international commercial banks. The $37 billion decline in net capital inflows between 1981 and 1982 implied a severe forced adjustment for the non-oil developing countries in the form of a sharp contraction in the volume of imports. Consequently, the steady slowdown in the growth of real GDP for these countries continued in 1982, when the increase on a weighted-average basis was only 1 1/2 percent, compared to nearly 3 percent in 1981 and almost 5 percent in 1980. The cutback in financial flows in 1982 was softened by a $4 billion drawdown in international reserves and by a $1 billion increase, to $8 billion, in reserve-related official borrowing (including more than $7 billion in net use of Fund credit). However, external payments arrears rose sharply in 1982.

In 1983, although the curtailed availability of external financing continued, the prospects for economic growth improved somewhat, following the pickup in world demand and the positive movement in the terms of trade that came with the onset of economic recovery in some industrial countries. The overall external position of the non-oil developing countries, although slightly improved in the course of 1983, remained very vulnerable, as illustrated by the low average ratio of foreign reserves to imports prevailing in most non-oil developing countries.

During 1980-82, the combined balance on current account 1/ of the non-oil developing countries reflected the deterioration of the world trade environment, the increased weight of net service payments, and disruptions in financial flows faced by some developing countries. After deteriorating from $88 billion in 1980 to a peak of $109 billion in 1981, the combined deficit on current account improved in 1982 ($82 billion) and in 1983 ($56 billion). This movement reflected that of the combined trade deficit, which, after deteriorating from $76 billion in 1980 to $83 billion in 1981, improved substantially in 1982 ($53 billion), owing to a severe contraction in imports. During the same period, however, the deficit on net services and private transfers grew by 142 percent, from $12 billion in 1980 to $29 billion in 1982, mainly because of the increase in interest payments associated with the outstanding debt and the high interest rates paid on it. The combined trade balance of the non-oil developing countries improved further in 1983, with an expansion in export earnings, at the same time as the decline in imports decelerated. There was also an improvement in the deficit on services and private transfers due to lower interest rates in world financial markets.

b. External debt developments

The decline in the current account deficit of non-oil developing countries over the past two years took place against the backdrop of serious external financing problems, which brought pressure on the external debt situation of many of them. Since 1982, the non-oil developing countries as a group have experienced a marked decline in the growth of both outstanding debt and debt service payments, measured in dollar terms. However, the debt servicing burden on most of these countries increased significantly and became unmanageable for many. Debt servicing problems were aggravated by the world recession as the declines in export earnings (especially in 1982) implied a reduced debt servicing capacity for most countries. The situation had already become

1/ Excluding official transfers.

critical when private lenders began, in mid-1982, to reassess the debt situation and sharply curtailed new lending. Widespread debt servicing difficulties were reflected in a record buildup of external payments arrears and in an unprecedented number of countries seeking debt restructurings. Debt servicing problems were not confined to the non-oil developing countries, and some oil exporting countries also faced similar difficulties and sought some form of debt relief.

Total debt outstanding (including short-term) of non-oil developing countries rose by 13 percent in 1982 and further by an estimated 6 percent in 1983, to reach about $670 billion. These increases were markedly lower than at any time since the early 1970s; in 1980-81, the average increase was of the order of 19 percent per year. The slowing trend was particularly pronounced for short-term debt and for debt to private creditors. Net disbursements of medium- and long-term debt, including refinancing, fell from $65 billion in 1981 to $55 billion on average over 1982-83. With many countries attempting to improve the maturity profile of debt, total outstanding short-term debt fell by $23 billion to about $102 billion in 1983, after having more than doubled over the preceding three years. To some extent, and particularly in 1982, the slower growth of debt owed to private creditors reflected a shortage in the supply of new financing from private lenders and was accompanied by a severe compression in imports for many countries. While there was a slowdown in dollar terms, the deceleration in relation to export earnings was not evident. Indeed, owing to depressed exports, the debt to export ratio of the non-oil developing countries jumped from 111 percent in 1980 to reach 144 percent in 1982. In 1983, the ratio rose more moderately to around 150 percent.

Scheduled debt service payments of the non-oil developing countries have also increased at a much slower pace since 1982, largely because the average interest cost on outstanding debt began to decline along with international interest rates from their historic high levels of 1980-81. Aside from the lower interest cost, debt service in terms of actual cash payments has increased still more slowly, owing to debt restructurings and the substantial postponements of scheduled payments, primarily since late 1982. Reflecting these factors, actual debt service payments rose by about 11 percent in 1982, significantly below the average increase of 26 percent during 1980-81. Furthermore, for 1983, it is presently estimated that actual debt service payments fell for the first time in recent history by 10 percent, or by $11 billion, mainly as a result of several large-scale restructuring arrangements. The debt service burden in terms of export receipts has not been eased to quite the same extent. The group's debt service ratio rose from an average of 19 percent in 1980-81 to reach an all-time high of some 25 percent in 1982. For 1983, due to the prevalence of debt restructurings together with the recovery in exports, the debt service ratio fell to about 22 percent.

For the 25 major borrowing countries, 1/ the overall debt situation has been about the same as for all the non-oil developing countries. Total debt for these countries is estimated to have increased by 5 percent in 1983, down from 12 percent in 1982 and an annual average of 18 percent during 1980-81. Since mid-1982, half of these countries have had difficulties of varying degrees in arranging new bank credits and have avoided a reduction in the level of outstanding debt through comprehensive restructuring/refinancing. For this group of countries, actual debt service payments increased by only 9 percent in 1982, down from 28 percent on average in 1980-81, and fell by 9 percent in 1983. The debt service ratio jumped from 24 percent on average during 1980-81 to a record high of 32 percent in 1982, before declining to 30 percent in 1983.

The unprecedented severity of debt servicing difficulties over the last two years is reflected in the sharp rise in external payments arrears and in the incidence of debt renegotiations. While, in the late 1970s, on average only 4 countries per year renegotiated debt, the number grew to 13 in 1981 and 18 in 1982. In 1983, 26 countries completed some 37 debt restructuring arrangements, while a number of others remain under negotiation. Furthermore, whereas previously most debt renegotiations concerned small debtor countries, recent debt restructurings have involved 12 of the major borrowers, including the top three borrowers: Brazil, Mexico, and Argentina. The amount of restructured debt increased to a record level of about $70 billion in 1983, compared with $5.5 billion in 1982 and only $3.5 billion on average in 1980-81. The amount of debt restructured by banks rose from under $2 billion on average during 1980-81 to $5 billion in 1982 and about $60 billion by 1983. Debt restructuring by official creditors also took place on a much larger scale, rising from $0.5 billion in 1982 to almost $11 billion in 1983.

In the near term, the debt situation will remain difficult for many developing countries. With the support of Fund resources, several countries have adopted adjustment policies to redress the situation. Sustained adjustment efforts should help improve their debt servicing capabilities. Notwithstanding this, the extent of the debt servicing difficulties will also be influenced by the evolution of international interest rates, the degree to which confidence will be restored in the international capital markets, and the degree of recovery in export markets. For 1984, total debt is expected to continue to increase only slowly, probably at about the same pace as in 1983, and in the form of medium- and long-term debt. Debt service payments, with the respite provided by restructuring agreements so far concluded, should also remain below the peak reached in 1982.

1/ Defined as the 25 developing countries with the largest outstanding external debt in 1982; these countries account for around four fifths of debt outstanding of the developing world. The countries are: Algeria, Argentina, Brazil, Chile, Colombia, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Nigeria, Pakistan, Peru, the Philippines, Portugal, Romania, South Africa, Thailand, Turkey, Venezuela, and Yugoslavia.

4. Restrictive measures in developing countries

Developing countries frequently pursue trade policies aimed at encouraging import substitution and safeguarding the balance of payments. During the 1970s, many of them adopted more open trade policies in order to promote competition in the internal market and reduce distortions in resource allocation. Subsequently, in the context of severe foreign exchange shortages compounded by disruptions in financial flows, many of these countries compressed imports to "financeable" levels. While the reduction in imports was brought about importantly through a reduction of domestic demand by tightening fiscal and monetary policies, in many developing countries reliance on exchange and trade restrictions also increased. In the exchange field, the most important restrictions were the tightening of foreign exchange allocations in line with foreign exchange availability; even so, there was a sharp buildup of external payments arrears on both imports and debt repayments. Import restrictions were intensified in the form of quantitative controls, especially on luxury or "nonessential" goods. Another aspect of the impact of the foreign exchange shortage on trade policies was the increasing resort to countertrade/barter-type arrangements in developing countries, despite frequent problems with the quality, cost, and range of goods obtained by one or both parties to the arrangements. The use of selective export incentives also increased in 1982, as several developing countries sought to promote their exports through new fiscal incentives or preferential financing facilities.

In 1983, as a result of some improvement in the external environment and developing countries' own adjustment efforts, there tended to be, on balance, a containment of the disorderly conditions of the previous year, although there was once again considerable variation among individual countries. In particular, moves toward more flexible and realistic exchange rates became more common, outstanding external payments arrears declined, and the frequency of resort to import restrictions was reduced. Furthermore, a number of developing countries initiated reviews and studies of their trade regimes with a view to identifying areas and methods to streamline import licensing, replacing quantitative restrictions with a more efficient tariff system, and reducing reliance on export subsidies.

Clearly, curtailment of imports and reliance on restrictions over extended periods will damage growth prospects and the development process. Over the medium term, countries would need to improve their own foreign exchange earning capacities in order to service debt and finance much-needed import increases. In the past two years, an increasing number of developing countries have embarked upon adjustment programs supported by Fund resources to bring about necessary changes in economic and financial conditions in an orderly fashion, and to lay the basis for a sustainable improvement in their balance of payments and growth prospects. These adjustment efforts have involved both prudent demand management and structural measures to promote efficiency in the context of more outward-oriented growth strategies. This has typically entailed moves toward more open exchange and trade systems to be brought about in stages involving, in the first instance, containment of the existing disorderly conditions, followed by moves toward liberalization. An immediate and first priority has normally been the establishment of more realistic exchange rates and reduction in exchange restrictions, particularly the orderly elimination of external payments arrears, since this is essential for any meaningful trade liberalization. In 1982-83, developing countries which achieved some liberalization of their import regimes included Bangladesh, Haiti, India, Jamaica, Korea, Mexico, Pakistan, Tunisia, Turkey, and Uganda. In many of these countries, the liberalization took place within the framework of adjustment programs supported by the use of Fund resources.

The scope for economic recovery in many developing countries will depend on how firmly the authorities implement the comprehensive adjustment programs they have recently adopted to reduce the severe internal and external imbalances that continue to afflict their economies. At the same time, the success of developing countries' efforts to strengthen their current accounts in a trade-expansionary manner depends importantly on the external environment. The important elements of the latter aspect include avoidance of disruptions of foreign financial resources, recovery in their export markets, and increased access to foreign markets for their exports.

5. Trade measures affecting developing countries

Protectionist measures facing developing countries may be classified into three broad categories. First, there are measures directed specifically against developing countries--the classic example being the textiles and clothing sector, where trade among industrial countries remains generally free of nontariff restrictions, while restrictions against developing countries--particularly the newly industrialized countries--have been steadily tightened. The second category includes measures that are not directed solely at developing countries, but which affect products of direct interest to them, in the sense that they have an existing or clearly emerging comparative advantage in these products. These include agricultural products, footwear, leather products, steel, and certain other manufactures. There has been an increasing tendency for measures by industrial countries in these sectors to be broadened and extended to developing countries. Third, there are measures in other sectors, such as automobiles, consumer electronics, and high technology products, which may not have a significant direct impact on developing countries, but have adverse indirect effects through increasing distortions and reducing efficiency globally, and creating uncertainty in investment decisions, thereby discouraging export diversification and the pursuit of outward-oriented growth strategies. On the other hand, a feature of trade policies toward developing countries has been the extension of preferences to them by industrial countries under the Generalized System of Preferences (GSP). However, in the aggregate, the impact of the GSP has been relatively limited, and in recent years the scope for growth of exports under some GSP schemes has been narrowed. Overall, in recent years, conditions of access to foreign markets for developing countries have deteriorated.

An improvement in market access for the exports of developing countries would make a significant contribution to the export and growth prospects and adjustment efforts of developing countries. This is substantiated by a number of existing studies which attribute positive overall welfare and trade effects to trade liberalization. 1/ Work in progress by the Fund staff also illustrates the benefits from trade liberalization for exports of developing countries. 2/

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For the September 1983 meeting of the Development Committee, the Fund staff prepared a background note on Fund activities in the trade field ("Linkages Between Trade and the Promotion of Development," EB/CW/DC/83/5, 8/8/83). The Fund staff is continuing efforts to critically examine trade policies in the context of Article IV consultations with individual members, particularly the major trading nations, and to incorporate exchange and trade liberalization measures in the design of adjustment programs supported by Fund resources. Management and staff are also continuing informal contacts and exchange of views with officials from member countries, GATT, and other competent institutions, with a view to encouraging mutual trade liberalization among Fund members.

6. Overview

In 1983, the world economy displayed signs of recovery from the recessionary conditions prevailing over the previous three years. In the industrial countries, the expansion of output averaged about 2 1/4 percent, though its geographical distribution was uneven. In the developing countries, economic and financial conditions remained difficult, but there were some signs of improvement. The combined current account deficit of the non-oil developing countries declined for the second consecutive year; this was accompanied by an expansion of exports and a moderate decline in imports. In contrast, 1982 had been characterized by a severe compression of import volumes, as countries adjusted to declines in export earnings, compounded, in some cases, by

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1/ See, for example, Deardorff, A. V. and R.M. Stern, Economic Effects of the Tokyo Round. Southern Economic Journal 49 (January 1983), pp. 605-624, and the studies cited therein.

2/ A current study examines the effects of improved market access on the exports of a geographically distributed sample of Fund members. The sample includes developing countries that are currently undertaking adjustment programs with Fund financial assistance, or have done so in the recent past. The exercise examines the impact of liberalization of tariff and nontariff barriers in the major OECD markets in selected agricultural and manufacturing sectors, including those with relatively high rates of protection. The study is based on partial analysis and utilizes price elasticities and tariff and nontariff barriers estimated in a number of previous studies.

abrupt disruptions in financial flows. Furthermore, external payments arrears were reduced in 1983, and the decline in the reserves/import ratio that had occurred during 1979-82 was arrested. However, these positive developments were only sufficient to arrest the steady deceleration in overall economic growth that had occurred since 1979. Real GDP of non-oil developing countries expanded by 1 1/2 percent in 1983, but real per capita incomes in many of these countries still declined significantly. Also, the overall improvement masked the severity of the problems faced by a number of developing countries. Moreover, the external debt situation remained under considerable pressure. Developments in 1983 were characterized by a continuation of widespread debt servicing difficulties and a record number of debt renegotiations. Although the growth of outstanding debt decelerated and the rising trend in the debt service ratio was reversed, the improvements already achieved, while highly important, must also be seen in a longer term context and in light of the fact that the debt renegotiations postponed debt service obligations to the future.

International trade relations remained very difficult in the past 12 months. Despite the acknowledged need to stem and reverse the drift toward protectionism, liberalization efforts were limited to Japan and a few developing countries undertaking balance of payments adjustment programs. Resort to protectionist measures continued to increase in most industrial countries, frequently taking the form of nontariff barriers negotiated on a bilateral basis outside the GATT framework, thereby further weakening the open multilateral trading system. Trade restrictions were extended or intensified, particularly in the agricultural, steel, automobile, textiles and clothing, and electronics sectors. Moreover, pressures for additional protection remained high, even in countries displaying clear signs of economic recovery, and trade policies were increasingly motivated by the desire to combat foreign competition perceived to be unfair. Despite several antiprotectionism pledges in international fora, governments continued to place priority on short-term economic and political considerations in the conduct of trade policies. In a number of developing countries, severe balance of payments difficulties prompted increased reliance on exchange and trade restrictions.

There has been a deterioration over the past 12 months in conditions of foreign market access for exports of developing countries. This reflects a tightening of restrictions directed specifically toward developing countries and an increasing tendency for measures by industrial countries to be broadened and extended to developing countries with an emerging comparative advantage in the relevant products. Furthermore, frequent recourse by industries and labor groups in industrial countries to domestic legal provisions to obtain additional protection, and moves to strengthen and expand such provisions, have spread uncertainty regarding export prospects and investment decisions in developing countries. Several studies confirm the positive effects of trade liberalization on the export and development prospects of developing countries.

In light of recent trade policy developments and trends, the following three subject headings are intended to serve as an aid to discussions. They are not intended to be exhaustive, or to preclude discussion of other issues.

a. The relationship between trade policy stance and global recovery

While individual protectionist actions may appear to be of modest significance, their cumulative impact can be considerable. There is a two-way relationship between protectionism and growth: increasing protectionism contributes to sluggish global recovery which, in turn, fuels additional protectionist pressures. A reversal of protectionist measures would contribute importantly to global structural adjustment and sustained world recovery, and accordingly it would be undesirable for governments to delay trade liberalization. An open trading system is indispensable for the success of the adjustment programs under way, and for an orderly solution to current debt problems; it is also indispensable for the industrial countries. Considering the favorable prospects for global economic recovery, is it not opportune for the industrial countries to take specific actions to reverse protectionist measures?

b. Adjustment in developing countries

Developing countries have made significant adjustment efforts in the past two years. Notwithstanding the improvement already achieved and the prospects for a more favorable external environment in 1984, their balance of payments and debt positions remain vulnerable. They will need to pursue adjustment policies steadfastly and reduce distortions in their economic and financial structures in order to lay the basis for a sustained improvement over the medium term in their balance of payments and growth prospects. Improvements in efficiency need to be brought about, inter alia, by steps toward more liberal exchange and trade systems in the context of outward-oriented growth strategies. Issues for discussion are the design and pace of liberalization measures by developing countries.

c. Market access for developing countries

In recent years, conditions of access to foreign markets for the exports of developing countries have deteriorated. If adjustment in developing countries were to rely mainly on curtailment of imports, growth prospects and the development process would be damaged in the medium term. Thus, developing countries, and especially the highly indebted countries, need to expand export earnings steadily in order to service debt and finance much-needed import increases. Improved foreign market access for developing countries through trade liberalization by their trading partners would contribute significantly to the success of developing countries' own adjustment efforts. How can political support be mobilized so as to promptly lead to concrete actions for such liberalization?

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(In collaboration with the Research and Area Departments)

Approved by Donald K. Palmer

February 10, 1984

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2. Recent trade policy developments and issues

The world economy in 1983 displayed signs of recovery from the recessionary conditions prevailing over the previous three years. World production and trade expanded, although the magnitude was modest, ~~and~~ with the increase in ~~trade lagged behind that of production~~ each being 2 percent. In the industrial countries, the expansion of output averaged about {2 1/4} percent, although its geographical distribution was uneven. Import volumes rose for the first time in three years--by ~~{3 1/2}~~ nearly 4 percent (compared to a decline averaging ~~1.4~~ 1.3 percent annually in 1980-82)--and ~~the decline in~~ export volumes ~~was arrested.~~ increased by about 2 percent. In the developing countries, economic and financial conditions remained difficult, but there were some signs of improvement compared with the previous year. Export ~~and import~~ volumes of the non-oil developing countries grew in 1983 by ~~...~~ over 5 percent and the decline in import volumes ~~... percent, respectively;~~ (0.6 percent) slowed down significantly; their overall real economic growth averaged {1 1/2} percent, arresting the declining trend which had begun in 1979.

International trade relations remained very difficult in the past 12 months. Despite the acknowledged need to stem and reverse the drift toward protectionism, liberalization efforts were limited. Tokyo Round

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~~1/ Pending completion of the current World Economic Outlook exercise, most data on balance of payments and debt developments in 1983 are not yet available. It is expected that the relevant revised pages will be issued when the data become available later this month.~~

tariff reductions took place, but little progress was made in removing nontariff trade barriers progressively introduced in specific sectors since the mid-1970s. In Japan, however, new measures aimed at streamlining import procedures and accelerating tariff reductions agreed during the Tokyo Round were put in place, as a continuation of liberalization efforts initiated since late 1981. In a few developing countries, the adoption of comprehensive adjustment policies aimed at restoring balance of payments viability enabled them, inter alia, to establish more realistic exchange rates and reduce external payments arrears, thus setting the stage for reducing reliance on nontariff trade barriers.

Apart from these few instances, resort to protectionist measures continued to increase. Among industrial countries, these measures frequently took the form of nontariff barriers negotiated on a bilateral basis outside the GATT framework, thereby further weakening the open multilateral trading system. Trade restrictions were extended or intensified, particularly in the steel, automobiles, textiles and clothing, electronics, and agricultural sectors. 1/ In a number of developing countries, severe balance of payments difficulties prompted increased reliance on exchange and trade restrictions over the past several years, as described in section 4.

Recent resort to nontariff trade barriers has taken a variety of forms, ranging from explicit import quotas to "nuisance" measures such as limitation of customs clearance to a few and/or less accessible locations. Among the myriad techniques employed, two stand out as the most frequent. The first is the technique of the "voluntary export restraint" arrangement (VER) under which the exporting country limits exports to a specific level or exercises moderation, thus avoiding the imposition of unilateral --and presumably more severe--import restrictions by the importing country. VERs have been the predominant technique for new restrictions on automobiles, steel, consumer electronics, and certain other manufactured products. Although bilaterally negotiated agreements have long been the

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1/ The main measures taken in 1983 were: (1) a three-year understanding between the EC and Japan, under which the latter will exercise moderation in export of ten sensitive manufactured products to the EC, including price and/or quantity provisions for some of these products; (2) U.S. safeguard actions under Article XIX of GATT on specialty steels and motorcycles; (3) extension to a fourth year of the three-year U.S.-Japan agreement on automobiles negotiated in 1981; (4) extension of the bilateral restraint agreement on Japanese automobile exports to Canada; (5) voluntary export restraint agreements on meat until end-1983 concluded by the United States with Australia, Canada, and New Zealand; (6) the new U.S. textile policy announced in late 1983, which expands the scope for surveillance and restrictions on exports of developing countries; (7) recourse by the EC and the United States to export subsidies in competition for third country markets for agricultural products; (8) increased frequency of countervailing duty actions in the United States and the EC; and (9) tightening and extension of bilateral agreements on steel negotiated by the EC with foreign suppliers.

practice in the textile and clothing sectors, these have been developed within the overall framework of the Multifiber Arrangement, with some assurance, in principle, of international surveillance. The newer VERs, however, have been a clear manifestation of the move toward managed trade and fragmentation of markets, and thus against multilateral principles. The implementation of VERs has necessitated increased surveillance of trade flows on both the import and export side, involving additional administrative costs. The second increasingly popular form has been resort to avenues for redressing "unfair" competition from abroad, made available under existing legislation. This has frequently involved a plethora of antidumping and countervailing suits by well-organized and powerful industries. Their most important effect has been to create uncertainty in trade flows and investment decisions. In order to avoid these effects, supplying countries have sometimes accepted VERs. Thus, the filing of suits has often been a precursor of a VER or a tightening of existing restrictions. The events leading to the U.S.-EC VER on carbon steel in late 1982 and the new textile policy announced by the United States in late 1983 are notable examples. Furthermore, moves to strengthen the legislative provisions for combating "unfair" competition are under way in a number of industrial countries, including Canada, the EC, and the United States.

An issue which has become increasingly contentious is that of subsidies--the predominant source of complaints about unfair competition and a major cause of friction in the steel and agricultural sectors. Within the EC, for example, notwithstanding plans to phase out state aids for steel by member states by 1985, the disruptive impact of subsidization on intra-EC trade flows has become a source of discontent for the more efficient EC producers and has threatened the operation of the Community's internal steel price and production regulation system. In the United States, attention has to some extent shifted from EC steel subsidization, following negotiation of the three-year VER in late 1982, to subsidies of developing countries to steel industries. More generally, the concern about foreign subsidization is rapidly spilling over from export subsidies per se to the broader issue of foreign official support through industrial "targeting" 1/ that may affect the competitiveness of a range of export sectors. This concern has raised demands for protection, and for matching subsidies and increased intervention.

Recent developments have again demonstrated the fallacy of relying on protectionist measures as temporary solutions and the ease with which protectionist sentiment tends to become entrenched. In addition to the classic cases of textiles and steel, a notable recent example is the

1/ "Targeting" refers to the selection by government of target industries, product areas, or technologies for special government guidance and assistance in promoting their development. Targeting policies may include subsidies, pro-merger policies, protection of the favored sector from imports, buy-national procurement policies, discriminatory technical standards, and similar measures to favor domestic production and eventual export expansion from the secure home base.

extension of the three-year U.S.-Japan VER on automobiles, despite evidence of an improvement in domestic sales and prospects of U.S. car manufacturers. Another lesson being relearnt is the inherent tendency of protection to spread across sectors and countries. For example, vertical and horizontal linkages (inputs and substitutes) encourage protectionism intra- and intersectorally, as evidenced by efforts to regulate imports of cereal substitutes in the EC. Trade restrictions also spread across countries, both when a country introduces a restriction to forestall deflection of exports from another market (exemplified by the Canada-Japan VER on automobiles which followed on the heels of the U.S.-Japan agreement), and when existing restrictions are broadened to encompass emerging new suppliers (for example, the EC expanded the number of bilateral agreements on steel to include Korea, Brazil, and South Africa in recent years). Thus, moves toward managed market-sharing in a dynamic framework inevitably face potential loopholes which need to be plugged by additional protection.

Another source of concern is that the threat of retaliation has become increasingly real, as illustrated by developments in the agricultural sector. While agricultural protectionism has long been entrenched and relatively high in most major industrial countries, the mounting frictions in international agricultural trade, particularly over the past two years, have centered around the operations of the Common Agricultural Policy (CAP) of the EC, which has induced the production of large surpluses, the disposal of which has caused problems for other major agricultural producers in third markets. Proposals by EC members to reform the CAP, motivated primarily by severe budgetary constraints, remain under discussion; in any case, these proposals are considered by the EC's trading partners to be inadequate to address the issue of surpluses, and problematic because they include measures to discourage imports of cereal substitutes and to tax vegetable oils and fats. The United States has responded to EC export subsidization by entering into subsidized sales of wheat flour to Egypt and has warned the Community of the possibility of further similar actions. Some Community members, in turn, have proposed intensified cereal export subsidization to counter the U.S. moves. Other moves of a similar nature include the Chinese action in early 1983 to limit certain agricultural imports from the United States pending agreement on textiles, and Turkey's import surcharge, imposed in 1982, on steel imports from the EC following the latter's measures on imports of Turkish textile products.

In the final analysis, however, the spread of protectionism is simply a manifestation of the weakening of the trade policy stance of governments and of the frequency with which they grant requests for protection against foreign competition. In the earlier stages of the recent recession, such a weakening was attributed primarily to concerns about rapidly rising unemployment levels, and the expectation was that the rising trend in protectionism would be, at the very least, arrested when recovery commenced. Despite recent signs of actual or prospective recovery, however, protectionist pressures continue to rise. A multiplicity of arguments is advanced for protectionism, such as concerns about safeguarding employment and avoiding disruption in the affected industries, the magnitude of bilateral trade balances, the impact of exchange rate movements on export competitiveness, strategic reasons, and combating a host of practices considered to be unfair. Indeed, it is tempting to deduce that some justification can be found to fit any case. In effect, however, governments have placed priority on short-term economic and political considerations, to the detriment of policies to promote structural adjustment and a lasting economic recovery. At the same time, there have been several antiprotectionism pledges by governments--for example, at the November 1982 GATT Ministerial meeting, the OECD Ministerial meeting in 1983, the Williamsburg Summit, and UNCTAD VI.

At their 39th session in November 1983, the GATT Contracting Parties reviewed progress on the work program adopted at the November 1982 Ministerial meeting. Since the latter meeting, little progress has been made on the issue of safeguards and the dispute settlement mechanism. However, new procedures or bodies have been set up to facilitate the review of the international trading system and to examine trade in agriculture, as well as quantitative restrictions and other nontariff measures. A study is in preparation on textiles and clothing to help explore possibilities of reverting to normal GATT rules in this sector; some GATT members have undertaken national studies in the services sector; and work has commenced on harmonization of tariff coding systems. The GATT Committee on Trade and Development has launched a series of consultations on tropical products and implementation of Part IV of GATT, which provides differential and more favorable treatment for developing countries. On the occasion of the 39th session, Japan and the United States proposed the launching of a new round of multilateral trade negotiations; certain other countries, including some developing countries, expressed reservations and attached greater importance to satisfactory implementation of the current work program. The Director-General of GATT has set up an independent study group to identify the fundamental causes of the problems affecting the international trading system and to consider how these may be overcome during the remainder of the 1980s.

3. Balance of payments and external debt situation of developing countries

a. Balance of payments developments

The overall balance of payments performance of the non-oil developing countries weakened progressively in 1980-82, at first in the face of a deteriorating balance on current account and then, in 1982, because of the sharp decline in aggregate net inflows of capital chiefly due to the reduction in lending by international commercial banks. The $~~35~~ 37 billion decline in net capital inflows between 1981 and 1982 implied a severe forced adjustment for the non-oil developing countries in the form of a sharp contraction in the volume of imports. Consequently, the steady slowdown in the growth of real GDP for these countries continued in 1982, when the increase on a weighted-average basis was only 1 1/2 percent, compared to ~~2 1/2~~ nearly 3 percent in 1981 and almost 5 percent in 1980. The cutback in financial flows in 1982 was softened by a $~~5~~ 4 billion drawdown in international reserves and by a $~~4~~ 1 billion increase, to $~~10~~ 8 billion, in reserve-related official borrowing (including more than $~~6~~ 7 billion in net use of Fund credit). However, external payments arrears rose sharply in 1982.

In 1983, although the curtailed availability of external financing continued, the prospects for economic growth improved somewhat, following the pickup in world demand and the positive movement in the terms of trade that came with the onset of economic recovery in some industrial countries. The overall external position of the non-oil developing countries, although slightly improved in the course of 1983, remained very vulnerable, as illustrated by the low average ratio of foreign reserves to imports ~~--which, at . . . percent, was hardly improved over the previous year.~~ *prevailing in most non-oil developing countries.*

During 1980-82, the combined balance on current account 1/ of the non-oil developing countries reflected the deterioration of the world trade environment, the increased weight of net service payments, and disruptions in financial flows faced by some developing countries. After deteriorating from $~~89~~ 88 billion in 1980 to a peak of $~~108~~ 109 billion in 1981, the combined deficit on current account improved in 1982 ($~~83~~ 82 billion) and in 1983 ($56. billion). This movement reflected that of the combined trade deficit, which, after deteriorating from $~~74~~ 76 billion in 1980 to $~~80~~ 83 billion in 1981, improved substantially in 1982 ($~~52~~ 53 billion), owing to a severe contraction in imports. During the same period, however, the deficit on net services and private transfers grew by ~~135~~ 142 percent, from $~~15~~ 12 billion in 1980 to $~~35~~ 29 billion in 1982, mainly because of the increase in interest payments associated with the outstanding debt and the high interest rates paid on it. The combined trade balance of the non-oil developing countries improved further in 1983, with an ~~substantial~~ expansion in export earnings, at the same time *as the decline* ~~as~~ *in* imports *decelerated.* ~~volumes showed some increase.~~ There was also an improvement in the deficit on services and private transfers due to lower interest rates in world financial markets.

b. External debt developments

The decline in the current account deficit of non-oil developing countries over the past two years took place against the backdrop of serious external financing problems, which brought pressure on the external debt situation of many of them. Since 1982, the non-oil developing countries as a group have experienced a marked decline in the growth of both outstanding debt and debt service payments, measured in dollar terms. However, the debt servicing burden on most of these countries increased significantly and became unmanageable for many. Debt servicing problems were aggravated by the world recession as the declines in export earnings (especially in 1982) implied a reduced debt servicing capacity for most countries. The situation had already become

1/ Excluding official transfers.

critical when private lenders began, in mid-1982, to reassess the debt situation and sharply curtailed new lending. Widespread debt servicing difficulties were reflected in a record buildup of external payments arrears and in an unprecedented number of countries seeking debt restructurings. Debt servicing problems were not confined to the non-oil developing countries, and some oil exporting countries also faced similar difficulties and sought some form of debt relief.

Total debt outstanding (including short-term) of non-oil developing countries rose by ~~12~~ 13 percent in 1982 and further by an estimated ~~[6 1/2]~~ percent in 1983, to reach about $[670] billion. These increases were markedly lower than at any time since the early 1970s; in 1980-81, the average increase was of the order of 19 percent per year. The slowing trend was particularly pronounced for short-term debt and for debt to private creditors. Net disbursements of medium- and long-term debt, including refinancing, fell from $65 billion in 1981 to $55. billion on average over 1982-83. With many countries attempting to improve the maturity profile of debt, total outstanding short-term debt fell by $~~[20]~~ 23 billion to about $~~[100]~~ 102 billion in 1983, after having ~~virtually~~ more than doubled over the preceding three years. To some extent, and particularly in 1982, the slower growth of debt owed to private creditors reflected a shortage in the supply of new financing from private lenders and was accompanied by a severe compression in imports for many countries. While there was a slowdown in dollar terms, the deceleration in relation to export earnings was not evident. Indeed, owing to depressed exports, the debt to export ratio of the non-oil developing countries jumped from 111 percent in 1980 to reach 144 percent in 1982. In 1983, the ratio ~~broadly stabilized, due mainly to an upturn in export earnings.~~ rose more moderately to around 150 percent.

Scheduled debt service payments of the non-oil developing countries have also increased at a much slower pace since 1982, largely because the average interest cost on outstanding debt began to decline along with international interest rates from their historic high levels of 1980-81. Aside from the lower interest cost, debt service in terms of actual cash payments has increased still more slowly, owing to debt restructurings and the substantial postponements of scheduled payments, primarily since late 1982. Reflecting these factors, actual debt service payments rose by about ~~13~~ 11 percent in 1982, significantly below the average increase of 26 ~~20~~ percent during 1980-81. Furthermore, for 1983, it is presently estimated that actual debt service payments fell for the first time in recent history by ~~[12]~~ 10 percent, or by $~~[13]~~ 11 billion, mainly as a result of several large-scale restructuring arrangements. The debt service burden in terms of export receipts has not been eased to quite the same extent. The group's debt service ratio rose from an average of 19 percent in 1980-81 to reach an all-time high of some [25] percent in 1982. For 1983, due to the prevalence of debt restructurings together with the recovery in exports, the debt service ratio fell to ~~an estimated [19] percent--a level more in line with previous magnitudes.~~ about 22 percent.

For the 25 major borrowing countries, 1/ the overall debt situation has been about the same as for all the non-oil developing countries. Total debt for these countries is estimated to have increased by .5. percent in 1983, down from ~~11~~ 12 percent in 1982 and an annual average of ~~21~~ 18 percent during 1980-81. Since mid-1982, half of these countries have had difficulties of varying degrees in arranging new bank credits and have avoided a reduction in the level of outstanding debt through comprehensive restructuring/refinancing. For this group of countries, actual debt service payments increased by only 9 ~~12~~ percent in 1982, down from ~~20~~ 28 percent on average in 1980-81, and fell by 24 .9. percent in 1983. The ~~combined~~ debt service ratio jumped from ~~30~~ 24 percent on average during 1980-81 to a record high of ~~38~~ 32 percent in 1982, before declining to .30 percent in 1983.

The unprecedented severity of debt servicing difficulties over the last two years is reflected in the sharp rise in external payments arrears and in the incidence of debt renegotiations. While, in the late 1970s, on average only 4 countries per year renegotiated debt, the number grew to 13 in 1981 and 18 in 1982. In 1983, ~~[28]~~ 26 countries completed some 37 ~~[36]~~ debt restructuring arrangements, while a number of others remain under negotiation. Furthermore, whereas previously most debt renegotiations concerned small debtor countries, recent debt restructurings have involved 12 of the major borrowers, including the top three borrowers: Brazil, Mexico, and Argentina. The amount of restructured debt increased to a record level of about $[70] billion in 1983, compared with $5.5 billion in 1982 and only $3.5 billion on average in 1980-81. The amount of debt restructured by banks rose from under $2 billion on average during 1980-81 to $5 billion in 1982 and about $[60] billion by 1983. Debt restructuring by official creditors also took place on a much larger scale, rising from $0.5 billion in 1982 to almost $11 billion in 1983.

In the near term, the debt situation will remain difficult for many developing countries. With the support of Fund resources, several countries have adopted adjustment policies to redress the situation. Sustained adjustment efforts should help improve their debt servicing capabilities. Notwithstanding this, the extent of the debt servicing difficulties will also be influenced by the evolution of international interest rates, the degree to which confidence will be restored in the international capital markets, and the degree of recovery in export markets. For 1984, total debt is expected to continue to increase only slowly, probably at about the same pace as in 1983, ~~with much of the increase~~ and in the form of medium- and long-term debt. Debt service payments, with the respite provided by restructuring agreements so far concluded, should also remain below the peak reached in 1982.

1/ Defined as the 25 developing countries with the largest outstanding external debt ~~to private creditors~~ in 1982; these countries account for around ~~three fourths~~ four fifths of debt outstanding of the developing world. The countries are: Algeria, Argentina, Brazil, Chile, Colombia, ~~Ecuador~~, Egypt, ~~Greece~~, Hungary, India, Indonesia, ~~Israel~~, Korea, Malaysia, Mexico, Morocco, Nigeria, ~~Peru, Nigeria~~, Pakistan, Peru, the Philippines, Portugal, Romania, South Africa, Thailand, Turkey, Venezuela, and Yugoslavia.

4. Restrictive measures in developing countries

Developing countries frequently pursue trade policies aimed at encouraging import substitution and safeguarding the balance of payments. During the 1970s, many of them adopted more open trade policies in order to promote competition in the internal market and reduce distortions in resource allocation. Subsequently, in the context of severe foreign exchange shortages compounded by disruptions in financial flows, many of these countries compressed imports to "financeable" levels. While the reduction in imports was brought about importantly through a reduction of domestic demand by tightening fiscal and monetary policies, in many developing countries reliance on exchange and trade restrictions also increased. In the exchange field, the most important restrictions were the tightening of foreign exchange allocations in line with foreign exchange availability; even so, there was a sharp buildup of external payments arrears on both imports and debt repayments. Import restrictions were intensified in the form of quantitative controls, especially on luxury or "nonessential" goods. Another aspect of the impact of the foreign exchange shortage on trade policies was the increasing resort to countertrade/barter-type arrangements in developing countries, despite frequent problems with the quality, cost, and range of goods obtained by one or both parties to the arrangements. The use of selective export incentives also increased in 1982, as several developing countries sought to promote their exports through new fiscal incentives or preferential financing facilities.

In 1983, as a result of some improvement in the external environment and developing countries' own adjustment efforts, there tended to be, on balance, a containment of the disorderly conditions of the previous year, although there was once again considerable variation among individual countries. In particular, moves toward more flexible and realistic exchange rates became more common, outstanding external payments arrears declined, and the frequency of resort to import restrictions was reduced. Furthermore, a number of developing countries initiated reviews and studies of their trade regimes with a view to identifying areas and methods to streamline import licensing, replacing quantitative restrictions with a more efficient tariff system, and reducing reliance on export subsidies.

Clearly, curtailment of imports and reliance on restrictions over extended periods will damage growth prospects and the development process. Over the medium term, countries would need to improve their own foreign exchange earning capacities in order to service debt and finance much-needed import increases. In the past two years, an increasing number of developing countries have embarked upon adjustment programs supported by Fund resources to bring about necessary changes in economic and financial conditions in an orderly fashion, and to lay the basis for a sustainable improvement in their balance of payments and growth prospects. These adjustment efforts have involved both prudent demand management and structural measures to promote efficiency in the context of more outward-oriented growth strategies. This has typically entailed moves toward more open exchange and trade systems to be brought about in stages involving, in the first instance, containment of the existing disorderly conditions, followed by moves toward liberalization. An immediate and first priority has normally been the establishment of more realistic exchange rates and reduction in exchange restrictions, particularly the orderly elimination of external payments arrears, since this is essential for any meaningful trade liberalization. In 1982-83, developing countries which achieved some liberalization of their import regimes included Bangladesh, Haiti, India, Jamaica, Korea, Mexico, Pakistan, Tunisia, Turkey, and Uganda. In many of these countries, the liberalization took place within the framework of adjustment programs supported by the use of Fund resources.

The scope for economic recovery in many developing countries will depend on how firmly the authorities implement the comprehensive adjustment programs they have recently adopted to reduce the severe internal and external imbalances that continue to afflict their economies. At the same time, the success of developing countries' efforts to strengthen their current accounts in a trade-expansionary manner depends importantly on the external environment. The important elements of the latter aspect include avoidance of disruptions of foreign financial resources, recovery in their export markets, and increased access to foreign markets for their exports.

5. Trade measures affecting developing countries

Protectionist measures facing developing countries may be classified into three broad categories. First, there are measures directed specifically against developing countries--the classic example being the textiles and clothing sector, where trade among industrial countries remains generally free of nontariff restrictions, while restrictions against developing countries--particularly the newly industrialized countries--have been steadily tightened. The second category includes measures that are not directed solely at developing countries, but which affect products of direct interest to them, in the sense that they have an existing or clearly emerging comparative advantage in these products. These include agricultural products, footwear, leather products, steel, and certain other manufactures. There has been an increasing tendency for measures by industrial countries in these sectors to be broadened and extended to developing countries. Third, there are measures in other sectors, such as automobiles, consumer electronics, and high technology products, which may not have a significant direct impact on developing countries, but have adverse indirect effects through increasing distortions and reducing efficiency globally, and creating uncertainty in investment decisions, thereby discouraging export diversification and the pursuit of outward-oriented growth strategies. On the other hand, a feature of trade policies toward developing countries has been the extension of preferences to them by industrial countries under the Generalized System of Preferences (GSP). However, in the aggregate, the impact of the GSP has been relatively limited, and in recent years the scope for growth of exports under some GSP schemes has been narrowed. Overall, in recent years, conditions of access to foreign markets for developing countries have deteriorated.

An improvement in market access for the exports of developing countries would make a significant contribution to the export and growth prospects and adjustment efforts of developing countries. This is substantiated by a number of existing studies which attribute positive overall welfare and trade effects to trade liberalization. 1/ Work in progress by the Fund staff also illustrates the benefits from trade liberalization for exports of developing countries. 2/

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For the September 1983 meeting of the Development Committee, the Fund staff prepared a background note on Fund activities in the trade field ("Linkages Between Trade and the Promotion of Development," EB/CW/DC/83/5, 8/8/83). The Fund staff is continuing efforts to critically examine trade policies in the context of Article IV consultations with individual members, particularly the major trading nations, and to incorporate exchange and trade liberalization measures in the design of adjustment programs supported by Fund resources. Management and staff are also continuing informal contacts and exchange of views with officials from member countries, GATT, and other competent institutions, with a view to encouraging mutual trade liberalization among Fund members.

6. Overview

In 1983, the world economy displayed signs of recovery from the recessionary conditions prevailing over the previous three years. In the industrial countries, the expansion of output averaged about [2 1/4] percent, though its geographical distribution was uneven. In the developing countries, economic and financial conditions remained difficult, but there were some signs of improvement. The combined current account deficit of the non-oil developing countries declined for the second consecutive year; this was accompanied by an expansion of ~~both~~ exports and/ a moderate decline in imports. In contrast, 1982 had been characterized by a severe compression of import volumes, as countries adjusted to declines in export earnings, compounded, in some cases, by abrupt disruptions in

1/ See, for example, Deardorff, A. V. and R.M. Stern, Economic Effects of the Tokyo Round. Southern Economic Journal 49 (January 1983), pp. 605-624, and the studies cited therein.

2/ A current study examines the effects of improved market access on the exports of a geographically distributed sample of Fund members. The sample includes developing countries that are currently undertaking adjustment programs with Fund financial assistance, or have done so in the recent past. The exercise examines the impact of liberalization of tariff and nontariff barriers in the major OECD markets in selected agricultural and manufacturing sectors, including those with relatively high rates of protection. The study is based on partial analysis and utilizes price elasticities and tariff and nontariff barriers estimated in a number of previous studies.

financial flows. Furthermore, external payments arrears were reduced in 1983, and the decline in the reserves/import ratio that had occurred during 1979-82 was arrested. However, these positive developments were only sufficient to arrest the steady deceleration in overall economic growth that had occurred since 1979. Real GDP of non-oil developing countries expanded by 1 1/2 percent in 1983, but real per capita incomes in many of these countries still declined significantly. Also, the overall improvement masked the severity of the problems faced by a number of developing countries. Moreover, the external debt situation remained under considerable pressure. Developments in 1983 were characterized by a continuation of widespread debt servicing difficulties and a record number of debt renegotiations. Although the growth of outstanding debt decelerated and the rising trend in the debt service ratio was reversed, the improvements already achieved, while highly important, must also be seen in a longer term context and in light of the fact that the debt renegotiations postponed debt service obligations to the future.

International trade relations remained very difficult in the past 12 months. Despite the acknowledged need to stem and reverse the drift toward protectionism, liberalization efforts were limited to Japan and a few developing countries undertaking balance of payments adjustment programs. Resort to protectionist measures continued to increase in most industrial countries, frequently taking the form of nontariff barriers negotiated on a bilateral basis outside the GATT framework, thereby further weakening the open multilateral trading system. Trade restrictions were extended or intensified, particularly in the agricultural, steel, automobile, textiles and clothing, and electronics sectors. Moreover, pressures for additional protection remained high, even in countries displaying clear signs of economic recovery, and trade policies were increasingly motivated by the desire to combat foreign competition perceived to be unfair. Despite several antiprotectionism pledges in international fora, governments continued to place priority on short-term economic and political considerations in the conduct of trade policies. In a number of developing countries, severe balance of payments difficulties prompted increased reliance on exchange and trade restrictions.

There has been a deterioration over the past 12 months in conditions of foreign market access for exports of developing countries. This reflects a tightening of restrictions directed specifically toward developing countries and an increasing tendency for measures by industrial countries to be broadened and extended to developing countries with an emerging comparative advantage in the relevant products. Furthermore, frequent recourse by industries and labor groups in industrial countries to domestic legal provisions to obtain additional protection, and moves to strengthen and expand such provisions, have spread uncertainty regarding export prospects and investment decisions in developing countries. Several studies confirm the positive effects of trade liberalization on the export and development prospects of developing countries.

In light of recent trade policy developments and trends, the following three subject headings are intended to serve as an aid to discussions. They are not intended to be exhaustive, or to preclude discussion of other issues.

a. The relationship between trade <u>policy stance and global recovery</u>

While individual protectionist actions may appear to be of modest significance, their cumulative impact can be considerable. There is a two-way relationship between protectionism and growth: increasing protectionism contributes to sluggish global recovery which, in turn, fuels additional protectionist pressures. A reversal of protectionist measures would contribute importantly to global structural adjustment and sustained world recovery, and accordingly it would be undesirable for governments to delay trade liberalization. An open trading system is indispensable for the success of the adjustment programs under way, and for an orderly solution to current debt problems; it is also indispensable for the industrial countries. Considering the favorable prospects for global economic recovery, is it not opportune for the industrial countries to take specific actions to reverse protectionist measures?

b. <u>Adjustment in developing countries</u>

Developing countries have made significant adjustment efforts in the past two years. Notwithstanding the improvement already achieved and the prospects for a more favorable external environment in 1984, their balance of payments and debt positions remain vulnerable. They will need to pursue adjustment policies steadfastly and reduce distortions in their economic and financial structures in order to lay the basis for a sustained improvement over the medium term in their balance of payments and growth prospects. Improvements in efficiency need to be brought about, inter alia, by steps toward more liberal exchange and trade systems in the context of outward-oriented growth strategies. Issues for discussion are the design and pace of liberalization measures by developing countries.

c. <u>Market access for developing countries</u>

In recent years, conditions of access to foreign markets for the exports of developing countries have deteriorated. If adjustment in developing countries were to rely mainly on curtailment of imports, growth prospects and the development process would be damaged in the medium term. Thus, developing countries, and especially the highly indebted countries, need to expand export earnings steadily in order to service debt and finance much-needed import increases. Improved foreign market access for developing countries through trade liberalization by their trading partners would contribute significantly to the success of developing countries' own adjustment efforts. How can political support be mobilized so as to promptly lead to concrete actions for such liberalization?