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May 24, 1984

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

From: The Secretary

Subject: Draft Minutes of Meeting 84/1

Attached are the draft minutes of the meeting of the Committee of the Whole on the Development Committee held on March 9, 1984. If no further revisions are proposed by the close of business on Friday, June 1, 1984, these draft minutes will be deemed approved on that date.

Att: (1)

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CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Committee of the Whole on the Development Committee

Meeting 84/1

3:30 p.m., March 9, 1984

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	G. Ercel, Temporary
	X. Blandin
A. Donoso	
R. D. Erb	M. K. Bush
	M. Z. M. Qureshi, Temporary
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	G. W. K. Pickering, Temporary
	J. R. N. Almeida, Temporary
G. Laske	
G. Lovato	C. P. Caranicas
	A. S. Jayawardena
	J. E. Suraisry
	T. de Vries
	K. G. Morrell
G. Salehkhou	
	E. I. M. Mtei
	E. Portas, Temporary
J. Tvedt	
N. Wicks	
Zhang Z.	Wang E.

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

H. E. Kastoft, Executive Secretary, Development Committee. A. Shakour, Senior Advisor, IBRD. African Department: O. B. Makalou, Deputy Director; D. E. Syvrud. Asian Department: K. A. Al-Eyd, X. Vongsathorn. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; S. Mookerjee, Deputy Director; S. J. Anjaria, N. Kirmani, P. A. Molajoni, C. Puckahtikom. Legal Department: G. P. Nicoletopoulos, Director; S. A. Silard. Research Department: A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Western Hemisphere Department: S. T. Beza, Associate Director. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, H. A. Arias, C. J. Batliwalla, J. Delgadillo, S. M. Hassan, L. Ionescu, H.-S. Lee, G. E. L. Nguyen, Y. Okubo, I. R. Panday, D. I. S. Shaw, D. C. Templeman. Assistants to Executive Directors: H. Alaoui-Abdallaoui, R. Bernardo, Chen J., L. E. J. M. Coene, I. Fridriksson, V. Govindarajan, D. Hammann, N. U. Haque, J. M. Jones, H. Kobayashi, M. J. Kooymans, M. Rasyid, J. Reddy, D. Robinson, A. A. Scholten, Shao Z., S. Sornyanyontr, P. Verly, Wang C. Y.

1. DRAFT AGENDA

The Executive Directors considered a draft agenda for the April 13, 1984 meeting of the Development Committee (EB/CW/DC/84/2, 2/27/84).

The Executive Secretary of the Development Committee noted that the draft agenda had been approved by the Executive Board of the World Bank.

The Executive Baord approved the draft agenda.

2. LINKAGES BETWEEN TRADE AND THE PROMOTION OF DEVELOPMENT

The Executive Directors considered a staff paper on the linkages between trade and the promotion of development (EB/CW/DC/84/1, Rev. 1, 3/7/84).

The Associate Director of the Exchange and Trade Relations Department remarked that the present staff paper was similar in style and content to papers that had been prepared during the previous several years. Even in the absence of the request by the Development Committee, much of the material in it would have been prepared--probably as an annex or supplement--for the World Economic Outlook, which traditionally included a survey of recent trade developments. The next set of World Economic Outlook papers would refer to the present paper as a background document.

Mr. de Vries noted that the Fund urged member countries using its resources to introduce an export-oriented adjustment program. That policy had been maintained with the support of most of the Fund's major member countries. However, it was said on page 10 of the staff paper that, while an important element in the success of that policy was the recovery of export markets in industrial countries, the access of developing countries to those markets had declined. In his summing up, the Chairman should stress the need for industrial countries to maintain a trade policy that would enable other countries to maintain export-oriented adjustment policies.

It was the duty of the Fund, Mr. de Vries continued, to point out to member countries that they should not maintain mutually inconsistent monetary and trade policies: the trade policies should help to ensure the success of the monetary policies. There was some question about how far the Fund could go in making that point. A recent study by the U.S. Council on Foreign Relations had argued that, given its present structure, the GATT was perhaps not the best forum for solving current problems in the trade field. The GATT had been designed to encourage participants to implement existing trade agreements. In fact, however, there was an array of nontariff trade barriers that were not covered by treaties and should be the subject of constant examination by a policymaking body; such action was not within the purview of the Fund. Still, all members should bear in mind that countries could not be expected to service their debt payments if they were not allowed to maintain their export earnings. He had been struck by the fact that only Japan and developing countries themselves had engaged in some trade liberalization in the recent past, while the other industrial countries had in fact moved in the opposite direction. The inconsistency apparent in that unfortunate development should be brought forcefully to the attention of the participants in the April meeting of the Development Committee.

Mr. Donoso remarked that the access of developing countries to export markets had clearly deteriorated during the previous year, as restrictions directly affecting developing countries had been introduced or extended. Some of the restrictive measures had affected areas of production in which developing countries enjoyed a comparative advantage. Trade restrictions had become so common that they were seriously affecting the growth even of industrial countries. Protection granted to specific industries provided an incentive for other industries to request the same treatment, thereby creating uncertainty in investment decision making in both developing and developed countries.

Progress in liberalizing trade had been very limited, Mr. Donoso went on. Developing countries with adjustment programs had made some headway, but among the industrial countries only Japan had moved in the direction of liberalizing trade, and the degree that it had done so was clearly insufficient. In the circumstances, it was difficult for developing countries to achieve economic growth while making costly adjustments and servicing foreign debt. The elimination of trade restrictions would obviously facilitate the world economic recovery and contribute to an early solution to the debt problem. The staff's comprehensive paper should help to generate discussion on trade liberalization.

Despite the recent signs of recovery, Mr. Donoso continued, protectionist pressures had continued to intensify. Countries where the economic environment was still unfavorable had given priority to short-term economic and political considerations at the cost of maintaining policies promoting structural adjustment and lasting economic recovery. Unless general economic conditions improved, the basic pressures for more protection would probably remain in most countries.

A reduction in the fiscal deficits of industrial countries would encourage a fall in interest rates, which, in turn, would support the general economic recovery and reduce pressures for protection, Mr. Donoso commented. Countries facing a shortage of liquidity could not realistically be expected to reduce the pressure for protection. Some progress had been made in transferring resources to countries that had to service their debt, but most of them still faced a sizable shortage of liquidity.

The staff paper should help both to generate political support for an improvement in the present trade situation, Mr. Donoso concluded, and to facilitate a productive discussion in the Development Committee. Governments should concentrate on the interrelated problems of fiscal deficits, interest rates, international liquidity, and foreign debt in their efforts to reverse the trend toward protectionism. The authorities in the various countries concerned should commit themselves to making progress in trade liberalization, and he hoped that concrete proposals for facilitating agreement in that area would be put forward.

Mr. Laske said that he agreed with the staff that there was a strong link between the growing protectionist pressures in industrial and developing countries and the apparent weakening in the commitment of governments to longer-term goals in international trade. Protectionist measures were invariably meant to be short term, but their short-term benefits were usually ambiguous, while their medium-term and long-term consequences--including a reduction in the flexibility in the economy, their inconsistency with the international division of labor, and a general decline in welfare--were always negative. The ongoing debate in the United States on automobile imports was a useful example: the benefits from the voluntary export restraint arrangements between the United States and Japan would accrue to U.S. and Japanese automobile producers and to automobile dealers in the United States. The arrangements involved essentially a substantial redistribution of income, and their effect on employment in the automobile industry remained unclear. The results in other lines of industry of such voluntary restraint arrangements were probably similar.

Protectionism was spreading, and it would be most unfortunate if it became an epidemic, Mr. Laske remarked. The list on page 2 of the staff paper showed that the European Communities were clearly involved, and the staff obviously hoped that a fresh look at international trade issues would be taken; governments should reconsider individual trade-related policies, assessing them in the framework of the desirability of a liberal, noninflationary, and growing world economy. Those objectives deserved the full support of member countries.

The present paper, Mr. Laske noted, had been designed explicitly to review trade policy trends in the light of developments in 1983. Future papers could usefully devote a section to the major costs of protection and include short case studies.

The staff had commended Japan for being the only industrial country that had made some progress toward liberalizing imports, Mr. Laske observed. Protection in other industrial countries--especially the United States--had been rising. Pressures in the European Communities had been intensifying, despite the efforts of his authorities to stem the tide.

The staff paper could have usefully mentioned the existing overall levels of protection in the industrial countries, Mr. Laske went on. The staff had usefully stressed that the trade and exchange rate policies of developing countries must be kept under close scrutiny, as restrictive measures were not helpful to those countries and could have an adverse effect on the international flow of goods and services.

He fully agreed with the staff, Mr. Laske stated, that a satisfactory solution to the debt problems facing developing countries would be impossible if those countries were not allowed to earn sufficient foreign exchange by increasing their exports. To that end, they would have to have adequate access to the domestic markets of industrial countries. Well-balanced growth in a prosperous world economy could be achieved only if import barriers and artificial export promotion schemes were avoided.

Mr. Mtei said that he broadly agreed with the staff analysis. Trade was clearly the engine of growth in developing countries, and curbs on their trade kept their economies from moving forward. The rising trend of protection and autarky in developed countries, despite their professed intentions of liberalization, was deplorable. An important factor in the continued difficult economic and financial conditions in developing countries was the absence of a spillover of the recovery in industrial countries through improved trade relations.

Protection had a detrimental effect on the prospects for growth in the industrial countries and the world economy, as well as in developing countries, Mr. Mtei noted. The apparent short-run benefits of restrictive measures should be weighed against the fundamental medium-term and long-term adverse effects on output, prices, economic efficiency, competitiveness, employment, and the need for structural economic changes.

The substantial progress toward recovery that had been made in industrial countries and the favorable prospects for world economic recovery gave the industrial countries a good opportunity to take serious steps toward dismantling existing protectionist measures, Mr. Mtei considered. Delays in trade liberalization had large global welfare costs, adversely affected trade, and could cause a premature end to the ongoing economic recovery in the industrial countries. All the industrial countries except Japan had introduced new and intensified protectionist measures, all of which had directly or indirectly affected the exports of developing countries.

If developing countries were to be able to reap the benefits of their adjustment efforts under Fund-supported programs that had been recommended by Executive Directors from developed countries, Mr. Mtei remarked, they would have to have secure access to foreign markets. The restrictive trade policies of industrial countries had spread uncertainty about the developing countries' export prospects, investment decisions, diversification policies, and outward-looking development strategies. The adjustments achieved thus far had been due mainly to import compression that had adversely affected economic growth. That trend could not continue much longer without undermining progress in the industrial countries themselves. Protectionism hurt not only the exports of developing countries but also their debt servicing capacity. Unless developing countries with large external debts were able to earn sufficient foreign exchange both to cover their essential imports and to meet their debt servicing obligations, the smooth operation of the international financial system in the future would be placed in jeopardy.

Although they had faced severe foreign exchange shortages in recent years, developing countries had continued to liberalize their external sector under Fund-supported programs, Mr. Mtei noted. The foreign exchange situation continued to be critical and should be taken into account when the pace of liberalization in developing countries was assessed. A country that opened its economy to imports while being denied the right to earn foreign exchange to finance imports would likely court financial disaster and accumulate import payments arrears.

It was important to stress the need to terminate unilateral, bilateral, and regional actions--such as those within the EC--and restrictive agreements outside the framework of the GATT, Mr. Mtei said. Such actions stifled trade and weakened the effectiveness of the multilateral institutions established to promote trade. Those institutions should be used by political leaders as instruments for resisting protectionist pressures. It might also be necessary for the authorities in developed countries to identify industries that could not compete with imports, with a view to providing incentives for them to shift into areas in which the countries concerned enjoyed a greater comparative advantage. Without such efforts, the needed structural adjustment might not be forthcoming, and there would be no end to protectionist pressures exerted by groups whose interests appeared to be threatened by a liberal trading system.

Mr. Suraisry remarked that, despite the strengthening of the economic recovery and the calls for free trade, the drift to protection had continued and even accelerated, especially in the major industrial countries--with the exception of Japan--where governments had given priority to short-term considerations at the expense of policies aimed at structural adjustment and lasting economic recovery. The accumulative impact of the protectionist barriers in industrial countries on world trade was considerable. The continued strong pressure for additional protection was equally worrying.

The Japanese authorities were to be commended for the steps taken to liberalize their trade system, Mr. Suraisry continued. It was difficult to overstate the harm that protection caused developing countries, whose access to foreign markets had been further curtailed in 1983. As the staff had noted, an open trading system was essential for the successful adjustment by those countries and for an orderly solution to their debt problems. The Fund in particular had been encouraging developing countries to remove restrictions, allocate resources more efficiently, and maintain outward-looking growth strategies, but that approach could work only if it involved a two-way process; industrial countries, too, would have to follow the principle of comparative advantage and open their markets to foreign competition. The cost of not doing so for both the industrial country economies and the rest of the world had been clearly stated by the staff.

The present recovery provided an excellent opportunity to move decisively back to free trade, Mr. Suraisry commented. The opportunity should not be missed, and he was pleased that the Development Committee planned to explore the prospects for such a move at its coming meeting. In the concluding section of its paper, the staff had raised fundamental questions, and concrete answers were needed if a balanced expansion of world trade, from which all countries would benefit, were to take place.

Mr. Portas said that he fully endorsed the staff's views. The international trade situation was clearly grim, particularly the position of developing countries. The role of international trade as an engine of growth for developing countries meant that there had to be an open multilateral payments system and a healthier macroeconomic environment. It was therefore worrying to note that in recent months there had been a deterioration in the already difficult conditions of market access for exports of developing countries. The strengthening and broadening of trade restrictions in the industrial world had been designed to prevent the penetration of those products, in whose production developing countries had invested considerable amounts of externally borrowed resources. The functioning of these export industries of developing countries at full capacity was a prerequisite for a satisfactory solution of the external debt problems facing those countries. The continued, and even increased, resort to protectionist measures in the industrial world had considerably worsened the prospects for a smooth transition toward a sustainable external debt structure in developing countries. Trade policy was a critical area of Fund surveillance, and the staff and management should be encouraged to continue to pay close attention to the evolution of trade issues.

Mr. Blandin said that he fully agreed with the staff that governments should pay more attention to the medium-term and long-term consequences of trade policy than to the very short-term benefits of restrictive measures. His authorities were committed to maintaining an open economy.

The staff paper provided a comprehensive description of protectionist measures in developing and developed countries, but the linkages between trade and development were apparently elusive, Mr. Blandin remarked. The paper could have usefully elaborated further on the connections between investment and the international division of labor on the one hand, and international trade on the other.

The staff apparently felt that the closing of industrial country markets was the principal obstacle to development, Mr. Blandin said. Protection was certainly an important factor, but other factors had also played an important role in the continued weak economic growth of developing countries in 1983. Promoting development, mainly through multilateral aid, was also an important factor in world trade growth. Recent data suggested that the recovery in the industrial countries had been the most important factor in economic developments in developing countries: in 1983, industrial country imports had increased by nearly 4 percent, while exports had risen by only 2 percent. The large gap between the dramatic improvement in the trade deficit of non-oil developing countries and the smaller improvement in their current account deficit in 1983 clearly confirmed the important constraint represented by high interest rates.

In any assessment of the various factors affecting the performance of developing countries, Mr. Blandin went on, different weights should be given to restrictive measures on imports--which were clearly open to criticism--and export subsidies and other measures promoting high-technology industries. The latter constituted a reallocation of domestic resources and might well favor positive adjustments.

The staff had not addressed the important subject of commodity prices, Mr. Blandin noted. The instability of the developing countries' commodity markets and of the exchange rates of the currencies in which commodity prices were denominated had been of some importance in restraining the growth of developing countries. The staff discussion could also have usefully referred to the agreement between the EC and the African, Caribbean, and Pacific States (ACP).

The staff paper was meant to facilitate the discussion during the April meeting of the Development Committee, Mr. Blandin remarked. It was important to bear in mind that at the Williamsburg summit the participants had stated: "We commit ourselves to halt protectionism, and as recovery proceeds, to reverse it by dismantling trade barriers." That commitment should be clearly reflected in the discussion on the subject headings on page 13 of the staff paper.

The staff discussion on the relationship between trade policy stance and global recovery, Mr. Blandin went on, should perhaps state more clearly that it was in the global interest for governments to commit themselves to avoid aggravating the present situation by adopting new protectionist measures, and that such an effort should be undertaken in particular by countries that were enjoying the strongest recovery. Those countries should reduce protectionist measures, especially those introduced since mid-1983. The staff discussion on market access for developing countries should be expanded to mention that the success of developing countries' adjustment endeavors required an increase in, and more reliable forecasts of, their export receipts and, to that end, greater stability of exchange rates and commodity prices.

Ms. Bush remarked that the staff had pointed to the need for trade liberalization efforts in particular to enhance the development process and had asked whether the time had not come for industrial countries to begin dismantling their restrictive trade measures. The United States strongly supported efforts to liberalize world trade and was currently engaged in efforts in the OECD and the GATT to roll back protectionist measures and eventually initiate another round of multilateral trade negotiations. Progress had been slow, because of strong protectionist pressures in the United States and in other developed and developing countries. All countries wished to enjoy the benefits of open markets, but few were willing to open their own markets further to competition from imports.

The United States had generally kept its markets open, despite the sharp appreciation of the dollar during the past three years, Ms. Bush said. That effort had helped to permit other industrial countries and developing countries to maintain strong export growth to the United States.

The staff had correctly noted the importance of trade liberalization in the effort to deal with debt problems, Ms. Bush commented, but it would be a mistake to conclude that simply buying more developing country exports would make the most significant contribution to solving the problems.

Economic adjustment, through changes in the policies that had contributed to the debt difficulties, was the fundamental solution. Realistic exchange rates would be particularly important, as they would facilitate the task of relaxing trade and payments restrictions.

She was pleased, Ms. Bush said, that the staff was continuing its efforts to develop specific country information on policies and practices affecting trade, to examine critically trade policies in the context of Article IV consultations, and to incorporate exchange and trade liberalization measures in Fund-supported adjustment measures. Objectives for the international monetary and trade systems were complementary, and the Fund had a vital interest in promoting the expansion of international trade of all its member countries. Improving trade was not a new objective for the Fund.

The staff had noted that a few developing countries had undertaken trade liberalization measures in the context of comprehensive adjustment programs, Ms. Bush commented. That development was welcome, but the majority of developing countries continued to rely on a wide array of subsidies and restrictive measures that hindered efforts to rationalize production. Such measures not only encouraged protection in industrial countries, but also impeded further development of trade among developing countries, which had been one of the fastest-growing trade areas. She agreed with the staff that there was a need to look systematically at the design and pace of liberalization measures of developing countries.

The introduction of more efficient trade policy measures was an important ingredient of any adjustment program and was essential to any long-run development program, Ms. Bush remarked. There was increasing evidence that countries that permitted trade flows to respond to demand and production advantages experienced relatively faster growth than other developing countries. In addition, liberalization could fuel the economic growth of developed countries and should be a part of their efforts to recover from the recent recession.

In some cases, Ms. Bush commented, liberalization could be a slow process. A shortage of foreign exchange could limit the extent to which import markets could be opened, but in such cases it would be more appropriate to permit exchange rate changes to induce a balance in net flows. It might also be necessary to introduce domestic firms to import competition gradually, rather than suddenly. However, it was obviously important not to put off liberalization to some distant time in the future. Even in a country facing severe foreign exchange restraints, policy planning to achieve trade liberalization should begin forthwith.

Fund encouragement of trade liberalization in the context of Article IV consultations and in the development of Fund-supported programs should be maintained and even strengthened, Ms. Bush considered. That conclusion was applicable to discussions and negotiations with both developed and developing countries.

Of the various elements of trade and investment policies, Ms. Bush said, special attention should be given to import restrictions, trade in services, countertrade, export subsidies, local content requirements, and export performance requirements for foreign investment. The need for liberalizing imports required no further elaboration. The services sectors of member countries' economies were growing in absolute and, often, in relative terms, so that liberalization of restrictions on service trade would constitute an important advance toward freer and more efficient world trade.

She was worried about the widespread use of countertrade, Ms. Bush remarked. Countertrade generally distorted trade patterns and was inconsistent with the achievement of an open multilateral trading system in which settlements were made in convertible currencies. Government intervention in the market through mandated countertrade was particularly objectionable. Some countries might find it necessary to use countertrade in the present environment of serious balance of payments difficulties, the stagnation in the growth of world trade, and the existence of some international financing difficulties. However, the existence of countertrade was a symptom of underlying problems involving the sale of goods and services that could not be sold freely in world markets, usually because of market imperfections and restrictions. Correcting the underlying problems was certainly preferable to resorting to countertrade. Could the staff assure Executive Directors that countertrade did not create a loophole for evading foreign debt limits under Fund-supported programs? That outcome might occur if imports were paid for by commitments of future exports, rather than by foreign financing.

Although export subsidies might appear to help alleviate serious balance of payments problems, Ms. Bush commented, they should be unnecessary in countries that maintained realistic exchange rates, and they could be counterproductive if they encouraged the development or continuation of uncompetitive industries and countervailing actions in other countries. In addition, they could compound budget deficit problems.

As to investment, Ms. Bush said, local content and export performance requirements could impede flows of direct investment and distort trade flows. Direct investment flows brought needed management and technology to individual countries and were a source of capital that could substitute in part for a further accumulation of foreign debt. The issues of export subsidies and investment requirements should be analyzed in future staff papers on trade matters.

The staff had raised the question of how political support for liberalization measures could be mobilized, Ms. Bush observed. Her authorities were making efforts in that area. The staffs of the relevant international organizations could make an important contribution by setting out the issues, as the Fund staff had done in the present paper, and by helping to organize discussions such as the one at the April 1984 meeting of the Development Committee. The GATT had an important role to play, and the efforts by the Fund and GATT staffs to increase their cooperation on trade matters were welcome.

Although liberalizing trade and investment barriers was important to all member countries, Ms. Bush concluded, it would not be easy to achieve. There were influential interests in all countries that had benefited from closed markets or generous subsidy programs, and their political influence was often significant. Nevertheless, governments must look beyond those narrow interests in formulating economic policy and consider measures that would benefit the overall economic growth and development of member countries. The liberalization effort would be easier if a wide array of countries participated, so that, for example, the loss of import-competing industries resulting from liberalization of import barriers could be compensated for by improved market access for exporting industries. The Fund's efforts in helping to achieve the various liberalization goals were welcome.

Mr. Ismael recalled that the linkages between trade and development had been discussed on previous occasions. The actual progress in reducing restrictions was disappointing; on the basis of the present paper, the discussion of the linkages at the April meeting of the Development Committee would probably accomplish little beyond the usual statements on the merits of free trade. In its present form, the staff paper was merely an academic exercise. He wondered what the participants in the Development Committee were expected to accomplish at their coming meeting.

Mr. Salehkhou remarked that in recent years adverse external factors had seriously affected the growth prospects of most developing countries and had underscored the many inconsistencies in their development strategies and the large distortions in their domestic economic and financial relationships. To deal with the resulting problems and to restore economic growth, those countries had been encouraged by, inter alia, the Fund and the World Bank to introduce structural adjustment policies designed mainly to correct domestic distortions and to strengthen the export sector, particularly through liberalizing their exchange and trade systems and promoting economic competitiveness.

The staff paper clearly showed that during the previous three years developing countries had intensified their adjustment efforts, and that many of them had made significant progress in eliminating domestic distortions, Mr. Salehkhou commented. Unfortunately, their external positions had generally shown little improvement, owing largely to their failure to increase significantly their export receipts in the face of growing external trade barriers. The continued expansion of protection undermined adjustment efforts, added to the burden of implementing adjustment programs, and prevented the continuation of trade liberalization policies. It also undermined domestic support for adjustment programs by limiting or preventing improvement in the economy.

There was an urgent need to improve the international trade situation, Mr. Salehkhou considered, particularly as the recent improvement in the external position of many developing countries could not be sustained in the medium term and was traceable in a large part to postponements in settling their foreign financial obligations. Furthermore, because rescheduling generally resulted in a further expansion of outstanding external debt, a resurgence of foreign debt difficulties would remain a real and dangerous threat to the system as long as debtor countries were not in a position to expand their economies and increase their external receipts.

The staff had noted that both industrial and developing countries had extended import restrictions and other protectionist practices, Mr. Salehkhou said. It should be noted, however, that new restrictions had been introduced in developing countries mainly as a result of the severe scarcity of foreign exchange in recent years. Because steep reductions in imports were usually achieved at a high cost in terms of lost growth, new import restrictions in developing countries could be considered temporary; they would probably be removed as the external condition of the countries concerned improved. Protection in major industrial countries was clearly different; protectionism there was growing despite the relatively strong economic recovery. The growing restrictiveness stemmed from the poor performance of a few sectors of the industrial economies. In addition, industrial countries used sophisticated techniques of restriction, ranging from so-called voluntary export restraint arrangements to claims of unfair competition. It was particularly unfortunate that many of those techniques were openly aimed at reducing the exports of developing countries. The impact of protection by industrial countries on international trade and the world recovery was particularly important because of the dominant position of industrial countries in the world economy.

There was obviously a discrepancy in the Fund's surveillance of protectionist practices in member countries using Fund resources--most of which were developing countries--compared with its treatment of other countries, Mr. Salehkhou commented. The liberalization of exchange and trade systems had traditionally been a standard feature of Fund conditionality, and in recent years it had resulted in significant easing of import restrictions in the countries concerned. However, the Fund had not been in a position to place any serious pressure on nonusers of its resources, whose economies normally had scope for more liberalization. At present, the Fund was clearly not equipped to induce large industrial countries to correct their protectionist practices, and there was clearly a need for ways in which to strengthen and extend the Fund's role beyond the making of routine recommendations in the context of Article IV consultations. In that connection, the recent increase in cooperation between the Fund and the GATT and other relevant institutions was a step in the right direction.

It was very important for industrial countries to adhere to their often-stated commitment to reverse protectionism and to promote international trade, Mr. Salehkhou concluded. Only a significant improvement in their export outlook would enable the developing countries to avoid increasing difficulties in meeting their external financial obligations. Finally, the relevant international organizations, including the Fund, should play a more dynamic role in order to correct present trends in a spirit of multilateral cooperation.

Mr. Jayawardena said that he welcomed discussion on linkages between trade and development, if only to keep that major issue alive. However, he, like Mr. Ismael, approached the present debate with caution and misgiving, as the extensive discussions in the past on the issue in the Fund and other international forums had had little positive practical result. Indeed, there had been a substantial reversal in the recent past in the progress in liberalizing world trade, despite the consistent declarations of all member countries in favor of free trade and the considerable criticism of restrictive trade measures. The Development Committee's initiative in taking another look at the problem was welcome, but the main question at hand was how to translate the stated conviction of member countries into positive action.

The staff paper clearly showed how many of the gains in improving trade during the postwar period had been systematically eroded as a result of the strong growth of protectionism in recent years, Mr. Jayawardena went on. With the exception of measures to improve trade in Japan and the trade liberalization under some Fund-supported adjustment programs in developing countries, trade restrictions had been substantially extended or intensified. The staff could perhaps have given credit to countries that had resisted strong pressures for additional protection, even if they had not succeeded in reducing the current level of protection.

The use of bilateral trade arrangements seemed to be rising, Mr. Jayawardena remarked. Industrial countries in particular were emphasizing bilateral arrangements over multilateral trade and had introduced a large number of nontariff trade barriers, such as import quotas, so-called voluntary export restraints, and "nuisance restrictions." Certain protectionist measures, introduced as temporary solutions to problems, had become entrenched. Moreover, large agricultural surpluses, which were difficult to dispose of, were being built up in some countries at a considerable domestic cost, including the provision of subsidies to farmers as an incentive not to produce. The restraints on agricultural exports contributed to food scarcities and high prices at a time when a majority of the world's population lived in hunger. The clear inequities characteristic of the international trading system called for humane solutions, but the best response that had been made thus far was merely a verbal commitment to free trade. Indeed, the most intense restraints on foreign trade had been imposed in countries that had been the greatest benefactors of free world trade in the past.

The Fund was not the proper forum in which to solve the difficult problems of international trade, Mr. Jayawardena said. The Fund should not be actively involved in trade matters, which were in the purview of other international forums. On the other hand, the Fund could not ignore the fact that the huge problem of world trade was at the core of international financial relationships, as clearly reflected in the recent evolution of the international debt problem. Many countries, especially developing countries, had limited access to export markets and had historically sizable debt service problems. They were therefore undertaking major adjustment programs with the support of the Fund. It was not clear how those countries could generate the required current account surpluses without creating disorderly conditions in their own economies, unless there were substantial improvement in their export prospects. The greater the protection in industrial countries, the greater the required adjustment in debtor developing countries under Fundsupported programs. Therefore, protection increased both the likelihood that good adjustment programs would become unworkable and the prospects for considerable economic and social upheaval in developing countries.

In the circumstances, Mr. Jayawardena continued, there seemed to be a transfer of international adjustment from industrial countries to developing countries. Industrial countries that were unable to adjust to a changing environment or were unable to handle the political implications of adjustment were trying to protect their senescent industries and employment, thereby transferring their own burden of adjustment to developing countries that could least afford to bear it. The process was inequitable and raised several problems. First, it seriously affected the Fund's function in, and responsibilities for, ensuring orderly adjustment. Second, it had caused the credibility of the Fund's adjustment programs to be questioned: developing countries naturally questioned the wisdom of the Fund's requiring them to further their trade liberalization at a time when trade barriers were being erected in other countries and when the Fund was unable to do anything about it. His chair had consistently noted that asymmetry in the Fund's effort to promote adjustment.

The references in the staff paper to restrictive measures in developing countries seemed inappropriate, Mr. Jayawardena went on. The staff should have quantified the extent to which world trade was restrained by measures in industrial countries in comparison with measures in developing countries. Many studies had shown that international trade restraint was traceable mainly to industrial countries. Protection in developing countries was well explained by the so-called infant industry argument. At some stage in their history, most industrial countries had protected their nascent industries until they had attained the desired level of maturity. Moreover, many developing countries had lopsided domestic economies that were heavily dependent on a few primary products for which prices were highly volatile. For that reason, developing countries had attempted to diversify their economies; the introduction of some protectionist measures was a price that they had to pay to meet the longer-term objective to achieve economic diversification. It was abundantly clear that such protectionist measures had not seriously restrained the massive growth of industrial economies in the postwar era, and it was noteworthy that the Fund clearly supported diversification of developing country economies. There seemed to be no way in which the design and pace of Fund-supported stabilization programs could be used to promote world trade; the problem concerned was much larger.

Commenting on the role of trade in relation to future world recovery, Mr. Jayawardena said that it was widely accepted that the anti-inflationary stabilization policies in industrial countries should pave the way for sustained noninflationary growth, and that the recovery in industrial countries would trickle down, through an increase in international trade, to the rest of the world, leading to a worldwide economic recovery. In fact, however, the staff paper had clearly shown that despite the revival of their economies, the industrial countries had intensified their restrictive trade measures. He doubted whether the expected world recovery would occur if that trend continued. The Fund's efforts to encourage world recovery might well be undermined by the rising tide of protection.

He fully agreed with the staff, Mr. Jayawardena remarked, that industrial countries should take actions specifically to promote global trade. At the outset, there should be an immediate halt to the introduction of protectionist measures. There should then be a programmed reduction in recently introduced protectionist measures--except short-term measures for balance of payments reasons--within an agreed period that should be as short as possible. Global negotiations to reduce tariffs around the world should be initiated forthwith. In that connection, any initiatives by the Managing Director would be most helpful.

Import liberalization under Fund-supported programs had caused an inequitable asymmetry in world adjustment, Mr. Jaywardena considered. International tariff negotiations were a bargaining process during which developing countries sacrificed their own tariff protection in return for similar measures in industrial countries. Moreover, some preferential treatment for developing countries was an accepted feature of the GATT. As a result, tariff reforms under Fund-supported programs weakened the bargaining position of developing countries in international negotiations. Trade liberalization measures required by the Fund should be designed to reduce clear long-standing distortions whose elimination would have an immediate and positive effect on the economies concerned. The Fund's credibility as a genuinely international organization might be doubted if it pursued worldwide trade liberalization through a limited number of member country adjustment programs.

The staff had raised the question how domestic political support could be mobilized to reduce protectionist barriers, Mr. Jayawardena observed. There was a consensus that trade restraints were fully counterproductive in the sense that they did not lead to the attainment of declared objectives. However, short-term political pressures for protection were likely to persist indefinitely, as they had persisted in the past. The main objective should be an orderly world economic recovery that would permit authorities to resist protectionist pressures effectively. Steps would have to be taken to break the following vicious cycle: protection hindered trade, development, and growth, but without growth and development protectionist pressures could not be reduced.

There were powerful forces dragging the world economy toward an abyss, Mr. Jayawardena continued, and only the major economies could rescue it; the large group of developing countries alone could not do so. The recent initiatives by the United States and Japan in the trade field were warmly welcome, and he hoped that important progress could be made at the coming meeting of the Development Committee. The staff paper and the

Chairman's summing up of the present discussion should be forwarded to the Development Committee together with specific proposals, such as a halt to the introduction of new restrictions, negotiations on an agreed schedule for rapidly reducing existing restrictions, and, as Mr. Donoso had proposed, action to ease the world liquidity situation, including an allocation of SDRs.

Mr. Qureshi considered that the staff paper would serve as a useful background document for the coming meeting of the Development Committee. The picture painted by the staff of increasing protection, especially in the industrial world, was obviously a cause for serious concern. He fully agreed with the staff that growing protectionist pressures should be contained, and that existing restrictions should be rolled back. The case for dismantling trade barriers was of course rooted in the classical argument that it improved allocative efficiency, but in present circumstances, including the need for a sustained recovery of the world economy, reducing trade barriers was particularly important for the success of the adjustment programs in many developing countries and for an orderly solution to the debt problem.

There was universal agreement that in theory a reduction in trade barriers would be beneficial, Mr. Qureshi continued. The main problem was to convince the countries concerned actually to reduce their barriers, and he hoped that the increasingly serious discussion of the matter in international forums, including the Fund, would contribute to developing the political support needed for the desired reform measures.

The brief discussion in the staff paper on the role of the Fund in promoting a growing and open world trading system could be expanded and presented as a separate section, Mr. Qureshi suggested. It could include three parts. First, a description of the ways in which Fund activities in the trade field had been strengthened since the emergence of large global payments imbalances and rising protectionist pressures would be suitable; a note to that effect had been prepared for the September 1983 meeting of the Development Committee. Second, the text could mention the ways in which the Fund's role was being further enhanced. For instance, reference could be made to some of the proposals contained in the latest paper on Fund surveillance for further expanding the coverage of trade policy in Article IV consultations. Third, the staff could discuss ways in which the Fund's role could be made still more effective--both through its own operations and in collaboration with other institutions--as well as the constraints on such efforts.

Mr. Zhang commented that the staff paper noted the harm done by restrictive trade measures, the causes for the introduction of such measures, and the benefits of liberalization. Unfortunately, the present report, like earlier ones, did not contain concrete proposals for eliminating or reducing existing trade protection that could be usefully discussed by the Development Committee. The issues involved were clearly understood by the world community, and the main need at present was for governments, particularly those of industrial countries, to show the will to act quickly to implement concrete and decisive measures. That no such action was yet in sight was indeed discouraging and frustrating. The coming meeting of the Development Committee would constitute another opportunity for the participants to reach agreement on concrete measures.

Although the present paper was meant to be only a background document for the coming meeting of the Development Committee, Mr. Zhang remarked, it could usefully be expanded to include a discussion of two technical factors. The staff had comprehensively analyzed the increase in protectionist measures, particularly nontariff barriers. The staff should further analyze the nature of those measures in order to distinguish between those induced by the recession, and which therefore could be reversed after a world recovery, and those imposed as a result of structural factors in the importing countries. Strong and concerted action by the countries concerned was needed to reduce the second group of restrictions. Second, although governments were not yet prepared to tackle the problem of protection in a fundamental way, it would be useful for the staff to include some suggestions on possible future approaches, particularly with respect to trade between industrial and non-oil developing countries. The roles that could be played by Fund or other competent international organizations in that process could be usefully discussed.

Restrictive measures in developing countries should not necessarily be assessed on an equal footing with restrictive measures in industrial countries, Mr. Zhang considered. Experience showed that the developing countries had occasionally resorted to such practices in order to achieve a sustainable balance of payments position rather than to protect their traditional industries or the level of domestic employment. The staff paper should make a clearer distinction between such cases.

In assessing the threat of retaliation, Mr. Zhang said, the staff should carefully distinguish the differences in the nature and intention of individual cases. He was particularly mindful of the case concerning China mentioned on page 4. The action by China in 1983 to limit certain agricultural imports from the United States was different from the cases mentioned by the staff for the purpose of comparison. China had not taken the action to protect its domestic agricultural sector; rather, the action had been intended as a temporary response to the protectionist measures that the United States had used to limit textile imports from China. That point had not been clearly made in the staff report. In any event, the issue had been settled, and the reference to it in the staff paper should be removed.

Mr. Morrell expressed general agreement with the thrust of the staff's conclusions. The staff paper provided a useful basis for the coming discussion in the Development Committee.

Open access to markets was critically important to both developed and developing countries, Mr. Morrell continued. In describing recent developments in world trade, the staff had correctly underscored the increasing trend toward protection, particularly of agriculture, and the reference to the Common Agricultural Policy (CAP) was welcome. The World Bank and the Fund should actively support the GATT in encouraging an open trading system, and the inclusion of the matter on the agenda of the coming meeting of the Development Committee was also welcome. At the same time, he agreed with previous speakers that, while the Fund should involve itself in trade matters, it had to bear in mind its main roles.

The pressure for protection had been intensified by the industrial countries' declining international competitiveness and falling employment levels, and also by the developing countries' growing balance of payments problems, Mr. Morrell remarked. The drift toward protection threatened to impede appropriate structural adjustment and efficient resource allocation. Protection had both trade-reducing and trade-distorting effects, and, in present circumstances, it was likely to endanger the medium-term prospects for world economic recovery and to compound significantly the balance of payments problems of developing countries. In particular, the future capacity of developing countries to service their foreign debt would obviously be influenced by the opportunities available to them for expanding their trade.

The staff had noted the worrying growth of sector-specific trade actions, including in particular ad hoc administrative arrangements and indirect subsidies, Mr. Morrell commented. The staff had also expressed concern about the increase in bilateralism at the expense of third countries. He agreed with Mr. Qureshi that the brief section in the staff paper on the role of the Fund could be expanded along the lines that Mr. Qureshi had mentioned.

Mr. Pickering said that the growth of protection, and particularly the growth of nontariff barriers and bilateral agreements, was a cause for major concern, as it threatened the spread of the international recovery and established a trend away from multilateral trading practices. He was pleased that the staff paper examined such measures as voluntary export restraint agreements as well as subsidies. The growth of subsidies in support of export industries could constitute a serious financial burden while hindering structural adjustment and providing an incentive for a country's international competitors to take retaliatory action.

It was important to stress, Mr. Pickering continued, that trade liberalization should not be viewed solely in terms of North-South relations, or in the context of the problems of debtor countries. An appropriate framework for multilateral negotiations under the GATT, in which all countries would be prepared to make the painful political decisions permitting them to make meaningful contributions, would ultimately be needed.

He agreed with the staff that there was a relationship between economic recovery and trade liberalization, Mr. Pickering said. A decline in protectionist pressures would provide an important boost to the expansion of world trade, to the benefit of industrial and developing countries alike. In the short run, however, the continuing decline in employment in

Europe and the rising trade deficit in the United States during an election year might offset the potentially liberalizing effects of the economic recovery. The large structural component of unemployment in a number of countries was particularly worrying. Ideally, efforts to reduce structural unemployment should include policies that encouraged adjustment away from reliance on declining industries, and toward sectors enjoying the greatest comparative advantage. Unfortunately, those weak industries often were the most difficult, in a political sense, for industrial countries to withdraw from, particularly if the countries felt that there was not an adequate quid pro quo from trading partners.

Many developing countries would have to liberalize their trading systems if they hoped to be able to move toward a sustainable medium-term balance of payments position while maintaining an adequate rate of economic growth, Mr. Pickering remarked. In any assessment of the need for trade liberalization in such cases, it was important to examine not only import barriers, but also export subsidies and multiple exchange rate practices. At the same time, however, it was also important not to place excessive emphasis in adjustment efforts on trade liberalization alone. Unlike some previous speakers, he did not believe that Fund-supported adjustment programs had been focused exclusively on export-oriented growth. The Fund had been realistic, and must continue to be so, in designing programs. Trade measures would not by themselves solve the balance of payments problems facing most highly indebted developing countries, and it was probably not prudent to rely on substantial progress in that area under adjustment programs in the short run. It was important to stress the need for developing countries to reduce their domestic and external imbalances in the context of a reduction in trade barriers.

Commenting on market access for developing countries, Mr. Pickering said that he agreed that, in the medium term, an expansion of exports would play an important role in sustaining growth in developing countries facing balance of payments problems. Nevertheless, a policy of linking trade liberalization in the industrial countries with assistance to developing countries in deficit would be a cause for some concern. Some developing countries that were hurt most by trade barriers in industrial countries were those whose external positions were not particularly weak. Concentrating import liberalization so that it would benefit mainly countries facing debt problems could run the risk of effectively penalizing countries that had succeeded in avoiding serious deteriorations in their economic position.

Mr. Hirao stated that he fully supported the thrust of the conclusions in the staff paper, which would be a useful background document for the coming discussion in the Development Committee. Import liberalization in the developing countries' trading partners would contribute significantly to the success of developing countries' adjustment efforts in the present favorable circumstances. That effort would in turn constitute one of the most important factors for a sustained recovery of both developed and developing countries.

Mr. Ercel said that he generally endorsed the staff analysis. Trade liberalization was needed to improve the growth prospects of developing countries, but it alone was not sufficient to do so. Liberalization could be effective only if there were sufficient worldwide demand; high demand was an essential condition for improving trade as well as development prospects. Widespread economic growth in industrial countries would be particularly important for the improvement in trade and development conditions. The adverse direct and indirect effects of the increase in protection on developing countries were obvious. Investment decisions in developing countries had been particularly hurt by the rise in protection.

Ms. Bush commented that she agreed with Mr. Zhang's suggestion for deleting the reference to the limitation imposed by China on agricultural imports from the United States, as the issue had been resolved. She also agreed with Mr. Qureshi's suggestion for expanding the section on Fund activities in the trade area, particularly the examination of trade matters during Article IV consultations.

The Associate Director of the Exchange and Trade Relations Department remarked that the coming discussion on the World Economic Outlook would provide an opportunity to review trade issues in the context of the economic recovery. A full list of measures needed to solve the debt problem would be mentioned.

Executive Directors had made a number of useful comments for the staff to bear in preparing of future papers on trade matters, the Associate Director commented. In the present paper, the reference to the restriction by China on agricultural imports from the United States could be eliminated, as the issue had been resolved. As for the role of the Fund in the trade area, he fully agreed with Executive Directors who had stressed its importance, and Executive Directors would have a further opportunity to discuss the matter during the scheduled review of surveillance practices. The Fund's role had been discussed on previous occasions, and the staff had not thought it necessary to include a lengthy discussion in the present paper; in particular, there were no unresolved issues that required the attention of the participants in the coming meeting of the Development Committee. The discussion on the role of the Fund in the present paper would be expanded to reflect points that had been made on previous occasions and in the latest paper on the review of surveillance (SM/84/44, 2/15/84).

One question that had been raised, the Associate Director of the Exchange and Trade Relations Department recalled, concerned what concrete steps or proposals might result from the present and coming discussions on trade issues. Although the Fund was of course concerned about trade matters and had certain operational responsibilities in the trade area, the hard decisions on trade would have to be made in other international forums, particularly in the GATT. The coming meeting of the Development Committee could be a useful opportunity for finance ministers--who usually were not deeply involved in their governments' discussions on trade matters--to see more clearly the importance that trade played in the whole network of finance and development; as a result, the participants in the meeting might wish to give an additional political impetus to decision making in the GATT and other international forums.

The Chairman made the following statement:

Executive Directors agreed that the paper prepared by the staff will be a clear and useful background document for the discussion in the Development Committee in April.

Serious concern was expressed regarding the continuing rise of protectionism in the recent past. It is indeed a preoccupying aspect of recent international economic developments, as it is hampering the expansion of world trade and the extension of the world recovery, given the clear relationship between trade expansion and the growth of output. It is also retarding the structural adjustment needed in industrial countries, thereby clouding the prospects for their future growth and employment.

Protectionism is endangering, or at least making more difficult, the orderly implementation of adjustment programs in a number of developing countries, some of which are introducing these programs at high social and political cost. For a number of heavily indebted developing countries that rely on the openness of trade markets, protectionism poses a threat to their balance of payments, and makes it more difficult to service their debt in an orderly fashion.

Today's discussion has stressed that there is an obvious relationship between the openness of the trading system and the orderly functioning of the international financial system. Protectionism has been spreading, despite these clear linkages between an open trading system, growth, adjustment, and financial stability. This has mainly taken the form of nontariff barriers, including bilateral arrangements, countertrade, voluntary restraint of exports, and subsidies to ailing industries. Protectionist practices are often introduced as temporary devices to permit real structural adjustments to take place; in no case should they be considered as replacements for structural adjustment measures. It has been noted that, among industrial countries, only one country has recently liberalized its imports, although not completely. Stronger and more widespread actions by the industrial countries to liberalize trade are therefore clearly necessary.

The need for liberalization of trade regimes is not exclusively limited to the industrial countries, although, because of their share in world trade, those countries have the major responsibility in the attack on protectionism. Developing countries, too, should seek to liberalize their exchange and trade policies, recognizing that such liberalization will promote the economic progress of the country concerned. The main reason that a number of developing countries are not in a position to liberalize further their trade regimes is their lack of sufficient foreign exchange.

It is particularly regrettable that, even though the economic recovery is taking off rather strongly in a number of industrial countries, those countries are resorting to protectionist practices. The opportunity exists for industrial countries to take specific actions to lead the way toward opening the trade system. A number of Executive Directors have recalled the language of the Williamsburg summit, which is extremely clear on this matter. In so doing, Directors reminded the countries concerned that the time has come to start rolling back protectionism, especially the growing nontariff barriers to trade, and other measures that are harming the developing countries and endangering the prospects for orderly adjustment.

Reducing protectionist measures is certainly one of the action-oriented steps that Executive Directors stressed today. Directors also emphasized that a further opening of the system itself is needed, and they welcomed the initiatives that have been taken by some countries to begin a new round of trade liberalization in the framework of the GATT. Such international action is extremely important, and all speakers today agreed that the GATT should play the central role in negotiations to bring about a more open trade system.

In that connection, a number of remarks have been made on the role of the Fund. Although the Fund is not a trade institution, it has a number of opportunities to deal with trade liberalization matters, and I have been encouraged by the observations and recommendations made to the staff and to the management in this context. Its role in devising adjustment programs gives the Fund an opportunity to look into the trade regimes of countries that are using its resources. But if we are to have an evenhanded approach, it is essential to devote greater attention to trade measures in our Article IV consultation reports, and to emphasize open trade policies during our discussions and in our recommendations to governments. Moreover, the Fund should examine member countries' general macroeconomic policies with a view to assessing the extent to which they could have negative consequences for international trade.

Directors have commented on the need for symmetry in the Fund's approach. It is fair to say that our analysis of the trade regimes in industrial countries under the Article IV consultation procedures has considerably improved in recent years. It is not yet as good as we would like it to be; and it is true that it has not led to tangible changes in protectionist practices. On the other hand, the Fund is now better equipped, through its working relations with the GATT, to analyze the protectionist measures of industrial countries, and to integrate the analysis in the appraisal of the economic policies of industrial countries as a part of Article IV consultations; and we will certainly be working to increase our capabilities in that area.

Executive Directors would like the Fund to take initiatives in the field of trade liberalization, and I have noted this with great attention. I will look carefully at the content of possible initiatives. Fund staff and management will work with the GATT to support all initiatives that could lead to trade liberalization. Finally, I note that Directors have encouraged me to make appropriately strong statements on protectionism in my remarks to the Development Committee.

The Committee of the Whole completed its discussion.